

### What it is

Retirement plan contributions cannot discriminate significantly in favor of highly compensated employees. However, the regulations allow such contributions to be tested as lifetime retirement benefit values, crossing over from a contribution test to a benefit test. This is known as cross-testing. Due to the nature of compound interest, a smaller contribution for a younger employee can be shown to be just as valuable at retirement as a larger contribution for an older employee. The plan can be designed to allow the employer to decide which employees receive larger contributions, and if cross-testing passes, these amounts are nondiscriminatory.

### How it works

Suppose a business owner is age 59 and the only other employee is age 25. In this example, the owner's contribution can be 16 times larger (as a percent of pay) than the contribution for the 25-year old. When projected to age 65, these contributions have the same lifetime value. Since this is such a great benefit for business owners, the price to use cross-testing requires a minimum "gateway" contribution for the non-highly compensated employees.

#### A highly compensated employee (HCE) is:

Any employee that owns over 5 percent of the business any time during the current or prior year, including certain family members regardless of wages; plus, any employee whose wages in the prior year were over the threshold (\$120,000 in 2016), regardless of current wages or ownership.

#### Passing the test

The contributions are projected to retirement and converted to their equivalent lifetime benefit values using the rates and conversion factors required by the regulations. These values are tested as rates of pay, comparing the rates for the highly compensated employees (HCEs) to rates for the non-highly compensated employees (NHCEs). The test passes when enough NHCEs rates are as high as the HCE rates, assuming the gateway minimum requirements are also met. The minimum gateway contribution for each NHCE is the lesser of 5 percent of pay or one-third of the highest percentage of pay allocated to any HCE.

#### Advantages of a cross-tested plan

- Can allow much larger contributions for participants selected by the employer
- Applies to 401(k)/profit sharing plans and can pair with a defined benefit plan
- Provides greater flexibility and control for the employer

#### The best candidates

- Businesses wanting larger contributions for targeted owners or certain key employees
- HCEs with enough age difference (older) than a minimum number of NHCEs

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