Alternative Retirement Plan Structures for Professional Groups

Like most of us, business owners are concerned about creating a secure retirement—both for themselves and their employees. With the variety of retirement plan choices available to business owners (including SEPs, SIMPLEs, 401(k)s, and profit-sharing plans), the challenge is often determining the most effective solution.

Some business owners are finding success with retirement programs that can be tailored to meet certain characteristics like:

- Mature businesses
- Stable profits, revenue, cash flow
- Employee demographics where the owners or key employees are older and more highly compensated than non-executive or non-managerial employees

These businesses may include professional groups such as medical or legal practices; engineering or architectural firms; and information technology consulting practices. In addition to favoring older and highly compensated employees, these retirement programs can often permit higher contribution levels than traditional retirement plans. Two general types of retirement plan structures can support these alternate retirement plan designs — defined contribution and defined benefit plans.

Defined Contribution Plans

Defined contribution plans focus on the employer contributions made to the plan annually, but do not guarantee or specify an income benefit at retirement for plan participants. In addition, the amount of employer contributions is flexible and at the discretion of the business owner.

Age-Weighted Plans & New Comparability Plans

These two plan designs allocate the employer contributions to plan participants based on age and compensation levels. This can be very advantageous to business owners in which the owners and key employees are generally older and more highly compensated than other employees. The contribution amounts for plan participants must still adhere to the overall defined contribution plan limits and are limited to no more than 25% of aggregate compensation for all participants, but within those parameters these plans can effectively favor the older and more highly compensated employee group.

Defined Benefit Plans

In contrast to defined contribution plans, defined benefit plans provide an income benefit at retirement for each plan participant. Contributions are calculated and made annually to fund the promised benefits to participants (and their beneficiaries). With a defined benefit plan, annual employer contributions are mandatory.

Defined Benefit and Cash Balance Plans

These two defined benefit plans designs also allocate contributions based on age and compensation and may also favor older and highly-compensated plan participants. In addition, the contribution limits for these plans exceed the traditional limits of the defined contribution plans discussed above, which can be quite beneficial to business owners or key employees nearing retirement age who are looking to “make-up” for the years in which they didn’t adequately save for retirement.

However, given that contributions to defined benefit and cash balance plans are mandatory commitments and plan administrative costs are typically higher than defined contribution plans, business owners should always consult with their tax or legal advisors regarding the appropriateness of these plan designs before establishing one.

Which is the right retirement plan? The plans highlighted here represent a subset of the choices available to business owners. Consideration of individual retirement goals, employee demographics and business tax deduction needs are all likely key components in determining the “right” type of retirement plan for a business owner so consultation with a tax and/or legal advisor should be made before establishing any retirement plan. ■