RETIREMENT SOLUTION GROUP, LLC

Memo

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Basics of Defined Benefit Plans

Defined benefit (or DB) pension plans are retirement plans that can offer substantial tax deductible retirement contributions and significant future retirement income to the self-employed and small business owners. For those that qualify, a defined benefit plan may allow significantly larger contributions compared to an Individual 401k or SEP IRA. Compared to an Individual 401k or SEP IRA, a defined benefit plan is more expensive administratively, but for the business owner who's goal is to maximize their retirement contributions and are looking for a way to quickly increase their accumulated retirement assets, a defined benefit pension plan can be an ideal retirement plan solution. Within IRS limits, contributions into a defined benefit pension plan are 100% tax deductible.

A defined benefit plan is a qualified retirement plan in which annual contributions are made to fund a chosen level of retirement income at a predetermined future retirement date. Contributions are made according to an actuarial formula to meet the target retirement income benefit. In 2009 and 2010, the annual benefit payable at retirement can be as high as $195,000 per year. As a result, annual contributions into a defined benefit plan can be even larger than $195,000 in some cases in order to meet that level of retirement income target. There are a number of factors involved with this calculation.

Calculating the annual dollar amount that can be contributed requires a mathematical calculation performed by an actuary involving the following factors:

1. *Client's age* - In general, the older the client then the larger the annual contribution that can be made into the plan.

2. *Client's income* - The calculation is based on the average of the client's highest 3 years of income. The greater the income then the greater the annual contribution can be (up to certain limits). Depending on a client's income, the annual benefit payable at retirement can be as high as $195,000 per year in 2009 and 2010.

3. *Planned retirement age* - In general, at least 5 years from the year the plan is adopted.

4. *Investment performance* - In the years after the defined benefit plan has been established an annual actuarial calculation is made based on the performance of the investments in the plan. The actual performance of the portfolio can impact the annual contribution amount that will need to be made so therefore having a portfolio that minimizes volatility is often prudent. When a defined benefit plan is established there is an rate of return assumption that is factored into the actuarial calculation to determine the annual contribution amount that is necessary in order to fund the future retirement income benefit. Each year the actual return of the portfolio will be compared to the rate of return assumption. When the portfolio's actual return is greater than rate of return assumption then there will be a smaller required annual contribution. Conversely, when the actual return is less than the rate of return assumption then the annual contribution will need to be increased to make up the shortfall. On an annual basis, an actuary makes calculations to determine the amount needed to be contributed into the plan to ensure the future target retirement income goal is reached.