

# The PRS Report

## THE WHEN, THE HOW AND THE HOW MUCH OF DEFINED CONTRIBUTION PLAN CONTRIBUTIONS

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What is the minimum pension contribution the company has to make in order to *maximize* the contribution to the owner(s)? In the world of pension administration such a calculation is known as “optimizing” the contribution to the owners. It is a calculation that can take place only after the plan year is over, when employee census information, including compensation of plan participants, is finalized and known. Given the complexity of some pension contribution formulas which are conditional on satisfying IRS-prescribed non-discrimination tests, more times than not both the employer and the accountant understand that it is the role of the Third Party Administrator (TPA) to perform this calculation.

The following issues and unpleasant consequences may arise when the TPA is not involved in the calculation of the contribution or in the timing of when the contribution is deposited:

### **Contributing to the Plan Before the Plan Year has Ended**

What if the contributions made during the Plan Year are greater than the amount needed to optimize the contribution for the owner?

- Contributions deposited during the Plan Year not allocable to the previous plan year must be allocated to participants in that year...they cannot be carried over as a prepayment to the next plan year and allocated then.



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- Amounts deposited above the optimal amount must be allocated to everyone else except the owner (This assumes the original allocation allocated the maximum allowable contribution to the owner.).

What if the amount contributed is greater than the maximum tax deductible contribution?

- A 10% excise tax on deposits made to the plan that are not deductible is assessed.
- The TPA will reflect on Form 5500 only a contribution amount that can be deducted, i.e. a lower contribution than the amount allocated.
- A discrepancy between the deduction on the company's tax return and the contribution amount as reflected on Form 5500 may then exist if the company's tax return is prepared utilizing the amount of the contribution actually paid. It's possible that such a discrepancy can trigger an IRS audit. We have attended several IRS audits in which the auditor asked for a reconciliation of the contribution allocated with the pension deductions taken on the business return.



The recommended course of action is to wait until the year is over to deposit pension contributions for the previous year. Then if the plan sponsor deposits too much, the excess can be a pre-payment toward the next year's contribution. Additional monies need not be allocated to participants and there is no excise tax!

But what about a plan sponsor, flush with cash who wants to make contributions to the plan before the cash is spent on other non-pension needs? Simple. The plan sponsor can open an investment account not in the name of the plan, but rather in the name of the company, and invest those funds until the time that the contribution needs to be funded. Then the company would transfer those funds from the new company investment account to the pension account to make the contribution.

### Pension Deduction Calculated without Consulting the TPA

When an accountant takes a limited view of the TPA's role in servicing his client's pension plan, he may calculate a pension deduction for the company tax return in excess of the optimal employer contribution. Such an accountant thinks that the role of the TPA is

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confined to completing the Form 5500 for his client. Unfortunately, he doesn't realize that the TPA can save his client thousands of dollars by calculating the optimal contribution.

Since the TPA is more versed in the eligibility provisions of the plan and in the area of non-discrimination testing rules for pension contributions, it's only natural that the TPA should be performing this calculation and not the accountant.

## The Preferred Contribution Procedure

1. Shortly after the plan year ends, PRS sends the annual reporting package for completion. Once all the plan-year-end data is available, the package should be completed and returned to us, as soon as possible.
2. PRS will analyze the data and calculate the amount of the contribution, and determine the allocation of the contribution which satisfies the plan sponsor's objectives.
3. The plan sponsor, along with his accountant, will then review the amount and allocations to see that it does meet his objectives. If it does not, then the Sponsor should contact PRS to ask for additional calculations, specifying what should change.
4. Once the Company decides on the contribution amount, PRS should be informed. We will then proceed with the annual valuation and preparation of the Form 5500 series.

If the above procedure is followed, the owner's retirement objectives will be met without paying needless excise taxes to the government and without contributing to the staff in excess of what is required.



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