WHAT YOU NEED TO KNOW ABOUT DEFINED BENEFIT PLAN INVESTING

Bessen Actuarial Services specializes in the design and administration of Defined Benefit Pension Plans for small-business owners. As an Actuarial services company, I'm licensed to certify that your plan satisfies government regulations. Among my services, I'll calculate your tax-deductible contributions and keep your plan in compliance. However, I do not sell any financial products, nor do I give investment advice. You're free to invest on your own, or if you prefer, find a professional financial consultant to invest on your behalf.

Whether you invest on your own or you get help, pension plan investing has special considerations. The following guidelines are *extremely* important in ensuring your pension plan stays out of trouble.

- **All contributions must be in cash.** So if, for example, you have a stock or a real estate parcel that you want to purchase for your pension plan, make sure your purchase is with funds *already deposited* in the plan.

- **Contributions for a plan year can be deposited as late as 8½ months after the end of the plan year**, even if your business is on a cash accounting basis. For instance, if your tax year (and plan year) ends on December 31, 2018, contributions between January 1, 2018 and September 15, 2019 are eligible to be deducted for the 2018 tax year. Stated differently, contributions between January 1, 2019 and September 15, 2019 can be deducted in either 2018 or 2019. Be careful not to over-contribute *during* the plan year, since excess contributions are subject to a non-deductible excise tax.

  Note: To be deductible, contributions must be deposited by the extended due date of your business' tax filing. Thus, you'll need to file extensions if you need extra time to fund your plan.

- **Avoid the "Prohibited Transaction".** Laws designed to prevent abuse may prohibit you from making a seemingly legitimate investment. As long as you follow the guidelines below, you should be in good shape. Please check with me *before* investing, however, if there's any question in your mind. The IRS has procedures in place to detect Prohibited Transactions, and the fines can be hefty.

  - Avoid pension asset transactions involving:
    1. Relatives
    2. Business partners, or other business entities in which you are (at least) a 10% shareholder or have a 50% ownership interest
    3. People providing services to the plan, such as your accountant and financial consultant
    4. Any combination of the above, for example, a business in which your father is a 25% shareholder.

  - Assets cannot be used to benefit you or your business. For example, your plan cannot own a house that you (or your relatives) pay rent to live in. Or, your plan cannot lend money to your business, even under the same terms and conditions that a bank would require.

  - Before any transaction, ask yourself, "Would this be viewed as an independent, arm's-length transaction?"

- **Real estate**, or other physical property, can be purchased by your pension plan (but make sure the purchase is not a Prohibited Transaction!) However, the fair market value of the property should be readily determinable. After all, the total value of your plan's assets figure into how much of a contribution you can deduct. So if the IRS, for example, claims you've undervalued your property, they'll disallow part of your deduction.

- **Diversify!** I recommend this because the IRS *requires* it. (Remember, I don't give investment advice!) While this rule is designed to protect *employees* covered by a pension plan, there's no exception for plans with few or no employees. So even though it's doubtful the IRS would penalize a plan for not diversifying when employee protection is not an issue, I advise against investing all plan assets in, for example, only one stock or only one real estate parcel.

- **Highly speculative investments,** with the potential for phenomenal return, can limit the deductible contributions you're counting on. In a Defined Benefit plan (such as your plan), the IRS limits the amount you can *take out* at retirement without penalty. So if, for example, your $50,000 investment is suddenly worth $500,000, you'll likely lose most of the deductible contributions you were counting on in the future. On the flip side, let me know immediately if a plan investment *drops* substantially in value. I may need to amend your plan, to keep you from having to contribute more than you want.

- **Loans** are permissible. However, there are limitations as to how much you can borrow, and the loan must be structured similar to how a bank would structure a loan (including the necessary paperwork). Please contact me *before* borrowing from your pension plan.

- **Withdrawals.** The IRS has tried very hard to discourage withdrawals from pension plans until retirement age (or an employee's separation from service), and the IRS has been fairly successful. Figure on not having access to your plan's assets until at least age 59½. I recommend consulting with a tax advisor prior to withdrawing any assets.

- **Unrelated Business Income Tax (UBIT).** As you know, the investment earnings on your plan assets are tax-deferred. However, if your plan has non-passive investments that produce income either by selling goods or providing services, that income may be subject to UBIT. Further, if any investments are debt-financed, such as purchases using margin accounts, the resulting income may be subject to UBIT. Check with your accountant to find out if you have plan income subject to UBIT.

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In summary, your pension plan is an excellent vehicle for deferring taxes by making deductible contributions. Further, your tax-deferred investment return will be significantly higher than if your initial investment had been reduced by taxes. In exchange, you must be aware of the restrictions and limitations imposed by the IRS and the Department of Labor regarding how assets can be invested.

These guidelines are not intended to provide a detailed analysis of the laws affecting pension plan investing. Although I'm available to discuss how the relevant laws impact your particular situation, if there's any uncertainty as to the legality of your situation, I recommend you contact a pension attorney for a second opinion.