HICKS NOTES

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Defined Benefit Plan Prospects & Clients Need Attention Now

Defined Benefit Plans offer small business owners a powerful opportunity to secure significantly larger tax deductions as compared to 401(k) plans. Understanding the key requirements and deadlines for establishing and maintaining these plans enables you to effectively guide your clients in maximizing their benefits.

The SECURE Act, passed in 2019, provides businesses with greater flexibility by allowing them to adopt a retirement plan up until they file their tax returns, including extensions. This means your clients have until September 15, 2025, to establish a Defined Benefit (DB) Plan for the 2024 tax year.

Many small and owner-only businesses—such as real estate agents, software developers, and contractors—experienced strong financial performance in 2024. As they finalize their 2024 tax returns, they may be facing significant tax liabilities. A Defined Benefit Plan could be a strategic solution to help them reduce their tax burden while building long-term retirement savings.

While some may have concerns about the funding requirements and flexibility of Defined Benefit Plans, these plans offer more adaptability than many realize, particularly for owner-only businesses. Understanding these options can help business owners maximize retirement benefits while maintaining financial flexibility.

For more information on owner-only Defined Benefit Plans, click here. If you are looking for an estimate of how much an owner can contribute into an owner only DB plan, see this **chart**.

DB Plans With Employees

Business owners with employees have several options when it comes to retirement plan design. By implementing a Defined Benefit (DB) Plan alongside a Defined Contribution (DC) Plan, such as a 401(k), they can maximize their own contributions in a DB plan while keeping employee contributions at a manageable level. This structure allows business owners to benefit from substantial retirement savings and tax advantages.

The DB/DC combination is especially effective for high-earning business owners who are older than their employees. This strategy works well for professionals with a small staff, such as doctors, dentists, lawyers, and consulting firms, allowing them to maximize retirement contributions while managing employee benefit costs. Click here to learn more about how these plans can be tailored to fit specific business needs.

Existing Defined Benefit Plans

Now is the ideal time to assist clients in addressing any issues with their existing Defined Benefit Plans. One key concern is managing overfunded and underfunded plans resulting from the year’s market performance.

Overfunded Plans

Market volatility can significantly impact DB plan funding. With the S&P 500 delivering gains exceeding 20% for the second consecutive year, some Defined Benefit Plans may now be overfunded. This occurs when investment returns surpass projections, leading to excess assets within the plan.

An overfunded Defined Benefit Plan has more than enough assets to cover its projected benefits. This can result from investment returns exceeding the assumed actuarial rate of 5 to 6% or from pre-funding benefits in earlier years. Proper planning and strategic adjustments can help clients manage overfunding effectively while maximizing long-term financial outcomes.

In some cases, immediate plan termination may be necessary to prevent the overfunding issue from escalating. Companies have several options to manage excess funds, including reclaiming the surplus (subject to a 50% excise tax), transferring the excess into a qualified replacement plan, or enhancing participant benefits.

It is essential to address these clients' needs promptly to ensure optimal outcomes and regulatory compliance.

Underfunded Plans
Conversely, if clients have experienced investment losses, they may face underfunding challenges. In such cases, the minimum required contribution will increase to compensate for the shortfall. This can be particularly burdensome for employers who have had a difficult business year, as reduced cash flow may make it challenging to meet contribution requirements.

If a client is unable to make the necessary contributions, proactive steps should be taken to prevent further financial strain. By reducing or freezing benefits before participants work 1,000 hours, employers may be able to stop or lower the required funding for at least 2025. However, outstanding 2024 funding obligations will still need to be addressed. In many cases, losses can be amortized over seven years to help ease the financial impact.

Clients who have experienced business downturns or significant plan losses require immediate attention to navigate these challenges effectively.

Combination Plans
Many existing Defined Benefit (DB) plans are structured as combination plans, paired with a 401(k) to provide greater funding flexibility and additional contribution opportunities.

In general, it is advisable to allocate more volatile investments to the defined contribution (DC) plan, as investment returns in these plans do not impact required funding levels. Conversely, investments within the DB plan should be more conservative, targeting an annual return of 5-7%.

A knowledgeable financial advisor can help navigate the complexities of DB plan investments, ensuring alignment with long-term funding goals. Regularly reviewing the investment mix is essential for DB clients to proactively manage the risk of overfunding or underfunding, maintaining the plan's financial stability.

DB Compliance
In addition, all existing Defined Benefit Plans must be restated by March 31, 2025. This is a mandatory IRS, and all existing plans must comply with this. We will be charging $1,200 for this work. For more information on this, click here.

Proposal Assistance
If you are interested in a proposal with a detailed illustration of available contributions, complete our proposal request form and return it to our consulting team of Debbie Rath at drath@nhhicks.com or Chris Ressa at cressa@nhhicks.com.

Bottom Line
Reach out to your Defined Benefit (DB) clients or prospects and act now. Connect with those who may have 2024 tax concerns and are seeking larger deductions. We are here to help explore their DB plan options and every step of the way!