



Consultants, Actuaries and Administrators of Pension
and Profit Sharing Plans Since 1970

One North Park Drive, Suite 104
Hunt Valley, MD 21030-1816
410.771.3035
fax 410.771.3036
pollardpensions.com

Defined Benefit Plan Overview

Advantages

1. A Defined Benefit Plan (DBP) is a type of qualified retirement plan that enables an employer to establish a retirement program that provides the following:
 - Guaranteed benefits
 - Annual contributions in excess of what is available through a Defined Contribution Plan (DCP) – currently \$50,000 (\$55,500 if the DCP includes a 401(k) feature and the individual is age 50 or older).
2. Maximum Annual Benefit, payable at Normal Retirement Age (NRA) is the lesser of \$200,000 or 100% of highest 3-year consecutive average compensation, provided the individual will have a minimum of 10 years of plan participation at NRA. Benefit limit is pro-rated for years of participation less than 10 years.
3. This maximum benefit is available beginning with a NRA as early as age 62. Benefit payments before age 62 or before completion of 10 years in the plan must be actuarially reduced.
4. Maximum benefit is not reduced by prior accumulation in a DCP maintained by the same or related entity, as it was pre-2002. Therefore, a DBP can be adopted after years of maintaining a DCP without reducing projected DB benefits. Vice versa, after a DBP is fully funded, the employer can revert to a DCP for remaining years of employment.
5. Benefits payable at retirement are not required to be paid as an annuity, but can be designed to allow equivalent lump-sum distributions or rollovers to an IRA.
6. DBPs can also be combined with a DCP depending on the overall retirement plan deduction limits available to the employer.
7. DBPs work very well for a one-person business entity or for entities with employees younger than owners/principals. One-person DBPs are best combined with a one-person 401(k) to maximize deductions and flexibility.

Disadvantages

1. Annual contributions are not as flexible as with a Profit Sharing Plan, but instead are tied to the plan's guaranteed benefits, fluctuation in market value of plan assets, and actuarial assumptions used to value benefits. The ability to generate the highest possible tax deductions results in loss of some flexibility.
2. The Plan must meet IRS's minimum annual funding obligations and is subject to an annual actuarial certification, which results in higher set up and ongoing administration costs than a typical DCP.
3. The Employer bears the full risk to guarantee benefits accrued by plan participants. If the plan funding is insufficient to meet plan benefit obligations at termination, the employer may either fully fund the plan or allow major shareholders/owners to waive benefits to funded levels.
4. If the Plan covers non-owner employees, it is subject to the Pension Benefit Guaranty Corporation (annual premiums and restrictions on plan termination) unless the employer is a small professional service corporation with less than 25 employees.
5. Funding maximums and annual deposit requirements are subject to change with legislation and IRS regulations.

**Maximum Benefit & Contribution Limits
Under a Defined Benefit Plan
(assuming a 10-year Plan)**

NRA	Maximum Annual Benefit	Projected Lump-Sum At NRA	Maximum Annual Contribution
55	\$120,000	\$1,670,000	\$160,000
60	\$169,000	\$2,140,000	\$210,000
62	\$195,000	\$2,360,000	\$235,000
65	\$195,000	\$2,210,000	\$220,000

Example:

An individual who adopts a DBP at age 55 and who maintains the plan for 10 years can deposit \$160,000 per year into the plan, provided he/she maintains at least 3 consecutive years with W-2 of \$120,000 and taxable profits before the contribution deposit of \$160,000.

A self-employed individual would need \$280,000 or more of net income to generate a \$160,000 deduction in the first 3 years if he or she had no earned income prior to plan inception. If the individual had a 3-year average taxable income prior to plan set up of at least \$120,000, then net income of \$160,000 or more in subsequent years could permit a deduction of \$160,000 (100%).

The average income level can be set either before or during the years the plan is in place, provided it is earned with the employer adopting the plan. Once the average is set, all current income can go into the plan.

Year	Total Net Income	Taxable Income	Plan Contribution
1	\$280,000	\$120,000	\$160,000
2	\$280,000	\$120,000	\$160,000
3	\$280,000	\$120,000	\$160,000
4 & after	\$160,000	0	\$160,000

The annual contribution amount is determined each year based on current income and investment growth/loss of the plan's assets and will be adjusted up or down based on experience and actuarial assumptions. These examples are intended to be an estimate only and cannot be relied upon as actual results.