F&B
FARMER & BETTS

Defined Benefit Pension Plan

General Overview

What is a Defined Benefit Pension Plan (DB)?

A Defined Benefit Pension Plan (DB) is a qualified retirement plan where contributions to the plan are based on a participant's age and compensation. While eligibility and distribution options are the same as other qualified plans, an actuary calculates how much a company must contribute to meet the 'benefit defined' in the plan document.

How does a Defined Benefit Pension Plan work?

A DB plan provides a specific benefit at a participant's retirement age. The plan's actuary determines the value of that benefit in the form of a single sum. The DB plan must accumulate the funds to provide that benefit by the time the participant reaches retirement age. The plan accumulates funds through contributions and earnings. An older participant has less time until retirement and therefore less time for the plan to accumulate the funds required to provide his/her retirement benefit. Accordingly, the contribution on behalf of the older participant must be relatively high compared to those required for a younger participant.

Here is a simple example:

Participant	Age	Compensation	Annual Contribution	Benefit at Retirement
Owner	55	$275,000	$235,548	$1,951,826
Employee	21	$24,000	$2,438	$299,507

How can the IRS allow such disparity between the owners and employees contributions?

It only appears there is disparity between the benefits being provided to the two individuals in the example above. Actually, the plan is providing the same benefit to both participants. The plan is providing a similar retirement annuity as a percentage of income to both participants. The perceived disparity exists because the owner's compensation is much larger than the employee's compensation and the owner is older than the employee.

This fact pattern is not unusual among small employers. Accordingly, the DB plan can be an extremely powerful tool enabling the small business owner large contributions, while minimizing employee cost.

Flexibility

DB plans are much more flexible than the typical business owner might think. These plans should exist for at least 3 years with a minimal contribution of $5,000 per year, unless terminated earlier for legitimate business reasons. Proper plan design and effective funding strategies can provide owners with the flexibility they need to annually contribute their desired amount. If the investments under perform, contributions should increase and likewise contributions will decrease if funds exceed plan expectations. Furthermore, if an owner's contribution objectives change considerably, the plan can be amended to provide the needed additional flexibility.

F&B
FARMER & BETTS

Cash Balance Plans

General Overview

A Cash Balance plan (CB) can provide the same high level benefits to employers. CB fits best when more than one business owner in the age 40+ range wants to put away more than $60,000 per year, and generally give employees a slightly higher level of benefit than a Defined Contribution plan. CB Plans are a form of Defined Benefit plan (DB) subject to the same $220,000 (2018 index) annual retirement benefit limit. There are many features of these plans that differentiate them from all other types of DB:

Reporting useful information
CB reports an account value to each plan participant. DB instead reports a theoretical monthly benefit upon retirement, always leaving participants without any idea of the actual present value of assets in their account. Hence the name "Cash Balance".

Added flexibility
CB plans are allowed to use current annual compensation *or* compensation history when written. In instances where participants may be paid less due to lower company income, contributions will follow. This is particularly noticeable with owners whose compensation is tied to profits, and employees with bonus or commission based pay structures. Contributions will generally follow changes in the business goals.

Contribution predictability
CB plans allow the ability to contribute a percentage of current pay *or* use a flat dollar formula (regardless of compensation). Employers can see what amount of plan cost they can expect ongoing. In addition to fixed dollar formulas, these plans are not required to follow government dictated 417(e) interest rates which are published by the IRS annually after plan year end. Therefore, funding requirements are always more consistent with expectations.

CB and DB plans alike can be paired with, or added to any existing 401(k) plan to increase annual contributions as well as provide additional contribution flexibility. Each participant can control the amount he has deducted from his taxable wages, and control investment choices offered by the plan custodian (or recordkeeper) if he chooses to.

Our team of experts can review prospective company census data and employer objectives to not only recommend a variety of plan design options. We prepare informative plan design proposal illustrations that are simple to follow and generally provide the tax savings an employer will experience with one of our plan design options. If you have questions or would like to meet with a plan consultant, please call FARMER & BETTS.