

SAALFELD GRIGGS DENTAL INDUSTRY TEAM

WHITE PAPER: RETIREMENT PLAN DESIGNS FOR DENTAL PROFESSIONALS



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Smart business.

BY CHRISTINE MOEHL

I. Introduction

A qualified retirement plan is one of the most valuable tools that a dental professional can use to reduce taxes and achieve retirement security. Retirement plans offer three unique benefits unparalleled by other investment vehicles: (1) contributions are tax-deductible; (2) plan assets grow tax deferred until distribution; and (3) plan assets are exempt from creditors. In order to reap these important benefits, a qualified retirement plan must be designed properly.

II. The Basics: A SIMPLE IRA

Many dental professionals just out of dental school will adopt a retirement plan known as a Savings Incentive Match Plan for Employees of Small Employers (the "SIMPLE"). The SIMPLE is an IRA-based plan that allows dental professionals and their employees the opportunity to start saving for retirement at a modest, but cost-effective rate. SIMPLE IRA plans are less expensive to set up and maintain than other types of retirement plans because no annual tax return is required and no sophisticated plan documents are necessary. Under a SIMPLE, eligible employees (including the owner) can contribute money out of their paychecks into the plan on a pre-tax basis (i.e., a "salary deferral"). The current limit on salary deferrals into a SIMPLE is \$12,000 per year (\$14,500 for employees age 50 or older). The owner/employer is then required to make one of two contributions:

1. A two percent "non-elective" contribution which goes to all eligible employees, regardless of whether the employee made a salary deferral; or
2. A dollar-for-dollar match for the first three percent of compensation deferred by each eligible employee (with no employer contribution going to those who did not defer).

The following is an example of what a SIMPLE plan with a matching contribution might look like to a dental practice with the following demographics:

Employee	Age	Wages	Salary Deferral	% of Pay	Matching Contribution	% of Pay	Total Contribution	% of Pay
Dentist	45	\$255,000	\$12,000	5%	\$7,650	3%	\$19,650	8%
Employee 1	35	\$23,000	\$1,150	5%	\$690	3%	\$1,840	8%
Employee 2	32	\$36,000	\$0	0%	\$1,080	3%	\$1,080	3%
Employee 3	29	\$65,000	\$1,950	3%	\$1,950	3%	\$3,900	6%
Employee 4	24	\$21,000	\$0	0%	\$630	3%	\$630	6%

TOTALS		\$400,000	\$15,100		\$12,000		\$27,100	
% to Owner						63%		82%
\$ to Staff					\$4,350			

Although SIMPLEs are inexpensive and easy to administer, the benefits that these plans offer are quite limited because owners are not able to contribute as much to these plans for themselves as they are to other types of retirement plans. In order to achieve higher contribution levels, an owner must look to either the 401(k) plan or the combined 401(k) / cash balance plan.

III. A Step Up: 401(k) Plans

The majority of dental professionals today utilize some form of 401(k) Plan. The 401(k) plan, like the SIMPLE plan, allows employees to make salary deferrals on a voluntary basis. Amounts that can be deferred by each employee into a 401(k) are much higher than in a SIMPLE. The current limit on salary deferrals in a 401(k) plan is \$17,500 per year (\$23,000 for employees age 50 or older). Also like a SIMPLE, owner/employers who sponsor 401(k) plans may make either a non-elective contribution or a matching contribution to the plan each year. Again, the amounts the owner/employer can contribute to a 401(k) plan are much higher than with SIMPLEs (currently as much as \$51,000 per employee per year).

Traditional 401(k) vs. Safe Harbor 401(k): Traditional 401(k) plans are subject to nondiscrimination rules that compare the salary deferrals of the rank-and-file employees against the salary deferrals made by the owners. In many cases, these nondiscrimination rules limit the amount that owners can defer. By contrast, Safe Harbor 401(k) plans are not subject to these nondiscrimination requirements. In a Safe Harbor plan, owners can make maximum salary deferrals regardless of the amount of salary deferrals that rank-and-file employees make. In order to qualify as a Safe Harbor plan, the owner/employer generally must make one of two employer contributions: (1) a non-elective "profit sharing" contribution equal to at least 3% of each eligible employee's compensation, regardless of whether the employee deferred or not; or (2) a matching contribution that matches employee deferrals dollar-for-dollar on the first 3% deferred, and then 50 cents on the dollar for the next 2% deferred.

Plain Vanilla Profit Sharing vs. Cross-Tested Profit Sharing: In a "plain vanilla" Safe Harbor 401(k) plan, the profit sharing and matching contributions that the owner/employer receives each year are the same (as a percentage of compensation) as all other employees in the plan. Thus, if the owner/employer makes a 5% profit sharing contribution for the employees, then the owner also receives a 5% contribution. By contrast, a "Cross-Tested" 401(k) plan is a unique form of plan that allows an owner/employer to receive a profit sharing contribution that is considerably higher than the profit sharing contribution received by other employees.

The following is an example of what a Cross-Tested / Safe Harbor 401(k) Plan might look like to a dental practice with the same demographics discussed above:

Employee	Age	Wages	Salary Deferral	% of Pay	Profit Sharing Contribution	% of Pay	Total Contribution	% of Pay
Dentist	45	\$255,000	\$17,500	7%	\$33,500	13%	\$51,000	53%
Employee 1	35	\$23,000	\$1,150	5%	\$1,150	5%	\$2,300	10%
Employee 2	32	\$36,000	\$0	0%	\$1,800	5%	\$1,800	5%
Employee 3	29	\$65,000	\$1,950	3%	\$3,250	5%	\$5,200	8%
Employee 4	24	\$21,000	\$0	0%	\$1,050	5%	\$1,050	5%

TOTALS		\$400,000	\$20,600		\$40,750		\$61,350	
% to Owner						82%		90%
\$ to Staff					\$7,250			

Although Cross-Tested plans are more expensive to set up and operate than SIMPLE plans, the tax savings realized by the owner/employer under these types of plan as well as the ability to accelerate retirement savings more than offsets those costs. For even great tax savings, some dental professionals go the extra mile and adopt the "Cadillac" of all retirement plans: The 401(k) / Cash Balance Combo Plan.

IV. The Cadillac of Retirement Plans: 401(k) / Cash Balance Combo

Although stand-alone 401(k) plans are the most common retirement plan utilized by dental professionals today, many wish to achieve even higher tax savings and larger deferrals. The Pension Protection Act of 2006 ("PPA") granted this wish by making it easier for employers to adopt "Cash Balance" plans. Cash Balance plans are retirement plans that are attractive to owner/employers because they are not subject to the \$51,000 per year limit imposed on stand-alone 401(k) plans. Rather, these types of plans are considered "defined benefit" plans, which means that employer contributions can be two to three times the 401(k) limit.

The Paired Approach: By combining an existing 401(k) plan with a Cash Balance plan, the opportunities for deductible retirement plan contributions are increased even further, while staff costs remain relatively low. The following is an example of what a 401(k) / Cash Balance Combo Plan might look like to a dental practice with the same demographics discussed above:

Employee	Age	Wages	Salary Deferral	% of Pay	Profit Sharing Contribution	% of Pay	Cash Balance Contribution	% of Pay	Total Contribution	% of Pay
Dentist	45	\$255,000	\$17,500	7%	\$5,000	2%	\$112,000	44%	\$134,500	53%
Employee 1	35	\$23,000	\$1,150	5%	\$1,610	7%	\$690	3%	\$2,300	15%
Employee 2	32	\$36,000	\$0	0%	\$2,520	7%	\$1,080	3%	\$3,600	10%
Employee 3	29	\$65,000	\$1,950	3%	\$4,550	7%	\$1,950	3%	\$6,500	13%
Employee 4	24	\$21,000	\$0	0%	\$1,470	7%	\$630	3%	\$2,100	10%

TOTALS		\$400,000	\$20,600		\$15,150		\$116,350		\$152,100	
% to Owner						33%		96%		90%
\$ to Staff					\$10,150		\$4,350		\$14,500	

Proper retirement plan design is essential for any dental practice in order to maximize the tax advantages of such a plan to the business owner and provide a valuable benefit to the employees of the practice. Lawyers in the Dental Industry Team frequently advise dentists on issues relating to the design, adoption and maintenance of qualified retirement plans. They also handle regulatory compliance issues related to such plans. If you have questions about retirement plans for dental professionals, or if you would like to receive a complimentary analysis of how these plans may fit with your practice, please contact a member of the Dental Industry Team.

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