

Physician Group 401(k)s

WHY IT'S TIME TO REVIEW
YOUR GROUP 401(k) PLAN

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Taking stock of the goals and performance of their retirement plans can help physicians save more than they imagine.

By Joe Bonnett, CFP®, ChFC®, Bonnett Wealth Management

An article published in Forbes, December 8, 2008, reported on a financial advisory firm who was hired to manage a physician group's retirement fund. He had been instructed to pursue the goal of capital preservation, yet in 2008 the plan's account balances plunged in value. One physician's account, which started the year at \$650,000, dropped to \$440,000 by November. Understandably, the group sought a new advisory firm.

"Some think 401(k) plans are a failed experiment," says Darrin Gessert, Vice President at Benefit Plans, Inc., an Omaha independent, third-party retirement plan administrator. "Most service providers believe that 401(k) plans simply need tweaking. They can be a boon to retirement savers, provided everyone has patience."

CHANGING TIMES

The October 9, 2009 cover-story in Time says, "Why it's time to retire the 401(k)." While that language made for a nifty, eye-catching headline, the truth is tax-deferred 401(k) plans in themselves are not the problem. They're merely one way the government encourages workers to save. The problem lies in how these plans are designed and thereafter managed and reviewed. A physician group's retirement plan should keep in stride with changing times.

"Market volatility and new regulatory requirements are having an impact on the medical industry," says Gessert, a Qualified 401(k) Administrator and Qualified Pension Administrator. "Market volatility has encouraged employers to seek out ways to cut costs, including freezing or terminating their current defined benefit plans. The speculation surrounding health care reform is also lending to the uncertainty." What do physician groups need to consider at this time?

1. Tax laws will be changing. Unfortunately for most physicians, taxes will be heading higher in 2011, when the tax rate for the top income bracket will jump from 35% to 39.5%. Capital gains taxes will rise from 15% to 20%. And beginning in 2011, dividend income will be treated as ordinary income and taxed at the highest marginal tax rate. (Source: Turbo Tax "Summary of Federal Tax Law Changes for 2009 – 2017.")

Thus, now may be a good time for physician groups to supplement their existing 401(k) with a cash balance plan. There are two general types of pension plans – defined benefit plans and defined contribution plans. In general, defined benefit plans provide a

specific benefit at retirement for each eligible employee, while defined contribution plans specify the amount of contributions to be made by the employer towards an employee's retirement account. A cash balance plan is a defined benefit plan that specifies both the contribution to be credited to each participant and the investment earnings to be credited on those contributions. Each participant has an account that resembles those in a 401(k) or profit sharing plan.

2. Maximize retirement plan contributions. Cash balance plans favor owners and key employees by giving them greater tax-deferred options. They work well when high-earning owners and employees are advanced in age, allowing them to increase the amount of money they can sock away. While contributions to cash balance plans are not discretionary like profit sharing plans, they can be ideal for many medical practices when combined with a 401(k) plan. Contributions to cash balance plans are calculated based on the ages, compensations and classes of employees in a group. According to Kravitz, Inc., a large cash balance plan administrator, EGTRRA, enacted in 2001, permits professionals like lawyers, physicians and business owners to dramatically increase their tax-deductible contributions, sometimes over \$100,000 per year for an employee over fifty and \$200,000 for an employee over sixty. The Pension Protection Act of 2006 further cemented the future of cash balance plans by allowing for substantial increases in contributions and tax savings. The employer decides the percent of contribution for each employee.

3. Amendments to retirement plans are due soon. According to section 1107 of the Pension Protection Act of 2006 (PPA), the

deadline for calendar-year plans to adopt required amendments is December 31, 2009. Non-calendar year plans have until the last day of the first plan year beginning on or after January 1, 2009. The amendments call for adding language about rollovers to Roth IRAs, rollovers by non-spouse beneficiaries and accelerated vesting for non-elective employer contributions.

Per the IRS.gov article, "Recent Guidance That May Require Interim or Discretionary Amendments," defined benefit plans must be updated to reflect the Qualified Optional Survivor Annuity, new funding-based limits on benefits and updates to the Qualified Domestic Relations Order Procedures and Special Tax Notice. In addition, physician groups must amend their plans to reflect the Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART), which affects participants who die while performing qualified military service. This summary of understanding is not exhaustive, is subject to change and is not intended to be tax or legal advice. Please work with your plan fiduciary to determine what amendments are applicable to your situation.

A GOOD IDEA

Beyond the new tax laws and required amendments, physician groups want to make sure that their retirement plans are working. A good plan can accommodate change in employee demographics, the ups and downs of business cycles and the contribution objectives of practice owners. In short, a good plan is flexible.

This is where an Investment Policy Statement (IPS) can help. While not required by law, the Department of Labor (DOL Interpretive

Bulletin 94-2) and “Does ERISA Require an IPS?” by Fred Reish and Joe Faucher has stated that the adoption and maintenance of an IPS is a good idea. The purpose of an IPS is to state the conditions under which investment alternatives will be monitored, added and changed. The IPS describes the long-term investment objectives of the retirement plan, establishes investment principles for the plan and creates guidelines for evaluating investment decisions. It acts as both a blueprint and a scorecard.

Regardless of negative press, retirement plans are still a great way for physicians to save, reduce their taxes and potentially offer creditor protection. Qualified plan assets are protected from creditors in the event of bankruptcy. The anti-alienation provision of ERISA states that “each pension plan shall provide that benefits provided under the plan may not be assigned or alienated.” This means that the assets in a qualified plan are not available to creditors.

“The 401(k) plan and other retirement plans may worry and disappoint some companies and policy makers,” Gessert says, “but progress and transformation are on the way to making them the vehicles of the future for savers.”

ABOUT THE AUTHOR

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