In addition to the employee deferral, the practice must make an employer contribution each year. This contribution goes into the dentist’s accounts as well as those of the other employees. The employer contribution must be either 2% of salary or a dollar-for-dollar match on the first 3% of the salary the employee elects to defer. (This 3% match can be reduced to 1% in two out of five years and would enable a practice to decrease its obligation to fund the retirement plan if times were lean.) Therefore a 40-year-old dentist earning $160,000 could save $12,800 in a SIMPLE plan in 2002. If the dental practice employs the dentist’s spouse, an amount can be added for the spouse as well. Not bad, but we can do better.

**SEP IRAs**
(Simplified Employee Pension)
SEP plans are not considered qualified plans under ERISA law. Structurally they are IRAs, but with certain features of a qualified plan. Like SIMPLE plans, they are easy to implement and operate because they essentially involve establishing IRA accounts for each eligible employee.

A SEP allows dentists to defer up to 25% of income, to a maximum of $40,000. Our dentist making $150,000 can defer $37,500 into his or her SEP and avoid income taxes on this amount. This yearly contribution is not mandatory, so each year the dentists can decide what the percentage of income to be contributed to the SEP will be.

There are significant drawbacks to SEP plans that make them somewhat unpalatable for dental practices that have employees. The main drawback is that the practice must contribute the same percentage of pay for the employees as it does for the dentists. That is, if the dentists want to make the maximum contribution of 25% of income to their SEP accounts, they must put in 25% of income for each of the employees. In most practices this can be quite burdensome. For practices looking to allow the dentists to defer up to $40,000 without having to put exorbitant amounts in for the other staff, a 401(k) Profit Sharing Plan might make sense.

**401(k) Profit Sharing Plan**
The 401(k) portion allows employees to defer up to $12,000 this year; $14,000 if they are 50 or over. This number will go up by $1,000 per year for the next three years, so that in 2006 it will be $15,000-$20,000 for those 50 and over.

In addition to the amount that individuals can defer for themselves, the practice can make contributions as well. This can allow a dentist earning $160,000 to put aside $40,000 per year into his or her retirement plan. In order to do this, the practice will have to make contributions for all the employees. But unlike an SEP plan, a higher percentage of income can be contributed for the dentists as long as rules are followed that are designed to prevent discrimination against employees who are not highly compensated.
Plan designs include age-weighted plans, cross-tested plans, and new comparability plans.

In addition to which plan design is used, the amounts that the practice can contribute for dentists relative to other employees will depend to some degree on the ages of the dentists and other employees and the incomes of the dentists and other employees, as well as other factors.

Again, good plan design can help address the needs of the practice. In some cases, this might mean getting the greatest amount of money to the dentists and one or two other valued employees while minimizing amounts being paid other employees. In other groups the focus may be on recruitment and retention of staff.

The illustration below shows what a practice might have to contribute in order to allow the dentists to be able to defer the maximum allowed.

In this example, there are four dentists, each a 25% owner of the practice. They are earning between $180,000 and $200,000. Their practice manager earns $80,000, and there are five other employees who qualify to participate in the 401(k). The dentists each defer the maximum allowed to the 401(k): $12,000 per year. (Two dentists over age 50 also contribute the extra $2,000 catch-up amount.) The practice contributes $28,000 per dentist, allowing each dentist to reach the $40,000 ($42,000 for the two over age 50) allowed by law. For this amount to be contributed for the dentist/owners, the practice must contribute the amounts shown for the employees in the column headed "employer contribution". There this practice would contribute $16,457 for the employees so that the dentist owners could maximize their pre-tax savings. This contribution is a tax deductible expense for the clinic.

As most dentists in Minnesota are in a tax bracket close to 50%, the ability to defer $40,000 of income free of taxes is a significant benefit.

401(k) plans are more complicated and more expensive to administer than the SIMPLE or SEP plans outlined above. The requirements include the annual filing of Form 5500 with the IRS, fiduciary obligations to review the performance of the investments offered to participants, making sure employees receive notification and education on the plan, and so forth.

Another feature that is available since the passage of the EGTRRA law is the advantage of employing a spouse in your practice. If your spouse earns $12,000 this year working in your practice, he or she can have 100% of this income go into the 401(k). If there is a profit-sharing feature, then even more of the spouse's compensation can go into the plan tax-free.

For practices currently without a retirement plan, the 2001 EGTRRA tax law allows tax credits for a new plan. For the next two years, the law allows a tax credit of $500/year for the expenses of setting up a new plan. That is a credit — a dollar for dollar offset on taxes — not simply a deduction.

**Defined Benefit Plan**

When people think of retirement plans, they usually think of defined contribution plans such as 401(k) plans, SEPs, SIMPLEs, etc. In these plans, what is defined is the annual contribution that the employer makes, say 3% of salary. Dentists often overlook defined benefit plans. These plans are somewhat more complicated, in part because they require the services of an actuary. In these plans, what is defined is a projected payout in retirement. The plan is then funded to the extent needed to meet this future obligation, which might be an annual payout of $150,000.
Defined benefit plans were more in vogue in the past and fell out of favor because of tax law changes. The recent changes contained in EGTRRA have again made these great vehicles in certain situations. Roughly speaking, if the dentists in the practice are 45 or older and are looking to contribute more than the $40,000 allowed under defined contribution plans, think defined benefit. It may allow tax deductible contributions to the retirement plan of more than $100,000 per year. These plans work best the older the dentists and the younger the other employees. As an example, above is a scenario of 55-year-old orthodontist with five staff members.

<table>
<thead>
<tr>
<th>Employees</th>
<th>Age</th>
<th>Compensation</th>
<th>Contribution</th>
</tr>
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<tbody>
<tr>
<td>Orthodontist/Owner</td>
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<td>$200,000</td>
<td>$120,000</td>
</tr>
<tr>
<td>Staff</td>
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<td>$40,000</td>
<td>$4,400</td>
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<tr>
<td>Staff</td>
<td>50</td>
<td>$30,000</td>
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<tr>
<td>Staff</td>
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<tr>
<td>Staff</td>
<td>21</td>
<td>$20,000</td>
<td>$2,200</td>
</tr>
<tr>
<td>Total Staff Contributions</td>
<td></td>
<td>$14,850</td>
<td></td>
</tr>
</tbody>
</table>

There are drawbacks to a defined benefit plan.

Defined benefit plans were more in vogue in the past and fell out of favor because of tax law changes. The recent changes contained in EGTRRA have again made these great vehicles in certain situations. Roughly speaking, if the dentists in the practice are 45 or older and are looking to contribute more than the $40,000 allowed under defined contribution plans, think defined benefit. It may allow tax deductible contributions to the retirement plan of more than $100,000 per year. These plans work best the older the dentists and the younger the other employees. As an example, above is a scenario of 55-year-old orthodontist with five staff members.

There are drawbacks to a defined benefit plan. One is that the contribution must be made to the plan each year. For practices that have uneven cash flow and profitability, this might be a hardship. Another drawback is the greater administrative complexity and expense. But for those looking to shelter income from current taxation, defined benefit plans can be an elegant solution.

Conclusion
Retirement plans for dental practices is a broad topic. I have attempted to highlight some of the things that dentists should be aware of as they establish or review their practices’ retirement plans. The right plan for a practice needs to take into account many factors, and it is best to involve a team of independent specialists in retirement plan design and implementation. Making smart choices about retirement plans can help dentists enjoy the financial success they deserve.

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