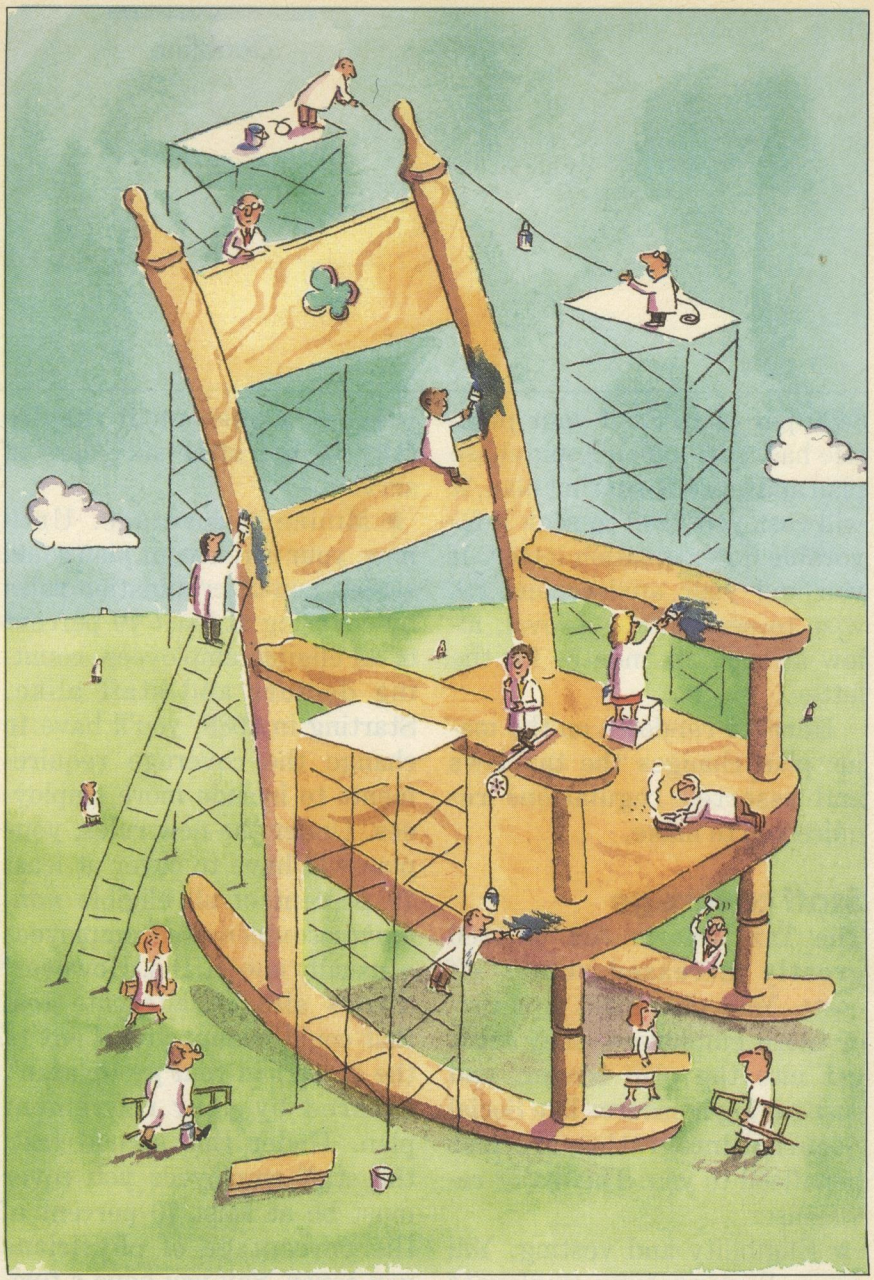

DON'T LET THIS RETIREMENT-PLAN DEADLINE SNEAK UP ON YOU

Federal law requires what amounts to a major overhaul of most pension plans. You don't have that long to make the changes.

By David J. Schiller, J.D.

It's no news that a load of retirement-plan changes will take effect in 1989. But few doctors know that next year they're required to formally amend their retirement-plan documents to reflect those changes.

Plans must be amended and signed by the end of the 1989 plan year. That may seem a long way off. Unincorporated practices have until Dec. 31, 1989; incorporated doctors who use a plan year other than the calendar year have even more time. But updating your plan isn't a cut-and-dried procedure. Many law changes will require you to make tough decisions about your plan, and if you practice in a group, you'll need to get together with the other doctors to iron out differences. The process is likely to take several months, so it's not too early to start on it now.

If you intend to submit your plan to the Internal Revenue Service for approval, your time constraints are especially tight; the agency isn't known for speedy decisions. IRS approval isn't mandatory, however, and you might want to think twice about getting it now that the agency has begun charging to review and rule on a plan's documents. New user fees are now

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$400 per plan. So if your practice has, say, a money-purchase plan and a profit-sharing plan, it will cost you $800 to seek a favorable determination letter. If you and your adviser feel it's wise to seek IRS approval, allow at least six months for the letter.

Here's a rundown on the major plan changes the tax laws and assorted regulations require you to make.

Staff coverage

The Tax Reform Act of 1986 greatly increased your staff costs. Your plan must now cover more employees, they must get into the plan sooner, and cost-saving measures like Social Security integration are less beneficial to you. The major revisions:

▶ Eligibility and vesting. You can no longer require employees to wait three years before they're eligible to participate in your plan. Now your plan must be amended to provide for a waiting period of no more than two years. At the end of that period, employees must become 100 percent vested in all future contributions.

If your plan currently provides for a "graded" vesting schedule, you don't need to make any changes. TRA '86 didn't touch that option: After a one-year wait, a plan can still begin vesting employees at 20 percent a year until they're fully vested after six years of service.

▶ Minimum coverage. Until now, your retirement plan could satisfy non-discrimination rules by covering at least 70 percent of all eligible employees, counting doctors and staff alike. Starting in 1989, you'll have to change the coverage requirements to include more employees. Under the new rules, your plan will have to cover at least 70 percent of all eligible *non-highly compensated* employees —usually non-M.D.s. However, there's also an alternate test that could benefit you if any of the doctors in your group aren't covered by your retirement plan. Under this second test, the staff employees you cover must be at least 70 percent of the percentage of physicians you cover. Say you have a five-doctor practice with six staff employees. If two of the doctors aren't included in the plan, you need to cover only three staffers. (Only 60 percent of the doctors are covered; 70 percent of 60 percent equals 42 percent of staff members who need to be covered.)

▶ Minimum participation. Besides minimum coverage, which concerns how many employees must be included in *any* of your practice's retirement plans, another rule concerns the number of employees who must be covered in *each* of your practice's retirement plans. Beginning in 1989, each qualified retirement plan will have to cover at least 50 employees or 40 percent of all eligible employees, whichever is less.

If your practice has set up several different retirement plans to benefit different participants, you'll probably have to combine them, and you'll have to do it quickly. Although you have until the end of the plan year to rewrite your plan, the rule itself goes into effect Jan. 1. Therefore, you must put the 50/40 rule into effect almost immediately, because any plan that violates the rule risks disqualification.

▶ Social Security integration. TRA '86 cut way back on this form of "legal discrimination." The basics remain unchanged: Integration allows you to reduce contributions on behalf of lower-paid employees to take into account the Social Security tax payments you've made on their behalf.

But tax law changes have cut back the savings from Social Security integration. For instance, you previously could integrate your plan so that you contributed, say, 3 percent of the first $20,000 of salary and 8 percent on salary above that integration level.

Starting in 1989, if you use Social Security integration,

you'll have to revise your plan to reflect two costly changes. First, the integration level can't be set lower than the Social Security wage base. With the wage base now at $45,000, the integration level in the example will have to be raised from $20,000 to $45,000. Second, a plan's "excess" rate on contributions above the integration level can't be greater than the "base" rate on contributions below the integration level. In the example, the excess rate is 5 percent—8 percent minus 3 percent—and greater than the base rate of 3 percent. To comply with the law, either the base rate would have to be increased to 5 percent or the excess rate reduced to 3 percent. Either change would reduce the advantage for higher-paid plan members—the doctors.

► Employee leasing. Under previous law, you were required to provide retirement benefits for leased employees only if the leasing company didn't cover them adequately. Now, if you lease more than 20 percent of your staff, you must include them in your plan and provide the same benefits for them as for staff employees. So you'll need to amend the definition of plan participants to include leased employees if they make up more than 20 percent of your practice's non-highly compensated employees.

Plan loans

TRA '86 clamped down on these loans, adding many new restrictions. As you know, you can no longer deduct any interest on plan loans taken out after Dec. 31, 1986. But changes that you need to incorporate into your plan documents reduce the advantages of loans still further:

► Restrictions on loan limits are tighter. Your plan must specify that loans to individual participants can't exceed $50,000, less the highest outstanding balance on any loans during the previous 12 months.

► Your plan must also specify a revised repayment schedule. Unless a participant borrows to buy a principal residence, the loan must be paid back within five years. Level amortization is required, with repayments made at least quarterly. Balloon payments are out.

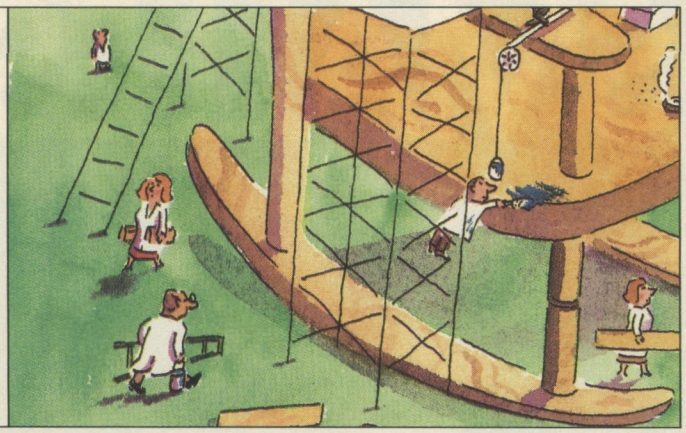
► Your plan will also have to specify the criteria for granting loans. You can no longer treat doctors and lower-paid staff differently. Each loan request must now be approved or rejected based on objective guidelines in your plan documents. So you'll need to answer such questions as these in your plan: What steps must every participant take to request a loan? Who approves the request? What percentage of a participant's vested interest may he borrow?

Plan distributions

Here's another area where new IRS regulations have undermined employer discretion. In the past, it was legal for your practice to decide, for instance, that one participant who leaves the practice before retirement age can receive his vested interest right away, while another must wait until he reaches 65. Or you could specify that if a participant's vested interest is less than a set amount, he must receive an annuity rather than a lump-sum payout. No longer.

Now all participants must be treated the same, and your retirement-plan documents must spell out the specific distribu-

The IRS means business about plan revisions. Audits have been stepped up, and out-of-date plans can be disqualified.



tion rules you intend to use.

New rules also govern early distributions. In the past, you couldn't receive money from your plan before age 59½ without penalty unless you died or became disabled. Now, your plan can specify that you can draw out benefits at any age, provided you receive them in level payments based on your life expectancy or on your and your spouse's joint life expectancy. In reality, this new distribution option will benefit few physicians. Especially if you're younger than 50, your life expectancy is so great that payments will be minimal.

A different change in the tax law might help you, however. The law now permits you to withdraw benefits without penalty if you're at least 55 when you retire from practice. To permit taking advantage of this new rule, your plan should specify that retirement is allowed as early as age 55.

Added contributions

For most doctors, voluntary non-deductible contributions to a retirement plan are no longer practical.

If your practice is already contributing the deductible maximum, then you can't contribute anything more, even on an after-tax basis. If your practice *isn't* contributing the maximum, new non-discrimination rules make it difficult for highly compensated physicians to make additional voluntary contributions. Under the new rules, these contributions can't exceed a certain percentage of the voluntary contributions made by lower-paid staff. If your plan permits voluntary contributions, you'll have to amend that section to include these new restrictions.

Similar non-discrimination rules make 401(k) plans less advantageous. Like voluntary contributions, the amount you can set aside in a 401(k) plan is tied to the amount staff employees contribute. If they contribute little or nothing, you're allowed only a minimal contribution. Also, the maximum 401(k) contribution has been slashed from its former $30,000 limit. This year, the inflation-adjusted limit is only $7,313. If your practice uses a profit-sharing plan with a 401(k) feature, these limitations must be spelled out in plan documents.

The IRS means business about plan revisions. Retirement-plan audits have been stepped up, and auditors can disqualify an out-of-date plan. So the risks are too great to put off this onerous project. Given the difficulties it involves, the sooner you get to it, the better. ■