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A Powerful Tax Strategy for Freelance Physicians
Defined Benefit Pension Plan White Paper

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Doctors who earn self-employment income by working freelance are in a great position to save a large amount on taxes in 2015 by establishing an IRS-approved qualified retirement plan called a small business defined benefit plan before December 31, 2015.

So what is a defined benefit plan and why is contributing to one such an effective tax reduction strategy for doctors who do freelance work?

Defined benefit (DB) plans offer by far the highest tax-deductible contribution potential of any retirement plan—much higher than SEP-IRAs or 401(k) plans. They therefore also offer the largest tax savings opportunity along with the most rapid retirement nest egg growth potential.

A defined benefit plan can enable a high-income freelance doctor to save tens of thousands of dollars in taxes each year while rapidly building a large retirement nest egg in a relatively short time.

DB plans work well for freelance doctors because these physicians typically:

- Are independent contractors with no employees
- Earn a high income
- Pay a high tax rate on their income
- Have few expenses or overhead, and therefore few available tax deductions

How does a defined benefit plan compare to other retirement plans?

Whether a defined benefit plan makes sense for a certain person depends on how much self-employment income he or she earns and how much of it can be contributed to a retirement plan. If the amount is less than $50,000 per year, it may make more sense to establish a SEP-IRA or Individual 401(k) first. Once an individual has self-employment income in excess of $50,000 per year (and would like to contribute that amount to a plan), it is time to consider a DB plan.

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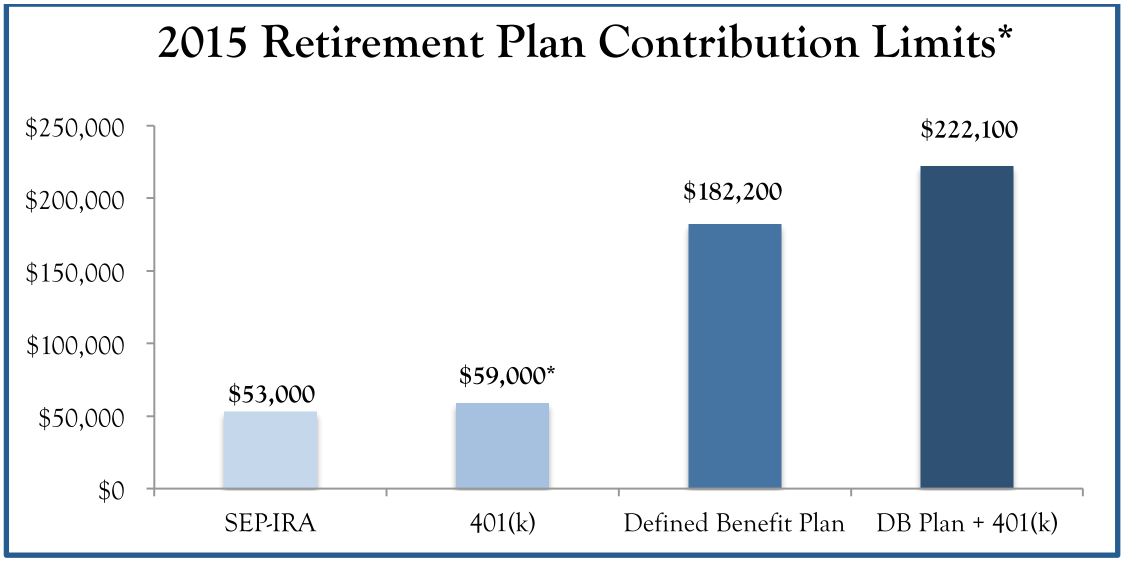
The chart below compares the contribution limits of various retirement plans:



*Hypothetical example: Maximum contribution limits for a 52-year old earning $300,000 in W-2 income and retiring in 10 years.

Defined benefit plans enable the self-employed to build a large retirement nest egg in a very short time. DB plan owners can accumulate as much as $1,000,000 to $2,000,000 in a plan in just 5-10 years. Once a defined benefit plan is funded to the IRS limit of $2.4 million, the plan can be terminated and its assets simply rolled into a regular IRA.

Why haven't I heard of a defined benefit pension plan before?

Many professionals for whom defined benefit plans would work very well are not familiar with the plans. Indeed, we have found that even many CPAs are also not well versed on DB plans. The reason may be that only a very small percentage of people are in a position—in terms of age, income and employment status—to capture the large benefits that DB plans offer.

However, in recent years DB plans have gotten more popular with small companies and high-income self-employed individuals due to recent favorable legislative changes that have increased the flexibility of retirement plans.

What types of investments can I use in a DB plan?

DB plans permit a wide range of investment choices, including stocks, bonds, mutual funds, exchange-traded funds and annuities. At Orion Portfolios, we provide a range of globally

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diversified, low-turnover portfolios that are "tilted" toward the types of securities that history suggests will produce higher future returns than the broad markets. (To read more on this topic, please visit us at www.orionportfolios.com) Because the investment performance of the plan can cause the annual required contribution to fluctuate, it is generally advisable for the plan to invest in a low volatility portfolio.

How are defined benefit plan contribution limits calculated?

The IRS has specified no hard-and fast contribution limits for defined benefit plans as it has for SEP-IRAs and 401(k)s, which are "defined contribution" plans. Instead, defined benefit plans are goal oriented, and the contribution limits for each particular DB plan are actuarially calculated on a case-by-case basis taking into account the ending "defined benefit" goal and the following attributes of the plan owner:

- **Age** – The older the plan owner, the larger the annual contribution that will be permitted because the owner will have fewer years to contribute to meet the plan's specific benefit target.
- **Income** – Eligible compensation differs based on the type of income received (e.g. W-2 or Form 1099).
- **Planned Retirement Age** – Usually at least 5 years or more after plan is established.
- **Plan Investment Performance** – A plan's balance grows through both contributions and investment gains. The pace of gains will affect contribution amounts as the plan matures.

With a defined benefit plan, the pension administrator takes the plan's annual "benefit" target and then works backward using the above factors to calculate how much needs to be invested in the plan each year to ultimately be able to provide the plan owner his or her annual "benefit" in retirement.

For tax year 2015, the projected annual retirement benefit for a participant under a defined benefit plan cannot exceed the lesser of:

- 100% of the participant's average compensation for his or her highest 3 consecutive calendar years, or
- $210,000

Plan owners are not required to contribute the maximum allowed by their particular circumstances. A particular plan can be customized to stipulate a contribution range that is comfortable for the plan owner. Once that range is set, however, annual contributions within the range are mandatory. If the plan owner's circumstances change, however, plans can be modified or terminated.

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Can I combine a DB Plan with an Individual 401(k) Plan?

For plan owners who have variable income and do not want to be pinned down to a contribution limit that may be too high, there is an excellent solution: combine a DB plan with an Individual 401(k) plan.

There are two excellent reasons for doing so:

- Additional tax savings above what a defined benefit plan alone would permit
- Year-to-year flexibility on overall contribution amount

Combining a DB plan with an Individual 401(k) plan increases the total amount of tax-deductible contributions that a plan owner can make and offers more flexibility as to how much a plan owner may contribute in a given year. The defined benefit plan contribution is mandatory each year, but 401(k) contributions are always optional. Therefore, a DB plan owner should set the DB plan contribution at a comfortable level. Then, in the case he or she would like to contribute more in a certain year, the Individual 401(k) will provide the extra capacity for the additional contribution. In leaner years, when the defined benefit contribution is all that the plan owner can manage, the Individual 401(k) would simply not receive a full (or any) contribution in that year.

What does Orion do?

Orion is an independent Registered Investment Advisor founded in 2002. We are an independent fiduciary serving a broad base of clients. We provide a comprehensive solution for our clients who wish to establish defined benefit plans. We coordinate the design and establishment of each plan with our pension administrator and ensure proper and timely filings are made with the IRS.

We work with each client to ensure that the DB plan is tailored specifically to meet each client's financial objectives as they pertain to cash flow, tax savings and accumulation of retirement wealth.

Once the plan is established, the plan's investment account resides on our platform at TD Ameritrade Institutional. We consult with our client to develop and execute an investment strategy for the plan. We perform all ongoing portfolio management, including selecting investments, trading and providing quarterly performance reports.

Can a DB plan help you save on taxes?

Let us prepare a complimentary Tax Savings Analysis for you. Call us at: 619-435-1701 or email us at thoms@orionportfolios.com.

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Case Studies

(for illustrative purposes only)

Owner Only Business

Objective: Maximize contribution and tax deduction

Profile: Freelance physician age 52, has W-2 income of $300,000 and plans to retire at 62.

Solution: Defined Benefit (DB) plan for10 years and a 401(k)

	DB Only	DB + 401(k)
2015 Contribution:	**$136,600**	**$165,700**
Tax Savings @ 38%:	$51,900	$62,900
Projected DB plan Accumulation:	$2.24 Million	
Annual DB Benefit:	$185,000	

Employee with Side-Income

Objective: Reduce taxes on side income

Profile: University professor, age 56, also has $150,000 in sole proprietor income for the past several years from freelance income and plans to retire at 62.

Solution: DB plan for 6 years for side income

	DB Only
2015 Contribution:	**$120,000**
Tax Savings @ 38%:	$45,600
Projected DB Accumulation:	$856,400
Annual DB Benefit:	$70,600

Married Business Partners, No Employees

Objective: Maximize retirement savings

Profile: Husband and wife doctors, Adam age 60, Eva age 58, W-2 income for each is $265,000, both plan to retire in 5 years.

Solution: DB plan with 5 years funding, optional 401(k)

	DB Only	DB + 401(k)
2015 Contribution:	**$426,000**	**$505,800**
Tax Savings @ 38%	$161,800	$192,200
Projected DB plan Accumulation:	$2.43 Million	
Annual DB Benefit:	$210,000	

Small Business with High Earning Owner, 1-4 Younger, Lower Paid Employees

Objective: Reach retirement savings goal faster & provide employee benefit

Profile: Physician age 55, plans to retire at 62, W-2 income of $400,000. Three employees, ages 28 – 40, who earning $35,000 - $50,000

Solution: DB plan for 7 years for physician & employees

	Owner	Employees
2015 Contribution:	**$205,700**	**$36,000**
Tax Savings @ 38%	$78,100	
Projected DB plan Accumulation:	$1.78 Million	
Annual DB Benefit:	$147,000	

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Frequently Asked Questions

What is the deadline for establishing a plan for 2015?

For anyone wishing to defer taxes from 2015 income, **a defined benefit plan must be established by December 31, 2015**. Contributions are due by the tax-filing deadline including extensions, but not later than eight and one-half months after the fiscal year end. **We recommend that anyone wishing to establish a plan for 2015 begin the process no later than December 1, 2015**.

Aren't defined benefit plans expensive to establish and administer?

They certainly can be, particularly if the plan documents need to be drawn up from scratch by your own actuary and tax attorney. We hold down costs in this regard by using a prototype plan developed and implemented by our pension administration partner. These plan documents are already in use with existing plan owners and are familiar to the IRS. Using a prototype plan is a very cost-effective solution.

What are the fees and expenses?

Plan design and document preparation fee (one-time payment):

DB Plan:	$1,250 one person
	$250 per additional participant
401(k) Plan:	$200

Annual plan administration fee:

DB Plan:	$1,950 one person
	$150 per additional participant
401(k) Plan:	$550
	$150 per additional participant

Annual investment management fee of plan assets: 0.60% - 0.90%

Are loans from the plan permissible?

Yes. DB plans can also be set up to permit participant loans.