

Benefit Issues Impacting Physician Groups

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There are a number of noteworthy employee benefit issues of interest to physician practices; some of them are addressed below.

Health and cafeteria plans

One of the most frequently asked health benefit questions posed by physician groups is this: Can the group provide family coverage to the physicians and employee-only coverage to the staff?

This is a rather technical question from the legal side. Very generally, physician groups may provide family coverage only to physicians if both of the following conditions are satisfied: (1) the health plan is insured (rather than self-insured) and (2) the physicians do not participate in a cafeteria (Section 125) plan (although employer contributions toward the cost of coverage may be made on a tax-free basis).

As to cafeteria plan participation, the IRS proposed regulations last year that clarify who may participate in cafeteria plans. Only employees may participate in cafeteria plans. Sole proprietors, partners, directors and two-percent shareholders of S corporations are not considered employees and may not participate; however, a sole

proprietor may sponsor a cafeteria plan covering the sole proprietor's employees (but not the sole proprietor). Similarly, a partnership or S corporation may sponsor a cafeteria plan covering employees (but not a partner or two percent shareholder of an S corporation). So, physicians in your practice may not be able to participate in a cafeteria plan, in any case.

Health savings accounts

Physicians considering establishing a Health Savings Account (HSA) this year must be aware of the following HSA limits for 2008:

- *Annual contribution limits.* The maximum HSA contribution is \$2,900 for individual coverage and \$5,800 for family coverage.
- *High deductible health plan limits.* The minimum deductible for HSA-qualified high deductible health plans is \$1,100 for individual coverage and \$2,200 for family coverage policies. Out-of-pocket maximums are \$5,600 for individual coverage and \$11,200 for family coverage policies.





Nonqualified deferred compensation arrangements

Important tax deadline fast approaching. By December 31, 2008, all nonqualified deferred compensation arrangements will need to be revised to comply with Section 409A and related IRS regulations. Failing to comply with Section 409A by the deadline (and at any time after) can result in severe adverse tax consequences.

Specifically, all compensation deferred under the arrangement would be immediately includable in taxable compensation and would then be subject to an additional 20 percent income tax. Interest and penalties also could apply. That means that a physician who is in the highest income tax bracket could lose over 50 percent of the deferred compensation if the arrangement fails to conform to regulations.

What is a nonqualified deferred compensation arrangement? In very general terms, a “nonqualified deferred compensation” arrangement is any arrangement (whether part of a plan, employment contract or some other agreement) under which taxable compensation is deferred to a future tax year. Some exceptions are qualified retirement plans, vacation leave, sick leave, compensatory time, disability pay or death benefit plans. The following examples may be subject to Section 409A, or may have a provision that is: severance plans, annual bonus programs, traditional deferred compensation arrangements (such as SERPS and other supplemental plans), split-dollar arrangements and employment agreements (including accounts receivable payout provisions).

What to Do? Without reviewing the different agreements and arrangements, it is difficult to know for sure whether anything in those agreements or arrangements is subject to Section 409A. Therefore, the first step is that all of the various arrangements and agreements providing any form of compensation should be reviewed. If taxable compensation is deferred—or there’s a potential to defer—to a future tax year, then those agreements and arrangements must be revised by December 31, 2008, to comply with Section 409A.

Improve contributions to physician retirement plans

What kind of improvements? A properly designed retirement program can increase an owner’s retirement plan benefit by more than \$80,000, while decreasing the owner’s contribution to the non-owner employees by

\$20,000. Of course, the demographics of the physician group can impact the numbers; but many, if not most, physician groups can improve their retirement plan benefits through effective planning and design.

In very general terms, many physician groups may take advantage of a two qualified retirement plan system: a profit-sharing plan with a 401(k) feature and a cash balance (defined benefit) plan. Using two qualified retirement plans can help the owners seriously increase contributions made on their behalf while still passing nondiscrimination tests.

Comparison of retirement plan designs. To help illustrate the impact of effective planning and design, the following examples are based on actual physician group numbers.

- First, take Dr. John. In 2007, Dr. John was 55, made around \$350,000 and had seven staff employees working for him. Dr. John’s practice had only one retirement plan in 2007: a basic profit-sharing plan. Dr. John wanted to put as much money away as allowed by law on a pre-tax basis for his retirement. However, because Dr. John has only one retirement plan, the basic profit-sharing plan, the contribution made to his individual account in the profit-sharing plan was limited to \$45,000. To be able to contribute the \$45,000 to his individual account, Dr. John’s practice also had to contribute an additional \$40,725 to be divided among the seven staff employees. Therefore, Dr. John received only 52.49 percent of his practice’s employer contribution.
- Second, take Dr. Jane. In 2007, Dr. Jane was 55, made around \$350,000 and employed one 36-year-old physician and four staff employees. Like Dr. John, Dr. Jane wanted to put as much money away as allowed by law in 2007 on a pre-tax basis for her retirement. However, Dr. Jane was able to accomplish a much higher savings rate on a pre-tax basis by using *two* retirement plans: a profit-sharing plan with a 401(k) feature and a cash balance pension plan.

By using the two-plan design, Dr. Jane was able to have her practice contribute \$124,000 on a pre-tax basis to her accounts under the retirement plans (\$78,000 more than Dr. John). Dr. Jane also contributed an additional \$20,500 in her own contributions to the profit sharing/401(k) plan. To be able to

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contribute the \$124,000 to the two plans on her behalf, Dr. Jane's practice had to contribute \$17,168 to the plans on behalf of her employees (\$10,725 to the 36-year-old physician and a total of \$6,443 to be divided among the accounts of the four staff employees). Therefore, Dr. Jane received 87.8 percent of her practice's employer contribution, as compared to Dr. John's receiving only 52.49 percent.

Your Practice. Your practice may be able to achieve results more along the lines of Dr. Jane's practice by instituting new features to your existing qualified retirement plans and/or by adding a cash balance plan.

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