

Retirement Savings Plans for Radiologists: Part 1—The Options

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Employer-sponsored retirement plans are the primary savings vehicles used by radiologists to fund their retirements. A variety of retirement plans are available with guidelines, benefits, and restrictions specified by the Internal Revenue Code. In this article, we review and summarize the salient features of these plans. A second article, in an upcoming issue of *JACR*, explores the current status of radiologists' retirement plans.

Key Words: Retirement savings plans, retirement benefits, financial planning, investing

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INTRODUCTION

The primary long-term financial goal of most radiologists is to retire with dignity and with the financial security to live out their remaining years in comfort. Achieving this goal requires a sound retirement savings plan. The retirement options offered to radiologists vary significantly, not only from one employer to another, but, as we will show, more notably between academic institutions and private practice groups.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) introduced provisions that increased retirement savings options and eased many of the limitations on retirement contributions. However, there have been considerable differences in how employers of radiologists have interpreted and implemented the new tax laws. It is the intent of this article to discuss the various retirement options allowed under the tax code. In Part 2 of this series, by using a survey we developed, we examine and compare the retirement benefits of a sampling of academic institutions and private practice groups. On the basis of this information, we offer some suggestions for improving the retirement savings plans for radiologists in both private and academic settings.

BACKGROUND

Employer-sponsored retirement savings plans have two important advantages over private taxable accounts: (1) they allow contributions out of pretax dollars, and (2) they allow investment returns to grow tax free. Taxation on these accounts is not avoided altogether, however, because withdrawals during retirement are taxed as ordinary income.

In 1974, Congress passed the Employee Retirement Income Security Act, which established federal provisions for em-

ployer-sponsored retirement plans. Out of these guidelines emerged two general classifications of retirement plans: the Defined Benefit Plan and the Defined Contribution Plan. Defined Benefit Plans provide an ongoing pension after retirement for each eligible employee, whereas Defined Contribution Plans provide annual employer contributions toward an employee's retirement savings, which are subsequently invested and paid out to the employee on retirement.

Most Defined Benefit and Defined Contribution Plans are considered qualified retirement plans under the Internal Revenue Code (IRC) Sections 401(a) and 403(a). This qualification provides the following benefits:

1. Employers are able to deduct all contributions that they make into a plan on their employees' behalf [1].
2. Employees are not taxed on the contributions they receive at the time they are conferred [2,3].
3. All contributions within the plan grow on a tax-deferred basis [4].
4. Payments that are received at retirement may qualify for favorable tax benefits [2,3].

The primary difference between qualified and nonqualified plans is that the latter do not allow employers to receive a current tax deduction for contributions made on behalf of their employees. Deductions are available to the employer only when funds are paid to the employee at the time of retirement. For this reason, employers that are subject to taxation invariably prefer qualified plans. Tax-exempt employers typically use nonqualified plans, which are less expensive to administer and allow more flexibility with regard to eligibility criteria, funding, vesting, and terms of forfeiture. The major categories of retirement savings plans are shown in Table 1 and are discussed in more detail below.

Defined Benefit Plans

A Defined Benefit Plan is a traditional pension plan in which the benefits consist of a fixed annual or monthly stipend payable for life beginning at the time of retirement. The pension benefit is calculated by using a formula that typically incorporates the employee's age, years of service, and average annual

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Table 1. Retirement savings plans

Defined Benefit Plans	Defined Contribution Plans
Traditional Pension Plan	401(k) plan
Cash Balance Plan	403(b) plan
	Profit-sharing plan
	Money pension purchase plan
	Deferred compensation plan

compensation before retirement. EGTRRA increased the maximum limitation on allowed annual benefits under Defined Benefit Plans from \$140,000 to \$160,000 for the year 2002, with future increases indexed to inflation in \$5000 increments [5].

An important feature of Defined Benefit Plans is that the employer bears the investment risk. The employer finances the plan by making contributions on behalf of eligible employees. These contributions are supplemented by revenues that accrue from the investment of these assets. In some cases, employers also require a minimum employee contribution to the plan. The employer determines how the contributions are invested and, regardless of investment performance, is ultimately obligated to pay the established benefits to eligible employees on retirement. The term *pension plan*, although generic, usually refers to this type of plan.

Cash Balance Plans

A Cash Balance Plan is a hybrid in that it is classified as a Defined Benefit Plan, yet it has some features of a Defined Contribution Plan. Cash Balance Plans provide each employee with a hypothetical investment account. As in a Defined Contribution Plan, the benefit to the employee is stated in terms of the account balance. Each year, the employer issues a pay credit to the employee's Cash Balance account based on a specified percentage of the employee's compensation. An annual interest credit on the account balance is also applied based on either a fixed interest rate or a variable rate tied to a benchmark such as the 1-year United States Treasury bill. The employee designates whether the payment is to be received in the form of monthly annuity payments for life beginning at retirement or as a lump sum distribution at the time of retirement. IRC regulations allow the distribution to be rolled over into an Individual Retirement Account (IRA) or another employer's retirement plan in the event of a termination or job change [6]. Cash Balance Plans typically appeal to younger employees who can realize higher benefits at an earlier age than those provided by a traditional pension plan while retaining the option to change employers without forfeiting their retirement savings.

As with a traditional pension plan, the employer determines how the plan assets are invested and bears all of the associated investment risk. The employer is obligated to credit the established benefit to each employee's account regardless of the performance of the invested funds. Both traditional Defined Benefit Plans and Cash Balance Plans are insured by the Pension Benefit Guaranty Corporation, which has the authority to

assume trusteeship and initiate pension payments in the event that a plan is terminated with insufficient funds. This safeguard is not available for Defined Contribution Plans and is reserved solely for qualified Defined Benefit Plans.

Defined Contribution Plans

In a Defined Contribution Plan, the employer makes contributions to an employee's individual investment account. This contribution is usually based on a percentage of the employee's compensation. In some cases, the contribution is automatic, without any employee participation required. Other plans require the employee to contribute a certain percentage of his or her salary each year to receive employer contributions.

Employers establish a vesting schedule that dictates how long an employee must participate in the plan before being guaranteed receipt of the benefits. EGTRRA guidelines specify that an employee must be fully vested within 3 years of initial participation in a plan with an immediate vesting schedule or within 6 years if a graded schedule is used (e.g. vesting accrues in annual increments of 20% beginning in the second year of participation) [7,8].

An important feature of Defined Contribution Plans is that the employee is responsible for determining how the assets are invested. However, the plan may place restrictions on which financial service providers can be used and may limit the choice of investment funds. The value of an employee's Defined Contribution account at the time of retirement depends not only on the total combined employer and employee contributions, but also on the net investment gains or losses in the employee's account. Unlike the Defined Benefit Plan, it is the employee who bears the investment risk. The retirement benefit is paid out on retirement either as a lump sum distribution or as a lifetime monthly annuity. Like the Cash Balance Plan, the account remains portable in the event of early termination or job change [9].

Under EGTRRA guidelines, the total maximum annual limit on all contributions toward an individual's Defined Contribution retirement account (including both employee and employer contributions, collectively) is set at the lesser of \$41,000 or 100% of compensation [10]. Subsequent increases to this limit may occur in \$1000 increments indexed to inflation, as determined annually by the Secretary of the Treasury [11]. IRC regulations also limit the maximum salary amount from which the employer and employee contributions can be calculated. EGTRRA increased this compensation ceiling from \$170,000 to \$200,000, with subsequent increases indexed to inflation in \$5000 increments [12]. In 2004, the maximum salary for contribution calculations was raised to \$205,000. The maximum elective employee contributions to 401(k), 403(b), and 457(b) plans are shown separately in Table 2. Table 3 summarizes the major provisions for retirement benefits that were introduced through EGTRRA.

To secure congressional passage of EGTRRA, a sunset provision was included that states that all regulations are applicable only until 2010 [13]. Any provision that is not extended or made permanent before this time will revert back to the provisions that were applicable before the passage of EGTRRA.

Table 2. Maximum elective employee contributions for 401(k), 403(b), and 457(b) plans

Year	Employees Less Than 50 Years Old	Employees 50 Years and Older
2002	\$11,000	\$12,000
2003	\$12,000	\$14,000
2004	\$13,000	\$16,000
2005	\$14,000	\$18,000
2006	\$15,000	\$20,000
2007	\$15,500	\$21,000
2008	\$16,000	\$22,000

Although it is widely anticipated that these provisions will be extended by future legislative action, this is not guaranteed.

401(k) Plans

A 401(k) plan is a qualified Defined Contribution Plan that is funded by pretax employee contributions, which may or may

not be supplemented by matching employer contributions. Employees are always fully vested in their own contributions, whereas matched contributions are subject to a vesting schedule established by the employer.

Although most 401(k) plans allow employees to direct their own investments, employers often provide a limited list of authorized investment providers or funds. As in all Defined Contribution Plans, the investment risk is borne by the employee, and the distribution of assets at retirement is based on the accumulation of employee and employer contributions and any accrued gains or losses.

Employers that offer 401(k) plans are required to fulfill significant administrative responsibilities, such as filing annual federal tax forms and complying with a battery of tests that ensure that there is no discrimination in favor of highly compensated employees. Because of the costs of these administrative requirements, many employers do not allow terminating employees to keep their accrued retirement assets in their 401(k) plans indefinitely after leaving the company. Instead,

Table 3. Abbreviated summary of EGTRRA provisions

Retirement Plan Feature	New EGTRRA Provisions
403(b), 401(k), and 457(b) elective deferral limits	\$11,000 in 2002 \$12,000 in 2003 \$13,000 in 2004 \$14,000 in 2005 \$15,000 in 2006 \$500 annual increments thereafter
403(b), 401(k), and 457(b) "catch-up" contributions for employees 50 years and older	\$1000 in 2002 \$2000 in 2003 \$3000 in 2004 \$4000 in 2005 \$5000 in 2006 \$500 annual increments thereafter
Maximum combined Defined Contribution Plan contribution limits	Lesser of \$40,000 or 100% of compensation in 2002 \$1000 annual increments thereafter as dictated by the Secretary of the Treasury (raised to 41,000 in 2004).
Maximum annual distribution under a Defined Benefit Plan	\$160,000 in 2002 \$5000 annual increments thereafter as dictated by the Secretary of the Treasury
Maximum salary allowed for contribution calculation	\$200,000 in 2002 (raised to \$205,000 in 2004) \$5000 annual increments thereafter as dictated by the Secretary of the Treasury
Pension portability	Funds from any 401(k), 403(b), or 457(b) plan can be rolled over into any other 401(k), 403(b), or 457(b) plan or IRA
Vesting requirements on matched contributions	3-year 100% immediate vesting or 6-year graded vesting, accruing in annual increments of 20% beginning after the second year of participation
Profit-sharing/money purchase pension plan contribution limits	25% of an employee's compensation

employees must roll these funds into an IRA or transfer them into a new employer's qualified plan. If this process is handled properly, there is no resulting tax liability, and the assets continue to grow tax free until withdrawal. However, it is generally up to the employee to make sure that the assets are transferred in a timely manner to avoid taxation and penalty fees for early withdrawal.

403(b) Plans

The 403(b) plan is commonly referred to as the 401(k) for nonprofits. These are nonqualified Defined Contribution Plans available only to employees of tax-exempt private organizations and public educational institutions. In most 403(b) plans, the primary source of funds is a direct pretax deduction from the employee's salary. Employers will often make a matching contribution based on the amount of the employee's contribution, the age of the employee, or the number of years of service. Employees are immediately vested in their own contributions, whereas employers typically establish a vesting period for the matched contributions. As with other Defined Contribution Plans, selection of investments and the associated risks reside with the employee.

A 403(b) plan offers the same employee tax advantages as a qualified Defined Contribution Plan. However, as a nonqualified plan, the 403(b) requires little administrative involvement from the employer beyond the coordination of payroll deductions. In the event of an employee's early termination, the employer bears no ongoing responsibility with regard to the funds and, hence, no ongoing expense. Therefore, most employers allow departing employees the choice of keeping the 403(b) funds in the original plan until retirement, rolling the accumulated funds into an IRA, or transferring them to a new employer's Defined Contribution Plan.

Before EGTRRA was enacted, most universities offered both a 403(b) and a supplemental 403(b) plan to their faculty members. The primary 403(b) plan was used for employer contributions, whereas the supplemental plan received all employee contributions. Since the passage of EGTRRA, this is no longer necessary, and many universities have combined their 403(b) offerings into a single plan, whereas other institutions have retained two plans for the sake of tracking employer and employee contributions separately.

Under EGTRRA guidelines, the annual limit that an employee under the age of 50 can contribute to a 403(b) plan in 2004 is \$13,000. Individuals who are 50 years of age and older can contribute up to \$16,000 in 2004.

Deferred Compensation Plans

Another type of nonqualified retirement plan is the Deferred Compensation Plan, most commonly offered as a 457(b) plan. Deferred Compensation Plans are offered only to employees of tax-exempt organizations and government entities. For university-based radiologists, they serve as an optional supplement to their 403(b) plan. Public institutions are able to offer these plans to a broad-based group of employees. At private institutions, the 457(b) plan is considered a "top hat" plan that limits participation to highly compensated employees or to a select group of managers, not to exceed 5% of all employees. Con-

tributions to a 457(b) plan are made on a pretax basis, and earnings grow tax-free until withdrawal. Employers may contribute a matched percentage based on the amount of the employee's contribution, the age of the employee, or the number of years of service.

As with 403(b) plans, the maximum allowable employee contribution to a 457(b) plan is \$13,000 in 2004. Employees eligible for both 403(b) and 457(b) plans can make maximum contributions to each plan. Furthermore, the "catch-up contributions" that are allowed in 403(b) plans for individuals 50 years of age and older also apply to 457(b) plans. By participating in both types of plans, eligible employees are allowed to make annual retirement contributions of \$26,000 (or \$32,000 if older than 50). With the addition of matching employer contributions greater than \$14,000, employees can exceed the \$41,000 annual limit placed on combined 403(b) contributions because 457(b) plans are not subject to this limit. Unlike most other retirement options, many 457(b) plans are unfunded, meaning that the plan assets are not protected from the employer's or the employee's creditors.

A less commonly used Deferred Compensation Plan is the 457(f) plan. The unique feature of this plan is that it is not subject to the employee contribution limits placed on other retirement plans. The participating employee can defer up to 100% of his or her salary into a tax-deferred 457(f) plan. However, administration of the plan is complex, the funds are unprotected from creditors, and the assets are subject to a substantial risk of forfeiture in the event of a job change or termination. As a result, most institutions are transitioning away from 457(f) plans in light of the increased allowances for 457(b) plans under EGTRRA.

Profit-Sharing Plans

Profit-sharing plans are the most flexible of the available Defined Contribution Plans. The employer is able to determine from year to year what the annual contributions to the plan will be, thus allowing the employees to participate in and benefit from the employer's profitability. Employers can contribute up to 25% of an employee's yearly compensation to the retirement plan, subject to the current \$41,000 annual limit [14]. Employers have the option of withholding contributions in any given year, as long as contributions in other years are substantial and recurring.

Profit-sharing plans are funded, meaning that the assets are protected from creditors. Vested employees are eligible to borrow from the plan and to roll over any vested assets into an IRA or other qualified plan in the event of an early termination or job change. Participants may benefit from reallocation of forfeitures in the event of another employee's termination before vesting. The assets in a profit-sharing plan can be invested in mutual funds, stocks, bonds, debt-free real estate, certificates of deposit, annuity policies, and even permanent life insurance policies. Although most plans involve employee-directed investments, some employers maintain control of the funds and require that all assets be invested in the same investment pool. In either case, the investment risk is borne by the employee.

Money Purchase Pension Plans

In a money purchase pension plan, the employer provides an annual contribution of up to 25% of the employee's total compensation, with a current maximum contribution of \$41,000 per year. Contributions can be made only by the employer, and although the contribution percentage may change, the employer is obligated to pay the benefit every year regardless of the company's profitability. As with other qualified plans, these contributions are tax deductible for the employer, and the employee is not taxed on the contributions or the investment earnings until retirement or death.

The money purchase pension plan is a funded plan, and its assets are therefore protected from creditors. Investment options mirror those of the profit-sharing plan, and the investment risk is again borne by the employee. Personal in-service withdrawals from the retirement account are not permitted, even in the setting of hardship. However, a vested employee can request a "plan loan" if certain legal guidelines are met. As with the profit-sharing plan, participants may receive reallocation of forfeitures from departing nonvested employees.

SUMMARY

- There are two major categories of employer-sponsored retirement plans specified in the tax code: Defined Benefit Plans and Defined Contribution Plans.
- Defined Benefit Plans include traditional pension plans and Cash Balance Plans. Defined Contribution Plans include 401(k), 403(b), profit-sharing, money pension purchase, and deferred compensation plans.
- Defined Benefit Plans provide a fixed annual or monthly pension payable for life beginning at the time of retirement.
- In a Defined Contribution Plan, employees have their own investment accounts funded by employer or employee contributions or both. The assets available to an employee on retirement depend on the total contributions and the accrued gains or losses within that individual's retirement savings account.
- In a Defined Benefit Plan, the employer determines how the plan assets are invested and bears the associated investment risk.

- In a Defined Contribution Plan, the employee determines how the plan assets are invested, although the plan may include restrictions regarding eligible investment vehicles. In any case, the employee bears the associated investment risk.
- The EGTRRA significantly improved the contribution limits and portability of employer-sponsored retirement plans.

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