Frequently Asked Questions on Defined Benefit Plans

PensionSite.Org
P.O. Box 1869
Winter Park, FL 32790-1869
Phone: 888-412-4120
Fax: 321-397-0409
Email: Bill@PensionSite.Org
www.PensionSite.Org

Defined Benefit Plans

I. Basics

A. What is a Defined Benefit Plan?

A pension plan that provides for retirement income that is stated as a percentage of one's annual earned income.

B. Who may sponsor a Defined Benefit Plan?

Any established business entity such as a Corporation, Sole Proprietor, or Partnership seeking to maximize tax deductions and provide a substantial retirement benefit for owners and other long-term quality employees.

C. Could all employers benefit from a Defined Benefit Plan?

No. The Defined Benefit Plan is most advantageous for small stable business owners who are age 45 and over with 15 or fewer employees.

D. If a sponsor has another plan in place can he/she still adopt a Defined Benefit Plan?

Usually yes. How this is achieved will depend on the current plan type. Talk to us about current plan specifics.

E. How does a Defined Benefit Plan work?

One's retirement benefit is expressed as a percentage of annual income.

The maximum benefit is 100% of annual earned income, not to exceed $195,000 (2010) per year. This benefit is indexed for inflation in $5,000 increments.

Benefits are funded over the working life of the participating employee with annual tax deductible contributions from the employer.

At retirement, the monies accumulated can be rolled over to one's IRA account without taxation (until withdrawn from the IRA), taken in cash (a taxable event), or taken as monthly income for life (taxed as ordinary income as received).

F. Does the IRS approve of these plans?

Yes. Our firm, Pension Services, Inc., will file the plan, along with all other required documents, with the Internal Revenue Service. A favorable determination letter is issued directly to the plan sponsor by the Internal Revenue Service.

G. Is an enrolled actuary required?

Yes, for Traditional Defined Benefit Plans an Enrolled Actuary is required to ensure all plans are designed and administered within the statutory requirements.

II. Requirements

A. What requirements must a plan meet to qualify?

Plans must be adequately funded. A Defined Benefit Plan must provide a "definitely determinable benefit." Therefore, a Defined Benefit Plan expresses the ultimate benefit as a percentage of "final compensation."

B. What investments are allowed in Defined Benefit Plans?

Typical investments are permissible: stocks, bonds, life insurance, mutual funds, REITS, Government Securities – in essence market-based investments. The trustees may invest in any of these permissible assets.

Certain investments are prohibited by law. These are known as Prohibited Transactions. For example, one may not purchase a house for the trustee, plan sponsor or any participant in which to live; one may not purchase a building for the sponsoring employer's business; one cannot invest in stock of the sponsoring employer (unless publicly traded); nor can trustees invest in "collectibles" such as coins, stamps, artwork, etc.

C. Do the Affiliated and Control Group Rules of IRC §414 apply?

Yes. It is very important we be made aware of any and all companies the employer has an interest in, no matter how obscure. These details have particular importance to the ongoing qualification of the plan.

III. Costs

A. Who bears the cost of a Defined Benefit Plan?

The sponsoring business entity covers the set-up and annual administration fees and makes all contributions to the plan.

B. The check for the plan contribution is made payable to whom?

The Defined Benefit Plan itself. The trustee opens an account in the name of the plan at a financial institution. The sponsoring employer deposits the contribution to that account.

C. Is there any cost to the employees?

The Defined Benefit Plan cost is borne solely by the employer.

IV. Tax Benefits

A. Are the contributions tax-deductible?

Yes. The employer's contributions are tax-deductible for the sponsoring employer and the contribution for employees' benefits are tax-deferred to the employee.

B. Are administration fees tax-deductible?

Administration fees are deductible expenses. In addition, the IRS allows a tax credit of 50% of the start-up costs (not to exceed $500).

C. Is there a tax on the asset growth in the plan?

No. All accumulations grow tax-free.

V. Funding

A. What is the maximum a "typical client" can put away?

This varies based on the client's age and Normal Retirement Date (NRD). However, due to the funding assumptions mentioned earlier, contributions may be up to six times more than in a defined contribution plan.

B. Can I design a plan to target at a certain contribution level?

Yes. Contributions can be made at whatever rate you are comfortable with, within the funding guidelines prescribed by law. This is an important aspect of the initial illustration. Be sure to mention this goal when discussing the plan design and objectives.

C. If there is a "bad year" in the business, can one skip a year of funding?

No. However the plan can be amended in future years to reduce funding levels.

D. How are the contributions for a Defined Benefit Plan determined?

Using actuarial assumptions we know how much is needed to provide the promised benefit at retirement (target). The number of years to normal retirement (NRA) is figured, and working backward with the assumed interest rates, the annual level contribution needed to reach the target at retirement is determined.

VI. Distributable benefits

A. At retirement, what happens to any life insurance benefit in the plan?

The participant may elect to continue the permanent life insurance benefit after retirement by buying it for its cash value, or the policy can be surrendered by the plan for its cash value. Another option is to have the policy distributed directly to the client as part of his benefit. The cash surrender value of the policy will be taxable to the recipient in the year the policy is distributed.

B. What happens if someone dies while an active plan participant?

This is an important reason why the plan has life insurance benefits. The beneficiary receives the difference between the policy's cash value and the total death benefit income tax free. The portion of the death benefit equal to the cash value minus the PS-58 costs paid for the "current economic benefit" is taxed as ordinary income. The invested monies are distributed to the beneficiary. Taxes are generally due at the time of distribution unless rolled to an IRA account.

VII. Installation

A. What are the fees for a Defined Benefit Plan?

Design and Installation Fee (one-time): $2,500

Annual Fee: $2,250 plus $50/per participant

Additional fees will be charged to terminate, take over the administration of an existing plan or freeze existing plans.

B. How do I get a Defined Benefit Plan Illustration or more information?

Go to our web site: www.PensionSite.Org

Or call:

Bill Black toll free at 888.412.4120

Fax: 321.397.0409

Email: Bill.Black@PensionSite.Org