

Combinations of Retirement Plans

Can an employer have more than one kind of tax-deductible retirement plan? Under current federal law the answer is yes. There are, however, certain limits imposed at both the individual plan level and at the combined plans level. In combining plans, an employer would not normally adopt more than one plan of the same type.



Individual Plan Limits

At the individual plan level, the maximum annual retirement benefit permitted under a defined benefit plan for a participant is the lesser of 100% of compensation or \$185,000.¹ The maximum allocation to a participant under a defined contribution plan is the lesser of 100%² of compensation or \$46,000.² If an employer adopts two plans of the same type, they would be aggregated for the purposes of these limits.

Combined Plan Deduction Limits

If an employer maintains both a defined contribution and a defined benefit plan at the same time, the individual plan limits discussed above apply separately to each type of plan. However, there is also an overall limitation to the deduction allowed to an employer for the combined plans. If any employee participates in both plans, the maximum employer deduction is limited to the greater of 25% of the total compensation of all employees participating in either plan or the normal cost of the defined benefit plan. This limit applies to employer-paid contributions, including pension, profit sharing, and matching contributions. 401(k) salary deferral contributions elected by employees are not subject to this 25% deduction limit.

Employer-paid contributions to a defined contribution plan that do not exceed 6% of total compensation of all employees participating in the defined contribution plan do not count toward this 25% deduction limit.

For example, assume an employer maintains both a defined benefit and a defined contribution plan, such as a profit sharing plan. Assume also that the total payroll of covered participants in either plan is \$100,000 and that the required defined benefit contribution is \$20,000. The most that could be contributed and deducted for the profit sharing plan is \$11,000. ($25\% \times \$100,000 = \$25,000$; $\$25,000 - \$20,000 = \$5,000$; $6\% \times \$100,000 = \$6,000$; $\$5,000 + \$6,000 = \$11,000$). If the employer in this example were to contribute \$13,500 to the profit sharing plan, \$2,500 of the contribution would be nondeductible. There would also be a 10% excise tax on the non-deductible \$2,500.

¹ These are 2008 limits. In some instances these limits may be reduced.

² These are 2008 limits.

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If the required defined benefit plan contribution were \$35,000, the employer could contribute and deduct the entire \$35,000. However, the deductible contribution to the profit sharing plan would be limited to \$6,000. If the defined contribution plan has a mandatory contribution (e.g., a target benefit or money purchase plan) a contribution is still required even though it may exceed the deductible limit and incur the 10% excise tax on the non-deductible portion.

Combined Plans with 401(k) Feature

Many different plan combinations are possible. One common arrangement is that of a defined benefit plan paired with a 401(k)/profit sharing plan. Consider what could be contributed and deducted in 2008 for an owner-only business, with the owner over age 50:

Individual	Compensation	Defined Benefit	Profit Sharing	401(k)	Total
Owner	\$230,000	\$200,000 ¹	\$13,800	\$20,500	\$234,300

If there are employees in addition to an owner-employee, the 401(k) might also provide for a safe harbor contribution and a tiered profit sharing contribution. With younger employees, and using a tiered 401(k) safe harbor plan with the defined benefit plan, the amount that could be contributed and deducted in 2008 would be:

Individual	Compensation	Defined Benefit	Safe Harbor & Profit Sharing	401(k) ²	Total
Owner	\$230,000	\$120,000	\$16,350	\$20,500	\$156,850
Employee 1	\$50,000	\$8,000	\$1,500	-	\$9,500
Employee 2	\$35,000	\$4,000	\$1,050	-	\$5,050
TOTAL	\$315,000	\$132,000³	\$18,900	\$20,500	\$171,400

There is a special exception to the 25% deduction limit. If no single employee participates in both plans, the 25% deduction limit does not apply. If this occurs, however, other discrimination problems may arise unless the plans are properly designed to work together to satisfy IRS requirements.

Sequential Plans

Rather than adopting two different types of plans simultaneously, an employer may choose to use different types of plans, at different points in time. Prior to 2000, a complicated set of rules and limits effectively made it impossible for one employer to have different types of plans, even at different times. For plan years beginning January 1, 2000 and later, however, the former rules and limits no longer applied.

¹ Normal cost plus 50% funding cushion.

² The 401(k) deferrals shown are for the owner as part of the owner's contribution. No contribution is shown for the employees as they depend on individual employee elections and are not paid by the employer, but by the employee.

³ Plus funding cushion of approximately 50% if desired.

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In the mid-1980s, for example, many defined benefit plans were terminated because a change in the law made them fully funded. Under the new rules, an employer who terminated such a plan could now adopt a defined contribution plan, and contribute and deduct the maximum allowable for all eligible participants.

An employer may have chosen a defined contribution plan in the past because the key participants were younger. After many years these same key people could benefit more from a defined benefit plan. With the increased flexibility now available, the employer could switch to a defined benefit plan. Given the deduction limits applicable to combined plans, the employer could adopt a maximum defined benefit plan and either terminate the defined contribution plan or reduce its contribution to no more than 6% of compensation.

Allowable Combinations of Employer-Sponsored Plans

The table below lists the allowable combinations of employer-sponsored retirement plans:

Plan Type	Defined Benefit Plan	Defined Contribution Pension ¹	Defined Contribution Profit-Sharing ²	Simple IRA	Simple 401(k)	SEP
Defined benefit plan	Yes	Yes	Yes	No	No	Maybe ³
Defined contribution pension ¹	Yes	Yes	Yes	No	No	Yes
Defined contribution profit-sharing ²	Yes	Yes	Yes	No	No	Yes
Simple IRA	No	No	No	No	No	No
Simple 401(k)	No	No	No	No	No	No
SEP	Maybe ³	Yes	Yes	No	No	Yes

¹ Defined contribution money purchase or target benefit plans, including tiered or cross-tested varieties.

² Profit sharing plans such as 401(k), ESOPs and stock bonus plans, as well as tiered or cross-tested variations.

³ Depends on whether this is allowed in the SEP plan documents.