

# The Defined Benefit Plan

A Powerful Tax Strategy for High Income  
Individuals With Self-Employment Income  
and Small Business Owners

BY DEDICATED DEFINED BENEFIT SERVICES



# The Defined Benefit Plan

The small business Defined Benefit (DB) plan is an IRS-approved qualified retirement plan that allows independent professionals and consultants, individuals with self-employment income and small business owners – to make large annual tax-deferred contributions and accumulate as much as \$1-3.4 million in just 5-10 years. The contributions are deductible and can potentially reduce income tax liability by \$40,000 or more annually.

## How Does It Work?

A Defined Benefit plan promises a specific annual benefit in retirement. To arrive at the benefit, business owners decide what percent of their annual income they want to have at retirement or what percent of current income they can comfortably afford to contribute to the plan, up to the maximum allowable amount. Current regulation defines the maximum annual benefit at \$275,000.

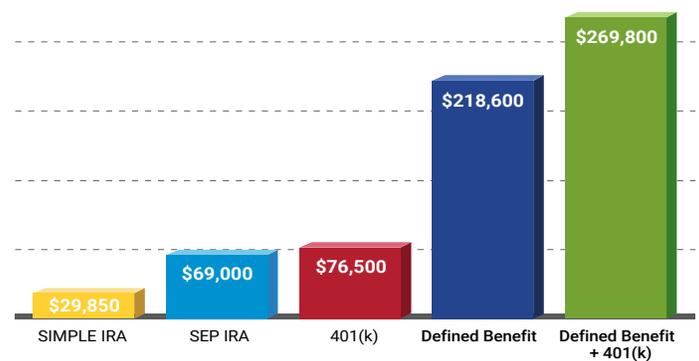
An annual contribution amount is required by the business owner to accumulate sufficient savings to pay out the benefit. The annual contribution is calculated using actuarial formulas based upon:

- **Current age** – the older the business owner, the larger the annual contribution needed to reach any specific benefit target because the owner will have fewer years to contribute
- **Compensation** – Eligible compensation differs based on the type of business
- **Planned retirement age** – usually at least five years from the year the plan is adopted
- In subsequent years, the balances accumulate through contribution and investment performance in the Defined Benefit plan

Assets may be invested in mutual funds, bonds, equities or other marketable securities. Investments with low volatility are generally recommended.

## RETIREMENT PLAN SAVING LIMITS

For a Client Age 52 Earning \$345,000



\*2024 plan maximum contribution limits for a 52 year-old, including "catch-up" contributions of \$3,500 for SIMPLE IRA, \$7,500 for 401(k).

**Example** A 53-year old radiologist expects to have an annual W-2 income of at least \$345,000 from his private medical practice until he retires in 10 years. He establishes a DB plan to increase his retirement savings and reduce his tax liability.

Here's how it works for him:

**Annual DB plan contribution** \$229,400  
**Annual tax savings @37%\*** \$103,820  
**Projected accumulation in 10 yrs** \$3.0 million\*\*  
**Annual retirement benefit** \$247,500

\* Assumes estimated 31% federal and 6% state tax rates. This example is based on specific assumptions and is used for illustrative purposes only.

\*\* Assumes 10 year funding, 5-7% rate of return.

## Who Is Eligible for a Defined Benefit Plan?

Defined Benefit plans aren't right for everyone. They are best suited for individuals with self-employment income or small business owners who are older and want to increase retirement savings while reducing their tax liability. Ideal candidates are:

- 35+ years of age
- Interested in contributing more than \$50,000 annually to their retirement or a higher percent of compensation than allowed in a 401(k)
- Able to make that contribution for at least the next 3-5 years
- Earning at least \$100,000 annually in one of these ways:
  - Owns a business with five or fewer permanent employees, including the owner
  - Is self-employed as primary means of earning a living
  - Has a second occupation in which client works for himself or herself
  - Is considered an independent contractor rather than an employee
  - Receives payments or royalties from patents, books, consulting, board of director fees, speaking engagements

Defined Benefit plans can work for companies that are sole proprietors, partnerships or corporations.

Typical Occupations of Plan Owners			
Attorney	Corporate Director	Farmer	Physician
Coach	Dentist	Financial Advisor	Real Estate Agent
Contractor	Engineer	Insurance Agent	Sales Rep
Consultant	Entertainer	Marketing Services	Software Developer

**Example** Husband, age 61, & wife, age 59, are marketing consultants in business together. The W-2 income for each is \$345,000. They want to retire in five years if they can bump up their retirement savings.

They establish a Defined Benefit plan that they will contribute to for five years. In addition, they set up a 401(k) to maximize contributions.

	<b>DB only</b>	<b>DB + 401(k)</b>
<b>Annual DB plan contribution</b>	\$537,100	\$639,500
<b>Annual tax savings @37%*</b>	\$198,725	\$236,615
<b>DB accumulation</b>	<b>\$3.22 million**</b>	
<b>Annual DB benefit</b>	\$275,000	

\* Assumes estimated 31% federal and 6% state tax rates. This example is based on specific assumptions and is used for illustrative purposes only.

\*\* Assumes 10 year funding, 5-7% rate of return.

Recent legislation has increased the flexibility of Defined Benefit plans so that business owners can better manage their contribution amounts from year to year. However, Defined Benefit plan contributions are required to keep the plan on track to deliver the promised benefit in retirement. Upon termination of the plan, the assets can be rolled into an IRA where they will continue to grow tax-deferred until withdrawal.

Plans should be opened by the business' tax filing deadline including extensions for the plan year. If you think a Defined Benefit might fit your situation, learn more before making any retirement contributions for 2024.

**Dedicated Defined Benefit Services** (Dedicated DB), a national third-party administrator, specializes in the design, marketing, and administration of Defined Benefit and Cash Balance plans for businesses with 1-10 employees. We're the "go-to" experts in small business Defined Benefit plans.

