



Understanding Your Defined Benefit Plan

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UNDERSTANDING YOUR DEFINED BENEFIT PLAN

Congratulations on your decision to implement a defined benefit plan.

IMPORTANT INFORMATION

This guide is for *informational purposes only*. It is NOT meant to replace or supersede the Summary Plan Description (SPD) or any other legal plan documents. In all cases, if there is a discrepancy between this brochure and the SPD, the SPD prevails. We strongly recommend you consult with competent, independent legal and tax counsel prior to making any decisions regarding your defined benefit plan.

If you have any questions or need further clarification about any of the information provided in this brochure, please call our office at (888) 412-4120.

IMPORTANT INFORMATION ABOUT YOUR NEW DEFINED BENEFIT PLAN

It is important the reader understand neither Carpenter Morse Group nor PensionSpecialist.Net, is the plan Trustee and consequently has no signature power over any accounts. It is the duty of the plan Trustee to timely make any and all contributions, distributions and filings, and when necessary, liquidate any assets.

Trust Account

All pension plans are trusts; therefore, a trust account at a bank or brokerage firm must be opened in the name of the defined benefit plan using the EIN (Employer Identification Number) provided specifically for the plan. Do not use the company's EIN or the social security number of any individual. The employer is the sponsor of the plan, not the trustee of the plan.

In order to effectively administer your plan, we need to ensure plan contributions are made timely and accurately. The easiest way to manage this is for us to receive duplicate statements for the trust account. Please ask your financial advisor to contact the bank or brokerage firm where the trust account has been established and request duplicate copies of statements be sent to us at the following address:

Carpenter Morse Group
4300 W Lake Mary Blvd., Suite 1010-401
Lake Mary, FL 32746

Deposits

All contributions to the plan **MUST** be made to the securities (trust) account opened in the name of the plan using the plan's EIN. All contributions must be in cash. "In kind" contributions are not permissible.

There is only **ONE** account for the plan. All assets owned by a defined benefit plan are co-mingled in one account.

All disbursements, e.g., life insurance premium checks, benefit distributions,

etc., should be paid from this account (NOT from the business (sponsor's) account).

When opening the account sign *only* a new account form. Do not sign any prototype documents or else you will inadvertently implement a second plan. Our office will need a copy of the new account form.

Investments

Pension investments must be made in passive investments. The permitted investments are outlined in the trust document. The Trustee must invest the monies as would a "prudent person".

There are prohibitions on certain investments -- these are known as "Prohibited Transactions". Essentially, there may be no "self-dealing".

Generally, any of the following transactions, whether direct or indirect, between a plan and a "disqualified person" will constitute a *prohibited transaction* under the Internal Revenue Code:

- (1) a sale, exchange, or leasing of any property, including a transfer of property subject to a security interest assumed by the plan or placed on it within 10 years prior to the transfer
- (2) lending of money or other extension of credit
- (3) furnishing of goods, services, or facilities
- (4) the transfer of plan assets or income to, or use of them by or for the benefit of a disqualified person.

In addition, it is a prohibited transaction for a disqualified person who is a fiduciary to deal with income or assets of a plan in his own interest, or to receive consideration for his own personal account from a party dealing with the plan in connection with a transaction involving plan income or assets.

Title I of ERISA also prohibits a fiduciary from acting, in any transaction involving the plan, on behalf of anyone having interests adverse to those of the plan or plan participants or beneficiaries.

Generally, a trustee may not invest the plan assets in 'collectibles' such as stamps, numismatic coins, art, wine, etc.

Life Insurance

When you sign the plan documents, you should also sign applications for all life insurance to be included in the plan. Your advisor should take applications on all plan participants at one time. Please note, we cannot complete the final administration for a plan until life insurance policies have been issued and paid for ALL plan participants.

This office will need copies of the first six pages of all life insurance policies, signed life insurance illustrations matching the issued policies, all signed delivery requirements and copies of the checks used to pay the premiums. You should instruct your advisor to provide our office with these copies.

Your plan will have life insurance policies for participants. The premiums and face amount of the life insurance policy must be determined under Revenue Ruling 74-307. That is, the premiums and face amount are determined based on the benefits the participants accrue from the plan. The benefit is also determined under the highest consecutive compensation for each participant under the plan's formula. As a result, in order for the life insurance to comply with IRS rules, the compensation for each participant for the next three consecutive years from the plan's effective date must be same or higher than the compensation in the proposal illustration.

Policy Owner and Beneficiary

Please make note of the following:

The defined benefit plan is the OWNER of any life insurance purchased in the plan. The owner is NOT the company OR any individual employed by the company. The company SPONSORS the defined benefit plan.

The defined benefit plan is the BENEFICIARY of any life insurance purchased in the plan. The beneficiary is NOT the company OR any individual employed by the company or their spouse or children. Beneficiaries of individual participants will be designated on a separate beneficiary designation form.

Should anything happen to one of the plan participants, the assets, which are owned by the defined benefit plan, remain in the trust account established for the plan. The plan trustee has control over the assets and must distribute benefits according to the terms of the trust document controlling the defined

benefit plan. Distributions are based on the beneficiary designation form completed by the participant. Carpenter Morse Group will calculate the amount of the former participant's distribution.

The employer is the sponsor of the plan.

The trustee holds and maintains the original life insurance policies. Policies are NOT to be distributed to any individual participants.

As a reminder, once your plan is set up, this office requires copies of the following:

- New account forms
- Checks deposited to the securities account
- Life insurance policies – Please note, we cannot complete the annual administration for a plan until life insurance policies have been issued and paid for on ALL plan participants.

Copy of first six pages of insurance policies

Copies of signed illustrations matching the issued policies

Copy of the signed delivery requirements

Copies of check(s) for payment of the insurance premiums

Copies of the checks used to purchase any other side funds

Economic Benefit Cost (P.S. 58 Cost) – Every year the Trustee will receive from the life insurance carrier the Economic Benefit Cost for each participant. *It is imperative the Trustee communicate this amount to the participant and the participant declare the Economic Benefit Cost as taxable income on the participant's Form 1040. Failure to do so will cause any life insurance proceeds to be taxable as ordinary income to the participant's beneficiary.*

AFTER THE PLAN IS IMPLEMENTED

IRS User Fees

The defined benefit plan was implemented using a proto-type document and has its own IRS favorable determination letter. Additionally, your plan will be individually submitted to IRS for review and approval. We anticipate IRS will issue a favorable determination letter for your plan. This letter be mailed directly to you. Once received, please provide us with a copy of the Favorable Determination Letter.

There are IRS User Fees associated with this submission. Those fees were disclosed in the original defined benefit plan illustration we prepared and the Client Engagement Letter. At a future date, prior to submission, Carpenter Morse Group will send you notice of any IRS User Fees as they become due. These fees generally range from \$125 to \$1,000 and are paid directly to the U.S. Treasury

Fidelity Bond

The Department of Labor (DOL) requires qualified retirement plan fiduciaries (the trustee(s) and plan administrator(s) named in your plan document) to be bonded. A fidelity bond protects the assets in the plan from misuse or misappropriation by the plan's fiduciaries. Plan fiduciaries, plan trustees and any person who has:

- Physical contact with cash, checks or other plan property,

- Power to transfer or negotiate plan property for a price,

- Power to disburse funds, sign checks or produce negotiable instruments from the plan assets, or

- Decision making authority over any individual described above.

How much coverage do I need?

The minimum required amount of fidelity insurance is 10% of the total plan assets in the preceding year. For the first year the bond amount will be based on the estimated amount of assets that will be handled by the plan for the year. The bond must be for no less than \$10,000 and no more than \$500,000.

What assets “qualify” for a 10% bond?

Plan assets that “qualify” for a 10% bond include employer securities; participant loans; assets held by financial institutions such as banks, insurance companies, broker-dealers, or other organizations authorized to hold IRA assets; mutual funds; investment and annuity contracts issued by an insurance company; and self-directed individual account plans in which the participant gets a statement of assets at least once a year.

How do I obtain a Fidelity Bond?

Generally, an ERISA fidelity bond may be secured through the agent that handles your property and casualty insurance. The premium is usually a nominal amount.

ANNUAL PLAN ADMINISTRATION

Gathering Data to Prepare the Annual Plan Administration

To properly administer the plan we require annually updated information similar to the data we gathered when implementing the plan. You will receive a request via email from Carpenter Morse Group asking for the following information:

1. **An updated census** – it is very important this be completed accurately and in its entirety and returned to us timely. The information needed includes names, dates of hire, dates of termination, dates of birth, hours worked and annual compensation. If information is missing or inaccurate, it will have an impact on your plan.
2. **12 months of account statements from the Plan's brokerage account.** If we have been set up to receive duplicate copies of the trust account statements, we will already have these. If we have not been set up, copies will need to be provided.
3. **Annual statement(s) of the life insurance policy(ies).**
4. **W-2 Forms for all employees as well as the W-3 Form. NOTE: The Defined Benefit Plan contribution is derived from earned income; generally, W-2 income (net Schedule C), NOT Schedule K-1 from S Corporations.**

Please note: The information request will be sent to you via email, and will most likely come from someone at carpentermorsegroup.com. We should be placed on the "safe sender" list. A prompt response is imperative if administration is to be completed timely.

We send requests via email to keep costs to a minimum. If you prefer we send requests via regular mail, we are happy to comply; however, please understand there will be an additional charge to cover the administrative costs associated with your request. These additional charges are a result of the additional time and materials necessary for copying and/or printing, the cost of paper, toner, machinery, envelopes, postage, collating documents, overnight express fees, etc.

You may ask why we need this information again; especially, if your plan was implemented toward the end of the year. It is because final earnings are not reported until after December 31. Ideally, we need copies of the Forms W-2 or an end of year payroll report to accurately complete the administration.

Following receipt of this information, we will calculate and notify you of the amount of your annual contribution. It is then your obligation to use this information to fund your defined benefit plan. You have until the date you file your tax return, including extensions, to complete the funding. The contribution to a Defined Benefit Plan is **required**. It is NOT flexible. Once your defined benefit plan has been fully funded, we must receive confirmation, e.g., copies of canceled checks or a copy of the trust account statement.

The data gathered by Carpenter Morse Group is used to prepare the annual administration for your plan as required by law. This includes, but is not limited to:

- Form 5500 and attached Schedule(s) - Schedule A, Schedule B, etc.
- Form PBGC-1 – Most defined benefit plans have Pension Benefit Guaranty Corporation (PBGC) coverage. PBGC is a quasi-governmental corporation that insures pension benefits. PBGC charges a flat premium of approximately \$31 per plan participant plus a variable premium based on plan assets versus liabilities.
- Actuarial Valuation Report
- Income Statement of Plan Assets
- Balance Sheet of Plan Assets
- Benefit Statement
- Summary Annual Report

Permanent Nature of Defined Benefit Plans - A Defined Benefit Plan has a degree of **permanency**. This type of plan is not established for the one year the business was extremely successful. One needs to understand and expect to contribute to the plan for a minimum of five years. If, for some reason, there is a material change to one's business, options are available. Please note, there are fees associated with amending the plan to adjust the

contribution requirement, and one is required to fund for benefits which have already been accrued.

SOME FREQUENTLY ASKED QUESTIONS

What if I have another type of Plan?

- If you have a SIMPLE plan, you may NOT have any other type of plan.
- If you have a Defined Benefit (DB) and a Defined Contribution (DC) plan in operation simultaneously they will, in all likelihood, in the aggregate, be Top Heavy. Top Heavy status will require a minimum contribution to the DC plan of 5% of eligible payroll.
- If you simultaneously have a DB and a DC plan in effect and the DB plan does NOT have PBGC coverage, the DC plan's tax deductible contribution will be limited to 6% of covered payroll. If the DB plan DOES have PBGC coverage the deduction to the DC plan is not limited from that which is statutorily permissible.

I have ownership in other companies. What effect will that have on this Plan?

- If you have ownership in other companies you may be a member of a Controlled Group or Affiliated Service Group. Your attorney should make this determination for you. This is a very important issue.
- If you are a member of a Controlled Group or Affiliated Service Group, you will need to take into account all employees in the Controlled Group or Affiliated Service Group when determining eligibility for participation in the Plan.

My plan includes life insurance. What happens if one of my employees passes away while a participant in the plan?

- The pension plan is both the owner and beneficiary of the life insurance policies on all plan participants. If a participant passes away, the life insurance proceeds are paid to the pension plan. A participant's vesting accelerates to 100% upon death. If this occurs, notify our office immediately and we will calculate the benefit due to

the participant's beneficiary. The benefit due is the PVAB, Present Value of Accrued Benefit + proceeds of the life insurance (less the cash value of the policy). Once we notify you of this amount, it is your duty as trustee to pay the benefit to the designated beneficiary.

DEFINED BENEFIT PLAN DISTRIBUTIONS

When an employee retires, resigns or is terminated from employment, we must be notified of their separation. Depending on how the plan was designed (refer to the Summary Plan Description (SPD)), the former participant may be owed a partial or full benefit from the plan.

A former plan participant is entitled to be paid their accrued benefit. We will prepare a Participant Distribution Election Form, with the exact amount of the distribution owed to the former participant. The form must be given to the former participant for completion and signature. The former participant has the option of selecting how to receive their distribution. For example, one may elect a lump sum payout, while another may elect a direct rollover to an IRA account or even a monthly pension at retirement age.

The Participant Distribution Election form must be signed by the former participant, their spouse if married and, when applicable, notarized and returned to our office. Once received, we will review the form and notify you to proceed with distribution of the plan assets.

TERMINATING YOUR DEFINED BENEFIT PLAN

At some point in the future you will terminate your plan. It may be that the plan has fully served its purpose, or it may be due to significant changes in your business model. In any case, it is important to notify us (TPA) as soon as you make that decision.

We will prepare and send to you, via email, a termination engagement letter for review and signature. The letter explains the reasons one may or may not decide to submit the plan to Internal Revenue for a favorable termination letter. It also explains the fee structure relative to plan termination.

Following receipt of the termination engagement letter, please review, indicate whether you wish to submit the plan termination to IRS, sign and return the letter to our office along with a check for the appropriate fee. Understand, we cannot move forward with the termination of the plan until we receive the signed termination engagement letter and check.

We will prepare all documentation necessary to terminate the plan. These documents will be forwarded to you for signature via email. Once returned, benefits will be calculated and submission forms prepared.

Important – some plans require submission to the Pension Benefit Guaranty Corporation (PBGC) for review. The only plans exempt from this process are those for Professional Practices and Single-Employee/Owner plans. The PBGC review process can take up to 60 days once all information is submitted and in good order. Until PBGC approval is received, plan assets **may not** be liquidated and distributed. Please keep this in mind when making the decision to terminate the plan.

GLOSSARY

Actuarial Valuation Report (Valuation) – Annual report calculating the required contribution. This report also serves as validation and certification of the deduction taken on client's tax return. Required by ERISA.

Benefit Statement – A statement of the pension benefits an individual has earned (in a defined benefit plan) or a prediction of what the final pension might be (in a defined contribution plan).

Census – The census is used to gather data on the employees of the company, and is submitted along with the Data Request in order to prepare the defined benefit plan illustration. Updated census is required annually for administration purposes.

Custodian – The entity responsible, as a minimum, for holding the pension fund assets and for ensuring their safekeeping.

Data Request – The data request provides information on the company for whom we are preparing the defined benefit illustration.

Defined Contribution Plan – A pension plan that defines the contribution made to the plan.

Defined Benefit Plan – A pension plan that defines the benefit to be received from the plan.

Department of Labor (DOL) - Fosters and promotes the welfare of job seekers, wage earners and retirees of the United States.

Economic Benefit Cost (P.S. 58 Cost) – Every year the Trustee will receive from the life insurance carrier the Economic Benefit Cost for each participant. *It is imperative the Trustee communicate this amount to the participant and the participant declare the Economic Benefit Cost as taxable income on the participant's Form 1040. Failure to do so will cause any life insurance proceeds to be taxable as ordinary income to the participant's beneficiary.*

Employer Identification Number (EIN) – Tax identification number issued by the Internal Revenue Service.

Enrolled Actuary - An actuary who has been licensed by a Joint Board of the Department of Treasury and Department of Labor to perform a variety of actuarial tasks required for pension plans in the U.S.

Employee Retirement Income Security Act of 1974 (ERISA) - Comprehensive legislation regarding qualified plans.

ERISA Bond – ERISA requires the trustees of an employee benefit plan to have fidelity coverage equal, at a minimum, to 10% of the total plan's assets.

Fiduciary (Named Fiduciary) – One or more persons who jointly or severally control and manage the operation and administration of the plan. A plan must have at least one named fiduciary and, if plan assets are held in trust, the plan must have at least one trustee.

Form 1099 – IRS Form used to report different types of income

Form 5500 – Annual Return/Report of Employee Benefit Plan

Form PBGC-1 - The PBGC (Pension Benefit Guaranty Corporation) collects insurance premiums from defined benefit pension plans protected by them. Form PBGC-1 must be completed to determine the appropriate plan premium.

Form SS-4 – Application for Employer Tax Identification Number

Form W-2 – Wage and Tax Statement

Pension Benefit Guaranty Corporation (PBGC) - PBGC is a federal corporation created by the Employee Retirement Income Security Act of 1974. It currently protects the pensions of nearly 44 million American workers and retirees in 30,330 private single-employer and multi-employer defined benefit pension plans. PBGC receives no funds from general tax revenues. Operations are financed by insurance premiums set by Congress and paid by sponsors of defined benefit plans, investment income, assets from pension plans trusted by PBGC, and recoveries from the companies formerly responsible for the plans.

Pension plan - A legally binding contract having an explicit retirement objective (or – in order to satisfy tax-related conditions or contract

provisions – the benefits cannot be paid at all or without a significant penalty unless the beneficiary is older than a legally defined retirement age). This contract may be part of a broader employment contract, it may be set forth in the plan rules or documents, or it may be required by law. In addition to having an explicit retirement objective, pension plans may offer additional benefits, such as disability, sickness, and survivors' benefits.

Pension Plan Administrator – The individual(s) ultimately responsible for the operation and oversight of the pension plan.

Pension Plan Sponsor (Sponsor) – An institution (e.g., company, industry/employment association) that designs, negotiates and normally helps to administer an occupational pension plan for its employees or members.

P.S. 58 Cost - (Economic Benefit Cost) – Every year the Trustee will receive from the life insurance carrier the Economic Benefit Cost for each participant. It is imperative the Trustee communicate this amount to the participant and the participant declare the Economic Benefit Cost as taxable income on the participant's Form 1040. Failure to do so will cause any life insurance proceeds to be taxable as ordinary income to the participant's beneficiary.

Revenue Ruling 74-307 – 1974 Revenue Ruling that addresses life insurance in a qualified plan. To be incidental one must spend less than 50 percent of the pension contribution on whole life insurance or less than 25 percent on term or universal life insurance.

Internal Revenue Code (IRC) – The main body of domestic tax law of the United States.

Internal Revenue Service (IRS) - The US government agency responsible for tax collection and tax law enforcement.

Schedule A – Part of IRS Form 5500 used to report commissions paid.

Schedule B – Part of IRS Form 5500 for reporting plan actuarial information.

Schedule C – Part of IRS Form 1040 used to report profit or loss from a business.

Standard Industrial Classification (SIC Code) – These codes are six digit numbers used to identify business type.

Summary Annual Report (SAR) – Annual summary of plan activity with regard to contributions, plan earnings, disbursement, etc.

Summary Plan Description (SPD) – Explains in plain English the terms of the Plan and is typically presented in an eight to 10 page document given to participants when they meet eligibility requirements.

Top Heavy 401(k) Plan – A 401(k) plan in which the accrued account balances of the key employer, in the aggregate, are more than 60% of the accrued account balances of all participants. If a plan is top heavy as of the last day of the preceding plan year, it is top heavy for the succeeding plan year. A minimum top heavy contribution is required to be made for any year for which the plan is determined to be top heavy.

Third Party Administrator (TPA) – An entity other than a plan sponsor that is responsible for administering an occupational pension plan.

Trustee – A person or a company appointed to carry out the tasks of the trust.

FOR ADDITIONAL INFORMATION AND DEFINITIONS PLEASE VISIT OUR WEBSITE:

www.PensionSpecialist.net

Unless otherwise expressly indicated and to ensure compliance with Treasury Regulations (31 CFR Part 10, Section 10.35), any federal tax advice contained in this message (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of avoiding federal tax penalties that may be imposed by the federal government or for promoting, marketing or recommending to another party any tax-related matters addressed herein. Further, any taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor with respect to any Federal tax transaction or matter contained in this message or correspondence.