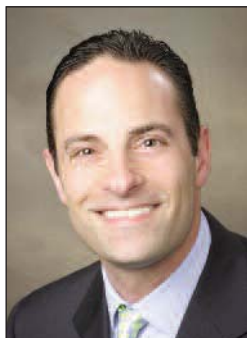


Retirement Plans and Your Medical Practice

By Lawrence B. Keller, CFP®, CLU, ChFC, RHU, LUTCF, and Peter M. Coleman, ASA, EA, FCA, MAAA, MBA



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In today's turbulent economic times, physicians are looking for solutions that provide tax deductions and the opportunity to save efficiently for their retirement. No matter whether you are self-employed, run a small medical practice, own shares in a large surgical center, or are directly involved in running a corporation/tax-exempt organization, you have the ability to establish a qualified retirement program for you and for your employees.

However, how do you create a retirement program to maximize your tax-deductible contributions without "breaking the bank" on employee costs? This article presents plan design concepts successfully used by others in the medical community, to help you better understand the elements that go into a well-designed and well-executed retirement program.

What Is a Qualified Retirement Plan?

The term "qualified" generally indicates that the plan must meet statutory requirements under the Employee Retirement Income Security Act of 1974 (ERISA), regarding issues such as participant eligibility, benefit coverage, vesting, funding requirements, and employee communication. Qualified plans are subject to the most stringent regula-

tion, but, as a result, receive the most favorable tax treatment. Two of the biggest benefits are (1) immediate income tax deductions, and (2) creditor protection.

Defined Contribution versus Defined Benefit Plans

As with any project, there is usually more than one way to accomplish your objective. The same holds true for retirement plans. Most people have heard about 401(k) plans, where you can defer a portion of your salary and the employer makes a discretionary contribution as a match or as a percentage of your compensation. These plans are called Defined Contribution Plans and function as a savings account that is affected by investment gains and losses. The contribution going into such a plan is "defined," but not the end benefit. The reverse of this is the Defined Benefit/Cash Balance Plan, in which an actuary determines the annual employer contribution that will provide a specific benefit payable at retirement.

Participants who begin saving later in life are at a distinct disadvantage in Defined Contribution Plans, because they have fewer years to accumulate funds for retirement. Conversely, Defined Benefit/Cash Balance Plans, for these same employees, allow them to accumulate considerable retirement assets in a relatively short period, because the end benefit has been predetermined.

401(k)/Profit-Sharing Plans

It is common for a medical practice to combine a 401(k) plan with a profit-sharing component. The 401(k) plans have become one of the most popular types of employer-sponsored retirement plans. The purpose is to permit you to defer a

portion of your salary, up to \$17,000 (\$22,500 for those aged 50 years or older) annually, on a pretax or post-tax (ie, Roth) basis. In addition, when there are ample funds, the employer can make a discretionary contribution that could increase the business owner up to \$50,000 (\$55,500 if aged 50 or older) in annual contributions. As your money grows in these plans, all income taxes are deferred until you take distributions at retirement.

This all sounds good, but is there a catch? The catch is that if you have employees, you must also provide them with a benefit and prove to the IRS that your plan encourages and benefits those rank-and-file employees. Although every organization's demographics are different, some of the best design tools include the following features:

- The Safe Harbor 401(k) plan is a 401(k) plan that eliminates all compliance testing. With this type of plan, employers with low-to-very-poor 401(k) participation by staff can safely defer their full \$17,000 (\$22,500 for those aged 50 or older) contribution, without fear that the plan will fail nondiscrimination testing and that part of their deferral will be refunded at the end of the year, creating a taxable event. Based on the design chosen, the employer will provide either a matching benefit (ie, 100% on the first 3% deferred, plus 50% on the next 2% deferred) or a nonelective benefit (ie, 3% of salary) for all participants. The "cost" for using this plan design is that all employer contributions are immediately vested.
- When additional benefits are desired, many business owners augment their 401(k) plan with a

Table. The Medical Practice Traditional 401(k) Plan with New Comparability Profit-Sharing and Cash Balance Components
Objective: Provide Maximum Benefit for Partners/Minimize Overall Costs

Participants	Age, yr	Profit-sharing contribution, %	Cash balance contribution, %	Maximum salary for benefit purposes, \$	(A) Projected voluntary employee 401(k) deferral, \$	(B) Employer profit-sharing contribution, \$	(C) Employer defined benefit contribution, \$	(B) + (C) Total employer contribution, \$	(A) + (B) + (C) Total partner benefits, \$	Allocation of total benefits, %
Group 1: Owner physicians										
Physician 1	60	13.2	Max	250,000	22,500	33,000	238,462	271,462	293,962	26.7
Physician 2	58	13.2	Max	250,000	22,500	33,000	217,949	250,949	273,449	24.9
Physician 3	55	13.2	Max	250,000	22,500	33,000	187,179	220,179	242,679	22.1
Physician 4	53	13.2	Max	250,000	22,500	33,000	169,231	202,231	224,731	20.4
Subtotal: Group 1				1,000,000	90,000	132,000	812,820	944,820	1,034,820	94.1
Group 2: Registered nurses (RNs)										
RN 1	40	3.0	0.0	112,000	4480	3360	0	3360		0.4
RN 2	52	3.0	0.0	130,000	5200	3900	0	3900		0.4
Subtotal: Group 2				242,000	9680	7260	0	7260		0.8
Group 3: Staff										
Staff 1	33	7.5	2.5	80,000	3200	6000	1385	7385		0.7
Staff 2	32	7.5	2.5	75,000	3000	5625	1281	6906		0.6
Staff 3	28	7.5	2.5	65,000	2600	4875	1051	5926		0.5
Staff 4	35	7.5	2.5	65,000	2600	4875	1157	6032		0.4
Staff 5	27	7.5	2.5	35,000	1400	2625	558	3183		0.3
Staff 6	25	7.5	2.5	35,000	1400	2625	543	3168		0.3
Staff 7	35	7.5	2.5	40,000	1600	3000	712	3712		0.3
Staff 8	42	7.5	2.5	37,000	1480	2775	726	3501		0.3
Staff 9	28	7.5	2.5	50,000	2000	3750	808	4558		0.4
Staff 10	35	7.5	2.5	60,000	2400	4500	1068	5568		0.5
Staff 11	47	7.5	2.5	55,000	2200	4125	1265	5390		0.5
Staff 12	21	7.5	2.5	32,000	1280	2400	470	2870		0.2
Subtotal: Group 3				629,000	25,160	47,175	11,024	58,199		5.1
Total										
				1,871,000	124,840	186,435	823,844	1,010,279		100
				Estimated tax savings for partners/firm						
					36,000	74,600	329,500	404,100	440,100	

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profit-sharing feature. Offering such a plan helps to attract quality employees and reduces employee turnover. The best part about the profit-sharing contribution is that it is discretionary in nature, and you are not required to make a set contribution (or any contribution) in any given year. This flexible standard allows medical practices considerable latitude in budgeting, especially for those with varying or uncertain profits. And with a properly designed program, the majority of the contributions will be allocated to the key employees in your practice.

A Properly Designed Program

What is a properly designed program? This is typically a plan in which the key staff members, inclusive of the owner(s), receive more than 60% of the total dollars going into the plan. One of the best ways we have accomplished this goal is by using a New Comparability Profit-Sharing (NCPS) design. An NCPS plan will allow you to place all participants in the appropriate group and to provide them with different contribution percentages, as long as you pass discrimination tests. For example, a profit-sharing allocation for the following participants could include:

- Senior physician (owner): 20% of compensation
- Junior physician (owner): 10%
- Office manager: 7%
- Remaining staff: 5%.

The employer contributions are usually made after the end of the plan year (but before filing your taxes), and when you have determined your ability to make the contribution. Each year, working with your retirement consultant, you determine the percentages to allocate to each group. If your demographics do not work well with this type of design, there are many other variations to

choose from, including pro rata, age based, service based, and integration with Social Security wage base. However, regardless of the design chosen, the maximum contribution any one person can receive, inclusive of the 401(k) component, is \$50,000 (\$55,500 for those aged 50 or older) per employee.

Combination Program

For some business owners, the benefits provided through a 401(k)/profit-sharing plan are just not enough. They are looking for programs that will provide tax-deductible contributions for themselves in excess of \$100,000. In these cases, the solution is the combination of a 401(k)/Profit-Sharing and Defined Benefit/Cash Balance Program. Like an NCPS, the Defined Benefit Plan can be structured to provide greater benefits for the key employees and minimize overall costs for the staff. With a Defined Benefit Plan, after 10 years of participation and retirement at age 62, you could amass an account balance of approximately \$2.5 million in addition to the account balance in your 401(k) profit-sharing plan. Please note that unlike the profit-sharing plan, the contribution to the Defined Benefit Plan is not discretionary and must be made for at least 3 to 5 years.

Multiple Plans: An Example

In this hypothetical medical practice listed in the **Table**, there are 4 high wage earners looking for ways to defer additional sums of money in excess of the \$50,000 permitted under a 401(k)/profit-sharing plan. The solution was to use the Combination Program, including a 401(k)/profit-sharing plan and a Defined Benefit/Cash Balance component. By adding on the Cash Balance Plan, the physicians' tax-deductible contributions increased by more than \$150,000 each, while

still maintaining a reasonable cost for the staff. As a result, the owners are able to collectively contribute more than \$1 million for themselves and receive more than 93% of all dollars going into the plan. In addition, if any of the physicians did not want such a large benefit, this could easily be modified.

Conclusion

When it comes to choosing an appropriate retirement program, there are many choices available, often too many. What we say to all our clients is, "Pretend there are no rules and regulations, and you can do whatever you would like. Now tell us how you would like to design your specific program." You should never be presented a solution before you have been able to communicate exactly what you would like from your plan. More often than not, a customized retirement program can very closely mirror the objectives of your practice. Working with an experienced third-party administrator and financial advisor, you will be able to craft the right tax-efficient program for your practice. ●

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