

Discretionary Company Contributions to

401(k) Plans

Since 401(k) plans were added to the law in the Revenue Act of 1978, they have become a leading employee benefit for all types and sizes of businesses, from *Fortune 100* companies to family businesses with fewer than five employees.

What many business owners and high-level managers don't realize is that IRS rules allow 401(k) plan sponsors many flexible ways to reward deserving employees beyond traditional company matching contributions. While additional levels of company contributions to 401(k) plans may not be appropriate for all plan sponsors, these contribution options should be considered to provide management the opportunity to make an informed decision, rather than be forced into adopting an unnecessarily restrictive 401(k) matching contribution plan design.

Company Matching Contributions – Benefits and Limitations

Most 401(k) plans provide that the employer make a matching contribution to those employees who contribute a portion of their own compensation into the 401(k)

plan. For example, a 401(k) plan matching contribution provision may call for an employer to match 25% of an employee's contribution up to a specified limit. There are many matching contribution variations available, with certain match levels customary for companies in similar industries and/or in the same geographic region.

There are many valid reasons for a company to have a 401(k) match, including attracting new employees and encouraging existing employees to save for their own retirement.

But what happens when valued and deserving employees are not financially able to give up a portion of their compensation by making a 401(k) salary deferral? They receive no company contribution at all, while the company is making matching contributions to less valuable (and even marginal) employees!

Overcome Matching Contribution Limitation – Reward Valued Employees

IRS rules permit companies that establish 401(k) plans to make discretionary contributions to select employees whether or not they made 401(k) salary deferrals, allowing the company to overcome the inequity of a fixed matching contribution formula. While there are IRS testing requirements if such discretionary company contributions are made to owners or highly compensated employees (those who earned more than \$105,000 in the prior year), there are virtually no restrictions on making such contributions to all other employees.

The Elusive Pre-Tax Bonus

Companies also may choose to use discretionary contributions as a performance-based, pre-tax bonus. Many companies reward their valued employees with periodic, performance-based bonus payments. Such bonuses may be based on a variety of factors, including achieving defined goals at an individual, departmental or company level. Companies should consider contributing a portion of an

employee's performance bonus into the employee's 401(k) plan account. Such discretionary company contributions are tax-deductible to the company, not currently taxable to the recipient employee and are not subject to payroll taxes, either from the company or the employee. With so many favorable attributes, discretionary company contributions to a 401(k) plan are a powerful compensation tool for many companies.

Discretionary 401(k) Company Contributions: Frequently Asked Questions

1. **Question:** Do all 401(k) plans allow a company to make discretionary company contributions?

Answer: Not all 401(k) plans allow a company to make discretionary company contributions. There must be IRS-approved language in the plan that allows the company to make such contributions.

2. **Question:** Must my 401(k) plan include a matching contribution in order to have a discretionary company contribution?

Answer: No – While a company's 401(k) plan may provide for both a matching contribution and a discretionary contribution, there is no requirement that the 401(k) plan have a matching contribution provision in order for the plan to allow a discretionary company contribution.

3. **Question:** May I choose any employee to receive a discretionary company contribution, or must an employee meet a defined goal to be eligible?

Answer: An employee does not have to meet a defined goal to receive a discretionary company contribution into his/her 401(k) plan account. Other than being subject to IRS testing requirements for discretionary contributions to highly compensated employees, management has complete discretion to select which employees, if any, receive a discretionary company contribution.

4. **Question:** If a company makes a discretionary contribution, does that require the company to make a similar contribution in a subsequent year?

Answer: No – If a company makes a discretionary contribution, there is no requirement that the company repeat a discretionary contribution in any subsequent year.

5. **Question:** What happens to an employee’s discretionary contribution account if his/her employment terminates?

Answer: The 401(k) plan may include a vesting schedule for discretionary company contributions, with forfeitures from an employee’s discretionary contribution account available to reduce subsequent company contributions, either matching or discretionary contributions.

6. **Question:** Does the existence of discretionary company contributions have any impact on the 401(k) plan investment structure?

Answer: No – The same investment choices are available whether or not a company makes a discretionary company contribution.

How Does the MandMarblestone Group Support Discretionary Company Contributions?

- **Implementation** – The MandMarblestone Group has received IRS approval for its One Category Per Participant (***OCPP***®) plan design. **This IRS-approved *OCPP*® plan document is the basis for allowing discretionary company contributions.** We work with management to craft the framework of the 401(k) plan design that not only provides a contribution structure to meet a company’s financial and tax objectives, but also is in alignment with the company’s compensation model and culture. We then draft the plan document to achieve those objectives. The MandMarblestone Group does not offer investments or provide investment advice.

- **Annual Consulting** – Depending upon a company’s needs, the MandMarblestone Group offers several annual service models to support efficient and compliant 401(k) plan operation. On a continuing basis, we are responsive to a variety of changing circumstances that impact the company, including changes in:

- Employee demographics
- Company profitability
- Industry trends
- New legislation
- Company growth

How to Reach Us

If you believe that the MandMarblestone IRS-approved **OCPP**® plan design, which allows discretionary company contributions, may be right for your company, contact: Bob Mand, Ken Marblestone or Lori Gordon.

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OCPP® is a registered service mark of The MandMarblestone Group llc, a Philadelphia, PA legal/consulting/third party administration firm that obtained IRS approval of the **OCPP**® plan design for its retirement plan clients.

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