OVERFUNDED DEFINED BENEFIT PLAN

For many plan sponsors, the prospect of adding a **defined benefit retirement plan** and the large tax-deductible contributions it affords can seem to be a wonderful solution in reducing a tax bill while also increasing retirement plan assets. However, without proper structure and guidance a defined benefit plan can have the exact opposite affect. With the recent bull stock market, many plan sponsors find themselves in the unenviable position of having an overfunded defined benefit plan. While this may seem innocuous, the tax ramifications can be staggering. If not treated properly, **overfunded plans can be taxed by as much as 90%**. For many plan sponsors, the solutions to an overfunded defined benefit plan are often suggested too late to alleviate the problem. Advanced preparation is essential to maintaining your defined benefit plan from reaching unintended tax consequences.

For 2024, the maximum defined benefit account balance per person is just over $3.4 million. Amounts over that may be subject to a 50% excise tax and any applicable federal and state income tax. Over the past five years, the annualized return of the S&P 500 is over 13%. Having an equity position in your defined benefit investment program may have subjected the plan to these high rates of return, especially when most defined benefit programs have a target return of between 4-5%.

There are solutions to alleviating an overfunded defined benefit plan. However, many of the steps are most advantageous while the plan sponsor still have a few years prior to accessing their retirement benefit. Plan sponsors that are nearing retirement still have options but time is of more critical importance compared to younger plan sponsors.

HERITAGE ADMINISTRATIVE SERVICES

FRANK MULLADY, JR. | NATIONAL SALES DIRECTOR | TEL: 631.659.1518 | FAX: 631.423.9656 | FRANKJR@HGTPA.COM | HGTPA.COM

OVERFUNDED DEFINED BENEFIT PLAN

2024 MAXIMUM DB ACCOUNT BALANCE:
$3.4 MILLION
ANY AMOUNTS OVER LIMIT
INCUR 50% EXCISE TAX
PLUS FEDERAL & STATE INCOME TAX
(UPWARDS OF 90% TAX LIABILITY)

Some of the easier steps in reducing an overfunded defined benefit plan include:

- Increasing benefit amounts; adding participants
- Increasing compensation
- Wait for cost of living adjustments

However, those solutions may only go so far in reducing the overage amount. For severely overfunded plans, those in excess of $500,000, advanced planning techniques must be utilized. A reallocation of the plan's investment structure is often necessary; one option that may be beneficial is the introduction of life insurance as a plan investment option.

Life insurance can offer an invaluable asset protection strategy to an overfunded defined benefit plan. If a business owner were to pass away while still a participant in an overfunded defined benefit plan, the excess/ overfunded benefits will be severely taxed by the IRS. Insurance held inside the plan pays to plan beneficiaries on a tax-free basis (net amount at risk of a life insurance policy pays income tax free to beneficiaries). Best of all is that the death benefit of a life insurance policy owned by a defined benefit plan does not count towards the $3.4 million benefit limit nor is it subject to any excise / over-funded taxes.

If you have clients that sponsor a defined benefit plan, please contact Heritage Administrative Services to review how to identify an overfunded defined benefit plan and means to mitigate their exposure.

HERITAGE ADMINISTRATIVE SERVICES

FRANK MULLADY, JR. | NATIONAL SALES DIRECTOR | TEL: 631.659.1518 | FAX: 631.423.9656 | FRANKJR@HGTPA.COM | HGTPA.COM