

ARE YOUR PARTNERS REACHING THEIR LIMIT ON 401(K) CONTRIBUTIONS? — Cash Balance Plans — The Law Firms' Next 401(K) Plan

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At a number of law firms in the Los Angeles area, partners have reached their maximum contribution level for their 401(k) plans. While certain partners may be aware of this dilemma, others may not. Many may have no idea that there is a solution to this "maxed out" issue.

As the fastest-growing retirement plan in the United States, 401(k) plans are cash or deferred arrangements under which partners and eligible employees can elect to have a portion of their compensation (otherwise payable in cash) contributed to a qualified retirement plan as pre-tax reduction in salary. Employers have the discretion whether or not to make matching contributions to their employees' 401(k) accounts.

The maximum 401(k) plan contributions vary by the participant's age from \$15,500 to \$20,500 for 2007. For law firms interested in allowing partners to defer additional taxable income, a profit-sharing plan can provide another \$29,500. However, once the \$50,000 maximum contribution per participant has been reached for those 50 years of age and over and a \$45,000 maximum has been reached for those under 50 years of age, then 401(k)/profit sharing plan participants can no longer defer income or contribute to their retirement plans. At that point, the 401(k)/profit sharing plan is maxed out.

However, by adding a cash balance plan, partners can contribute as much as \$200,000 per year. A cash balance plan is a defined benefit plan that specifies the amount of contribution to be credited to each participant and credits investment earnings on those contributions. Each participant has an individual account which resembles the accounts in a 401(k)/profit sharing plan. All participant accounts are maintained by the plan's actuary who generates an annual statement for each participant.

The account grows annually in two ways. First, a firm contribution that is determined by a formula specified in the plan document. This formula can be a percentage of pay or a flat dollar amount. Second, the account grows with an annual interest credit. The rate of return is guaranteed and is not dependent on the plan's investment performance. The rate of return changes each year and is usually equal to the yield on the 30-year Treasury bond, which in recent years has been around 5%. Once participants terminate employment, they will be eligible to receive the vested portion of their account balance, which is determined by the plan's vesting schedule. Law firms typically make certain that partner accounts are 100% vested.

The advantage of the cash balance plan over the traditional defined benefit plan is that each partner or shareholder knows what is going into the plan on his or her behalf and what will come out upon leaving the firm. When partners reduce their compensation to contribute to a retirement plan, it is important that they know that when they leave the firm what they put into the plan, will come out (plus interest). For this reason, many law firms invest the plan's assets conservatively to minimize the possibility of investment losses. However, how the plan's assets are actually invested greatly depends on a law firm's particular situation and the partners' tolerance for risk. For example, a law firm may choose to invest a portion of the plan's assets in equities to achieve a higher rate of return.

If you answer "Yes" to one or more of the following questions, your law firm is a good candidate for a cash balance plan:

- Do you have partners who desire to contribute more than \$45,000 per year to a retirement plan?
- Has your firm demonstrated a relatively consistent profit pattern?
- Is your firm already contributing 3 to 4% to employees' plans or willing to do so?
- Do you have partners over 40 years of age who would like increased tax deferrals or wish to catch up on their retirement savings?

To determine an individual's maximum contribution to a cash balance plan, click on the link:

<http://www.lkravitz.com/cashbalance/yourmax2007.htm>

If your partners have reached the limit for maximum contributions into their 401(k) and/or profit sharing plan, you may want to suggest that your firm join the growing number of Los Angeles law firms that have added a cash balance plan where partners and eligible employees can increase contributions as well as defer taxable income.

About the Author: *Dan Kravitz is the president of Louis Kravitz & Associates, which has been designing and administering retirement plans, such as 401(k)s, profit sharing and cash balance plans, since 1977. He can be reached at dkravitz@lkravitz.com.*