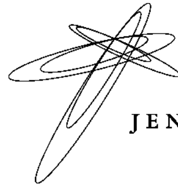

memorandum

February 9, 2007

AGE-WEIGHTED RETIREMENT PLANS

An important service that we provide to our retirement plan clients is plan design. In our view, retirement plans should be viewed not only as employee benefit programs that benefit all employees but also as powerful wealth accumulation tools for the company's owners and managers.

Several years ago the IRS introduced the concept of allocating a company's discretionary contribution to a profit sharing plan by taking into account employees' ages as well as their pay. This technique allows for substantially higher annual contributions for older owners and managers than is presently allowed using other allocation techniques.

This memorandum describes the technique and provides you with an actual example from one of our client's plan.

Explanation of the Age-Weighted Technique

A fundamental rule governing tax qualified retirement plans is that contributions or benefits cannot discriminate in favor of highly compensated employees (HCEs). I have underlined the word "or" in the preceding sentence since it is not necessary that both contributions and benefits be nondiscriminatory, only that contributions or benefits be nondiscriminatory. The IRS permits an employer to test nondiscrimination on a contributions basis or a benefits basis.

An employer would test nondiscrimination on a benefits basis by, in effect, looking at what the annual contributions to the plan, and earnings, would grow to when each employee attains age 65. For example, a plan that provided $1,000 to each employee at age 65 would clearly be nondiscriminatory since each employee at age 65 would be receiving the exact same benefit. Thus, if we can show that a contribution of, say, $500 for Employee A and a contribution of, say, $100 for Employee B would both grow to $1,000 when each employee attains age 65, those contributions would be nondiscriminatory, even though Employee A receives a contribution that is five times higher than Employee B's contribution. Moreover, the nondiscrimination rules only require that non-HCEs receive 70% of what the HCEs receive as a group. Thus, in the example above, if Employee A is an HCE and Employee B is a non-HCE, contributions would be nondiscriminatory if Employee A's contribution would grow to $1,000 at age 65, while Employee B's contribution would only grow to $700.

This is the basis of the age-weighted technique. The applicable regulations actually call the technique cross-testing. Some of my competitors call their version of the technique super integration and one competitor called his version Phase IV. They are all variations on the same basic idea, which is to test contributions based on what those contributions grow to when the employee attains age 65.

It should be noted that the age-weighted technique is merely a technique to test whether contributions are nondiscriminatory. The employer's plan never guarantees to provide $1,000 (or any other amount for that matter) to each employee at age 65. Contributions to the plan may continue to be completely discretionary if that is what the plan presently provides. If the plan is top-heavy, the employer must continue to provide top-heavy minimum contributions but this applies regardless of the way the plan allocates contributions. Finally, the age-weighted technique can be applied in any plan year that it

produces the most desirable results. An employer who adopts an age-weighted allocation formula in one plan year is not required to use it again in any subsequent plan year.

Another point to keep in mind is that nondiscrimination is tested by reference to HCEs as a group. Not all HCEs are required to receive the same contribution. Thus, an employer can discriminate against some HCEs without running afoul of the nondiscrimination rules. We see this often with our medical and law firm clients who have young associates who are HCEs but do not receive significant contributions. In fact, in these cases the age-weighted technique works particularly well since the lower contributions for these associate HCEs allow significantly higher contributions for the senior partners of the employer. The age-weighted technique enables an employer to "cherry pick" which employees to favor and which not to favor.

Age-weighted plans may also be combined with 401k plans (including safe harbor plans).

The age-weighted technique was created by the government in its regulations. Our analysis follows the steps set out in the applicable regulations. Thus, this is not an aggressive technique from a tax perspective and will not jeopardize the plan's tax qualification.

Actual Example

We are enclosing a worksheet that we prepared for an actual firm client. [We have deleted their names for privacy.] This client maintained a profit sharing plan that allocated contributions based on pro-rata pay. By age-weighting the contributions, we were able to substantially increase the contributions for the owner's family members and reduce the contribution for the rank-and-file employees to their minimum 5%-of-pay gateway contribution.

Services We Can Provide

We can prepare the plan documents to amend and restate your existing plan to incorporate an age-weighted allocation formula. Additionally, we can prepare the annual allocation calculations. If you wish, our affiliate, Dana Consulting Group, can provide administrative services for your existing plan.

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The age-weighted technique has been an extremely successful way for family-owned businesses to increase the family's annual allocations under the retirement plan. We would appreciate the opportunity to work with you to adopt an age-weighted plan for your company.

If you have any questions or comments, please feel free to contact us.

Please visit our web site at www.danaconsulting.com

Sample Medical Practice

Cross Tested Plan Only

Retirement Plan Proposal for the plan year ending on December 31, 2008

C:\Documents and Settings\ljennings\My Documents\My Files\Powerpoint\[SAMPLE MD PRACTICE-2008- Cross Tested Plan Only Wksht w logo.xls]Sheet1

Rev 3/19/08

EMPLOYEE	OWNERSHIP	AGE	PAY	401k DEFERRALS	% OF PAY	401K CATCH UP	% OF PAY	3% SAFE HARBOR	% OF PAY	PROFIT SHARING	% OF PAY	TOTAL CONTRIBUTION	% OF PAY
Kildare, Joseph	51%	56	230,000	15,500	6.74%	5,000	2.17%	0	0.00%	30,500	13.26%	51,000	22.17%
Kildare, Joan	Spouse	53	34,500	15,500	44.93%	5,000	14.49%	0	0.00%	19,000	55.07%	39,500	114.49%
Welby, Marcus	25%	44	230,000	15,500	6.74%	0	0.00%	0	0.00%	30,500	13.26%	46,000	20.00%
Gross, Brian	24%	52	158,772	15,500	9.76%	0	0.00%	0	0.00%	0	0.00%	15,500	9.76%
Nader, Ralph	0%	35	216,090	0	0.00%	0	0.00%	0	0.00%	6,483	3.00%	6,483	3.00%
Employee		53	73,884	4,875	6.60%	0	0.00%	2,217	3.00%	1,478	2.00%	8,570	11.60%
Employee		70	10,521	0	0.00%	0	0.00%	316	3.00%	210	2.00%	526	5.00%
Employee		37	30,789	1,539	5.00%	0	0.00%	924	3.00%	616	2.00%	3,079	10.00%
Employee		32	37,224	0	0.00%	0	0.00%	1,117	3.00%	744	2.00%	1,861	5.00%
Employee		34	34,328	0	0.00%	0	0.00%	1,030	3.00%	687	2.00%	1,717	5.00%
Employee		39	25,108	340	1.35%	0	0.00%	753	3.00%	502	2.00%	1,595	6.35%
Employee		34	42,075	421	1.00%	0	0.00%	1,262	3.00%	842	2.00%	2,525	6.00%
Employee		33	10,814	0	0.00%	0	0.00%	324	3.00%	216	2.00%	540	5.00%
Employee		47	60,493	0	0.00%	0	0.00%	1,815	3.00%	1,210	2.00%	3,025	5.00%
Employee		26	20,955	0	0.00%	0	0.00%	629	3.00%	419	2.00%	1,048	5.00%
Employee		44	24,066	722	3.00%	0	0.00%	722	3.00%	481	2.00%	1,925	8.00%
Employee		45	26,666	1,333	5.00%	0	0.00%	800	3.00%	533	2.00%	2,666	10.00%
Employee		50	26,893	0	0.00%	0	0.00%	807	3.00%	538	2.00%	1,345	5.00%
TOTALS			1,293,178	71,230		10,000		12,714		94,959		188,903	