

HOW TO BOOST DEDUCTIONS WITH A CASH BALANCE PLAN



This form of qualified retirement plan can increase savings while lowering taxable income.

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As advisors to physicians and medical practices for more than 25 years, we have found that the leading short-term financial planning goal for most physicians in private practice is to reduce their income taxes. This is not surprising because everyone wants to reduce their taxes, especially with taxes likely to rise. In addition, exerting control over tax planning options is one of the reasons retina specialists want to remain in private practice and resist W-2 employment with larger employers.

The cash balance plan (CBP) is a qualified retirement plan (QRP) that can provide physicians with a way to increase tax deductions and boost retirement savings. A CBP is a powerful tax planning tool, and one that many private practices may want to consider. Let's explore how they work.

BENEFITS FOR PHYSICIAN PRACTICE OWNERS

There are four compelling reasons why physicians in private practice are interested in CBPs:

Increased deductions. While 401(k) plans are subject to a 2021 maximum contribution limit of \$19,500, and profit-sharing plans have a contribution limit of \$58,000, properly structured CBPs allow tax-deductible contributions of \$200,000 or more.

Benefits outweigh costs. CBPs have higher administrative costs and, typically, higher employer contributions compared with 401(k)s or profit-sharing plans. The tax savings for physicians, however, typically dwarf these expenses, making CBPs extremely attractive for many medical practices.

More than one deduction. For physicians whose income puts them above the tax code's qualified business income (QBI) threshold limits, a CBP can be a tool to reduce taxable income enough to qualify for the QBI deduction, creating one deduction that leads to a second deduction.

Top asset protection. As an exempt asset under federal law and most state laws, ERISA-qualified QRPs are protected

at the highest (+5) level. Unless a CBP is put in place for one owner with no employees, the ERISA protection will usually also apply to the CBP.

PLAN BASICS

In a CBP, a participating employee will have access to a specified sum upon retirement. To get to \$100,000 at retirement, for example, the plan assumes a combination of employer contributions and compound interest over time. When the employee retires, he or she can take the \$100,000 either as a lump sum or as an annuity that pays a portion of the \$100,000 in periodic payments. Each participant's account grows annually in two ways:

Benefit credit. This is a percentage of pay or a flat dollar amount that is specified in the plan document. The credit is often class-based so that higher dollar or percentage amounts accrue to owners or partners and lower dollar or percentage amounts to staff members. This, as one would expect, makes the CBP ideally suited for medical practices—the physicians or partners can be a separate class.

Interest credit. This guaranteed rate of return specified in the plan document is typically tied to federal long-term interest rates or set at a fixed rate around 5%. The interest credit is not dependent on the plan's actual investment performance, but the investment portfolio should be structured to perform in line with the anticipated crediting rate.

401(k) SIMILARITIES AND DIFFERENCES

A CBP is similar to a 401(k) or other QRP in many respects, including rules on employee eligibility, nondiscrimination regulations, timing of deductible contributions, roll over eligibility, and early withdrawal penalties.

However, a CBP is also different from a 401(k) in several ways. With a 401(k), an employee makes contributions to the retirement plan. The employer sponsoring the 401(k)

may or may not make matching or profit-sharing contributions. The amount that the employee will have in retirement is not defined. Instead, the employee's retirement benefits depend on the performance of their funds in the plan.

With a CBP, by contrast, the amount of money an employee can expect in retirement is defined. (That's what makes it a defined benefit plan.) The employer, not the employee, bears the risk of market fluctuations. Also, participation in a CBP does not depend on employees contributing part of their compensation to the plan—contributions by employees are not permitted.

The costs of a CBP are certainly greater than for a 401(k) or profit-sharing plan. This is because the CBP's funding must be certified by an actuary each year. However, the tax benefits of the CBP often significantly exceed the additional cost. The costs and tax benefits can be modeled on a case-by-case basis before any new plan is implemented.

MANAGING BOTH TYPES OF PLANS

CBPs and 401(k)s are not mutually exclusive. A medical practice can typically use both types of plans simultaneously. In fact, because so many medical practices already have 401(k) plans in place, physician owners often consider layering in a CBP on top of their existing 401(k).

IDEAL PRACTICES

In general, any medical practice with the necessary cash flow whose physician owners are looking for a retirement tool that provides greater deductible contributions is a good candidate for a CBP. Because it is not difficult to model CBP economics for a medical practice, it makes sense for most practices to explore what the financial model shows.

There are a few situations in which a CBP goes from a home run to a grand slam: practices with older physicians and younger staff; those with reasonable ratios of physicians to employees; and physicians with outside business income from moonlighting, speaking, or working with industry.

TWO DEDUCTIONS FOR THE PRICE OF ONE

In December 2017, the Tax Cuts and Jobs Act created a possible 20% deduction on QBI. Income limitations may preclude many retina specialists from meeting the criteria. A CBP can help to reduce taxable income enough to qualify for the QBI deduction. That is, a CBP can create one deduction that leads to a second deduction.

As an example, consider a solo ophthalmologist with a taxable income above the QBI threshold. This year, he creates a CBP, allowing a contribution of \$210,000, which is deductible from the practice's taxable income. The reduced taxable income for the practice could reduce the physician's personal taxable income below the threshold amount, so that the ophthalmologist could take the 20% QBI deduction on his individual tax return.

CONCLUSION

CBPs are powerful planning tools that allow larger contributions than most plans. CBPs may be attractive to practice owners who are looking for larger tax deductions, asset protection, and superior retirement income. ■

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