PENSION TRENDS
BY INDEPENDENT ACTUARIES, INC.

IndependentActuaries.com

Volume XIX, Issue I
January 2018

Pension Plans and Fireworks

On the Fourth of July, several small neighborhood kids were sitting side by side watching fireworks take off, barely able to contain their excitement and stay in one spot. This is when my neighbor asked me where I work. Just like the little kids anticipating the next firework with smiles on their faces, I started to get excited as thoughts were racing through my head. I love my work. I'm a pension actuary. And although most people don't equate pension plans with the excitement of fireworks, perhaps they should. Pension plans can be an amazing vehicle for business owners who need a tax deductible way to save for retirement.

For self-employed and small business owners who need to build up their retirement savings in a short amount of time, pension plans are a great solution. At Independent Actuaries, we specialize in these types of plans, and there are some interesting and creative things we can do with them. Over the next few newsletters, we will show you some examples of situations in which an employer can utilize a pension plan to their advantage, meanwhile providing reasonable benefits for their employees. In this first letter, we will start with a single owner with no employees and look at how much this owner can save under various circumstances.

In the first scenario, the owner starts a 401(k) profit sharing plan at age 57 and would like to retire at age 62. Between deferrals and employer contributions he or she can currently contribute up to $60k a year. (For those folks under 50 at the end of the year, the maximum allowable contribution is $54k.) If the employer contributes $60k each year until he or she retires at 62, assuming a 5% rate of return on assets, there will be about $330k in the plan's trust. Note that if the sponsor had started the 401(k) profit sharing plan at 52 and contributed $60k each year for 10 years, there would have been $750k in the trust at retirement age 62.

Let's compare that to the same owner age 57 who starts a defined benefit pension plan at age 57. The mechanics of a defined benefit plan are very different than those of a defined contribution (401(k), profit sharing, SEP, SIMPLE) plan. While the IRS limits the *contribution* to a defined contribution plan, it's the benefit at retirement that is limited in a defined benefit plan. In many cases, this means an owner starting a defined benefit plan five to ten years before retirement can make much larger contributions to a defined benefit plan than they could to a defined contribution plan.

When a defined benefit plan terminates, most owners take the lump sum value of their benefit as a tax-deferred rollover into an IRA. Currently, the maximum a 62-year-old with 5 years of participation can roll over from a defined benefit plan is about $1,340,000. (This is assuming the employer meets certain requirements on their pay and service.) That is about $1M more than in the 401(k) profit sharing plan example above. Assuming the plan assets earn 5% each year, the $1,340,000 target translates to average annual contributions of roughly $243k a year for five years. If instead the sponsor had started the defined benefit plan at 52, the maximum he or she could roll over from a defined benefit plan at age 62 (assuming they meet certain pay and service requirements) would be about $2,690,000. That is about $2M more than in the 401(k) profit sharing plan example above. Again assuming the plan assets earn 5% each year, the $2,690,000 target translates to average annual contributions of roughly $214k for 10 years.

In order to make a contribution and have a 2017 deduction, a plan document must be in place by December 31st of the year it is effective. So before you ring in the new year with friends and fireworks, consider how a pension plan can help facilitate your retirement with tax deductible contributions. If you are interested in exploring a qualified plan, please contact us at 503-520-0848 or at www.independentactuaries.com/contact.

Age When Plan Adopted	Age at Retirement	Number of Years Contribution is Made	Level Contribution Each Year 401(k) PS Plan	Lump Sum at Retirement Age 401(k) PS Plan	Level Contribution Each Year Defined Benefit Plan	Lump Sum at Retirement Age Defined Benefit Plan
57	62	5	$60,000	$330,000	$243,000	$1,340,000
52	62	10	$60,000	$750,000	$214,000	$2,690,000

To subscribe to our Pension Trends newsletter, visit IndependentActuaries.com and submit your email address. Or you can send an email to KristenMeredith@indact.com

To read previous issues of Pension Trends, visit our Pension Trends Archive at :

IndependentActuaries.com/resources/general-resources/pension-trends-newsletter/pension-trends-archive/

Author Profile:

This article was written by Kerry M. Smith, ASA, EA, MAAA. Kerry's specialties and areas of interest include designing proposals and working with aggregate plan designs, like floor offset and cash balance plans.

INDEPENDENT ACTUARIES, INC.

4500 Kruse Way, Suite 200
Lake Oswego, OR 97035
Phone: 503.520.0848
Fax: 503.520.1147
IndependentActuaries.com

email:
info@indact.com