

Employee Benefits Plan Newsletter

Tax Advantages of Setting Up a One Person Pension Plan

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High income self-employed individuals or corporation owners can save thousands of dollars on income taxes every year by setting up their own pension plan. These plans allow taxes to be avoided on a substantial amount of income – in certain situations up to \$3.5 million over a working career – by exchanging pre-tax income into a qualified private pension plan.

Typical defined contribution plans, i.e., 401(k) and profit sharing, limit the tax deduction to approximately \$50,000 per year. Instead, a one person tax-deductible pension plan contribution can be much larger than the maximum 401(k) plan deduction. In certain situations, contribution amounts can reach up to \$200,000. In recent years, the cost of pension plan administration services has become more affordable, so these types of retirement plans have increased in popularity especially for one-person businesses.

Additional benefits include:

- Qualified pension plan assets are generally protected from creditors, and
- Offer the opportunity to pass wealth on to the next generation.

Participant Trends

While pension plans are available to any business, they are particularly popular with one-person or closed-end family businesses since all of the plan's cost is geared to the business owner's investment account. These plans have been found to be very popular with: doctors, dentists, attorneys, architects, and accountants.

A recent trend in the adoption and implementation of defined benefit plans has come from professionals in the health care industry, including physical therapists, optical professionals, and nurse anesthetists. Also, real estate related occupations, such as general contractors, designers, realtors and remodelers, are adopting such plans.

How-To Groundwork

Planning includes the following steps:

Step 1. Estimate the amount of the intended (sustainable) contribution

Determine profits, available cash flow, and desired retirement benefit. Decide how much can be annually contributed to the plan. These factors influence the contribution amount that can exceed \$100,000 but lesser contributions are still efficient from a tax, legal and administrative perspective. Actual data is needed to determine the exact contribution that is possible. Note that it is usually recommended to keep the plan open for at least 5 years.

Special circumstances:

- An S corporation can use all components of the net business income as potential pension contribution.
- For a C corporation, the maximum pension contribution may be a lower percentage than for a similarly situated S corporation since a C corporation pays a salary and the pension contribution separately.

Step 2. Choose options

Some options that are possible (but are not limited to) include:

1. Spousal income from the pension – Employers can decide whether they want a benefit for their lifetime or their and their spouse’s lifetime.
2. Determine retirement age – The employer can decide to retire as early as age 55. Typical retirement age is 65.
3. Determine how the plan will be funded.

Step 3. Gather data

The employer provides basic data such as date of birth, date of hire, compensation or distributions which is provided to the actuary to develop the amount of contribution and benefit that can be used. If there are employees, similar data needs to be provided for these employees.

Step 4. Sign Plan Documents and Open an Account

Once the employer is happy with the numbers and projections of benefits and contributions, the employer would then sign a plan document that would dictate all the plan rules and open an investment account to hold the plan’s money.

Timing

All the above steps need to be done before the end of the year. The actual contribution needs to be made before the tax forms are due. The plan document must be completed and signed before the end of the tax year.

Contact Us

If you would like more information about the benefits of setting up a one person pension plan, please contact Lou LiBrandi at llibrandi@pkfod.com or any member of your PKF O’Connor Davies team. Our Employee Benefit Services Group provides a full spectrum of compliance services for qualified and non-qualified benefit plans, as well as representation during IRS examinations.

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