Dedicated DB
Defined Benefit Services

New Flexibility in Defined Benefit Plans

Independent professionals and consultants, small business owners, and individuals with self-employment income often are so busy with their day-to-day responsibilities that they don't take the time to think about preparing for the day they finally retire. Since they aren't thinking about the future – at least not one that includes life beyond their daily work – they may not accumulate retirement savings sufficient to maintain their pre-retirement lifestyle. Business owners are also more likely to put the needs of their business ahead of their well-being; they tend to invest any excess capital back into the business instead of putting it aside for retirement. And then, as retirement looms on the horizon, perhaps 5-15 years ahead, they have a lot of catching up to do – even those with high incomes.

A powerful solution is available to help these high income earners achieve their retirement goals – one that requires minimal effort to set up, and offers tremendous benefits. A small business defined benefit plan allows the small business owners and self-employed individuals to set aside additional savings when it makes the most sense to do so –in years of enhanced profits, for example, when taxes may be a big concern. The plans are easy to implement, and they provide a way for business owners to reduce current income taxes while building up retirement wealth.

Defined benefit plans differ from retirement plans such as SEP IRAs and 401(k) plans in terms of limits and how contributions are determined. Defined benefit plans may allow the highest tax-deductible contributions in an IRS-approved retirement plan, often 2-3 times what can be contributed to other plans. While defined benefit plans may allow much higher contributions for many people, an annual contribution is required. This commitment to contribute each year can be off-putting for some small business owners, particularly if their income fluctuates from year to year.

A **defined benefit plan** (DB) provides the plan sponsor (business owner) an opportunity to make contributions that are typically in excess of the limits allowed under traditional defined contribution plans, such as 401(k)s or profit sharing plans. In general, the older the defined benefit participant, the higher the allowable contribution.

DB plans offer a tax-advantaged way to save for retirement, along with relatively fast rates of wealth accumulation. As with a defined contribution plan, at retirement or when the plan is terminated, the account balance in a defined benefit plan can be rolled over into an Individual Retirement Account (IRA) where assets continue to grow tax-deferred until withdrawn.

However, recent changes in regulation through the Pension Protection Act of 2006 provide defined benefit plan administrators and their clients an array of tools and strategies to build in flexibility. A well-designed plan allows small business owners to minimize their taxes, maximize their personal retirement accumulations, and feel confident that they won't ever be locked into a plan that they can't afford. A well-designed plan can be modified when necessary. If a business owner's situation changes, numerous strategies can be implemented and the plan tailored to accommodate a client's specific situation.

This paper examines some of these strategies and provides illustrations.

Strategy 1 **Combine a defined benefit plan with a defined contribution plan to maximize contributions and increase flexibility**

Business owners can open a defined benefit plan in combination with a defined contribution plan (i.e. 401(k) plan) to maximize tax deductions and the accumulation of retirement dollars. In addition, because contributions to a defined contribution plan are discretionary, the combination of the two plans can provide additional flexibility. In a year of lower profits, a business owner can fund the defined benefit plan while forgoing the funding of the defined contribution plan. When profitability returns to higher levels, both plans may be funded, allowing for maximum retirement savings – and maximum tax benefits.

Example: *An energy consultant age 50 will make $200,000 in W-2 income from his S-Corporation this year which would qualify him to contribute as much as ~$124,000 to a Defined Benefit plan for 2016. Although he is trying to accumulate assets for his retirement -- which he thinks will be in about 12 years -- he is not sure that he will want to make that level of contribution each year. He would be more comfortable committing to about $75,000 a year and contributing more only in high income years.*

Solution

2016 Annual Estimated DB Contribution:	$75,000
2016 401(k) Contribution:	$35,000
Total 2016 Contribution	**$110,000**

In 2017, if our consultant wants to reduce contributions, he would contribute approximately $75,000 to the DB and contribute as little as zero to the 401(k).

2017 DB Contribution:	$75,000
2017 401(k) Contribution:	$0
Total 2017 Contribution	**$75,000**

Strategy 2 **Take advantage of legislative changes that allow for a range of contributions**

The Pension Protection Act (PPA) of 2006 included modifications to the way defined benefit plan contributions are calculated. Instead of a single required contribution, PPA changed the rules so that business owners may decide how much to contribute each year, within a range calculated by the plan's actuary. This range is calculated by Dedicated Defined Benefit Services, LLC based on the business and plan information provided by the plan sponsor each year. Once the actuary arrives at a minimum and maximum contribution, the plan sponsor decides how much to contribute within that range. For example, the first year's contribution can be maximized and in subsequent years, the plan sponsor can minimize the contribution.

Example: *Eric, age 48, plans to retire at age 62. In 2016, his compensation is $120,000 from his LLC and he contributes $100,000 to a defined benefit plan. In 2017, his compensation is $90,000 and he can contribute as little as $38,000 or as much as $90,000 to the DB plan.*

Strategy 3 **Use average compensation, rather than current compensation only, to increase flexibility in contributions**

Often, compensation for independent consultants, professionals, small business owners and self-employed individuals fluctuates from year to year. Because compensation is one factor in determining the plan's benefit and annual contribution to the plan, using an average of the three highest consecutive years of compensation reduces the future impact of any year's change in compensation.

Example: *Susan is a graphic designer in business for herself. Her income fluctuates quite a bit. Her husband works for a large company and can support their lifestyle so they would like to use Susan's income to bolster their retirement savings. To give Susan a broader contribution range and more flexibility, we can use her compensation from three consecutive years prior to her opening the plan in 2016. She is more comfortable knowing that she can control how much she contributes each year:*

Years	Compensation	Contribution Range	Susan Chooses to Contribute
2013	$95,000	---	---
2014	$150,000	---	---
2015	$115,000	---	---
2016	$120,000	$40,000 to $120,000	$110,000
2017	$70,000	$30,000 to $120,000	$50,000
2018	$95,000	$44,000 to $120,000	$120,000
2019	$120,000	$25,000 to $120,000	$60,000
2020	$135,000	$25,000 to $135,000	$130,000

Strategy 4 **Take plenty of time to make the contribution**

Contributions to a defined benefit plan can be timed to work with other cash flow needs. We recommend that no more than 50% of the contribution be made during the plan tax year. Then, when the plan year is over and the exact contribution amount has been calculated, plan sponsors have until they file their taxes with extensions to make the remainder of the contribution. The full contribution amount is not due until 8 ½ months after the end of the plan year, allowing for additional flexibility in cash flow. If the plan is opened in May 2016 and the business' fiscal year ends December 31st, the latest date to make the full contribution is not until September 15, 2017 (assuming the business has filed an IRS tax extension).

Strategy 5 **Amend the plan when necessary**

Given adequate time, amending the plan is simple. When it becomes clear that the current year's balance sheet will not be as positive as it was in prior years, just inform the plan consultant at Dedicated Defined Benefit Services as soon as possible. That way, the consultant can offer expert assistance to help mitigate any issues or concerns. For example, the plan could be amended to allow for smaller contributions going forward if profits are not quite as robust as anticipated when the plan was established.

Example: *Physician has had a thriving practice and establishes a defined benefit plan in 2016. A few years later he decides to cut back to half time as he approaches retirement. The plan is amended in 2019 to allow him to continue to contribute at a much reduced rate in the years ahead.*

Years	Compensation	Contribution
2013	$250,000	---
2014	$250,000	---
2015	$250,000	---
2016	$250,000	$145,000
2017	$250,000	$145,000
2018	$250,000	$145,000
2019	$120,000	$60,000
2020	$80,000	$40,000

Strategy 6 **When the client is ready to retire, sells the business or business conditions change, the plan sponsor can terminate the plan.**

When it's time to terminate a defined benefit plan, business owners can roll over their assets to an Individual Retirement Account (IRA) where the assets can continue to grow tax deferred until withdrawn. Dedicated Defined Benefit Services consultants handle all of the paperwork. The majority of our clients – 99.9% – choose the rollover option at plan termination.

A defined benefit plan has the potential to provide the **largest available** potential annual tax deduction as well as the **highest benefit** of any other qualified retirement plan. When a small business owner implements a new defined benefit plan, he or she:

- May contribute as much as $100,000 or more per year;
- May accumulate **up to $2.4 million** over a 10-year period;
- Enjoy large tax deductions each year; and
- ***Still maintain flexibility in funding the plan!***

Talk to your professional advisor today for a proposal customized to meet your retirement savings objectives. Plans must be opened by the end of the business fiscal year, generally December 31st.

Who to Contact for Additional Information

Name:
Title:
Company:
Address:
Phone:
Email:

Annual reviews and consistent communications are key to a plan's success

Before a defined benefit plan is opened, Dedicated Defined Benefit Services plan design specialist will review each client's unique situation and provide a recommendation. In some cases, a defined benefit plan may not be the best retirement solution and we will suggest alternatives.

Once the plan is established, Dedicated Defined Benefit Services consultants will gather information each year from the business owner and review the plan. They will analyze the plan's performance and discuss with the business owner to identify what is working and what isn't. They will address any aspects of the plan design that may need modification or improvement so that the plan will continue to support a client's unique needs.

Working closely with an assigned consultant is the best way to ensure that the right tools and strategies are used to meet a client's changing business situation.