

## KEY FACTORS TO REMEMBER WHEN SPONSORING A DEFINED BENEFIT PENSION PLAN

Defined Benefit Pension Plans are important to the retirement security of business owners and their employees. They provide a promise to employees of a valuable income after retirement, and they provide an opportunity for business owners to defer large amounts of taxable income until later years. But these plans need to be properly managed. Here are some issues to consider.

- *Plan Design* – The Pension Plan’s provisions dictate the size and timing of participants’ benefits, and therefore the cost to the employer. The size of the benefit is determined by the plan’s mathematical formula (e.g., 1% of Average Monthly Compensation per year of plan participation). The richer the benefit formula, the greater the required (and maximum deductible) contribution. Plans can retroactively increase benefits as late as 2.5 months after the plan year, while reductions in benefits are also permitted, but only on a prospective basis.
- *Age and compensation of employees* – Generally, the older a given employee and the higher the employee’s compensation, the greater the employer’s required contribution. This is because the pension plan’s benefit is described as a lifetime income starting at a specified “Normal Retirement Date”. The closer an employee is to his or her Normal Retirement Date, the greater the cost of the future retirement benefit. Changes in the workforce, like replacing a younger employee with an older one, also impacts plan contribution requirements. Cash balance plan formulas do not follow this age related pattern.
- *Accumulated Plan assets* – The employer’s prior contributions, increased by accumulated investment results and reduced by benefit payments and expenses, equal the pension fund available to pay participant benefits. If the pension fund’s *actual* rate of return does not equal the *assumed* rate of return, this increases or decreases the required funding, depending on the nature of the difference. When pension plan’s assets approach or exceed plan liabilities for accrued plan benefits, required contributions may be reduced or eliminated.
- *Required Annual Contributions* - Minimum required and maximum deductible annual employer contributions are determined by an enrolled actuary. Amounts determined depend primarily upon the three factors described above: (1) plan design, (2) ages and compensation of the covered employees, and (3) accumulated plan assets. Failure to make required contributions within 8.5 months after the end of a plan year results in a 10% excise tax.
- *Employer Financial Stability* –A pension plan is designed to be a permanent retirement benefit program with certain required employer contributions. Adverse investment results and other factors discussed above can result in unintended contribution requirements. In general, if an employer’s business lacks the stability to make unexpected pension contributions, a defined contribution plan, such as a profit sharing plan, is probably a better idea.

### Freezing Benefit Accruals:

An employer can adopt an amendment that stops all future benefit accruals. Participants must receive advance written notice of the benefit

freeze. Occasionally, plans with assets in excess of benefit liabilities must declare full vesting when the freeze occurs. The employer is still required to make contributions necessary to cover the cost of benefits already earned, if the plan is underfunded.

*Note: Fully insured plans funded by individual insurance contracts have issues and concerns that are not addressed in this article. Please consult your NRS Account Manager for additional information.*

### **SIGN OF THE TIMES: IRS ELIMINATES “FEDERAL TAX DEPOSIT (FTD) COUPON”**

In an obvious nod to the elimination of paper (or at least paper minimization), the Internal Revenue Service has eliminated the long standing practice of using paper coupons to accompany paper checks when entities such as retirement plans deposit withheld federal income taxes from participant distributions. Form 8109, the old tax deposit coupon, is obsolete effective January 1, 2011. Instead, those who withhold federal income taxes must use the new **Electronic Federal Tax Payment System** (“EFTPS”). The new system involves enrolling via the Internet at [www.eftps.gov](http://www.eftps.gov), although those who remain computer shy may complete IRS Form 9779 and mail it to the specified EFTPS Center. Also, some payroll companies and financial service vendors offer to perform the chore for a nominal fee. Note that the timing rules for depositing withheld taxes (generally monthly or semi-weekly, depending upon the size of deposits) have not changed.

Once enrolled in **EFTPS**, including a password, the payer is able to provide payment instructions to the IRS through the web site up to one day before payments are due. The IRS initiates a debit against

the payer’s bank account, sends the withheld taxes to the Treasury, and updates its pertinent records. There is no charge for the EFTPS service and interested parties may contact the Center by telephone at 1(800) 555-4477 for more details.

**For more information or to request a proposal, please visit our website at [www.NRServices.com](http://www.NRServices.com), or for sales support, please contact:**

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