Anjali:	00:00:07	Hi everyone. Thanks for tuning in to today's episode of Money Checkup where we take a deep dive into matters related to money, business and personal finance. I'm your host, Anjali Jariwala, CPA and Certified Financial Planner. My guest today is Neil shore. I'm really excited to have him here to talk through retirement plans for small businesses. Neil, welcome to the podcast.
Neil:	00:00:35	Thank you. Anjali. Very happy to be here.
Anjali:	00:00:38	So let's start with having you walk our listeners through your background and how you started your firm and where your areas of expertise are.
Neil:	00:00:47	Ah Shore Tompkins, it's been around for a 14 and a half years, so it's hard to believe we'd be celebrating our 50th anniversary of, uh, shortly.
New Speaker:	00:00:57	Congrats.
New Speaker:	00:00:58	Thank you. Part of starting Shore Tompkins. I ran RSM McGladrey's national actuarial practice for out of Chicago. And uh, back in 2004, I left the firm along with my partner Kathy Tompkins to start Shore Tompkins. I was running the national practice. Kathy was the, um, director of actual operations at McGladrey. So, uh, 2004, we started out, we are a, we did all of the processing, all of the marketing, all of the administration. I learned how to, uh, I've learned how to send out federal express packages and buying reports. Those were the days that we actually did vinyl it. Now we post reports on the portal. We, we, uh, we, we should, we designed it, administer retirement plans for other companies. So we started from scratch in 2000 hour service about 600 retirement plans and basically our practice is divided into kind of, I hate to say maybe two generally general types of retirement plans out there. One is we're out. The retirement plan is used as what we call an employee benefit plan. That's to attract, retain and reward employees like a large 401k plan or a, we are, people have had the opportunity to put, uh, put money into the plan, has the money grow, tax deferred. This is strictly for employees benefits and, uh, against the track retain and reward employees. And it's a way of providing employees tax effect that benefits will bill into a little later. On the other type of plans that we have, which I would say is the majority out of our practice or what we call wealth accumulation vehicles. We are, the plan is used as a tax savings vehicle for business owners. We are, if we could somehow quantify or associate the quantified, the value of the owner's grown tax firm, we put money in a retirement plan. You

get a tax deduction as all of the investment earnings is also not taxed until the money comes out of the play and a wrapped up in a rollover Ira many years later. So you kind of get a compounding effect. You have the fact that you're not used for the money you're putting into the plan is not being taxed. You have more money to invest. The more money they have to invest, the more investment return you're going to get. The investment return itself is not taxed. So not only are you getting a, you have more money to invest if you're getting higher interests or more return the return itself as a higher rate because that's not the tax in this compounding effect. Really the ultimate result is that when you ultimately retire, you have a lot more, a lot more wealth accumulation than if he's tried to invest outside of the plant who's got more money grow tax effectively for you. So in these wealth accumulation type plans, if we could somehow quantify these tax benefits that the owner realizes on his or her own benefits that are going into the plan, if that far outweighs the cost to provide benefits for the staff, it's a good wealth accumulation vehicle. The owner is a, uh, all the employees are our winners. They had nice benefits, ice tax effect, the benefits that are essentially being paid by the government because of all the tax breaks that the owner get from the owner's perspective, he's basically providing a nice benefit for his employees. It was just fully being paid for by the governments and providing a very generous benefit for himself. That's, that's partners mostly being paid for by the governments. So everybody's a winner though. The employers of winter, the employees, the weather. And, uh, that's the, the notion of why these plans are, uh, are become so popular and why, why they're being well read. It's so many more qualified retirement plans. So I would say that this part of our practice where we, the plans are being used to benefit, uh, owners and see and help owners accumulate wealth. That's the fastest growing part of our practice. The concepts basically are selling themselves. If the owner is putting away, uh, to put away 70, 80% of the money get to the plan for themselves. The concept basically is, uh, is, is it solid themselves? They wind up having a lot more wealth down the road even after considering the cost of the benefits for the staff. So there's a lot of these yourself, this then sell computers or sell something that, you know, uh, it's almost as though the concept is basically selling itself. I mentioned that we have about 600 retirement plans right now. We have 15 employees and we really focus on trying to nurture relationships that the consulting ends, who all of this we think of ourselves more than just processors, but rather a rather consultants, help the clients meet their objectives. It's really important to be, you know, good service providers that needs, you know, teaching our people about returning phone calls promptly. A client, uh, clients may not know when you found the very creative way to help them with their objective or saved them a lot of money. That makes, it may be, I know for your, to something totally different than anybody else is doing with. He certainly understands, uh, whether you're returning a phone call or not with clients, call and ask, ask for studies or objected or a consulting advice. Well, you know, one of the things you think about, are they asking the right questions? Are they, uh, they don't know where there's something takes five minutes, five hours or five days to complete. So speak to them in a way that they could, uh, give, an idea of what the expectations might be. And I think that's a very, very important part of the surface and providing, uh, providing, uh, these types of plans because the fairly complex, they're not easy to understand or you want to make this as easy as soon as the client as possible.

Anjali: [00:07:06] Yeah, no, I think that's great. And that's how you and I actually met was a mutual client, small business owners and how we've continued to work together since I do have a lot of small business owner clients and, and they get to a certain point where revenue is pretty consistent in their practice and they're looking to be able to put more away into retirement, which is such a great benefit that small business owners can have if, if their cashflow and their situation permits for it. So let's walk through, that was a great introduction, by the way, ted, everything we're going to discuss today. So let's kind of start with some of the basics. Can you walk us through the common retirement plans for small businesses?

Neil: [00:07:45] Well, sure. Let's start out with the real basic. A simple IRA. A simple IRA is an IRA that's set up by the employer. Now keep in mind, normally IRAs are set up by people who are earned incomes, that are these individuals, not their employer, sets up an IRA or a company may not have a retirement plan. You go and put my, you put up a you up to $6,000 into this IRA. Well, in a simple IRA, the companies actually sponsoring the IRA for the individuals. Uh, now you can have no more than a hundred employees in this, um, and that's earned over $5,000. Uh, but I think of the, you could require their number $5,000 or two of the last five years. And then the simple IRA, unlike a traditional IRA, the employees can actually the for up to $13,000. Those over age 50 could put another $3,000 yet. So there are two differences between a simple IRA and a traditional IRA. What's a traditional, I mean in one way or an employee is doing it on their own as opposed to the employer. One is that people under 50 can put in, $13,000 instead of $6,000 seconds in order to have this greater deferral amounts or the opportunity for this deferral amount and in order to avoid complex testing or government filings, it's, it's called simple because it's a simple more simple approach that this the there you don't really need this expansive work that a TPA like us might do. Basically you, you must provide certain benefits for the employees as well. So you to do one of two things, you provide 100% matching contribution on the first 3% of pay. Although it can be lower to 1% to two out of every five years or provide 2% across the board for their employees. So basically under the simple IRA, you basically are the employees are setting up IRA accounts, for all its employees, they can put $13,000 in there's no testing many qualified plans. How about what a highly compensated employees put in might be limited depending on what non highly compensated employees put it in. There's no limits here as long as you basically meet the requirements of the simple IRA. And again, that's a that's providing this matching contribution or this 2% across the board for the employees. The advantage of this plan is that it's simple, no government requirements. It doesn't really cost very much show or if anything's really, uh, administer the disadvantages as we get into some of the later plans as you'll lose some of the design flexibility and our other other types of plans were much more money could be put in. When I say design flexibility, here you are, you're required to put money if the plans, it's a, into the plan for your employees. Other plans, you don't require that other plans, you might want to put more money in for the employees because then you can really put even greater amounts greater than the 13,000 that's discussed here for, for owners or for highly paid people. Uh, so that's a simple IRA. A Sep IRA is also an IRA sponsored by the employer rather than it's visual and it's, again, it's like the company setting up Iras for their employees. Under this plan, the limits are the same of what an employee might be able to defer. The limits are the same is what it is for a traditional Ira, $6,000 so there's a $1000 catch up for those over age 50 now we we're where this differs from a traditional IRA. I mentioned that the limits of what you attributed the same, again, it's sponsored by the employer, but the, there are no employer, unlike a simple IRA, there are no required contributions to a Sep IRA, but the employer could put it up to 25% of pay for each of those employees limited to $56,000. So in a way, the SEP IRA is allowing smaller deferrals only $6,000 with referrals like a traditional IRA, but it's allowing an option to put in fairly large amounts of employer contributions. Uh, so again, the advantage of this plan is it straightforward? There's no testing. There's no 55 hundreds. Uh, the disadvantage is you don't have designed flexibility. You putting the same amount in as a percentage of paid for all your employees if you decide to up their contributions also compared to other plans we're going to get mentioned in a moments, uh, employees are limited and only being able to defer $6,000 into this plan. So these first two plans, the simple IRAs and the Sep IRAs, I really both Iras sponsored by the employer, but you basically are a little more limited in your benefits and contributions and flexibility in the design and how much you give to each person. Excuse me, but uh, but you wind up having a less flexibility but you winds up having no testing. You know exactly what each person can get each year and no 5,500. So it's more simple type of approach. You're giving up complexity and in design, in exchange for simplicity and writing of the plan. Now let's talk about a four one k profit sharing plan. That one, there are required 5,500 filings in reports and testing and so forth. But that work is being done by a third party administrator like us, like Shore Tompkins. Now, why would somebody have a 401k profit sharing plan instead of a, a simple or a Sep IRA and a 401k people defer as much as $19,000 and if you're over age 50 you can put another $6,000 in for a total of $25,000 if the 2019 for somebody who's 50 or over, there all, you can also have profit sharing contributions. When I say profit sharing contributions, there's a thought that it must mean that the money comes out of profits. Put profit sharing contributions referred to is an employer, uh, depositing, making kind of what's called a nonelective discretionary contribution in a 401k profit sharing plan. A plan could be designed where you could pick and choose up to certain limits, how much to give certain people you might provide executives 25% of pay and maybe non executives, 4% of pay. No one might ask, how could you do that? Isn't that discriminatory? Well, if you could numerically prove that these benefits are non discriminatory even though you providing greater benefits for certain employees versus other employees that the plan is qualified. So one of the big advantages of the 401k profit sharing, two big advantages. One is you can get greater contributions, greater deferrals $19,000 in the 401K for people under 50 compared to 13 in a simple IRA or six in a in a Sep IRA. And they could also get these greater profit sharing amounts. than you could get in the simple, you could get these employer contributions in a SEP, but when you do it for a profit sharing, you have much more flexibility on how you might want to design the plan, who you might want to provide your benefits for. And I mentioned earlier that we have a lot of, we call these wealth accumulations type play as it sometimes as a business owner, might provide employees five or 6% of pay, which is fairly generous. It becomes much easier to absorb it if they can give themselves a larger benefit and be able to get. ah. save a lot of taxes for themselves. That helps pay for the benefits for the employees. That can also be matching contributions. When employees a certain amount of money in the 401k, the company might match a portion of the employees deferrals, so the 401k profit sharing plan does cost money, small amounts to administer. There are testing, but it allows overall greater design flexibility and overall greater contributions. One other thing that I mentioned relative to that, as I mentioned before that you have to prove that it's not discriminatory that I went on to say that you can sometimes provide certain employees much more than others. Well, one of the components of the testing considers the fact that when you put a dollar in a funds for a a 25 year olds, it buys you a lot more age 65 accumulation. Then when you put a dollar in a fun for a 55 year olds, well one of the opponents of the test, it considers that fact and if the people were trying to benefit most tend to be much older than the remaining workforce. You could quite often give these people a lot more money as a percentage of pay. Uh, what's what's called a new comparability or cross test, the profit sharing plan and quite often a business owner between 401k profit sharing, uh, Might get 56,000 or even 61,000 with that cash up for people over age 50, while the staff might only be getting about four and a half to 5% of pay. Um, so that's how the 401k profit sharing works out with the fine benefit plan.

Anjali:	00:17:23	Before we get into DB because that was such a lot of really great information to, I wanted to summarize a few things. So in my experience, and I think you probably have seen this as well, a lot of small businesses when they first start up, I usually see things like the simpler the Sep Ira because as you mentioned, it's very low cost. If, if any cost in terms of setting up the plan, it doesn't have to go through the testing requirements. You don't necessarily need to hire a tpa for that. The 5,500 is actually an IRS filing that you need to do every year for your retirement plan. That one you don't have to do with a simple or a Sep Ira, but the trade off is that you may not get the same flexibility you would otherwise. So what I've tended to see is people start with something like a simple or a SEP as their business continues to grow as they're making more consistent cash flow, then they look to the next step, which is this 401k profit share. And so you know, as you mentioned, there's two pieces to it. There's the employee deferral, which for this year is 19,000 and then there's a profit sharing piece. So the combination of those two, the Max for this year is 56,000 and just to confirm if anyone's an S corporation that that profit share is usually based on the salary that the, that the person, the owner is taking for their business. Is that correct?
Neil:	00:18:38	That's correct, Anjali, absolutely. When it comes up all the time and relative to the point you're making about starting with something that might be more simple like a like a simple IRA or

Sep Iras then moving on to a 401K plan. One of the components, obviously we want to help, we'll want to help our clients is we should only go to the qualified plan if it works out that they really need to want to make these additional contributions or need these flex leave, this extra flexibility and easy way to look at it is, is the tax benefits associated with the extra contributions that can go into a 401K profit sharing plan instead of the IRA approach or the flexibility that you're getting, being able to give the money to the people who you want to realize these tax benefits. If those additional tax benefits far outweigh the costs to administer the plan, again, there were no costs for, for, for Iras, then that would be certainly a reason to go to a 401k uh, or profit sharing plan. And from our experience it's not a very costly endeavor. So unless people are really limited on their needs or on what they want to pause it, once they determine that they'd like to be put in a little more money away. The 401k profit sharing plan is usually a fairly a fairly easy decision to make and a good good way for me to point that out is, let's say we have a a small business with 20 people in it might be a few thousand dollars to $3,000 a year to administer these 401k profit sharing plans. If we have one employee age 25 who puts an extra $5,000 in a 401k plans opposed to take it as taxable income that a low, when you think about the compounding effect of the money grows tax deferred or if it was a Roth type contribution where the money grows tax free with after tax dollars, either way, that alone is probably worth 10 to $12,000 just to that one employee. So generally speaking, if we, if we, I think the real with decision making process really comes into play is if you realize that you want to put away more amounts than the limits the SEP Iras, simple Iras or one a little more flexibility and who gets the dollars. I think that's the time when it's, when you're ready for the 401k profit sharing approach.

Anjali: 00:21:22

Yeah, no, that's a really great point. And the other piece to that is that's where it really helps to have someone like your team there to help from those proposals. Because as you mentioned, there's more than just a safe harbor type 401k plan. There's, there's new compatibility test in the cross tested plan. So there there's ways to structure the plan to help maximize owner contributions. And sometimes people get a little shocked when they look at how much they need to put away for the employees, but once they factor in how much they're able to put away, you know, which is a deferral. So it comes out pre tax and the tax savings can be really huge, especially for people of early high cost of living states. Like in California, you know if you're in top rates across federal and California, you're paying close to 50% in taxes. So every dollar that you can put away as into a plan, you'd saving you 50% on taxes, which is great. And the other piece of it is, I think, you know, as a small business owner, employee retention is really important because the cost of turnover can be pretty significant in terms of that. So it's a, it's a way to attract and retain good employees. And even though I'll, a lot of my clients when, when they start putting these types of plans in place, they actually will then structure the overall compensation package for their employees to take into account the fact that they were going to make, be making either, you know, the profit share or whatever piece of the employer contribution on, on their behalf. So it's, it's another way to present a more generous compensation structure for your employees. And all of that is tax deductible to you as a business owner.

Neil:	00:22:49	Exactly. That's a great point. Anjali cause so I think one of the things you're pointing out is I started earlier mentioning that you have these two objectives. What is an employee benefit plan and one is a wealth accumulation plan for business owners. When you go to the wealth accumulation approach, just because you're required to give a certain gateway or certain minimum amounts to your employees to be allowed to use the utilize the concepts that allow a lot of benefits for business owners. These will all have employee benefit, uh, concepts to all of this. There all employee benefit plans. You get some, uh, some extent. All of these players are employee benefit plans and it may be wealth accumulation plans for business owners as well. You have to take away from that. The, the benefits as far as the employee benefits is a wonderful tax effect. The form of compensation for an employee
Anjali:	00:23:43	Agreed. Okay. So now let's get into the the the complex of all the plans, the defined benefit plan, which you and I have been working on more of those over the over the past year. I think it's, it's a great, great tool, but it has its own complexities, its own costs, and there's some nuances with it that, that you may not seen a four one k plan. So love to dissect your brain and get your expertise on this one.
Neil:	00:24:09	Well, absolutely it is and that's probably the fastest growing area of our practice and these, this way to first explain what is a defined benefit plan that is, is by comparing it to what more people are familiar with the 401k profit sharing class in a 401k profit sharing plan, or at least the profit sharing portion of the of a 401k profit sharing the company is putting a certain amount of money into accounts for all of their employees. It might be 5% of pay or 10% of pay or whatever it might be. So there defining what they're giving them. The ultimate benefits of the

employee retires with is the or the is aggregate of contributions that were deposited and all of the investment return. So that's really what your retirement benefit is. This your contributions plus all your investment returns and in a defined benefit plan. It's just the opposite. Instead of defining what we're putting in. And then the ultimate benefit is whatever it accumulates to based on specific formula. We're defining what comes out of the plan either as an annuity or maybe small or small clients. For small closely held businesses, it's normally like a lump, some pot of money. So we might be, say for example, that we might be funding for let's say for a business owner or for anybody. Um, I'll, I'll, I'll make up a number for an employee that based on the formula, uh, it, depending upon when they leave, let's say that the projected to get $100,000 had a, as a lump sum at age 62. Well, if the investment returns are poor, the company's to put more money. to pay for that promise benefit. If it's richer, if the investment returns are greater, you might put less money. And so one big difference between the 401k profit sharing plan, which is called a defined contribution plan, where you're defining the contribution versus a defined benefit plan or pension plan is that the employer is basically taking the investment risk. So right now the type of this, a special type of defined benefit plan called a cash balance pension plan, which kinda has a look and feel of a profit sharing plan where basically we have a a theoretical account where the employer might say that at the end of each year we're going to allocate 5% of 10% of your salary, your account, plus we're going to give you 5% earnings each year. So if you have employees that are $50,000 in the first year of the plan, they a balance of $5,000 that the ends of the second year. If they earned $50,000 again in the second year that they give it a promise. This 5% return on the $5,000 which is $250 plus another $5,000 it's allocate on the last day of the second year and their balance is $10,250 and that doesn't mean there's 10,250 in the plan because just because we're promising somebody 5% investment return, it doesn't mean they're going to get 5% in the fund if the return is actually lower. The employer might put a little more money will in these defined, the advantage of these defined benefit plans is we could provide a lot richer benefits. Sometimes business owners, depending upon their age, for funding for two and a half million dollars, which is about the maximum we could fund for at age 62 for for a people in their thirties a, we might be able to put 50 to $100,000 in the plan. People in their forties it might be a hundred to $200,000 in the plan just for the one business owner. People in their 50s so might be well over $200,000 a year and a lot of this depends on this, their salaries, how many years they've been with the company. There's a lot of things that kind of play play into this, but under this type of an approach, sometimes business owners can get very, very substantial benefits at the, not only are we able to provide much greater benefits, we also the disparity between the people who are trying to benefit most and are made it workforce also tends to, that disparity also widens as well, so we get overall greater benefits for owners and you get rid of disparity of benefits between the owners and staff and that concept we've mentioned earlier about using this plan as a wealth accumulation vehicle. It's that much better that quite often depending upon the demographics. Normally these concepts work best when the owners or people who are trying to benefit most tend to be older than a lot of remaining workforce. But even with some of these testing methodologies, it doesn't always have to be that way, but that would be the most desirable as far as getting the best disparity benefits between the owners and staff, but quite often there might be a two owners and eight employees as the owners might be getting benefits of well over $100,000 a year. A piece for the two owners and the aggregate costs for the staff between money that goes into this pension plan. Plus maybe somebody that might have also go into a profit sharing plan might be somewhere between seven to 8% of pay basically so Sometimes owners are getting $200,000 of benefits of the aggregate cost for the staff might be 30 or 40,000 someone might say, well, Gee, 30 or 40,000 is a lot to give the staff. It's very nominal or modest relative to the tax savings that the owner is going to get on having their own money grow tax deferred.

Anjali: 00:29:49 right, they're going to get 10 differ much more. And then on top of that they're getting the text induction what they're putting in for their employees. So so that the overall true cost can be pretty minimal in comparison to that to the savings that they're going to get on the tax side.

Neil: 00:30:05 That's correct. And again the uh, the defined benefit play out when you start a lot of times where we got these plans where we try to provide a lot of money for business owners, it works out better to have a profit sharing plan 401k profit sharing and a defined benefit plan because would you put some money in the profit sharing plan? If you put a majority of the staff, the staff's money in the profit sharing plan, it's also tend to get greater disparity. You better off putting more of the owner's money in the defined benefit cash balance piece, more of the staffs money, the profit sharing and that allows overall grades disparities. So someone might see what, Oh, I have to suddenly have two plans Serviced? Doesn't that get expensive. Well, it might be with again talking about plans for in our eample of the 10 to 20 employees for the moment there might cost another five. I'm making up numbers, $5,000 a year to administer the plan, but we would never suggest a plan that costs $5,000 more to provide six or $7,000 of value. These types of approaches, quite often the business owner, even after we consider the cost to provide the staff extra money, the owners will accumulate hundreds of thousands or millions of dollars more of wealth by having these more creative type designs. So the big advantage of the defined benefit plan is allows the owners to accumulate far, far more wealth. But I mentioned earlier that there was required contributions to these defined benefit pension plans and sometimes depending upon the investment returns that they might fluctuate somewhat. So we only want to make the defined benefit plan as generous as the owner feels relatively confident that the cash is going to be there for a few years. Uh, that was possible for something to occur. We are objectives change where we might have to modify the plan, but that should generally be the exception rather than the rule. The mind frame should be that let's only make the plan as generous as we feel relatively confident in the next few years. So if someone says, Gee, I could put in $200,000 this year but I may not be able to put it in anything next year, it's probably not the right approach. So it's normally for organizations that have relatively steady earnings, sometimes like professional service organizations like physician groups or accountants or attorneys, those tend to have fairly steady earnings. So again, a defined benefit plan, you'll get overall much greater tax savings, but even less. I mentioned earlier that 401k profit sharing plan is less flexibility than a simple IRA or defined benefit plan even has less flexibility than a four o one k profit sharing plan.

Anjali: 00:32:59

No, that's all very great information. So I'm gonna, I'm going to break down some of this for people who have no background on, on these retirement plans. So I always describe, and you can tell me if this is wrong, I had described the, the, you know the cash balance pension slashed defined benefit plan is as a hypothetical pension that you're trying to essentially fill. So as you mentioned, essentially working backwards as to what that benefit amount is going to be. And then the older you are, the more you'll be able to put away because you just have less time to, to fund that benefit. But even on the younger end, like you mentioned someone in their thirties they're still able to potentially put 50 to a hundred thousand away each year. So that is something closer to 100,000 is a much sizable difference in the 401k plan. And when you talk about disparity, you're really referring to the difference in terms of how much you can put away as an owner versus what you have to put away as the employees. And so the greater the disparity, the more benefit you're going to see as an owner being able to do so. But you know, on the flip side of it, the defined benefit plan is very structured and you have to make those contributions. So as an advisor, I don't recommend it to clients who are just starting off on your cash flow needs to be consistent. And I usually suggest doing it if you can max out the benefit. So if you currently have a 401k plan and it's set up where you're able to put away the Max, which is 56,000 and you want to do a defined benefit plan, and let's say the defined benefit plan will allow you to put away 90,000 for yourself, but you don't think you can manage that so. Maybe you're only gonna put away 60 in that situation, it may not make sense. I tend to like clients to do it who can kind of get to the Max because that's where you're going to get the most bang for your buck and you need to fund that piece every year. And so as you, Neil, you mentioned there is this interest credit, this assumed a return that the plan is supposed to get every year. So if we have a year where the market didn't do as well, let's take like the end of 2018 where we saw huge jobs, you may have to fund more than what you expected just to make that thing whole again, which on one side is great because it's more money, you're deferring, but on the other side, if your cashflow is pretty tight in your business, um, you may run into a situation where you're scrambling to get that benefit, you know, doing the, the, the amount of contribution you need to. So, so you really need to have consistent cash flow. It's good to have a little bit of excess and to make sure you understand all the pieces and how it works before you decide to put something like that in place.

Neil: [00:35:23] Right. And Anjali, I think it's an important part of this piece that relates to your services. I got, and I realize you're very experienced with these types of plans and you're very talented with this. Uh, this sort of thing. Uh, I think it's worth pointing out. We start mentioning defined benefit plan has required contributions and obviously to the extent that that uh, if, if there's negative returns that you have to put more money in to the extent that thats a concern, that's a consideration and how you help clients structure their in their investments between defined benefit 401k profit sharing money invested outside the plan and even not withstanding that issue. I'll let you comment further on this. Uh, not withstanding that, that that issue, I would tend to contend that to the extent that the sponsor and going, I don't give investment advice I realize that is your area and you're very, very good at that. To the extent that the owner has an overall diversified portfolio and you look at their pension, their fund's pension meaning defined benefit 401k profit sharing money invested outside the plan. To the extent that it's an overall diversified portfolio, I would think that the defined benefit plans should be the lesser aggressive investments. Not just simply because you don't have to worry about over funding and required contributions going up and down. If you get big negative returns, well let's say you got a 12% return on your aggressive investments. Well when the money is in the defined benefit plan and you are funded for two and a half million dollars for retirement, you're reduces what you can put it in future years. If you get your 12 and a half percent return in your profit sharing contribution, you could still make a maximum of profit sharing contribution that following year. So it seems as though to the extent that you have a diversified portfolio and you have certain investments that are really geared to get four or 5%, there might as well go in the defined benefit bucket where you could get the larger contributions of the larger the deductions. If you only have aggressive investments and you don't have a diversified portfolio, I don't think that any of this really matters. But most people have some sort of planning or diverse, uh, some sort of diversified portfolio. And the difference I think between doing this right and wrong as far as setting up where you were, where the investments go from, plan by plan again is worth hundreds of thousands of dollars in the long run of getting this right a lot more important than whether you can get them an extra one or 2% return on their investments in aggregate.

Anjali: [00:38:09] That's an excellent point. When I look at investing in the defined benefit plan on, we tend to go either moderate or conservative for that exact reason. It seems a little counter intuitive because most people are concerned about getting as much return as their risk tolerance and their time horizon can handle, but in the defined benefit plan, you're actually taking somewhat of an opposite approach. Do you want that thing to grow? You know you don't want it to lose money, but you want it to grow a lot less perhaps the rest of your portfolio. So when I'm looking at the defined benefit plan, we're going to make that much more conservative even if it's someone who's young and what we do on that. On the personal side of things, because I work with a lot, a lot of my small business owner clients or you know, I'm managing about the business and the personal side of things is that we may increase the aggressiveness on the rest of their portfolio so that in totality their portfolio is in line with what they want in terms of their allocation. But we're just kind of piecemealing it a little bit. So we're getting the Max benefit we can into that cash balance plan. So no, that's a, that's a great point. I'm glad you brought that up because I think people need to understand that when they're thinking about that plan and how it's going to be invested. So let's talk about controlled groups and how that might affect retirement plan designs. And the reason I want to talk about this is because I have clients where they may be like 100% owner of one business, but then they own other businesses as well. And sometimes people just want to set up a plan for that one business, but they may not be able to do so because of these controlled group rules.

Neil: 00:39:39

Right? Yeah. This comes up all the time with small closely held businesses and what the, the, uh, there's, uh, we have what, we could have a three hour session on all the issues of control groups and how they work. But I think the important things to realize is that when, when people have ownership in, multiple companies or one company owns a, a second company or third company or two companies with some common ownership work together to service the same employees. I'll give you the most typical example. Let's say for example, uh, you have two companies. One is a, uh, a radiologist and then one is the image except that basically they're working together basically to, uh, to service the same ah customers. Sometimes it's common ownership between, uh, maybe to talk through. So who were the radiologist? Also we'll have all the imaging center. What the law is Trying to avoid is people simply setting up two companies or multiple companies is saying, you know what, the owner or the people I want to benefit or this company everybody else's in this other company and therefore we'll just have the we'll just put a plan in for the business owner who happens to be one company will those employees are another company. Now the law doesn't say that you have to provide benefits to all your companies. All it's saying is in determining whether your plans are discriminatory. I mentioned earlier we have a 401k profit sharing plan or the defined benefit plan unlike Iras or simple approaches, you have to do some new miracle test to prove that the plan is nondiscriminatory. Well, when the, when a plan is part of a control group, it, by the way, he could have ownership in multiple companies that may not be a control. There's numerical tests of what, what, what constitutes a control group, but to the extent that it's the term or that you at that certain number of people have enough ownership in multiple companies. All that means is that all of the employees, all of the companies need to be considered in determining whether these are qualified plans. It's theoretically possible to still say we're going to have a plan for company A. Even though I, even though I have ownership at two companies, uh, those who are your plan up pension plan or retirement plan for a company a but not for company B or we'll have plans for both but they'll be very different benefits and if you have enough highly compensated employees in both companies and based on numerical tests, you could still show that it's not discriminatory. Theoretically could of have a plan for one company and not the other company are very different benefits, but the main point of control groups affiliated services is when companies have this enough overlapping ownership or they basically are associated enough where they work together to service. A third company was really what's called an affiliated service arrangement and determining whether these plans or discriminatory or not. The government is basically saying they want you to look at these companies, separate companies as though they're one company, and then determine whether the plans are under the law discriminatory or not using numerical calculator calculations. So for, I think for our listeners benefit, the important thing to get out of it is if you have ownership in multiple companies, we need to kind of look at all of your companies, uh, in determining the, being able to decide to put together a plan. It's very important that we get information and understand your ownership in all of the companies. Otherwise we can very usually put plan or they can think it's qualified. And then it turns out that because of ownership and other companies there, uh, there's compliance problems.

Anjali: 00:43:41

Yeah, no, that's, that's a great point. And, and why I want you to highlight that because it does happen especially, um, amongst our, like the physician community because they do have ownership and usually their main practice may be a surgical center and the various other businesses, maybe the real estate piece of it as well. So we need to have all of that information. When you sit down with the, with the TPA to run through those proposals to make sure that it is a compliant plan. Otherwise that that'll cause more, more headaches and issues and then it's worth. Okay, that's great. So the other piece I kind of wanted to walk through is how all of this plays into the new qualified business income deduction Qbi and far listeners. I did a deep dive into Qbi in episode four, so you can check that out if you want to get an overview. But there's been some interesting nuances that have come out of having a plan like, or setting one up and then how it plays into Qbi. So I'd love to get your thoughts on that

Neil: 00:44:37

then we're spending a lot of time on this is really helping a lot of our clients and prospects. And let me give a, uh, I'm not an accountant, but let me give a, give a, a brief overview of how that Qbi deduction generally works is there's some nuances to it, but I think go through the very general approach. Then we can talk about how we could use pension plans to really benefit at all of this. Basically, if a, if a company is what's called a pass through organization, we should we be like an s corporation or partnership or a sole proprietor. The what the law is indicating is that the business income part of all of this, like not like for an S corporation, not your salary, but the extra business income that comes in that's not part of your salary but the other income or sometimes when you have a partnership you have a little more flexibility in what you are so-called salary or guaranteed payment is, but the difference is that you're guaranteed payment, but the rest of the income that's we'll call qualified business income. Now for these pass through organizations, if you are not a certain service type organization, a select service type organization, almost all of those companies get this 20% deduction. on their qualified business income so like in other words, if the company, for example, what was after you give yourself, I'll make up numbers, $200,000 salary, there's another $300,000 of income, 20% of $300,000, you might get another $60,000 deduction. Now the, the, uh, this benefit is pretty much, I don't want to say, it's the exception. It's relatively uniform for people who are in what's called service type organizations there. Um, now there is one exception. If it turns out that these nonservice organizations, based on the, has very little payroll. Uh, there's like a payroll threshold. Most of these non service organizations, w we'll have payroll. Well in excess of this thresholds. If you were, don't have very much threshold, let's say a very, very few employees and very few very little payroll, there's a scenario where you might have to get your income on your personal tax return, your joint tax return under $350,000 to get this 20% deduction. Now, if you are a service organization, you always have to get it below your, uh, your, your taxable income on your joint tax return below $315,000 before you were eligible for this Qbi deduction. So what does this have to do with pension? Well, if you have a business that for sample, let's say you have a lot of this quality, a lot of this business income, but you are going to have, but you're already $415,000 on your joint tax returns as adjusted taxable income. If you could somehow get that to be three 50 instead of four 15, you get this extra deduction. So let's say we have a sole proprietor, for example, and this can be an S corporation or a partnership. We're where the income is $415,000. And they basically might have, let's forget, state income taxes. They might pay about $125,000 of federal a federal income taxes. If they put $100,000 in a pension plan and get their income down for four 15 to three 15. Let's do all $315,000 we're so sole proprietor, it would would be qualified business income. They would get a 20% deduction on this 315,000 which, uh, comes out to be about $63,000 so their taxable income is suddenly 252,000 if you pay federal income tax, on the two 52, you suddenly paying federal income taxes of about a little over $60,000. So by putting $100,000 in the pension plan and reducing your, your personal income from four 15 three 15, you've actually saved over $60,000 in taxes. As I mentioned, there was about $125,000 when your income was four 15, when it was three 15 that less than 20% deduction brings out the two 50 to the taxable income was a little over 60,000 so we might've saved about $63,000 on a $100,000 contribution. All as though you were at a 63% federal income tax bracket. Now, uh, the employer, this individual will say retire next year and they don't roll the money into an IRA. Of course they will and the money will grow. We'll continue to grow tax deferred. They might be in the 25% tax bracket. So by you're getting this greater deduction on your, uh, will you benefit from this? Qualified businesses could be getting a greater deduction on your, on your, uh, contributions to the pension plan that we are that will far exceed the likely a tax bracket that you'll be in when you a, when you retire. And the, so the short story of this is, I mentioned earlier, we have these combined defined benefit and profit sharing plans and the money grows tax deferred and the owner will accumulate so much more wealth even have to take us through the cost, provide money for the staff because of this qualified business income. deduction. That story becomes even much more valuable. You're going to accumulate even greater wealth. So the pension plan, even if you're not in that situation where you're using the plan to get below this thresholds, pension plans, a wonderful thing. I still suggest it for people who are $2 million and we'll never get below three 15. But what this does is it gives them even more tax benefit. And second, for those people who say, you know, I kinda liked this pension plan but I'm not really sure whether I could afford to make these contributions. Since it can save so much more taxes immediately it makes the contribution that much more affordable and it makes it easier to have these types of plans. So one is the tax, the long term tax benefits aren't greater where this qualified business income scenario is it play and second because you're saving uh, more taxes obediently right now. Uh, it might make the contributions that much more affordable immediately and make it easier to sleep nights with, uh, knowing that they've contributed a lot of money and you have less, uh, you might have a little less money to live on the decrease in your taxes in your money to live on right now, you can put up with $100,000 in the plan you'll still have a little higher, um, level of, of income to live on immediately because of this extra deduction that you're getting.

Anjali: 00:51:40 Yeah. Now that's a great point. I always tell clients a dollar that you're deferring into a plan isn't necessarily a dollar less of living expenses because you have to take the tax differential into account so it might not be as big of a burden as one may think. And you brought up so many great points that I'm going to quickly try to summarize here before we get into the personal question. So, you know, as Neil mentioned, the QBI has a threshold. So if you're a married filing joint return, that threshold is 315,000 for any other filing type. It's 157500 and so if your income and the testing for this is based on taxable income, so if you're a married couple, it's combined income. So that's something to keep in mind. It's not just your business income. So if your business may be under this amount, but you're married to someone who makes significantly more, you could get easily pushed over the threshold amount. So if you're under the threshold amount, you get the full 20% deduction, which is based on essentially the net profit of your business. If you're in the phase out range, which is 315,000 to 415,000 for a married couple, you may see the, the 20% deduction decreased. I mean, I really comes down to what type of business you have in. Neil mentioned, uh, a service business. If you're a specified service trade or business, which essentially is any type of service business outside of like engineering. And I think architecture was the other one, and you're going to see some limits to it. And then once your income is above 415,000 you get no benefit at all. So I actually had a few clients scenarios where the CPA ran a projection in which the combined income so that that taxable income threshold was in phase out range. So it was between the 315 to 415,000 and because one of one of the individuals was 1099 independent contractors at least set them up with their own business, them maxing out their, their solo 401k plan, push them below that threshold. So not only did they, they, they were able to put away that 56,000 into their retirement plan. On top of that, they got a 20% deduction. So they saw a huge decrease in their tax liability. And it's, it's been interesting to see the Qbi because even when I talk to my CPA, we just don't know what's going to happen until we put the numbers in the return. So that's why I think this is such a great planning opportunity. If someone is considering putting one of these plans in place, it would be helpful to have your CPA run your projection, incorporating this aspect into it so you can really see what the true benefit is because it could be more than just being able to defer the money, um, differ more money than you would otherwise. So I think in light of the new tax law that I think there's more planning opportunities. And so that's where having the good CPA to run that projection for you will be very useful and valuable when you're trying to assess whether the plan makes sense or not. So Neil, there's always a few personal questions I like to ask my guests to, to wrap up. So the first question I have for you is what's one financial goal that you're currently working towards?

Neil: 00:54:24 Oh, on a personal level, I had, I, uh, I see, I think about this for years and all my life. I want to in my retirement, be able to live at the same standards that I was, that I was able to live at prior to retirement. Even if I live very healthy, until the age of a hundred and twenty, I want to be able to be able to do the same things, uh, live to the same not to have to change my standard of living upon, my retirement. And I, I jokingly say, even if I live to a hundred twenty, so obviously what that really means is I, I'd like to, we have money left over that'd be able to provide for my, for my heir. So I want to be able to be a maybe better, maybe better way to save is I want to be financially independent, uh, throughout my life. Don't have to worry about, I don't have to worry you. Did the stock market go up to the stock market goes down that I don't have to take any short crazy risks in retirement to continue to live the same standards that I've lived pre retirement.

Anjali:	00:55:26	I love that. That's great. And then what's one piece of financial advice, good or bad that you'd like to give our listeners?
Neil:	00:55:32	Oh, well I give a lot of thought to this and it's what I, I have, uh, three kids that I talked about this all the time. I, I believe that you should always live your life clearly well beneath your well beneath your means not living on the edge should always be willing. Whether you make 50,000, a hundred thousand or 200,000, if you're in a 401k plan, you should always be Maxine putting the money. Yeah, I've actually got your 401k Plan. Someone who earns $60,000 puts $19,000 in the 401k plan. You're acting like you're earning 41,000. You live your life that way. That $19,000, the payoff of what that's really by not putting that 19,000 and in the retirement plan You're leaving so much money on the table throughout your life and it's, it's like throwing out Money so I believe that having the mind frame that you're a real salaries real is, well, you know, again, just try to live as far beneath your means as possible, but at the very worst, your, your, your real salary in your own mind is your salary less than maximum amount that you're allowed to put away your retirement plan?
Anjali:	00:56:53	No, I love that. That's great. And you know that the value of, of compounding is, is so key. So someone who's putting away 19,000 at age 22 the amount of money you'll have by the time you're 55 or 60 is, it's crazy. It really is. So that there earlier, I always tell people the earlier you can start, the better I'm living below your means. Is, is kind of a consistent theme that I've been getting amongst my guests. I think that's one of the pieces to the financial independence, which is it a goal that you're currently working towards, which I think is great. So tell our listeners how they can learn more about you.

Neil:	00:57:26	Well, our, our, our website is www.shoretompkins.com That's shoretompkins.com. My phone, my phone number is area code three one two seven six two five, nine four four. We have clients all over the country. We typically, what we do is when somebody is a business owner or how has from a cup is that management a company. And they liked this idea which were most of these plans and having the money grows. tax deferred and putting in these plans to help them save for retirement. Typically we'll, we'll ask for his will email census information, uh, our request for census information. And what we'll do is we'll show them various options of the various types of plans, how much money they might be able, a business owner might be able to put in for themselves. And one of my require and benefits for the staff that we can reevaluate does what is, what are your cash flow constraints? And under these scenarios it doesn't work financially. Workout appropriately. Is the money that you provided for the staff, is, is tax benefits for yourself, uh, clearly outweighing that. So that would be certainly the tea, the type of approach that we, that we initially take one of these types of plans and we don't charge for these original design studies that we've used as marketing time that, you know, the, um, the clients will, uh, most of the time these plans work very nicely for the clients. If for some reason they all these, they don't put the plan in place, that's okay. But we think the important thing is to be able to run these designs and be able to show as many people out there what's available for them and they'll be plenty of business that comes in and plenty of people that we could help. So that's typically the, uh, the approach. And obviously, uh, Anjali, we, our organizations work so closely together, uh, more typically they start with, he goes directly to you and of course you contact us and quite often they provide you the census information that we've worked through. Your would provide the information together because how the, we can't underestimate how both parts of our services are important and, and, uh, how the investments are structured is a very, very important part. How they're structured within the retirement plans is a very important part of being able to maximize people's wealth accumulation for retirement.
Anjali:	00:59:52	Yeah, no, that's great. And for our listeners, all of Neil's information will also be in the, in the show notes so you can can there it to reach out to him directly. Well, thank you Neil. This was so great. I'm glad we could have you on and again, do a deep dive into retirement plans.
Neil:	01:00:06	Thank you, Anjali. I enjoyed it very much.

Anjali:	01:00:09	Thanks for tuning in today. If you're interested in making better financial decisions and are considering working with the professional, please visit us at www.fitadvisors.com to schedule a free initial consultation.