# Price & Farrington's Estate and Tax Planning *Fast* Faxts

July, 2002

***Estate, Tax, and Wealth Planning For Advisors and Clients***



**Price & Farrington**

***Attorneys and Counselors at Law***

**12501 Bel-Red Road, Suite 215**

**Bellevue, Washington 98005**

**425-451-3583**

**Email: pricefarr@aol.com**

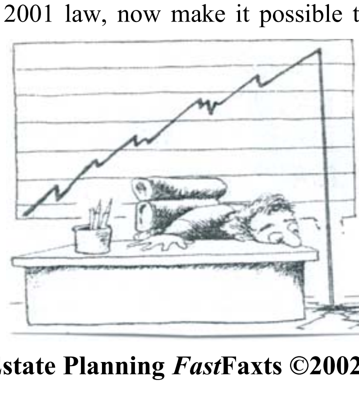

## Powerful Tax, Retirement and Asset Protection Planning: Rediscovering Defined Benefit Plans

Perhaps the most dramatic change in the U.S. retirement system during the last half of the 20th century was the decline of traditional defined benefit (DB) plans and the growth of defined contribution (DC) plans. This, according to the Employee Benefit Research Institute in Wash., D.C., whose 2002 projections put DC plans ahead, $2.76 trillion to $2.39 trillion, with the gap widening to $1.2 trillion by 2005.

So, the traditional DB plan has lost ground. Major employers no longer have the paternal attitude that caused them to provide pension plans. They've shifted to DC plans in order to have their employees pay a greater share of retirement costs. This isn't likely to change unless there is a groundswell of objections from participants who become disenchanted with market volatility and Enron, Global Crossing and WorldCom-like meltdowns. And yet, the winds are beginning to shift in the opposite direction. Over the past nine months our clients have shown increasing interest in defined benefit plans.

***What's behind the mini-boom?*** In large part, the 2001 tax law. The maximum benefit now payable under a DB plan is $160,000 per year, up from $140,000 in 2001. And, while under prior law the maximum DB payment was reduced for those who retired before age 65, retirees as young as 62 can now get the maximum benefit. Payments may be even higher for those who retire after 65. Along with rising DB levels, the 2001 tax law also increased compensation levels. Compensation up to $200,000 can now be taken into account, a dramatic increase from $170,000 in 2001.

***Larger contributions.*** These new rules, along with some technical changes in the 2001 law, now make it possible to deduct much larger contributions to DB plans. For one 58 year old client, illustrations run under the old and the new rules show an increase in maximum contributions from $227,000 in 2001 to $292,000 this year. Another client, a 67 year old desperate to defer tax on high compensation, was able to contribute over $325,000 annually! DB plans offer clients the opportunity to make much larger deductible contributions than with DC plans.



***Market woes, boomers and safety.*** Recent market volatility has increased people's willingness to put money somewhere other than in stocks. Baby boomers, starting to think seriously about retirement at the same time they're losing money in stocks, view DB plans as an opportunity to catch up. They also like the idea of placing large amounts of money into retirement plans which are safe from creditors, i.e., provide security and asset protection.

***Ideal client.*** These advantages make DB plans a perfect fit for some clients, especially older ones. The older a client and the closer he is to retirement age, the more money has to be contributed to a plan in fewer years in order to fund a pension. This year, annual contributions of up to $40,000 can go into a DC plan. Calculations show a person would have to be at least 51 in order to put a larger amount into a DB plan. Typically, 50-somethings and clients still working in their 60s will gain the most from a DB plan (*but see* 412(i), below).

The right circumstances are not always available. A medical group, for example, may include younger doctors who are not as happy as the older physicians might be with a defined benefit plan. On the other hand, a 55 year old business owner whose only employee is a 28 year old receptionist might be a good candidate for a DB plan, especially if the employee position is low pay and high turnover.

Clients who want to skew benefits will find DB plans attractive. Sponsors can exclude certain employees. They can also set up a vesting schedule that rewards long-term employees. In an era of volatile stocks, the security of a pension is appealing to such valued employees. The ideal DB candidate, therefore, might be a pre-retiree who is either self-employed or an employer with much younger employees.

***"It's moved and seconded that the compulsory retirement age be advanced to ninety-five."***

***The 412(i) plan.*** Prospects for DB plans can choose between traditional DB and IRC Section 412(i) plans. (For more on 412(i) see our Nov. 2001 *Fast*Faxts) 412(i) plans are required to be funded with insurance and annuity products. These products literally *guarantee* the pension payments. The life insurance component may allow higher deductible contributions and make the plan "self-completing" if the client dies prematurely. This is because the beneficiary will receive the insurance proceeds in lieu of yet-to-be-made contributions.

As clients grow older, 412(i) plans offer larger deductions. And they usually work best where a business owner or professional has only a few employees. The "new comparability" and "cross-testing" rules allow a 412(i) plan owner, even at a younger age, to make smaller contributions to employees' plans while funding his own plan much more generously than traditional DB plans.

*Questions about opportunities in defined benefit pension planning or 412(i)? Contact us. As always, our goal is to help advisors make a good living helping their clients protect their wealth.*

*Happy planning!*

Glen D. Price