Inc.
BUSINESS OWNERS COUNCIL

High and DRY

Russ Alan **PRINCE** and Hannah Shaw **GROVE**

The historical mismatch between **POPULAR RETIREMENT PLANS** and the **NEEDS OF SMALL- AND MEDIUM-SIZED BUSINESSES** have left many business owners **WOEFULLY UNDER-PREPARED FOR RETIREMENT.**

In Association With:

HERALD NATIONAL BANK

Rothstein Kass EST. 1959 50

Letter from
LEWIS SCHIFF

The impact of the business owner is felt among several different communities over a long period of time. Not only can they personally benefit from their hard work and risk-taking, so can their families, their employees, their employees families and so on.

Even more significantly, the money earned for work done today can be saved and spent later, when the employees — or even the business owner — has stopped working. For decades, the federal government has been a willing partner in this exercise, understanding that if it lets us save with "pre-tax" dollars and allows that money to grow in a tax-advantaged environment, we are more likely to have a well-funded retirement and therefore be less of a burden on the state.

It sounds simple, but as with all tax-related programs, the devil is in the details. The regulations and the complexity of maintaining these programs has always made them a difficult proposition for small- or medium- businesses.

The research shared by Russ Alan Prince and Hannah Shaw Grove in this enlightening report suggest that too many business owners are failing to take advantage of these plans because of this complexity. For those that *do* have retirement plans, there's a high level of dissatisfaction in their plans.

This is an unfortunate result because business owners are "leaving money on the table" as they say in Vegas — money that could play an important role in their retirement planning, business succession planning and estate planning.

Recent changes in retirement planning regulations inspired this research report. In a special sponsor section and case study, Richard Flynn and Frank Seneco describe new "benefit-focused" plans that address some of these long standing concerns found in the traditional programs. Take a look.

Sincerely,

Lewis Schiff
Chairman, Executive Director
Inc. Business Owners Council

Inc.
BUSINESS OWNERS COUNCIL

ABOUT INC. BUSINESS OWNERS COUNCIL

Inc. Business Owners Council (www.inc.net) is *Inc.* magazine's membership organization for top entrepreneurs and family business owners. **The Council** brings thought leaders together with Council members to explore best practices and develop insight that help members make smarter business decisions.

Contact:
Inc. Business Owners Council
7 World Trade Center
New York, NY 10007
www.inc.net
membership@inc.net
(800) 536-0046

Key THEMES

- Only half of business owners are using retirement plans with tax-preferential treatment even though they are an effective tool for saving money for retirement. Of those who do use such plans, only one-third are satisfied with the program they have.
- Low adoption rates and satisfaction levels with these plans are due primarily to the poor fit between plan features and the business owner's needs.
- Most business owners feel they don't personally benefit from traditional retirement savings programs.
- Without a clear and substantial personal benefit, the large majority of business owners will not assume the expense or administrative complexity of a retirement plan. As a result, many business owners will end up inadequately planning and saving for their retirement needs.
- Out of dissatisfaction with traditional options, many business owners rely on alternative savings strategies without taxable advantages which may be less advantageous to them.
- New options have emerged from recent tax legislation that offer more attractive retirement planning options to business owners and their employees.

A principal purpose of any retirement plan is to enable business owners to put away money now so they will have that money and more when they retire. Retirement plans offer other advantages to business owners, as well. For instance, these plans can be very useful in attracting and retaining talent to the company. From the perspective of business owners:

Retirement plans enable business owners on a tax preferential basis to financially prepare for living the lifestyles they and their employees want when they stop working with due regard to inflation.

Retirement programs that meet certain IRS requirements are defined as "qualified." Qualified retirement programs have three distinguishing characteristics:

- **Money placed in the plan is tax deductible for the employer.** The money the business owner places into the retirement plan is deducted against the corporate income taxes owed.
- **Retirement program participants are not taxed on the monies placed in the program until those monies are received.** All the participants in a qualified retirement plan don't pay taxes on their retirement plan monies until they take them out of the plan.
- **Monies in the retirement plan accumulate tax deferred.** The monies placed in the plan grow unencumbered by taxes. And, the compounding effect can be considerable.

Qualified plans have primarily been valuable to large corporations where the majority of employees and managers could benefit. Other complementary programs, such as profit sharing and executive compensation, address the unique needs of highly-compensated executives.

In smaller firms, however, traditional qualified plans made less sense as they rarely offered significant personal upside to the owners of the businesses. New pension reform has yielded a new approach to retirement planning that will help business owners, and their employees, plan more effectively.

About the **AUTHORS**

Hannah Shaw **GROVE**

Principal
HSGrove Private Wealth Consultancy

Ms. Grove is a respected author, columnist and speaker and a leading authority on the mindset, behavior, concerns, preferences and finances of high-net-worth individuals. She is the executive editor of *Private Wealth*, the first and only magazine for professionals with ultra-affluent clients, and the author of nine books and numerous reports on private wealth and related topics. She co-authors columns for *Elite Traveler* and *Robb Report China* and is widely quoted in the national, trade and online press.

She spent nearly 20 years in the financial services industry where she worked closely with institutional and high-net-worth investors to develop sophisticated financial, planning and servicing solutions. Grove is the principal of HSGrove Private Wealth Consultancy, and a long-time partner of Russ Alan Prince, the president and founder of Prince & Associates, Inc.

Russ Alan **PRINCE**

President
Prince and Associates, Inc.

Mr. Prince is the president of Prince & Associates, Inc., the leading market research firm specializing in private wealth. He is one of the most prolific authors on the topic of high-net-worth individuals and has completed work on more than 40 books covering subjects ranging from investor psychology to luxury spending, from prospecting in the mass-affluent segment to the political philosophies of the super-rich. His body of work is regularly consulted by family offices, private bankers, wealth managers, estate planning specialists, elite advisors and producers, academia, the press — even the wealthy themselves. Collectively, the cache of research-based insights within Prince's publications is the most complete longitudinal data and the largest, most comprehensive database on the topic.

Mr. Prince consults to high-net-worth families on accessing various family office and wealth management services. He also works with financial and legal experts who provide cutting-edge strategies and concepts to families with exceptional wealth. He is a highly sought consultant to the ultra-high-net-worth and elite advisors, and is regularly cited in the worldwide press.

About the RESEARCH

To understand the current mindset among business owners regarding their retirement planning and savings options, we undertook a research initiative. We spoke with 1,402 owners of businesses.

Nearly 80% of them were at least 40 years old (Exhibit 1). When it comes to the business, about two- thirds have between 5 and 30 employees. The remaining businesses had between 30 and 100 employees (Exhibit A.3).

EXHIBIT 1: Age

[N = 1,402 BUSINESS OWNERS]

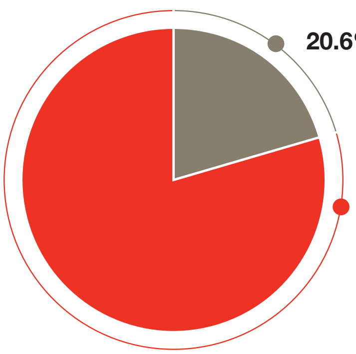
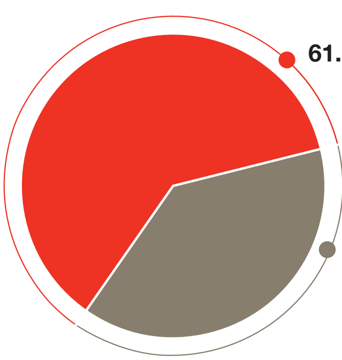


EXHIBIT 2: Number of Employees

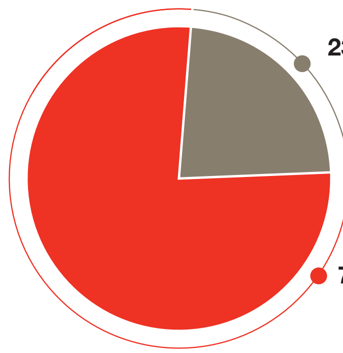
[N = 1,402 BUSINESS OWNERS]



About three-quarters of the business have been operational for more than 15 years. The remaining businesses have been in business between 5 years and 15 years (Exhibit 3).

EXHIBIT 3: Years in Business

[N = 1,402 BUSINESS OWNERS]



Use of Qualified RETIREMENT PLANS

What proved telling was that only about half the business owners we surveyed have a qualified retirement plan (Exhibit 4). Moreover, only about a third of them are satisfied with their plans (Exhibit 5).

EXHIBIT 4: Have Qualified Plan

[N = 1,402 BUSINESS OWNERS]

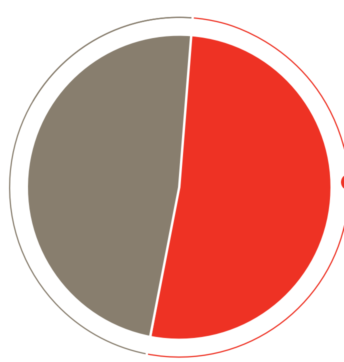
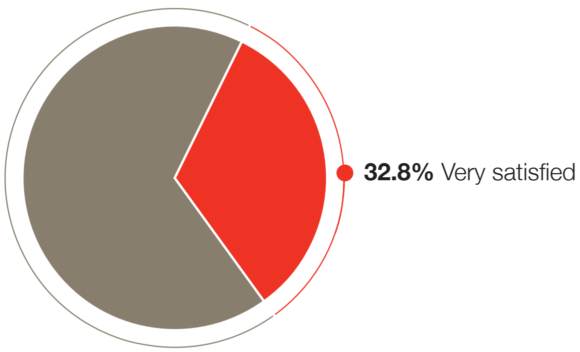


EXHIBIT 5: Very Satisfied with Their Qualified Retirement Plans

[N = 726 BUSINESS OWNERS]

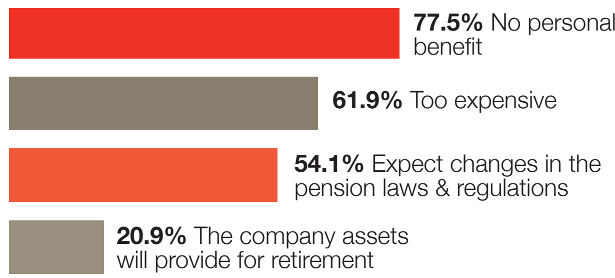


With twice as many business owners unhappy with their qualified retirement plans, we analyzed the reasons why (Exhibit 6). Topping the list is a lack of personal benefit – a perspective expressed by nearly three out of four of the business owners. It's not uncommon for small business owners to have "top heavy" plans which leaves them with little to no personal benefit from a qualified retirement plan.

For a little more than 60% of the business owners, qualified retirement plans are just too expensive to establish and maintain. More than half of them expect changes in the pension laws and regulations. Moreover, these kinds of changes can prove costly and highly problematic. Nevertheless, for many business owners, the benefits of qualified retirement plans significantly outweigh the possibility of the government fiddling with the rules. About a fifth of the business owners are looking to the company's assets to provide for their retirement. In effect, they're anticipating selling the company or selected assets to fund their retirements.

EXHIBIT 6: Reasons for Dissatisfaction

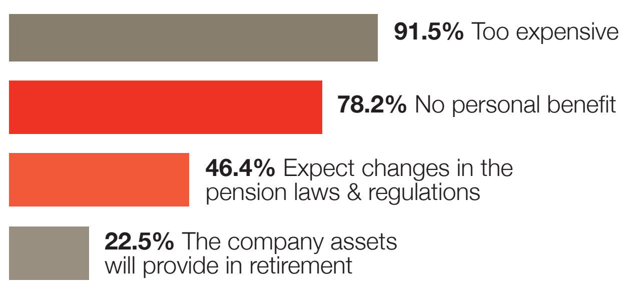
[N = 488 BUSINESS OWNERS]



We also queried the business owners who did not have a qualified retirement plan about their reasons for not having one (Exhibit 7). Nine out of ten said having a qualified retirement plan was just too expensive, while almost eight out of ten said there wasn't a personal benefit for implementing a retirement plan. About half the business owners are disinclined because of changes in the pension laws and regulations. Almost a quarter of the business owners are looking at some sort of future asset sale to finance – at least in part – their retirements.

EXHIBIT 7: Reasons for Not Having a Qualified Retirement Plan

[N = 488 BUSINESS OWNERS]



In sum, most business owners see little personal benefit in establishing and maintaining a qualified retirement plan. Clearly, there are many business and financial benefits of these plans, but the costs tend to tip the balance against them. Based on decades of experience working with business owners, we've found that if they can see how they benefit personally from a qualified retirement plan, they are much more motivated to have such a plan. In the next section, experts Richard Flynn and Frank Seneco describe the newly permissible "Benefits-Focused Retirement Plan" and how it addresses the concerns of our survey respondents.

High and DRY

Retirement Planning Solutions
FOR PRIVATE BUSINESS OWNERS

Rothstein Kass 50 EST. 1959

HERALD NATIONAL BANK

Richard
FLYNN

Principal and Head of Family Office Group
Rothstein Kass

Richard J. Flynn, JD, is a principal and the head of Rothstein Kass' Family Office Group. A lawyer and advanced planning specialist, he advises high-net-worth clients on wealth enhancement, wealth transfer and asset protection planning. His clients include hedge fund managers, business owners and other executives, professional athletes, and entertainers. He is co-author of *Fame & Fortune: Maximizing Celebrity Wealth.* He also contributed to the publication *Beyond Performance: How Hedge Funds Can Strengthen and Build Their Affluent Client Base.*

Frank
SENECO

President
Seneco & Associates, Inc.

Frank Seneco is President of Seneco & Associates, Inc., an advanced planning firm located in New Haven, CT. He has 20 years experience in the life insurance industry starting in what was left over from the old debit business collecting weekly premiums from clients early on, then evolving into the advanced planning market place. Seneco is a frequent speaker on these topics, regularly speaking to other professionals and ultra-affluent families. He has written for a variety of trade publications including *Private Wealth* and *Elite Traveler*. He is co-author of the newly released book *Protecting the Family Fortune* and the forthcoming books entitled, *Retire Rich* and *Tax Wise Business Planning*. He is a member of Top of the Table, AALU and The International Forum.

Types of QUALIFIED RETIREMENT PLANS

1. DEFINED CONTRIBUTION PLANS

In a defined contribution plan each participant has his or her own individual account. The benefits that will be received at retirement are based on the amount contributed to the plan coupled with gains and losses due to the performance of the investments minus expenses. Defined contribution plans come in two flavors: profit sharing and pensions.

- **Profit sharing plans** allows for the employer and or participants to determine how much to put into the plan. There are dollar limits to contributions and limits on the maximum salary to be considered regardless of income. The business owner does not have to put in that amount or anything at all for that matter. Profit sharing can be divided into deferred plans and salary reduction plans.

- There are basically two types of deferred plans. One is referred to as traditional profit sharing plans. The other is generically known as cross-tested plans where age weighted plans (those benefiting older employees) also exist. There are a number of different varieties of cross-tested plans. The difference in the types of deferred plans is in how the monies are allocated among the participants in the plan.

- **Salary deferral plans** allow participants to reduce their compensation by having monies go into the plan. The two types of salary deferral plans are 401(k) plans and 403(b) plans. The employer *has the choice* to match the amount put into these plans. The primary advantage of a 401(k) plan is that it allows flexible contributions and salary deferrals which are not taxed to the participant.

- **Pension plans** require a fixed commitment. With a defined contribution pension plan, there is a promise to contribute a certain percentage of salary. As with profit sharing plans, there is a limit on what percentage and total amount is permissible.

— There are also two types of defined contribution pension plans. One is called a money purchase plan. Here, the employer puts in a fixed percentage of the employee's salary. The advantages of the money purchase plan include predictable costs, simple plan design and ease of administration.

— The other type is a target benefit plan. Here the percentages vary by age with older participants getting a higher percentage than younger participants.

2. DEFINED BENEFIT PLANS

All defined benefit plans are pension plans and therefore have a fixed commitment. Here the promise is a fixed percentage of compensation received at retirement. The advantages to defined benefit plans include a predictability of benefits at retirement as well as maximizing tax deductions.

- **Traditional plans** like all defined benefit plans are geared to a set payout to participants at retirement. The employer has wide latitude in the choice of investment vehicles – stocks, bonds and so forth. A drawback of the traditional plans is that they can become overfunded. This is where the actuarial estimates project that the annual return on the fund, on retirement, will exceed annual limits. When a plan becomes overfunded additional monies cannot be contributed thereby eliminating the tax deductions.

- **412(e) plans** are funded with a combination of life insurance and annuity contracts. This type of plan cannot be overfunded and larger tax deductions are available then with a traditional plan.

- **Benefit-focused plans** provide, for the "right" business owner with the "right" employee makeup the greatest benefits. Specifically, it efficaciously addresses the critical concern of business owners (see above) that they do not personally benefit. Here, the benefits to the business owners are greatest. Because of the newness and appeal of these plans, lets take a closer look.

Progress for
RETIREMENT PLANNING

The Pension Protection Act of 2006 took effect in 2008 and changed all the rules for funding a defined benefit plan. It brought to life the benefit-focused plan which more than triples the potential tax deductions of a traditional defined benefit retirement plan. The benefit-focused retirement plan is backed by IRS letters of determination.

The key benefits of the plan include:

- Significant corporate income tax deductions. Of all qualified retirement plans, the highest possible deductions are possible with this plan making it very useful in adroit income tax planning.

- The ability for business owners to obtain meaningful benefits for themselves over their lifetimes. And, in case of their demise, the benefits can transfer to their spouses and heirs over their respective lifetimes.

- Business owners are able to designate – based on governmentally set criteria – who can participate. The "testing requirements" provide a fair amount of latitude resulting in the business owners deriving most (and in some cases all) the benefits for themselves. Additionally, various vesting schedules can be applied depending on the objectives of the business owner within the framework of the governmentally set criteria.

- The ability to obtain life insurance using pre-tax dollars. The proceeds are paid income tax and potentially estate tax free. This benefit proves useful in succession and estate planning as well as in dealing with forced equity transitions.

- As a qualified retirement plan, the plan assets are principally protected from creditors and litigants.

One Hundred Ninth Congress of the United States of America

AT THE SECOND SESSION

Begun and held at the City of Washington on Tuesday, the third day of January, two thousand and six

An Act

To provide economic security for all Americans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE AND TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Pension Protection Act of 2006".

(b) TABLE OF CONTENTS.—The table of contents for this Act (other than so much of title XIV as follows section 1401) is as follows:

CASE STUDIES

To get a better "feel" for the power of benefit-focused retirement plans, let's look at a few cases. In 2009, with a defined benefit plan, a business owner can structure the plan and make contributions that result in $16,250 a month beginning as early as age 62 or being as high as $20,417 a month beginning as age 69 for their lifetimes with the possibility of the monthly benefit being increased annually by a cost of living. Therefore, in all the following examples, that is the payout to the business owners. As noted, with benefit-focused retirement plans, this benefit can apply to heirs. A summary of key advantages of the plan for these business owners is shown in Exhibit 8.

CASE #1 TRAINING FIRM

Mr. Watts owns an 18-person management training firm. Most of his clients are Fortune 500 companies. Except for a few support personnel, his employees are all professionals. He set up a benefit-focused retirement plan and was able in each of the next 10 years to put in about $550,000 per year. He can therefore deduct the $550,000 from his income taxes every year he makes a contribution. Of the monies he's putting into the plan more then 90% per year is for his retirement. At the same time, he will have in excess of $1.6 million in life insurance that he purchased with pre-tax dollars. The life insurance is earmarked to pay estate taxes.

CASE #2 CONSTRUCTION COMPANY

Mr. Mostert and Mr. Barns are partners in a 26-person construction company. They set up a benefit-focused retirement plan and are putting in $700,000 which is income tax deductible. More than 85% of the monies go to the two partners. In addition, there is about $2 million in life insurance for each of them that's being used to fund a buy/sell agreement between them (see *Chapter 9: Forces Equity Transitions).*

CASE #3 FRANCHISEE

Ms. Baines owns three fast food restaurants employing over 40 people a fair number of them her relatives. She set up a benefit-focused retirement plan and was able to contribute about $625,000 each year. She also receives about 70% of the benefits and her relatives receive the remaining benefits. The proceeds from the life insurance she was able to purchase with pre-tax dollars is intended to pay off the debt on the business.

EXHIBIT 8: Summary of Benefits

Business owners	Amount of tax deductible contribution	Percentage going to the business owner(s)	Use of life insurance
Mr. Watts	$550,000	90%	Pay estate taxes
Mr. Mostert and Mr. Barnes	$700,000	85%	Fund the buy/sell agreement
Ms. Baines	$625,000	70%	Pay off the debt on the restaurant business

About the
SPONSORS

623 Fifth Avenue, 11th Floor
New York, NY 10022
800.498.3173
www.heraldnb.com

HERALD NATIONAL BANK

Herald National Bank is a relationship-based banking institution dedicated to serving the commercial and private banking needs of small to mid-sized businesses, their owners, executives and senior managers, as well as high-net-worth individuals in the New York metropolitan area. Herald National Bank clients benefit from direct relationships with a single private banking team carefully selected for its ability to cater to the specific financial needs of each client.

1350 Avenue of Americas
New York, NY
www.rkco.com

ROTHSTEIN KASS

Rothstein Kass provides audit, tax, accounting and consulting services to hedge funds, fund of funds, private equity funds, broker-dealers and registered investment advisors. The Firm is recognized nationally as a top service provider to the industry throught its Financial Services Group. The Financial Services Group consults on a wide range of organizational, operational and regulatory issues. The firm also advises on fund structure, both inside and outside the U.S., compliance and financial reporting, as well as tax issues from a federal, state, local and international compliance perspective. Rothstein Kass has offices in New York, New Jersey, California, Colorado, texas and the Cayman Islands.

BUSINESS OWNERS COUNCIL

ABOUT INC. BUSINESS OWNERS COUNCIL

Inc. Business Owners Council (www.inc.net) is *Inc.* magazine's membership organization for top entrepreneurs and family business owners. **The Council** brings thought leaders together with Council members to explore best practices and develop insight that help members make smarter business decisions.

Contact:
Inc. Business Owners Council
7 World Trade Center
New York, NY 10007
www.inc.net
membership@inc.net
(800) 536-00466