BUSTING MYTHS ABOUT QUALIFIED PLANS

There are a lot of questions and misconceptions about how Defined Benefit Plans and Profit Sharing Plans work for clients -- below are just a handful that are addressed

MYTH 1: With qualified plans, I'm locked into a contribution structure and I don't know where my business will be in 5 years.
When necessary, you may amend your plan and change the level of contributions should business conditions change. You cannot take away any benefits from employees that have been earned in the plan up to the date of change; however, you can change the future benefits that the pension will provide.

MYTH 2: With qualified plans I have to pay way too much toward employees.
A pension plan must consider all full-time employees who meet certain age and service requirements. However, available design options may allow a company to carve-out selected employees from the plan. In most instances the cost for funding benefits for employees is money that would have been lost to income taxes anyway if there were no plan.

MYTH 3: With qualified plans, if something changes, I have no flexibility.
The Pension Protection Act of 2006 has created much more year-to-year flexibility of funding contributions as every plan is now designed with a minimum and maximum funding range. We design each plan so that the first year contributions are near the maximum levels. When funding at the maximum level, this results in a continuous reduction in the required minimum contribution levels in future years.

MYTH 4: Life insurance in a qualified plan doesn't make sense.
The addition of an insured, pre-retirement death benefit increases the permitted tax deductible contributions, which results in larger income tax savings and provides a self-completion feature of the plan in the event of an untimely death. Net proceeds from life insurance are income tax free* to the beneficiary. This ability to get a "tax break" on both ends of the transaction is unique to life insurance in a qualified plan.

MYTH 5: I already have a Profit Sharing Plan. It sounds like a hassle to install a Defined Benefit (DB) Plan as well.
Companies that already maximize contributions into a 401(k)/Profit Sharing Plan can install a DB Plan and deduct the contributions to both plans. The DB Plan will provide maximum benefits to the principal(s) of the company and very minimal contributions for the rank & file employees.

MYTH 6: Pension Plans are only good for people in their 50's.
Pension Plans can be designed to benefit both younger and older business owners and key employees.

MYTH 7: I fully fund my Profit Sharing Plan. That should be enough, shouldn't it?
If you are 55 and contribute $55,000/year for 10 years and earn 8% on your investments, you'll have $796,761 at the end of 10 years. That will provide you with a $200,000 salary for about 5 years! That's why you need a pension plan to save more money.

MYTH 8: I can live on 70% of my working income in retirement.
The things that retirees spend a lot of their money on, medical and nursing care, are inflating faster than the economy in general. Those things could double in cost in 10 years or less.

MYTH 9: I can earn 8% on my money over a long period of time.
While that is probably true, retirement planning is not about averages. The sequence of returns is a critical factor. If there is a significant downturn in the market just before your retirement (like 2008-2009 or 2000-2003) it is likely to have a significant impact. More conservative assumptions put less dependence on investment returns to get you to a comfortable, secure retirement.

MYTH 10: Only large corporations can sponsor a Defined Benefit Plan.
Any type of entity can sponsor a Defined Benefit Plan. This includes Sole Proprietors, S-Corp.'s, Partnerships, LLC's, etc.

**For federal income tax purposes, life insurance death benefits generally pay income tax-free to beneficiaries pursuant to IRC Sec. 101(a)(1). In certain situations, however, life insurance death benefits may be partially or wholly taxable. Situations include, but are not limited to: the transfer of a life insurance policy for valuable consideration unless the transfer qualifies for an exception under IRC Sec. 101(a)(2) (i.e. the transfer-for-value rule); arrangements that lack an insurable interest based on state law; and an employer-owned policy unless the policy qualifies for an exception under IRC Sec. 101(j).*

(Information obtained from our technical expertise and the examples given are either actual questions or made up to make the point.)