RANDALL & HURLEY

OVERVIEW OF DEFINED BENEFIT PLANS

Despite the popularity of 401(k) plans, defined benefit plans have been a proven track record and provide many unique benefits to employers. A defined benefit plan can be a high-powered tool to assist key employees in accumulating significant retirement benefits in a short time period. Before adopting a defined benefit plan, you should be familiar with the contents of this overview.

Defined Benefit Plan Operations

- May Provide a Substantial Increase in Benefits to “Key” Employees Versus 401(k) & Other Defined Contribution Plans
  - “Key” employees include owners and highly compensated employees.

- Benefit Is Formula-Driven
  - It’s possible to have different formulas apply to different owners based on your objectives.
  - Changes to the benefit formula, which could affect the funding or required contributions, need to be made with advance planning. Depending on the situation and timing, it may not be possible to reduce the required contribution once the year has already started.

- Required Contributions
  - A minimum contribution is required annually. This contribution is based on expected compensation levels and various assumptions, some of which are mandated by the IRS. Significant penalties could be realized if the minimum contribution is not made timely.
  - The amount of contribution will fluctuate depending on investment returns, demographics, and realization of assumptions.
  - Contributions could be required up and until the plan is terminated (including the year in which the plan is terminated), depending on funding level of plan.

- Employer Assumes Investment Risk
  - Benefits are guaranteed, and the value of the benefit fluctuates from year to year depending on mandated IRS assumptions. The increase in value is not tied to investment performance.
  - The value of benefits most likely will increase each year (at least for traditional plans); therefore, if the investments decrease in value, this shortfall will be made up through larger future contributions.

Special Considerations

Implementation of a defined benefit plan requires a “long-term” commitment. Generally, defined benefit plans should be in place for a minimum of 5 years to be considered long-term; however, this commitment has not been defined by the IRS and will ultimately be based on all relevant facts and circumstances.

The defined benefit formula can be altered prospectively on a facts and circumstances basis. Generally, it is not advised to alter this formula on a frequent basis.

This document contains a brief overview of defined benefit plans features. Please contact Randall & Hurley for more details about adopting a defined benefit plan.

How to Get More Information

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