

# Financial Advisor Magazine

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## High-Income Clients Save More With These Underutilized Retirement Plans

By Jerilyn Klein Bier

Ask a roomful of middle-aged, high-net-worth solo practitioners or small business owners if they've saved enough for retirement and you're unlikely to see a big show of hands. Many have come into substantial earnings late in the game after years of keeping most of their assets tied up in their businesses. Even with the Internal Revenue Service's catch-up contribution allowance, the maximum a person age 52 or older could save tax-free in 2011 was \$54,500 with a Simple 401(k) plan, \$49,000 with a SEP plan.

But depending on age and income, individuals could potentially be socking away more than \$100,000 a year tax-deferred with a solo or small business defined benefit plan. Over five to 10 years, they can accumulate \$1 million to \$2 million.

Solo and small business defined benefit plans aren't new but are underutilized. Dedicated Defined Benefit Services LLC (Dedicated DB), a San Francisco Bay area provider of defined benefit plans for small businesses, has helped set up roughly 1,800 to 2,000 of them over the past decade. Co-founder Art Leaffer figures nearly one million people could benefit from such plans.

Business owners are contributing an average \$125,000 a year and plan terms are averaging at least eight years, say Leaffer and Karen Shapiro, CEO and co-founder of Dedicated DB. An individual's total allowable contribution to these plans, which have a lifetime ceiling of \$2.4 million, is calculated by an actuary. Dedicated DB shared this example:

Let's take a 52-year-old doctor, a solo proprietor, with annual earnings of \$400,000. Based on age and income, he could contribute \$147,800 to a defined benefit plan plus \$36,700 to a solo 401(k) plan this year. Under a combined state and federal tax rate of 38%, he'd defer \$70,100 in income taxes. By age 62, his defined benefit contributions (assuming a 5% to 7% return) would grow to \$2.36 million.

About 20% of Dedicated DB's clients opening plans are consultants, 30% are physicians and dentists, and 10% are financial professionals including CPAs and FAs.

Five or six years ago, Seth Pearson, CFP, owner of Pearson Financial Services in the Cape Cod, Mass., town of Dennis, started a small-business defined benefit plan for himself and four employees through Dedicated DB.

"From a short-term standpoint, there's absolutely nothing that can equal this for me or anyone older with excess income and big taxes," says Pearson, 66, who's been watching other people's retirement money since the early 1970s. "Every \$1 saved is like earning 35% on an investment."

Pearson has already reached the contribution target for his plan, which he set up for age 66, but doesn't plan to retire now. He's also set up defined benefit plans through Dedicated DB for five or six clients, including one who receives consulting fees for a business he sold. Most of his clients are retirees, not active business owners. "If I had more in this category, probably 100% would do them," he says.

Shapiro sees these plans appealing to the growing number of baby boomers who are retiring but launching second careers as consultants.

Business owners must contribute to a defined benefit plan for at least three consecutive years or the IRS can challenge and

take away a tax deduction.

Peggy McGillin, CFP, principal of Journey Financial Planners in Concord, Mass., expects that more people will be in a position to fund these plans when the economy picks up. The Pension Protection Act now enables business owners to fund more during good years and IRS-approved prototype plans, such as Dedicated DB's, have made plan design more affordable, she also notes.

Plans for 2011 must be set up by year-end but contributions can be made as late as September 15, 2012, if clients have tax extensions, says Shapiro.