

Retro Pension

Defined-benefit plans for small businesses can help owners catch up on savings.

By Temma Ehrenfeld

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When Bob Bove was 46, he and his wife had saved only \$50,000. As a successful sales manager, retirement savings just hadn't been on his mind.

Then Bove launched a second career as a financial planner and did so well that in 2008, he was able to open a defined-benefit plan. Now 55, he has \$70 million in assets under management, and he is stashing more than \$65,000 into his pension each year. "I'm playing catch up," he says. "Most successful financial advisors could probably afford a pension plan, and it's a wonderful tax-savings tool."

The traditional pension may seem on its way to extinction. Between 1979 and 2008, the latest figure available, the Employee Benefit Research Institute reports that the portion of U.S. private-sector workers participating in a defined-benefit plan dropped from 38% to 15%. Meanwhile, the headlines multiply about underfunded pensions, both public and private.

Yet as more high-net-worth Americans earn income in their own small businesses, traditional pensions may see a revival, especially among boomers, like Bove, who came to saving late. Says Michael Kay, president of Financial Focus in Livingston, N.J., "I wouldn't be at all surprised if small pension plans become a big trend as Americans emerge from the recession."

THE BASICS

The key is that pensions allow participants to protect substantially more money from taxes.

"I've been struck by how many advisors just don't know about defined-benefit plans," says Karen Shapiro, a co-founder of [Dedicated DB](#), a San Francisco firm that provides a streamlined plan for small businesses, [OnePersonPlus](#), with marketing support for financial planners. On average, people in new plans provided by Shapiro's company are contributing \$115,000 a year, and the plans last eight years.

Those contributions create a pool of funds for planners to manage. "Some advisors see these plans as an asset-gatherer that works like an annuity for them," says Shapiro, since with each sale, the client is committing to regular contributions.

Shapiro, who focuses on companies with one to five employees, saw a 25% increase in sales in 2010. Competitors include Schwab's Personal Defined Benefit Plan and a customized plan from Peter Austin in WestLake Village, Ca.

The typical candidate, Shapiro says, is an independent professional, a small business owner with just a few employees or an individual with self-employment income. Most owners are 45 to 65 years old and want to save more than \$50,000 a year. Likely clients include architects, attorneys, consultants, physicians, web-based businesses, real estate agents -and not least, financial planners.

This past October, when [Dedicated DB](#) surveyed its own pension owners, 19% of the respondents said they planned to retire earlier because their plans had done so well.

Unlike a 401(k), a pension is a commitment. But contributions can be front-loaded, Shapiro says, with smaller amounts required in later years. It's also possible to start modestly and increase contributions in good years.

SOME SCENARIOS

Here are some ways clients can use small pension plans:

* **Solo self-employed.** Let's say your client works alone and wants to save as much as possible. He's 52 years old, with W-2 income of \$300,000, and plans to retire at 62. With a pension, he could put away about \$138,000 next year, saving \$52,600 in taxes (in the 38% bracket). His projected accumulation would be \$2.36 million, with a yearly benefit of \$195,000. Often, pension assets are rolled into an IRA and continue to grow tax-deferred until withdrawn.

If he also maxed out a 401(k) contribution, his total retirement savings for the year rise to \$175,200, and he'd avoid \$66,500 in taxes.

His alternatives? With a SIMPLE, he can contribute only \$21,350, and a SEP would raise the amount to \$49,000. He could put only \$54,500 in a 401(k).

Russell Cesari, a wealth manager in Herndon, Va., works frequently with government professionals. He always brings up the option of funding a pension as a consultant. "If they leave government service at 60, they might consult for three to 10 years. It's a limited opportunity to put away the extra money," he says.

* **Couple, business partners.** In this scenario, the husband is 60 and the wife 58, and they each earn \$245,000 and plan to retire in five years. They could contribute \$365,300 to their pension, and \$438,700 if they have a 401(k) as well. The combined tax savings, at a 38% rate, come to \$305,500. After five years, they'd have a \$2.26 million kitty that they could roll into an IRA. (A parent-child team will do better with a cash balance plan that will even out the benefit.)

* **Self-employed spouse.** If she earns \$100,000 after self-employment taxes, a 60-year-old could sock away \$80,000 this year and in five years fund a \$45,000 yearly benefit.

* **Business with young staff.** If a wealthy owner employs much younger employees with relatively low compensation, a traditional pension can make more sense than a cash balance plan, which has to be redesigned if someone leaves. Defined-benefit plans will be "a growth area because of the growing discrepancy between the income of owners and employees," says Pavlos Panagopoulos, a financial planner with Financial Network Investment Corp. and Bar Financial in New Mexico.

OVERCOMING OBJECTIONS

Cesari's clients are typically entering the private sector for the first time when they begin consulting, and they may be nervous about cash flow or their commitment to the new business. "You have to really understand the client and what the future income stream will be from his or her business," Cesari says. "Let's say somebody could put in \$200,000. He or she might be more comfortable starting at \$100,000." In a good year, the client might be able to contribute \$130,000; then less the next year. In a pinch, Cesari says, "we can take money from a non-retirement account to fund it."

If a client is anxious about cash flow in the first year, Shapiro suggests spreading out the steps. You might establish the plan at the end of one year and set the contribution amount in the first quarter of the next. Your client can contribute when filing taxes with extensions in the fourth quarter. In a cash crunch, it's possible to take a loan of up to half of the balance, up to a maximum of \$50,000.

AN EMPLOYEE BENEFIT

While the tax-savings may be the biggest draw, it's still true that a pension plan is a sterling benefit that attracts and keeps the best staff. That advantage will grow more powerful as Americans face the need to support themselves into old age.

With \$250 million in assets under management, Panagopoulos and his wife, Vicki, now employ six people they want to keep. That's one reason they expect to start a pension in a few years. "I may have no choice because my income is rising," he says. "And it'll be a golden handcuff for my staff."

Committing to large annual contributions may sound scary or pie-in-the-sky, but Bove disagrees: "A lot of people can actually afford to make this commitment if they aren't living over their means." And the timing may be right as baby boomers get serious about saving.

