



## legal matters

**The Ins and Outs of Retirement Plans, I of II** Various retirement accounts offer different kinds of benefits, and your employment situation determines which ones are appropriate for you. The best solution may be a combination of plans.

BY JOHN ALLEVATO



If there is one absolute truism about the various types of retirement plans and the options available for retirement planning, it is to secure the services of a financial professional to assist you. This is absolutely true if you are establishing retirement accounts for your medical practice. That said, there is a wealth of information you need to understand just to get the ball rolling for your own retirement.

The recent changes in the law, mostly relating to distribution options, (covered in Part II in the November/December

issue), which in many ways were positive to taxpayers, still left the terrain of retirement planning rocky and full of dangerous potholes. I cannot solve all your dilemmas here (whether you know you have any or not), but I can provide some helpful background information so that you can understand better what is available and how to get help in navigating the possibilities. I'll introduce you to some types of retirement accounts and their proper funding. In Part II, I will discuss the rules surrounding withdrawal of amounts from those retirement plans.

Let's start with some background. The field of retirement planning has its own special language, and to begin to make

any sense of the whole thing you must be familiar with the many terms used in the realm of retirement planning.

Compounding the confusion is that many terms are used interchangeably in ways which are not always technically correct. It is this misuse of the language which causes much of the misunderstanding. For example, people often use the term "pension" when referring to their retirement accounts. As you will learn, most retirement plans are not pensions, but defined contribution plans.

### Qualified Plans

First you should recognize what are commonly referred to as "qualified plans." That term generally covers all plans

where the contributions made to the plans are deductible for federal tax purposes. There are a number of types of qualified plans, including 401(k) plans, Keogh plans, and several types of defined benefit and defined contribution plans.

If you are an employee, you can participate in a number of qualified plans. A "defined contribution" plan can be a profit-sharing plan or a money purchase plan. These are the most common types of employee plans, and they can also have 401(k) features (more on this later). The participant owns her own account within a defined contribution plan and it is usually portable, that is, if the employee leaves the practice, she takes this account with her.

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A “defined benefit” plan is much like what most of us would think of as a pension. The participant who qualifies receives a stated amount at a fixed age or upon retirement. For example, your father may have worked in the plant for 35 years, which entitled him to a monthly pension amount for the rest of his life of \$30 for every year of service he worked at the plant. Thus, your father would have received \$1,050 per month for the rest of his life. Some plans had cost-of-living increases, some didn't. The point is that the benefit was fixed, and the participant did not have a portable account which was his under any circumstance. This type of plan is not common in physician practices, but certain types of defined benefit plans can be designed to provide significant benefits under certain circumstances to physicians and their employees. A retirement planning expert can help you figure it out.

Those of you who are not employees, but owner-employees of unincorporated entities such as partnerships, limited liability companies, or sole proprietorships, can have plans that are almost identical to those of employees, commonly called “Keogh” plans. These plans are virtually indistinguishable from corporate qualified plans except that they are established for owner-employees.

Unless you have been in a cave for the past few years (or perhaps in medical school or in a residency program), you have probably heard about “401(k) plans.” That code name refers to the section of the Internal Revenue Code which permits their benefits. A 401(k) plan allows the participant to reduce and defer part of her salary, and have that amount put into an account for her benefit at retirement. A primary advantage is that the amount so deferred is not taxable at the time it is earned, and the amount grows tax free until it is withdrawn. This type of plan is not mutually exclusive with other qualified plans—it

works with, and is commonly a part of, the retirement planning package which employers offer their employees (or to you owner-employees).

### **A Package Deal**

For example, assume we have a 12-doctor multi-specialty practice. It operates as a limited liability company and has 39 non-physician full-time employees (more than 1,000 hours of service per year), and eight part-time employees. The practice offers a defined contribution profit-sharing plan which makes contributions to the plan for the benefit of the employees who are qualified to participate—if the practice so chooses in a given year. This plan can provide for each employee up to five percent of his or her salary. This benefit is available to all full-time employees who have been at the practice for at least a year. This benefit is also provided to the physicians, who are owner-employees (the practice is a partnership for this purpose). In addition, the practice has a 401(k) feature, and permits employees to reduce their salary by, let's say, 10 percent and contribute that amount to the employees' individual accounts within the plan. The employees do not pay income tax on the deferred amount. Similar, though probably not identical, salary deferrals are available to the partner physicians, limited to an amount of about \$10,500 per year of their own income which is voluntarily deferred.

Utilizing a 401(k) plan along with another retirement plan allows employees the choice of deferring and saving a portion of their salaries for retirement in addition to what their employer contributes on their behalf to their retirement accounts.

Retirement plans and their terms and provisions are governed by rules established by the Department of Labor as well as the Internal Revenue Service and are very closely monitored by those agencies.

The IRS is involved because of the significant tax benefits available through the use of qualified plans, and rules are in place to insure the employer offers the plan and benefit on a non-discriminatory basis to all similarly situated employees. Failure to offer the plan equitably can result in loss of the tax benefits of the plan.

### **IRAs**

The final retirement plan to be discussed is the individual retirement account or IRA. Much used, much misunderstood, an IRA is an account that just about everyone will have at retirement (and often more than one). Understanding IRAs has become more difficult with the advent of Roth IRAs, education IRAs, and others.

Basically, an IRA is an account set up by an individual which is designed to provide for retirement. While there are exceptions, amounts in an IRA cannot be withdrawn until age 59 1/2 without penalty, because the funds are to be used for retirement.

IRAs were created to provide a retirement vehicle in situations where an employee is not covered by a retirement plan at work. Under those circumstances, and depending on the employee's income, income tax deductible amounts can be contributed to that individual's own IRA. The utilization of IRAs, however, has far surpassed that narrow purpose, as many people have multiple rollover IRA accounts, or IRA accounts which were established on a non-deductible basis. For example, even if an individual is covered by a qualified plan at work, he may still be able to contribute to an IRA on a non-deductible basis. What's the point of that, you say? Amounts earned in that account are still tax deferred until withdrawn at retirement or after the death of the account holder.

Another common form of IRA is a “rollover IRA,” so designated because funds from another type of qualified plan were withdrawn and transferred into an

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IRA. This usually happens when an employee leaves an employer, who may have had a defined contribution qualified plan, and takes her retirement account with her. One way to do that without incurring tax and penalties is to roll the amount in her account over into an IRA for the benefit of that employee.

A Simplified Employee Pension (SEP) IRA is an individual account that is funded by the employer. The employer contributes a set percentage of each qualified employee's salary to the plan each year. Those funds and the interest they accrue are taxed only when they are withdrawn at retirement. The employee maintains control of the account.

Now that you know some of the basics, in the next issue we will discuss the rules surrounding withdrawal of amounts from your retirement plan. ■

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