What's New In Retirement Planning?

Defined Benefit Plans can provide larger tax deductions than 401(k)s/Profit-Sharing plans.

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Defined Benefit Pension Plans as well as Cash Balance Plans are generating a lot of interest with medical practices, both large and small.

Medical practices generally find that these retirement plans are a great way to increase retirement savings and reduce taxes at the same time. As an additional benefit, the plans provide a level of asset protection for doctors. In addition to reducing income taxes, the significant contributions are a great way to catch up if you have not saved enough in the past or if your retirement account balances are still lagging after market losses during the recent economic turmoil.

Compared to 401(k)s and Profit-Sharing Plans

In 2017, an individual under 50 years old may defer $18,000 into his 401(k) account. With matching and Profit Sharing Plan contributions, the total may be increased to $54,000. If the individual is over 50, they may defer an additional $6,000.

In comparison, a doctor in his late 50s could contribute and deduct nearly $210,000 in a properly designed Defined Benefit or Cash Balance Plan. This allows you to turbocharge your retirement savings. You may accumulate close to $2.5 million in the plan by age 62, which is at least double what you would accumulate outside a tax-qualified plan. So if you plan to withdraw only the earnings each year after you retire, you'll have twice the annual income.

Pension Protection Act of 2006

Defined Benefit and Cash Balance plans have become more popular since the Pension Protection Act of 2006 (PPA). The Act made these plans more appealing in several ways. First, the Act clarified the legality of Cash Balance Plans. Second, the Pension Protection Act explained how a company, such as a medical practice, might be able to sponsor both a 401(k) Profit Sharing and a Defined Benefit Plan to take advantage of the unique characteristics of each and benefit from the combination of the two. Third, the Pension Protection Act of 2006 explained how to cross test the benefits from both types of plans and be able to weight the contributions more heavily toward the professionals/business owners if the demographics were right.

A sample case (Table 1) shows a medical practice where a physician's spouse is employed along with seven employees. When a Defined Benefit Plan is added to an existing Profit Sharing Plan, contributions can be significantly increased, while keeping financial obligations to non-owner employees to a minimum (Table 2).

Company Name	ABC Company
First Plan Year End	12/31/2017
Normal Retirement	Age 62
Income Tax Rate	44.0%

Sex	Name	Age	Annual Salary
M	Dr. Owner	51	$265,000
F	Owner Spouse	50	$26,000
F	Employee 1	28	$57,446
F	Employee 2	41	$47,262
F	Employee 3	48	$65,495
F	Employee 4	31	$83,655
F	Employee 5	28	$37,891
F	Employee 6	43	$34,453
F	Employee 7	24	$17,120

Table 1. Company information and census

DEFINED BENEFIT PENSION PLAN WITH 401(K)PROFIT SHARING PLAN – CROSS TESTED DESIGN						
Participant Name	**Plan Age**	**Ret Age**	**Total DB Plan Contribution**	**Total 401(k) Profit Sharing Contribution***	**Grand Total Contribution**	**% of Total**
Dr. Owner	51	62	$155,000	38,550	193,550	74.66
Owner Spouse	50	62	15,000	24,100	39,100	15.08
Sub-Total			170,000	62,650	232,650	89.74
Employee 1	28	62	500	3,906	4,406	1.70
Employee 2	41	62	500	3,214	3,714	1.43
Employee 3	48	62	500	4,454	4,954	1.91
Employee 4	31	62	500	5,689	6,189	2.39
Employee 5	28	62	500	2,577	3,077	1.19
Employee 6	43	62	500	2,343	2,843	1.10
Employee 7	24	62	257	1,164	1,421	0.55
TOTALS			171,257	85,996	259,254	100%

*Combined plan tax deduction rules effectively limit employer contributions to defined contribution plan to 6% of total eligible payroll. To satisfy combined plan general nondiscrimination testing and other requirements, the exhibit shows employees receiving 3% safe harbor and about 4% profit sharing; the owner receives about 5% profit sharing. The owner's contribution also includes a 401(k) deferral of $18,000 plus $6,000 catch up contribution. The spouse's contribution includes this same generous deferral amount.

Table 2. Company data analysis

Table 3 provides a comparison of "before and after" to illustrate improvement of plan design from one year to the next.

Historically, Defined Benefit plans were thought to be fixed and inflexible. The PPA brought a funding method that gave rise to a range of funding options. The contributions in the range, from maximum to minimum, are all acceptable and income tax-deductible. With the proper plan design and the new funding method, there can be flexible year-to-year funding.

As a result of these changes, business owners, such as doctors, can now have larger retirement plan contributions that are income tax-deductible. The plan designs are doctor friendly, allowing a contribution level that fits the needs of the business. This increased funding flexibility can also allow more predictable contribution totals from year to year.

Another important change brought about by the PPA is the Inherited IRA. Prior to the PPA, in the event of a participant's death, a spouse beneficiary could roll the account into his own IRA, stretch the benefits over his lifetime and pass them on to future generations that provided for the deferral of the income tax for possibly decades. If the beneficiary was a non-spouse, the taxation was either in the year of death or no later than the end of the fifth year following. Taking a lifetime of accumulations and taxing them over a short time was not a good result.

The PPA changed this and allows a non-spouse beneficiary to receive this "Inherited IRA" and stretch out the payments in a similar fashion to a spouse, putting non-spouse beneficiaries on a more equal footing. With a high rate of divorce or the possibility that your spouse might predecease you, this is an important change.

ABC COMPANY – COMPARISON OF PLAN DESIGNS		
Participant	**Previous Year Design**	**Proposed New Design**
Dr. Owner	59,000	193,550
Owner Spouse	26,600	39,100
Sub-Total	85,600	232,650
Employee 1	2,872	4,406
Employee 2	2,363	3,714
Employee 3	3,275	4,954
Employee 4	4,183	6,189
Employee 5	1,895	3,077
Employee 6	1,723	2,843
Employee 7	856	1,421
Sub-Total	17,167	26,604
Grand Totals	**104,167**	**259,254**
Increase in contribution to Dr. and Spouse		**147,050**
Increase in total contributions		**155,087**
% of increase for Dr. and Spouse		**94.82**

Table 3.

Conclusion

If you want to find out if a Defined Benefit Pension Plan or a combination of plans is right for you, or if your current plan provides for an Inherited IRA, call OJM Group and speak to one of their Retirement Plan Specialists. You might be very surprised at how a few changes can enhance your retirement and income tax planning. ■

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