General Overview
DEFINED BENEFIT PENSION PLAN

What is a Defined Benefit Pension Plan (DB)?
A Defined Benefit Pension Plan (DB) is a qualified retirement plan where contributions to the plan are based on a participant's age and compensation. While eligibility and distribution options are the same as other qualified plans, an actuary calculates how much a company must contribute to meet the 'benefit defined' in the plan document.

How does a Defined Benefit Pension Plan work?
A DB plan provides a specific benefit at a participant's retirement age. The plan's actuary determines the value of that benefit in the form of a single sum. The DB plan must accumulate the funds to provide that benefit by the time the participant reaches retirement age. The plan accumulates funds through contributions and earnings. An older participant has less time until retirement and therefore less time for the plan to accumulate the funds required to provide his/her retirement benefit. Accordingly, the contribution on behalf of the older participant must be relatively high compared to those required for a younger participant.

Here is a simple example:

Participant	Age	Compensation	Annual Contribution	Benefit at Retirement
Owner	55	$275,000	$232,102	$1,907,466
Employee	21	$24,000	$2,521	$304,181

How can the IRS allow such disparity between the owners and employees contributions?

It only appears there is disparity between the benefits being provided to the two individuals in the example above. Actually, the plan is providing the same benefit to both participants. The plan is providing a similar retirement annuity as a percentage of income to both participants. The perceived disparity exists because the owner's compensation is much larger than the employee's compensation and the owner is older than the employee.

This fact pattern is not unusual among small employers. Accordingly, the DB plan can be an extremely powerful tool enabling the small business owner large contributions, while minimizing employee cost.

Flexibility
DB plans are much more flexible than the typical business owner might think. With a valid business reason, these Plans can be terminated in as few as three years after inception (assuming a minimal contribution of $5,000 per year). Proper plan design and effective funding strategies can provide owners with the flexibility they need to annually contribute their desired amount. If the investments underperform, contributions should increase and likewise contributions will decrease if funds exceed plan expectations. Furthermore, if an owner's contribution objectives change considerably, the plan can be amended to provide the needed additional flexibility.

Defined Benefit/Defined Contribution Combo Plan

A Defined Benefit/Defined Contribution Combination Plan (DB/DC) offers owners a two-plan approach to saving for retirement. Due to the Pension Protection Act, many plans allow owners an additional DC contribution as well as individual 401(k) salary deferrals of $18,500 ($24,500 if age 50). A general example of a DB/DC Combo Plan is outlined below, followed by an explanation of several variations:

Participant	Age	Compensation	Defined Benefit Contribution	DB/DC Combination Contribution
Owner	57	$100,000	$256,634	$260,277
Spouse	57	$30,000	80,514	81,823
Employee 1	30	50,000	27,566	5,550
Employee 2	25	50,000	18,913	5,550

1. **Turbo-charge any Defined Benefit Pension Plan (maximizes benefits for all participants)**
   In addition to the DB plan contribution, owners may contribute up to 6% into a DC plan. Individuals may also contribute an additional $18,500 pre-tax into a separate 401(k) Profit Sharing Plan ($24,500 if age 50). This will work well for an employer without employees; otherwise the plan must satisfy the 401(k) ADP test (a safe harbor may be used).
2. **Floor Offset (good for PBGC covered plans)**
   The Floor Offset establishes a DB Plan for owners and a DC Plan for employees. The benefits provided under the DB Plan are reduced by the value of the participant's account in the DC Plan. The DC Plan participants receive an estimated 5 – 10% of pay contribution.
3. **Super Combo (good for non-PBGC covered plans)**
   This design establishes both plans, and all participants receive benefits in both plans. In the DC Plan, 6% of total compensation is allocated using tiers; where the employees receive an estimated 7.5% and owners receive the remainder. In the DB Plan, owners receive the maximum benefit and the employees receive the smallest benefit permitted.
4. **Carve Out (good for 2+ owners with 3 or fewer employees)**
   This design establishes a DB Plan for owners and a DC Plan for employees. It is a great way to maximize contributions for owners while controlling the employee cost. There are requirements which must be considered including at least 2 participants in the DB Plan, 40% of the participants are in the DB Plan, and there are no common participants between the DB and DC company contributions (except 401(k)).
5. **Cash Balance Plans (good for plans with multiple owners)**
   This is a DB Plan that specifies both the contribution to be credited to each participant account (such as a percent of pay or a flat dollar amount) and the investment earnings to be credited on those contributions. Each participant has an account that resembles those in a 401(k) plan. The advantage of this DB Plan is you know what is going into the plan for each participant and what will be paid out when they leave. A 401(k) Plan may also be added.

If you have any questions or would like to meet with a plan consultant, please call NICHOLAS PENSION CONSULTANTS.