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Back to Basics – When a DB Plan is a Solution for the Small Business Owner



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When a DB Plan is a Solution for the
Small Business Owner

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We added 51 new retirement plan clients in 2009, most of which were small defined benefit plans. 2009 was a good but not extraordinary year for us. We have had similar results each year as far back as 2001. Clearly, what we have to offer is of value to our clients and their advisors – and more tellingly, it has proven valuable for many years, through recessions and boom times, one tax reform act after the other.

Why? What makes a defined benefit plan the answer to the retirement planning goals of so many?

Here are some guidelines to help you recognize when a defined benefit plan is likely to be a valuable solution to your client's retirement planning goals:

- **Accumulate a lot of money in a short period of time.** *Nothing* works as well as a defined benefit plan for the owner who is approaching retirement with the realization he or she does not have enough money set aside to be able to afford to retire. We have many clients setting aside \$200,000 to \$300,000 in tax-deductible contributions per year for the several years building up to their target retirement age. Some are contributing even more. Can you name another method of accumulating tax-deferred savings that comes even close to these numbers?
- **Older owner – younger workforce.** Unlike a traditional 401(k) plan where contributions are related only to wages, contributions in a defined benefit plan are heavily skewed by age; the closer one is to retirement, the fewer years there are to fund a benefit, so the larger each year's contribution needs to be. And what is the typical demographic make-up of most small business? Generally older owners and younger workers, which translate to a greater portion of the total plan contribution being allocated to the benefit of the owners.





- **Satisfy partners with different savings goals.** In professional organizations with multiple partners, it is not unusual for the partners to have varying retirement savings abilities and goals. Older partners may want to maximize their tax-deferred compensation while younger partners may have a more pressing need for current wages. Some partners are savers, others spenders. Combining a cash balance form of defined benefit plan with a 401(k) plan is an effective way to satisfy everyone. The cash balance plan can have different contribution “tiers” for each partner or groups of partners, some tiers with high contributions and others with lesser or even \$0 contribution amounts. In combination with a 401(k) plan, the cash balance plan provides customization and flexibility for all.
- **A (relatively) safe path to retirement.** The past couple of years have reminded all of us of the perils of relying on the stock market alone to achieve our retirement goals. Our 401(k) accounts have taken a beating and recovery is proving to be painfully slow. For many, this may mean the dream of retirement is now delayed a year, or two ... or more. A defined benefit plan promises a specific benefit to be paid at a specified date. Most defined benefit plans have a portion of their assets invested in the stock market, so they are not immune to market fluctuations. But, with a defined benefit plan the business owner can increase his or her contributions to whatever amount is necessary in order to hit the specific benefit target. By making larger tax-deductible contributions, the owner can still retire “on schedule.”

The answer to why we are setting up so many defined benefit plans for professional organizations and other small business owners is clear. Many small businesses are owned by baby boomers approaching retirement. Many have seen their 401(k) savings take a big hit. Most owners are older than the majority of their workforce. If they have partners, they struggle to satisfy conflicting retirement savings abilities and goals. In other words, a defined benefit plan is the best solution for many, not just a few, successful small business owners who are planning for their financial security in retirement.

Still, a defined benefit plan does not work in all situations. In the next issue of *Pension Trends* we will discuss when a 401(k) plan or other retirement plan design is likely to be a better solution.



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