GETTING PERSONAL: Setting Up Pensions For Small Businesses

By Tara Siegel Bernard

NEW YORK (Dow Jones)--Yashodhara Kirtane, a 47-year-old internist with a practice on Long Island, would eventually like to retire to Manhattan with her cardiologist husband, where she can stay young by volunteering, taking some art history classes, and perhaps teaching young medical students.

Kirtane was saving for her retirement using a SEP-IRA, which allows you to stow away up to 25% of your income. However, her financial advisor recommended that she start more aggressively funding her golden years using a defined-benefit pension plan, which in her case allows her to put away nearly double than what she was saving before. "I am saving on my taxes, plus I'm saving much more," she added.

The mother of three children was an ideal candidate for a defined-benefit plan, which provides participants with a fixed, pre-established stream of income after retirement. She's in her mid-forties, owns her own business, employs only two part-time staffers and has established a practice where she can simply afford to fund such a plan.

Indeed, the popularity of pension plans has dwindled as much of corporate America phased them out given their high costs. However, financial planners say they are a viable option for certain individuals, notably the self-employed or small business owners with few full-time employees, who are typically upwards of about 45 years old and who earn a high, predictable, and steady stream of income.

"From what I hear from other professionals, I think there is a resurging interest, particularly with the graying and approaching of retirement of the baby boomers, in the concept of a defined benefit plan for funding retirement and deferring taxes," said Doug Adams, a certified financial planner and accountant in the Annandale, Va., office of Fiducial, a business-consulting and financial-planning firm.

Contributions in defined-benefit plans are computed by actuaries as the amount necessary to provide the benefit. The maximum annual contribution employers can make is one that would be projected to yield a benefit equal to the lesser of $165,000 for 2004, or 100% of the participant's average compensation for the three highest consecutive years. Comparatively speaking, the SEP-IRA allows companies to contribute an amount equal to 25% of an employee's income, with a cap of $41,000, the IRS says.

Pensions are especially attractive if you run a business few or no workers - or a relatively young staff or one that turns over frequently - since you cut down on the contributions that must be made on their behalf. If you have part-time workers who log fewer than 1,000 hours annually, they do not have to be included in the plan, pension experts said.

"The window of opportunity in pension planning is wide open for business owners right now, and they should absolutely be taking advantage of it," said Ian Weinberg, a certified financial planner and president of Family Wealth & Pension Management in Jericho, N.Y.

That opportunity is best suited for a variety of situations: business owners or professional practice partners who for years poured capital back into their business at the expense of their retirement accounts; husband-and-wife teams; or former executives-turned-consultants who earn a nice income from sitting on a couple of boards of publicly traded companies.

However, defined benefit plans aren't quite as simple to set up as other retirement packages. They're actually quite complex, and employers are obligated to meet the set funding requirements - calculated by actuaries - while the company (or, in this case, the business owners) also assume all investment-management risk. While contributions are tax-deductible, these plans are also a bit more expensive to set up and maintain than other plans. Costs ride on the complexity and number of people in the plan. However, setup fees can run you anywhere from $1,500 to several thousand dollars or more to set up and maintain.

That said, the costs should not outweigh the added benefits of being able to stash away and defer taxes on large amounts of money. "They are all very reasonable and deductible costs when you are talking about deferring six figures each year," Weinberg said. "Though I have seen many business owners shy away from the concept" because of the costs, he said.

If you're going to set up a defined benefit plan, be sure you can make at least a three-year commitment. "One other caveat is that we want to make sure they will continue to work as a self-employed person with high income for at least three years," said Sandra Bragar, a certified financial planner and accountant with Kochis Fitz, San Francisco, who often sets up plans for affluent self-employed individuals. "The IRS doesn't like it when people set up a defined benefit plan for just a year."

Also, be sure you seek out seasoned experts in setting up pension plans. They can be customized and come in different flavors and you want to be sure you are maximizing the benefits you are allowed. "Defined benefit plans are very flexible, but you have to design them around your situation," said Lorraine Dorsa, an actuary and president of Dorsa Consulting, a pension design and consulting firm in Jacksonville, Fla.

Typically, a good accountant or financial planner should be able to identify if you're a good candidate for a pension plan. It's advisable to work with an attorney well-versed in the Employee Retirement Income Security Act of 1974, a law that covers pension plans. You'll also need to hire a third-party administrator/actuarial firm to set up and administer the plan, as well as someone to manage the assets.

"There are multiple planning scenarios and it needs to be done right," Weinberg cautions, "If you take the off the shelf advice...and don't engage an ERISA attorney, your document could be suspect or out of compliance."

(Tara Siegel Bernard is one of four Getting Personal columnists who write about personal-finance issues ranging from new tax proposals to education-funding strategies to estate planning.)