

Retirement Planning

Small business owners should rethink their plans for their own benefits.

The Omnibus Budget Reconciliation Act of 1993 reduced the maximum annual compensation that can be considered for purposes of computing benefits, contributions and discrimination testing to \$150,000. Previously, it had been \$235,840. This is effective for plan years beginning on or after Jan. 1, 1994. It preserves — but freezes — previously accrued higher benefits, and the limit will be indexed for inflation in

same cost structure.

"It gets worse if you look at investments where you've got a compounding effect attributable to the lost earnings," Fragasso says.

If the employer jumps to a defined contribution plan, which defines the contribution as opposed to defining a benefit, he or she takes the same percentage of payroll for everyone. The most common forms of defined contributions, by the way, are profit-sharing and 401(k) plans.

Most plans do not integrate social security; employers, however, are already contributing to it.

increments of \$10,000.

All qualified retirement plans are subject to the new compensation limit.

"It throws out over 10 years of inflation," says Robert Fragasso, senior vice president at Smith Barney Shearson.

Let's view this from the perspective of a small business owner — an entrepreneur who heads a small company or a dentist overseeing a staff of six. Basically, there are two kinds of retirement plans — defined benefits and defined contributions. Assume the owner makes \$300,000 a year and is the sole plan participant who exceeds the \$150,000 limit.

If a defined benefits program is selected, the contributions toward the employees' benefits remains the same, but the owner's are cut substantially.

This program is determined by a funding formula based on salary. Therefore, the owner is funded at a lower benefit structure while keeping the

In either scenario, the owner is at a disadvantage. He or she takes the monetary risks but has the same overhead, and contributions to his or her own account will be cut from 25% to 40%, depending on the formula.

Bill Winschel, a partner at law firm Wirtz & Reagle and a CPA, believes that many small business owners have yet to address the impact of the new law. He also thinks that when they do, the lower limit will prompt some business owners to drop retirement plans altogether.

"If you go back 10 years, there were some law changes that significantly increased [instances of] small businesses terminating defined benefit plans and going almost exclusively with defined contribution plans," he says. "The new compensation limit, which applies to both, certainly will not result in companies turning back to defined benefit plans. They will either stay with

defined contribution plans or, in a lot of cases, I suspect companies will terminate their qualified plans altogether and do nothing."

"I really don't see that happening," says Sue Waeltermann, associate vice president at Beaconsfield Financial Services. "Qualified plans serve more than the one purpose of setting aside an employer's profits, pretax. Qualified plans are a big factor in assisting the reduction of employee turnover."

There are other alternatives:

- All business owners should examine their retirement plans — using a census of employees and going to professional advisors, attorneys and accountants — to make sure they are using the proper format or to revise the current plan's configuration or to use a composite of plans.

Depending on the type of plan the owner has, if he is doing a salary-reduction simplified employee pension, he needs to change it to include a paired money purchase and profit-sharing plan, which will basically double his capabilities. Once he hits the cap, there's not much he can do.

- They might also make up for the shortfall by looking to alternative sources of income to put on auxiliary plans. For example, an attorney in a professional corporation makes

\$400,000, of which less than half is now covered by his company's retirement plan. But he also teaches, so he can set up another retirement plan for this second source of income.

- Also, says Fragasso, all plans should be relooked with an eye toward adding social security benefits. "Most plans



Robert Fragasso, senior vice president at Smith Barney Shearson

do not integrate social security," he says, adding that employers are already contributing to it anyway.

"Basically," says Waeltermann, "that reduces the company's cost of the contributions. Sometimes it can be a substantial reduction in the company's costs while preserving the tax contribution."

Waeltermann offers yet another strategy for the business owner. "Go ahead, take the tax cuts, get into tax-exempt securities." ■