# Choosing the Right Retirement Plan for a Dental Practice

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Most dentists as business owners share a variety of critical priorities, such as managing taxes, attracting and rewarding valued employees, and establishing a long-term strategy to ensure their own financial security. Fortunately, small-business owners also share an option that could help address all of those goals: Sponsoring a workplace retirement plan.

Among small employers (5 to 100 workers) who decided to sponsor a plan, the strategy is generally expected to enhance the overall business, according to one major survey. In fact, the most common motivations for employers to sponsor a plan were to increase their ability to attract and retain employees, and to improve employee morale. In addition, retirement plans offer valuable tax deductions and allow for tax-deferred compounding of investment earnings.

## Types of plans

There are several types of retirement plans to choose from, and each type of plan has advantages and disadvantages. This discussion covers the most popular plans. You should also know that the law may permit you to have more than one retirement plan, and with sophisticated planning, a combination of plans might best suit your business's needs.

## SEP-IRAs

A Simplified Employee Pension plan (SEP-IRA) may be ideal for a one-person business or a business with just a few employees. It is relatively inexpensive and easy to start and administer.

The employer — not the employees — contributes to a SEP-IRA. Employees are immediately vested, and each employee decides how his or her money is to be invested.

Although there are some exceptions, in general, a SEP-IRA must cover any employee who is 21 or older, earned at least $500 from the business, and has worked there during at least three of the preceding five years. In 2008, the annual contribution limit for each employee is 25% of compensation (or, for the self-employed, net earnings) or $46,000, whichever is less.

SEP-IRAs also offer small-business owners flexibility regarding both the amount and timing of contributions. As a result, a SEP-IRA may make sense for a business with profits that tend to fluctuate from year to year.

## SIMPLE IRAs

Actually a sophisticated type of individual retirement account (IRA), the SIMPLE (Savings Incentive Match Plan for Employees) IRA plan allows employees to defer up to $10,500 (for 2008) of annual compensation by contributing it to an IRA. In addition, employees age 50 and over may make an extra "catch-up" contribution of $2,500 for 2008. Employers are required to match deferrals, up to 3 percent of the contributing employee's wages (or make a fixed contribution of 2 percent to the accounts of all participating employees whether or not they defer to the SIMPLE plan).

SIMPLE plans work much like 401(k) plans, but do not have all the testing requirements. So, they're cheaper to maintain. There are several drawbacks, however. First, all contributions are immediately vested, meaning any money contributed by the employer immediately belongs to the employee (employer contributions are usually "earned" over a period of years in other retirement plans). Second, the amount of contributions the highly paid employees (usually the owners) can receive is severely limited compared to other plans. Finally, the employer cannot maintain any other retirement plans. SIMPLE plans cannot be utilized by employers with more than 100 employees.

## Profit-sharing plans

Profit-sharing plans are among the most popular employer-sponsored retirement plans. These straightforward plans allow you, as an employer, to make a contribution that is spread among the plan participants. You are not required to make an annual contribution in any given year. However, contributions must be made on a regular basis.

With a profit-sharing plan, a separate account is established for each plan participant, and contributions are allocated to each participant based on the plan's formula (this formula can be amended from time to time). As with all retirement plans, the contributions must be prudently invested. Each participant's account must also be credited with his or her share of investment income (or loss).

For 2008, no individual is allowed to receive contributions for his or her account that exceed the lesser of 100 percent of his or her earnings for that year or $46,000. Your total deductible contributions to a profit-sharing plan may not exceed 25 percent of the total compensation of all the plan participants in that year. So, if there were four plan participants each earning $50,000, your total deductible contribution to the plan could not exceed $50,000 ($50,000 x 4 = $200,000; $200,000 x 25% = $50,000). (When calculating your deductible contribution, you can only count compensation up to $230,000 (in 2008) for any individual employee.)

## 401(k) plans

A type of deferred compensation plan, and now the most popular type of plan by far, the 401(k) plan allows contributions to be funded by the participants themselves, rather than by the employer. Employees elect to forgo a portion of their salary and have it put in the plan instead.

The requirements for 401(k) plans are complicated, and several tests must be met for the plan to remain in force. For example, the higher paid employees' deferral percentage cannot be disproportionate to the rank-and-file's percentage of compensation deferred.

These plans can be extremely expensive to administer, but the employer's contribution cost is generally very small (employers often offer to match employee deferrals as an incentive for employees to participate). Thus, in the long run, 401(k) plans tend to be relatively inexpensive for the employer.

If you don't have any employees (or your spouse is your only employee) a 401(k) plan (an "individual 401(k)" or "solo 401(k)" plan) may be especially attractive, Because you have no employees, you won't need to perform discrimination testing, and your plan will be exempt from the requirements of the Employee Retirement Income Security Act of 1974 (ERISA). You can make a deductible profit-sharing contribution of up to 25% of pay (to $230,000) on your own behalf in 2008, and in addition you can make deductible pre-tax contributions of up to $15,500 in 2008 (plus an additional $5,000 of pre-tax catch-up contributions if you're age 50 or older). However, total annual additions to your account in 2008 can't exceed $46,000 (plus any age-50 catch-up contributions).

Note: Beginning in 2006, a 401(k) plan can let employees designate all or part of their elective deferrals as Roth 401(k) contributions. Roth 401(k) contributions are made on an after-tax basis, just like Roth IRA contributions. Unlike pre-tax contributions to a 401(k) plan, there's no up-front tax benefit--contributions are deducted from pay and transferred to the plan after taxes are calculated. Because taxes have already been paid on these amounts, a distribution of Roth 401(k) contributions is always free from federal income tax. And all earnings on Roth 401(k) contributions are free from federal income tax if received in a "qualified distribution."

Note: 401(k) plans are generally established as part of a profit-sharing plan.

## Defined benefit plans

By far the most sophisticated type of retirement plan, a defined benefit program sets out a formula that defines how much each participant will receive annually after retirement if he or she works until retirement age. This is generally stated as a percentage of pay, and can be as much as 100 percent of final average pay at retirement.

An actuary certifies how much will be required each year to fund the projected retirement payments for all employees. The employer then must make the contribution based on the actuarial determination. In 2008, the maximum annual retirement benefit an individual may receive is $185,000 or 100 percent of final average pay at retirement.

Unlike defined contribution plans, there is no limit on the contribution. The employer's total contribution is based on the projected benefits. Therefore, defined benefit plans potentially offer the largest contribution deduction and the highest retirement benefits to business owners.

## Other plans

The above sections are not exhaustive, but represent the most popular plans in use today. Recent tax law changes have given retirement plan professionals new and creative ways to write plan formulas and combine different types of plans, in order to maximize contributions and benefits for higher paid employees.

**Small Business Retirement Plan Comparison**

**Plans at a Glance**

| | **SEP IRA** | **SIMPLE IRA** | **Profit Sharing Plan** | **Group 401(k) & Roth 401(k)** | **Defined Benefit Plan** |
|---|---|---|---|---|---|
| Key Advantage(s) | Ease of setup/ maintenance | Ease of setup/ maintenance | Can be used in conjunction with other retirement plans | Higher contributions allowed | Much Higher contributions allowed |
| Funding Responsibility | Discretionary employer contributions | Employers and employees | Employers | Employers and employees | Generally, Employers/owners<br><br>Sometimes, employee contributions are |

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| | | | | | either required or voluntary. |
| Level of Complexity/ Reporting | Low | Low | High | High | Very High |
| Vesting | Immediate | Immediate | Flexible | Flexible | Flexible |
| Plan Setup/Funding Deadline | April 15 | October 1 of current tax year | April 15 | April 15<br><br>Employer profit-sharing deadline: April 15 | December 31<br><br>April 15 |
| Contribution Limits | Up to 25% of employee pay, not to exceed $46,000 | Employees: $10,500<br><br>Catch-up contributions: $2,500<br><br>Employers: 1% to 3% of employee compensation | Up to 25% of employee pay, not to exceed $46,000 | Employees: $15,500<br><br>Catch-up contributions: $5,000<br><br>Employers: discretionary<br><br>Combined total not to exceed $46,000 or 100% of employee pay | Deduction limit is any amount up to the plan's unfunded current liability (see an enrolled actuary for further details). |

## Making the Right Choice

As you review these retirement plan options, keep in mind there are many points to consider. For example, thanks to 2001's sweeping tax legislation, employers may now take a limited tax credit during the first three years they maintain a plan. Other considerations include evaluating your business's unique needs and goals, protecting your plan from creditors, and limiting your own fiduciary responsibility. For these reasons, it is generally advisable to speak with a retirement plan expert before making any decisions.

## Points to Remember

1. By sponsoring a workplace retirement plan, dentist practice owners may be able to better pursue a wide range of important goals, such as managing taxes, attracting and retaining employees, and preparing for a financially secure future.
2. The vast majority of dentists who sponsor a retirement plan believe that it has a positive effect on their ability to retain employees and on workers attitudes and performance.
3. Of the three main types of retirement plans, SEP-IRAs and SIMPLE IRAs are the least expensive and most convenient to administer. Qualified plans are more complex, but 401(k) and Roth 401(k) plans are typically the most expensive and time consuming to manage.
4. Before deciding on a plan, small-business owners should reflect on the goals they hope to achieve and their financial and managerial ability to pursue those goals in light of each plans unique requirements.
5. It is also widely recommended that dentists consult an experienced retirement plan professional in order to arrive at and implement the right decision.

Sincerely, Rick Epple, CFP®

Rick Epple, CFP®, is the founder and president of Epple Financial Advisors (EFA). We at EFA work in our client's (including dentists) best interest to understand their unique issues and create a flexible but clear and direct road map to achieve their goals. This consists of a comprehensive and integrated wealth management plan and corresponding unbiased custom solution. Our plan will continue to guide and protect our clients in the years ahead, regardless of the changing market and economic condition.

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