RIA Advice

Is it possible to get both 6-figure tax deductions and asset protection? It is common for business owners who are late in their careers to start thinking about increasing their savings outside of their business, which makes perfect sense.

Having your savings tied up in your business is like holding a concentrated position in venture capital or private equity. ***It is incredibly risky.***

On top of that, having your financial capital and human capital linked to the same venture can be potentially disastrous in the event of a significant adverse event like a pandemic, a congressional bill, or litigation.

Background

I recently sat down with a new RIA Advisors client and took them through our discovery process of figuring out what precisely they were looking to do in sponsoring a company retirement plan.

This client happened to be a physician who was about 70 years of age, had nine other employees, and was looking to work for another year. In his mind, he was looking to accelerate retirement savings over that 10-year time horizon and protect his own assets. As a physician, it is not uncommon to face real litigation risk in being accused of malpractice.

Further, he was looking to sell his business to an outsider at the end of the 10-year time horizon.

As a C-Corporation, two different employer-sponsored plans made the most sense:

1. Safe Harbor 401(k)/Profit-Sharing Plan
2. Cash Balance Plan

We ruled out a non-qualified deferred compensation plan, given that assets within this plan are not protected. We also ruled out an ESOP plan, given that he was looking to sell his business to an outsider and not from within the company.

The Design

For a physician who also had his wife and daughter on staff and six other non-highly compensated staff members, the initial thought was to do a combination plan of both a Safe Harbor 401(k)/Profit Sharing Plan and a Cash Balance Plan. This combo plan would allow him to save the most tax-deferred monies and maintain asset protection under the Employee Retirement Income Security Act of 1974 (ERISA).

Given the nature of the plan design, I would typically recommend an "unbundled" plan that uses two different parties for third-party administration and recordkeeping. When doing actuary work (for the cash balance plan), you want to make sure you are working with the very best who do complex plan designs regularly.

The Results

Below is a graph showing overall contributions for Year 1, the percentage of employer contributions going to my client and his family. There are 5 "buckets" of contributions going into the plan. First, we have deferrals and catch-up contributions taken out of each participant's (including owners) paychecks. Second, we have safe harbor contributions of 3% of compensation, profit-sharing contributions, and cash balance plan contributions made by the employer on behalf of each participant (including owners).

Name	Compensation	Deferral	Safe Harbor	Catch-Up	Profit Sharing	Cash Balance Plan	Total
Owner	$290,000	$19,500	$8,700	$6,500	$12,325	$333,475	$380,500
Spouse	$105,000	$19,500	$3,150	$6,500	$0	$49,500	$78,650
Child	$55,200	$19,500	$1,656	$0	$0	$10,500	$31,656
Total Owners	**$450,200**	**$58,500**	**$13,506**	**$13,000**	**$12,325**	**$393,475**	**$490,806**
Employee #1	$36,000	$0	$1,080	$0	$1,620	$0	$2,700
Employee #2	$32,600	$0	$978	$0	$1467	$0	$2,445
Employee #3	$18,300	$0	$549	$0	$549	$0	$1,098
Total Non-Owners	**$86,900**	**$0**	**$2,607**	**$0**	**$3,636**	**$0**	**$6,243**
Grand Totals	**$537,100**	**$58,500**	**$16,113**	**$13,000**	**$15,961**	**$393,475**	**$497,049**
Owner %		**100%**	**83.82%**		**77.22%**	**100.00%**	**98.74%**

As you can see in the table, my client's household is saving close to half a million dollars per year for the next ten years, creating tax savings of somewhere between $100K to $200K per year. Further, we can attach vesting schedules for six years for profit sharing allocations and three years for cash balance allocations made to the employees.

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Cost to Implement

There are real costs involved in setting up, maintaining, and servicing an employer-sponsored plan, especially if actuarial calculations are required. But I always like to remind my clients that these costs are nowhere near the savings in taxes that we create year-over-year by implementing these plans.

My philosophy on service provider selection is that Third Party Administrators and Recordkeepers should always be as flat fee as possible. Their job doesn't get more complicated as assets grow.

Their job requirements increase slightly as more participants join the plan, so they should be charging for their services accordingly. On the other hand, providers like RIA Advisors, who serve as the investment fiduciary and asset managers that manage the mutual funds in the plan, should have compensation tied to assets. The better we do our job, the better our participants will do. In other words, our goals are in alignment with compensation.

Here were the costs associated with this specific's plan implementation:

Service Provider	Annual Fee
One-Time Start-Up Costs	$3,100
Third Party Administration	$5,760
Recordkeeping Fees	$1,810
Plan Advisory & 3(38) Investment Fiduciary Services	0.70%
Mutual Fund Expenses	0.20%

Tax-Deductibility

As a reminder, any expenses paid by the plan sponsor are tax-deductible. In this case, the plan sponsor would be covering all costs except for the Plan Advisory and Mutual Fund Expenses. As a small business, this client also qualifies for the Retirement Plan Start-Up Cost Tax Credit of $500 per year for the first three years of the plan's existence. Assuming a 21% effective tax rate as a C-Corp, here are what net costs look like for the plan:

Item	Amount
First Year Annual Fees	$10,670
Tax Savings (21%)	($2,240)
After-Tax Cost of Plan	$8,430
Tax Credit	($500)
Total After-Tax Cost in Year 1	$7,930

In summary, we created a tax savings windfall of approximately $100K per year for a cost of $7,930 in Year 1 and $5,480 after that with an estimated $7 million in federally protected assets after 10-years.

Seems like a good deal to me!

If you are interested in learning how RIA Retirement can assist your business and retirement needs, you can schedule a complimentary discovery call here: https://realinvestmentadvice.com/connect-now.