Own your own business — and your retirement

A defined-benefit plan can help the self-employed save up

By PAMELA YIP
Personal Finance Writer

Sometimes becoming your own boss means not paying enough attention to saving for retirement.

Many entrepreneurs such as Bob Adkins never see themselves hanging it up.

"I don't ever see myself retiring, but you never know when there's that one injury or that unforeseen mishap," says Mr. Adkins, who with his wife, Shannon, owns Paul Welch Associates, a management-consulting firm in Plano.

The Adkinses have been planning for retirement and have a defined-benefit plan.

Some of his peers are not as prepared.

JUAN GARCIA/Staff Photographer

Bob and Shannon Adkins own a consulting firm in Plano. "I don't ever see myself retiring, but you never know when there's that one injury or that unforeseen mishap," says Mr. Adkins.

DEFINED-BENEFIT PENSION PLANS: WHAT ARE THEY?

Defined-benefit pension plans promise workers a specific monthly benefit at retirement.

The amount of the benefit is known in advance, usually based on factors such as age, earnings and how long someone has worked for an employer.

To be able to pay the pension benefits, employers are required to make contributions to the plans.

Those contributions are supplemented by revenue gained through the investment of the assets. The employer bears the investment risk; normally professional money managers control the funds.

In a defined-contribution plan, such as a 401(k), the investment responsibility and risk sit squarely with employees. How much money they have at retirement depends on how well they've invested.

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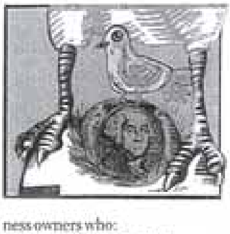

Confidence lacking

While the number of self-employed keeps climbing, most owners of small businesses don't feel confident about having enough resources for retirement.

A September poll of its online members by the National Association for the Self-Employed found that only 7.5 percent of respondents feel "very confident about retirement," and 56.6 percent feel "not very or not at all confident."

Almost 30 percent of the respondents have no retirement savings, and about 25 percent have less than $15,000.

Many small-business owners are reluctant to put money into a retirement account because they want the cash available for emergencies.

They also like to make investing in their businesses their first priority.

Cash-flow needs

"Retirement savings often have to take a back seat to other pressing micro-business costs," says Robert Hughes, president of the organization.

"Here at the NASE, we do all that we can to encourage the self-employed to invest in future retirement plans and encourage the government to provide incentives for retirement saving."

Experts say one of the best retirement tools for small-business owners is the individual defined-benefit plan.

"The individual defined-benefit plan gives you a much higher contribution limit, depending on your age," says E. Thomas Foster Jr., national spokesman for The Hartford's corporate retirement plans business.

"It's really such an age-driven opportunity."

Hartford's product is called the Hartford Solo DB (for defined benefit).

Benefits all

The solo defined-benefit plan isn't limited to small-business owners.

Federal anti-discrimination rules require that tax-qualified retirement plans cover a wide range of employees so as not to favor the highly compensated.

To establish an individual defined-benefit plan, you need to have a trust document signed and in place by Dec. 31 of the year that you would like to have the plan in place, says Morey Glazer, chief executive of Glazer Financial Network in Dallas, an investment advisory firm that deals in individual DB plans.

You'll also need to hire an actuary to determine the amount needed by the defined-benefit plan to pay future retirement benefits to participants.

"Assumptions and methods chosen by the actuary represent both his professional judgment and legislative constraints, and affect the amount required to fund the plan," Mr. Glazer says.

Defined-benefit plans aren't for every small-business owner.

"The first thing you need to decide is whether you can put away the contributions over a period of time," Mr. Glazer says.

That's because defined-benefit plans require mandatory contributions.

"It's not suitable for people who have incomes that vary year to year, like a real estate agent," says Andrew Keith, senior product manager of retirement and annuity markets for Pioneer Investments, whose individual defined-benefit product is called the Uni-DB Plan.

Five-year plan

Mr. Glazer also discourages small-business owners whose income varies year to year from establishing defined-benefit plans.

"We don't want someone to put in a defined-benefit plan who's had one good year because it's a fixed commitment, and to unravel this would be somewhat difficult," he says. "The IRS wants it to be consistent [in contributions]."

You ought to be able to fund the defined-benefit plan for at least five years, Mr. Glazer says.

"If you have employees, what we look for is if the benefit to you in tax savings is more than what you would give to the employees. If you have too many employees, it might be better to consider a defined-contribution plan — either a 401(k) or profit-sharing plan, or a combination of both."

Experts say solo defined-benefit plans are best suited for business owners who:

- Are 40 or older. Older owners can put more away for retirement because they don't have as much time as younger counterparts to save for retirement.

"I get to put a lot more money away each year, but I've got to make the commitment that no matter what my bottom line is, I have to make that commitment every year [to fund the plan]," Mr. Foster says. "That's why many larger companies don't want that long-term commitment."

- Own a business that produces consistent income.
- Have five employees or fewer.

"The more employees you have, the larger the contribution amount you also have to give to those employees," Mr. Keith says.

"From a budget standpoint, it gives you less money to contribute for yourself. The number of people can impact the amount of the benefit the owner is going to get if they have a fixed contribution that they want to go into the plan on an annual basis."

Individual control

With individual defined-benefit plans, business owners make their own investment choices.

That control delights Kevin Knight, 48, who owns Knight Marketing Communications in Dallas.

"The big interest for me was always to be able to control my portfolio as much as possible and be in a position to have as much growth as possible," Mr. Knight says.

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