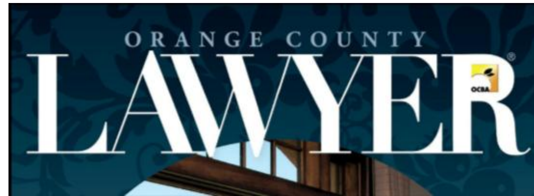

ONE MAJOR TAX BREAK IN THE LEGAL PROFESSION: QUALIFIED RETIREMENT PLANS

by BRADFORD L. HALL

Everyone hopes to have a high standard of living during retirement, but getting there poses a series of challenges. For lawyers, those challenges are unique to their profession, and a different approach to retirement planning is warranted.

Unlike other businesses that are built up and sold by the owners, law firms seldom sell. They tend to be very individual-based. Different from very large firms with large clientele, smaller firms simply close down or the junior attorneys (those attorneys with no real equity in the firm) assume the clients and set up their own shop.

The bottom line is that senior attorneys really need to focus on retirement by the time they are fifty, at the latest, and putting the maximum contribution into a 401(k) won't quite be enough. Ages fifty to sixty are the years in which those who risked it all need to take a significant portion of their allocable income and sock it away in a pension plan or other qualified retirement plan. Since contributions into a plan are tax deductible and investments are non-taxable while in the plan along with creditor protection, these are beneficial tax and financial incentives to consider when creating a plan for a law firm.

A cash balance pension plan provides the ability to specify and track different contribution amounts for different partners and allocate the respective contribution costs. It gives the option to go well beyond the $57,500 limit of a 401(k)/Profit Sharing plan; potentially having contributions in excess of $200,000, depending on a partner's age as he or she reaches retirement. One can exclude the attorneys who are not equity partners from the plan. Non-attorney staff and equity partners are covered in a cash balance plan. Contribution expense for non-attorney staff can run between 7% and 10% of payroll, which, in most cases, is a small cost to the firm. Basically, a law firm can legally discriminate in favor of the senior equity partners.

Consider this example: Kelley, a fifty-year-old business owner, is facing a combined tax rate of 52.9% plus the 3.8% investment income tax, totaling 56.7%. Kelley sets aside $70,000 per year to save for retirement. Without a qualified retirement plan, Kelley will be able to invest only about $33,000 after paying taxes. At 6% growth (also taxed each year), this will grow to about $595,000 by the time Kelley is sixty-five. If Kelley then begins to withdraw this at a fixed amount over the next twenty-five years, this will yield a little over $33,000 in annual after-tax cash flow that can be spent at Kelley's discretion.

Now, assume the same owner sets up a retirement plan with a $100,000 annual budget ($1,250 more per month after-tax dollars). Of this budget, $85,000 is deposited into Kelley's retirement account and the balance is used to cover other employees and pay expenses. By age sixty-five, Kelley's account will grow to just over $2 million. Again, withdrawing over twenty-five years and paying income taxes on the withdrawal each year at 49.9%, this provides about $74,000 annually in after-tax cash flow available to spend. This is almost 2.25 times the amount available to Kelley just using the after-tax savings.

The best advantage to a qualified retirement account is the ability to utilize tax deductions upon retirement. Many retirees have no income to offset their deductions, especially now with the low interest and dividend rates that conventional savings accounts offer. No longer can one count on having interest and dividends support one's lifestyle.

By contributing to a qualified retirement plan, even after paying $15,000 per year in expenses to cover other employees and meet IRS requirements, business owners can increase their retirement income by 224%. Additionally, by funding retirement accounts for the non-attorney staff, the firm will keep them engaged and provide stability, ultimately reducing the rate of support staff turnover.

In summary, setting up the right pension plan is critical to enabling law firm employees to retire. My hope and desire is that all those attorneys without a robust pension plan in place will take an incisive look at the many options available to their firms. It is the tax gift that gives back when you really need it most.

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