ATTORNEY RETIREMENT PLANS—Do You Need More Than a 401(k)?

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Unfortunately, attorneys, like many other individuals, have witnessed their retirement plans shrink over the past year. The remaining monies left may hardly be enough to fund their retirement. Certain attorneys may have to work longer before they are able to retire.

One of the barriers to quickly replacing the lost funds is that simple 401(k) plan participants can contribute only $11,500 in 2010. A qualified profit sharing plan allows a maximum contribution of $49,000 in 2010. If the qualified profit sharing plan includes a 401(k) plan, an elective deferral of $16,500 towards a 401(k) can be made as part of the qualified profit sharing plan contribution limits. If you're more than fifty years of age, participants can make "catch-up" contributions of an additional $5,500 in 2010. However, once the annual maximum contribution has been reached, then no further contributions can be made for that participant on a pretax basis.

That low annual contribution is hardly enough to restore retirement plans quickly to their previous levels. Another plan, the cash balance plan, allows pretax contributions of up to $220,000 in 2010, depending upon the participant's age.

A cash balance plan designates two annual amounts for the participant: the first is the contribution amount, which can be a flat dollar amount or a percent-age of pay; and the second is the interest rate based on those contributions, which is not dependent on the plan's investment performance. The rate of return changes each year as a floating benchmark and for many plans is equal to the yield on the thirty-year treasury bond, which in recent years has been around 4.5 percent.

Each participant has an account, similar to a 401(k) or profit sharing plan account. Once participants terminate employment, they are eligible to receive the vested portion of their account balance, which is determined by the plan's vesting schedule. The plan actuary maintains the accounts and generates annual statements for the participants.

The types of businesses for which cash balance plans are best include professional service businesses such as law practices, medical groups, and CPA firms where there are a number of shareholders/partners who are at their 401(k) and profit sharing contribution limits. Companies have implemented approximately 5,500 cash balance plans nationwide with about 9 percent of those plans installed in law firms.

Law practices that are good candidates for cash balance plans have one or more of the following characteristics: The firm's shareholders/partners desire to contribute more than the $49,000 per year allowed by a 401(k)/profit sharing plan. Those who have seen their retirement plan assets decline may want to make up the losses quickly. Also, those who may have neglected their personal pension plans while they were building their law practices may need to catch up on their retirement savings. A cash balance plan allows for both an acceleration of savings and a large tax deduction.

Other ideal candidates are law practices that are already contributing 3 percent or more to employees' retirement accounts or are at least willing to do so. While cash balance plans are often established for the benefit of shareholders/partners, employees also benefit. Such plans normally provide a minimum contribution of 5 to 7 percent of pay for the firm's staff.

Law practices that have demonstrated consistent profit patterns are well suited for cash balance plans. Because a cash balance plan is a defined benefit plan with required contributions, a consistent cash flow and profit are important.

If the annual contributions must change, the cash balance plan has to be amended. Although law practices can designate different contribution amounts for various participants, the frequency of amendments to change benefits may be restricted if a business reason is not valid.

One of the most attractive benefits of the cash balance plan is the tax advantage. Contributions are not taxed when they go into the plan. Interest on the investment is not taxed as it is earned, so the investment grows tax-deferred. Only when a distribution is made is the money taxed, which gives groups a substantial tax benefit.

This planning must be reviewed with your tax and financial advisors to ensure it is the right match for your practice, but for law firms with shareholders/partners who are interested in increasing their pretax contributions to pension plans, the cash balance plan may be an excellent vehicle.

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