Introduction to a New Pension Plan

The "pension plan of the future" has finally arrived. The new defined benefit 401(k) plan—often referred to as "the DB(k)" or a close variation—is available for the first time in 2010 to small companies with 500 or fewer employees. This new hybrid plan was authorized almost four years ago by the Pension Protection Act of 2006 (PPA).

Background: If certain requirements are met, employees may benefit from tax-deferred contributions to a qualified retirement plan. No tax is due on the contributions or earnings until amounts are withdrawn from the plan.

There are two main types of qualified plans. With a "defined contribution plan," such as a 401(k), amounts are contributed to separate accounts set up for participants. A 401(k) plan generally features elective salary deferrals and "matching contributions" by employers based on a percentage of salary. With a defined benefit plan, like a traditional pension plan, retirement benefits are based on actuarial computations taking into account age and years of service.

Both types of qualified plans are subject to annual limits adjusted for inflation. (Due to the relatively low inflation rate, the limits for 2010 remain the same as 2009.) In addition, each plan must meet strict nondiscrimination rules spelled out in the tax law.

As the name implies, a DB(k) melds some of the aspects of a 401(k) with a pension plan. Here are some of the key elements of this new type of plan:

*A defined benefit equal to 1% of final average pay for each year of the employee's service up to 20 years.

*An automatic enrollment feature for the 401(k) portion of the plan. Unless an employee specifically opts out, 4% of pay is automatically transferred to the plan.

*A matching contribution by the employer of at least 50% of employee 401(k) contributions with a maximum required match of 2% of compensation.

To encourage use of DB(k)s, the PPA provides an exemption from the "top-heavy rules" that ensure retirement plan benefits are not unfairly tilted in favor of highly compensated employees. Furthermore, the paperwork burden for DB(k)s is relatively light. All the employer has to do is maintain one plan document and file one annual information return with the IRS, even though it is essentially operating two plans.

Summary: The DB(k) was meant to encourage greater retirement savings among employees even before the recent stock market downturn. In particular, it is expected to appeal to owners of professional corporations and partnerships, such as physicians and attorneys, as well as other small-business owners. Consult with a benefits specialist for implementation of this new plan.