Defined Benefit Plans offer Substantial Tax Savings

Defined Benefit (DB) plans have gotten a bad rap. Companies don't like them because they became very costly due to stock market losses, both after the tech bubble burst and the Great Recession, and accountants hate the potential corporate liability. But many smaller firms around the country have come to love them because DB plans can deliver huge tax savings. Over 99% of US employers are small businesses with 73% of them having a single owner. These smaller firms can take full advantage of the DB plan's tax savings.

In 2014, the maximum Defined Contribution (DC) annual addition limit is $52,000[1] or an extra $5,500[1] for employees at least age 50 and in a 401(k) plan. Whereas a DB plan can provide a benefit up to $210,000[1] per year which equates to a total value in excess of $2,600,000[22] at age 62! DB plans aren't for everyone, but for baby boomer proprietors of smaller companies, the tax savings are dramatic.

Many companies are wary of DB plans because they have heard that they are inflexible, complicated and costly. Keith Kowalczyk, the Chief Actuary at Ekon Benefits, debunks these three DB myths:

1. With the Pension Protection Act's new contribution requirements (both minimum required and maximum allowable), after a couple years, most plans enjoy a very wide range of allowable contributions permitting for flexible funding.
2. Proper plan design and administration removes complications and delivers a smooth running retirement savings plan with the most significant tax deductions available under any retirement plan.
3. Actuarial and compliance fees are approximately $3,000 to $4,000 per year for smaller firms.

DB plans are not for everyone. Prime candidates are companies with owners age 50 or older with younger or few staff employees.

Cash Balance plans, which look like defined contribution plans but are actually defined benefit, have garnered a great deal of press. These plans work well in certain situations, however they are usually combined with profit sharing plans in complex multi-plan structures. Many smaller employers choose not to incur the extra costs and complications involved with the multi-plan structure.

Now with the Affordable Care Act's additional 3.8% tax on unearned income for taxpayers with Adjusted Gross Income over $200,000 single or $250,000 married and potential higher income taxes on the horizon, tax deferred savings will be more and more valuable. If you haven't saved much for retirement yet or want to reduce your taxable income, don't rule out setting up a DB plan before you weigh the tax advantages and see how much you can save.

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[1] Internal Revenue Code §415 IRS News Release IR-2013-86, Oct. 31, 2013

[2] Based on a life annuity, 2014 Applicable Mortality and a discount rate of 5.5% per annum