

RETIREMENT
Insight

Plan Design

Consulting

Administration

IRS/DOL Resolutions

DEFINED BENEFIT/
DEFINED CONTRIBUTION
COMBINATION PLAN

Design Options



Creating the future you envision

DEFINED BENEFIT PLAN DESIGN OPTIONS

Qualified pension plans and retirement savings programs fall into one of two categories: Defined Contribution Plans or Defined Benefit Plans.

Defined Contribution Plans comprise a broad range of programs such as profit-sharing, 401(k), money purchase, and SEP-IRA plans. DC plans allow owners and employees to make retirement contributions that are allocated to individual participant accounts. Funds available at retirement are the accumulation of those contributions plus investment earnings. However, it's uncertain what the expected amount, or benefit, will be at retirement. These plans are generally more favorable to younger employees who have a longer time horizon until retirement.

Defined Benefit Plans promise participants a specific monthly lifetime benefit amount at retirement (which is usually taken as a one-time, lump-sum payment). A benefit formula is created that targets a level of retirement income that can be supported by your desired annual contribution level (but is subject to IRS benefit limit). Contribution amounts are then actuarially calculated and adjusted annually to ensure that the target goal is reached. Contributions for all the plan participants are kept in a single account that is used to pay the promised benefits. Defined Benefit Plans tend to favor long-service, highly compensated business owners, partners and key employees who are in their peak earning years. DB plans can also be especially beneficial for those who need to quickly increase their retirement assets.

Advantages of a DB Plan

Higher contribution limits- Contributions can be significantly higher than those of other business retirement plans. This can help those nearing retirement grow their nest egg quickly. The Defined Benefit Plan is an appropriate retirement savings vehicle when the participants to be maximized are over age 50 and earning over \$275,000 each year.

Tax deductions- The contributions made are generally 100% tax-deductible to the sponsoring business. This can translate into substantial tax savings.

Targeted income for retirement- Plan contributions are adjusted each year according to investment results to help reach set retirement goals.

Important Considerations

Have contributions already been made to another plan for the current year? If these contributions exceed certain limits, the Employer will likely need to wait until next year to open up the DB plan. This is due to IRS limits on total contributions to all plans of the employer.

Duration of the plan- The IRS requires that a plan be "permanent" and used for retirement purposes only. The employer should expect to maintain the plan for at least five years.

Terminating your plan- Plans can be terminated earlier than your pre-selected retirement age for several reasons, such as serious financial distress, death of the employer, or dissolution of the business. However, due to the permanency requirement, the IRS could disqualify the plan if it is terminated in less than five years. Regardless of when the plan is terminated, an additional fee will be charged to prepare the termination paperwork.

Amending your plan- Occasionally, the employer may want to change plan provisions in order to increase or decrease future plan contributions. An additional fee will be charged to modify the benefit formula and process amendments to the plan.

Investment responsibility- Unless investment authority is delegated to another party, the Employer will be responsible for investing plan assets to ensure that asset growth will meet Plan funding projections.

Deadlines- The DB Plan must be opened by the end of the business fiscal year (usually December 31) to make contributions for that tax year. Contributions are due by the tax year's filing deadline plus extensions.

Does the business have steady annual income needed to cover required annual DB plan contributions? The IRS has strict required minimum contribution rules. Should investment losses occur, the required contributions may increase as well. It is important to have steady income to meet these needs. Remember, a DB plan is not like a profit sharing plan in which a sponsor can suspend contributions in certain years. Funding is not discretionary.

Receiving Your Benefit at Retirement

When you reach retirement age, you will have three options for receiving your benefit payout:

- 1. Roll the assets into an IRA.** A participant can roll their assets into an IRA and they will remain tax-deferred until they withdraw them. This may allow for more flexibility, as distributions from the IRA aren't required until age 70½.
- 2. Set up an annuity.** This will provide a monthly benefit from the plan over the lifetime of the participant.
- 3. Lump-sum distribution.** A lump-sum distribution for the full amount of the Plan benefit due can be elected. The amount is taxed immediately and a 10% penalty may apply if the participant is under age 59½ at the time of distribution.

Why Combine a DB/DC Plan?

A DB Plan can provide higher contribution amounts; thus for employer deduction purposes and future benefit purposes, this may be better than a 401(k). In some instances, these plans side-by-side would be even more ideal.

Prior to 2006, an employer typically did not combine a DB Plan with a 401(k) Plan because generally, with a DB Plan in place, employer contributions could not be made to the 401(k) Plan. With no employer contributions in the 401(k) Plan, deferral contributions from the employees were very low, making the deferral contributions of the key people very limited.

The Pension Protection Act of 2006 (PPA) substantially changed this by allowing **up to a 6% employer contribution into the 401(k) Plan.** Now an employer can implement a safe harbor 401(k) Plan and be assured of a deferral of \$18,500 or \$24,500 (if over 50). However, the employer will have to commit to a 3% safe harbor employer contribution.

Once this 401(k) plan is implemented, we add a Defined Benefit Plan into the mix. Typically, different benefit levels are allocated to different employees. We can design a plan to maximize the benefits (thus, the contributions) to the older key employees, while providing a minimum type of benefit formula to the younger employees. Simply expressed, as long as the benefits the highly compensated employees will receive at retirement age are equal to those the non-highly compensated employees will receive expressed as a percent of pay then the plan will pass compliance (this is known as the 401(a)(4) test).

Sample 401(k) Cash Balance Plan Illustration

Employee Name	Birth Date	Hire Date	Compensation	Deferral	SHNEC	Employer PS	DB Pension	Total
Owner 1	7/31/65	7/6/90	\$275,000	\$24,500.00	\$0.00	\$36,500.00	\$177,379.00	\$238,379.00
Owner 2	11/5/59	9/18/92	\$275,000	\$24,500.00	\$0.00	\$36,500.00	\$229,497.00	\$290,497.00
Owner 3	4/2/62	7/6/90	\$275,000	\$24,500.00	\$0.00	\$36,500.00	\$218,190.00	\$279,190.00
Employee 1	8/21/89	5/12/09	\$38,000	\$0.00	\$1,140.00	\$1,444.00	\$950.00	\$3,534.00
Employee 2	10/28/74	7/14/14	\$45,000	\$0.00	\$1,350.00	\$1,710.00	\$1,125.00	\$4,185.00
Employee 3	6/9/81	6/1/06	\$35,000	\$0.00	\$1,050.00	\$1,330.00	\$875.00	\$3,255.00
Employee 4	3/21/75	8/31/11	\$55,000	\$0.00	\$1,650.00	\$2,090.00	\$1,375.00	\$5,115.00
Employee 5	10/22/89	2/16/16	\$24,050	\$0.00	\$722.00	\$914.00	\$601.00	\$2,237.00
Employee 6	6/9/84	4/4/14	\$42,000	\$0.00	\$1,260.00	\$1,596.00	\$1,050.00	\$3,906.00
Employee 7	2/20/93	3/5/12	\$36,450	\$0.00	\$1,094.00	\$1,385.00	\$911.00	\$3,390.00
Employee 8	1/14/81	11/1/08	\$52,000	\$0.00	\$1,560.00	\$1,976.00	\$1,300.00	\$4,836.00
Employee 9	8/17/94	5/29/15	\$26,850	\$0.00	\$806.00	\$1,020.00	\$671.00	\$2,497.00
Employee 10	5/26/79	10/16/07	\$37,750	\$0.00	\$1,133.00	\$1,435.00	\$944.00	\$3,511.00
Totals				\$73,500.00	\$11,763.00	\$124,400.00	\$634,869.00	\$844,532.00

Tax Analysis:

Assumed Tax Brackets

37%

Employer Contribution	771,032
Estimated Tax Savings	285,282
Net Cost After Estimated Tax Savings	485,750
Contribution For Principals	734,567
Principal Contribution As A Percentage Of Net Cost	151.22%
Estimated Annual Administrative Cost for DB/DC Combination Plan	3,630

Net Cost after all Factors

-245,187

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