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February 2021 By Tom Hicks, Attorney At Law

DEFINED BENEFIT PLANS: NOW MORE THAN EVER!

The SECURE Act, passed in December 2019, allows a business to adopt a retirement plan up until they file their tax returns, plus extensions. This gives your clients the option to set up a Defined Benefit Plan for 2020 up until September 15, 2021.

Many small and owner-only businesses, such as real-estate agents, software developers, contractors, and others, had a good year in 2020 and may find that they owe tax dollars as they are completing their 2020 tax returns. A defined benefit plan (DB) may be the solution they are looking for.

In addition, while establishing these plans over the next few months, the same clients will know how 2021 is going and whether they will also need tax deductions for this year.

Many are concerned with the funding and flexibility issues of defined benefit plans, however there is a certain flexibility in these plans that many do not know about. This is especially true with owner-only companies. For more information on owner-only DB Plans, click here. For an estimate of how much an owner could contribute put into a solo plan, see this chart. If you are interested in a proposal with firm numbers, complete our proposal request form and return it to Debbie Rath at drath@nhhicks.com.

Now is also the time to assist clients with their existing defined benefit plan issues.

The first issue is over and underfunded plans based on 2020 market returns. We have many clients whose defined benefit assets earned upwards of 20% in 2020. This means they may have met their funding requirement for 2020 without having to contribute for the year. These zero or reduced contributions will hurt 2020 tax planning, as deductions may not be available. Clients and their financial advisors need to understand that while this may not allow tax deductions, they are still ahead because they get “free” funding towards their retirement benefits.

An overfunded defined benefit plan is a retirement plan that has more than enough funds to cover the plan’s benefits. These plans may need to be terminated immediately to stop the excess problem from getting worse. The company has options available including taking the excess back which are subject to a 50% excise tax, transferring the excess into a qualified transfer plan, or increasing benefits. Clearly these clients need attention now.

Underfunding is also an issue if business cash flow is down. If a client is unable to fund prior amounts for 2020, action should be taken so they do not get further behind. If they reduce or freeze benefits before participants earn 1000 hours of service, funding can be stopped or greatly reduced for at least 2021, although the 2020 funding issues will still have to be resolved. Clients who have had business downturns or who have taken big losses in the plan are also clients who need attention now.

Finally, there are also many options for business owners who have employees. By starting a Defined Benefit Plan in combination with a Defined Contribution Plan (DC), business owners can get large contributions for themselves in a DB Plan and minimize contributions to employees who primarily participate in a DC plan, typically a 401(k) Profit Sharing Plan. These plans work great where the owner is making a good income and older than their employees. Doctors, lawyers, tech companies and other professionals are potential for this DB/DC Combo design. To learn more about these plans, click here.

We have only scratched the surface on DB plan issues here. You may want to review the information from our DB webinar that covers all the funding and flexibility issues here.

Bottom line: The only way to see if these plans will benefit your client is to have us run a proposal. For a free proposal, click here. Please complete and return all the information including the compensation history requested for a DB proposal.

Now is a great time to check up on existing and potential DB clients and ask the pertinent questions. As always, we are here to help. Thank you for your time.