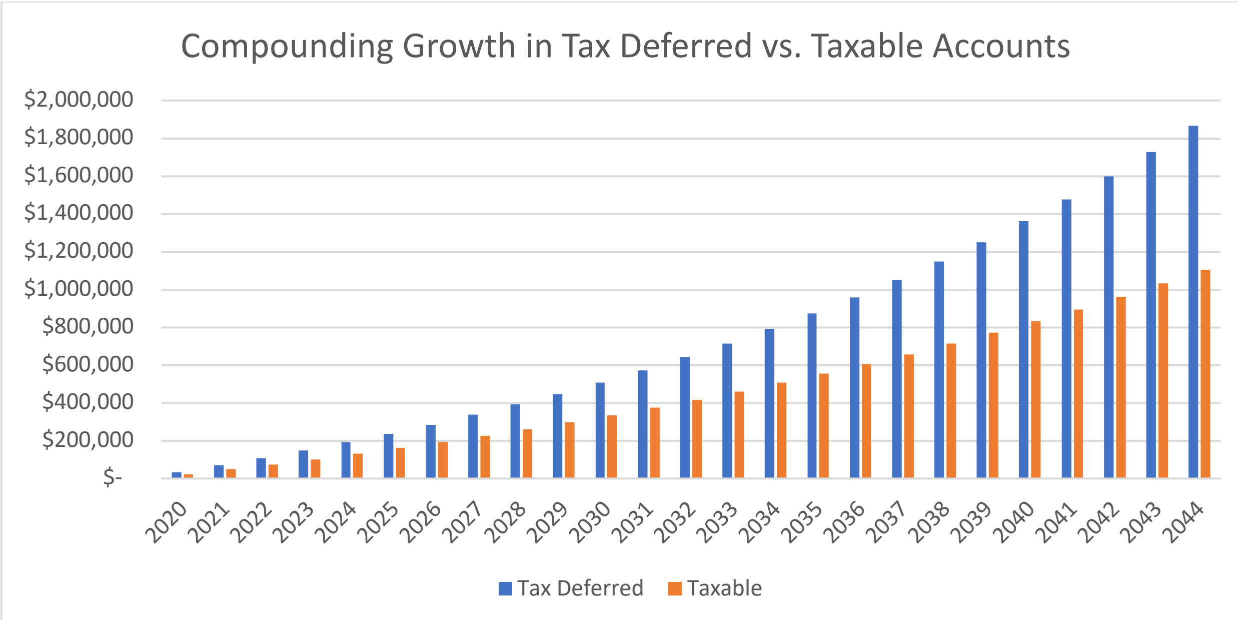
Taxes: Don't Pay More than You Have to

Establishing a retirement plan for your practice is a great way to lower your taxable income while also saving for your (and possibly your staff's) retirement. For example, take a hypothetical single-doctor practice with four employees: the doctor, a hygienist, one assistant, and an office manager. Assume that the dentist sets up a basic safe harbor match 401k, where the practice matches 100% of the first 3% of each employee's contribution, and 50% of the next 2% (a cumulative maximum of 4% employer match).

Position	W-2 Salary	Employee Contribution	Employer Contribution	Total Annual 401k Contribution
Dentist	$280,000	$19,500 (7%)	$11,200 (4%)	$30,700
Hygienist	$60,000	$3,000 (5%)	$2,400 (4%)	$5,400
Dental Assistant	$30,000	$0	$0	$0
Office Manager	$45,000	$900 (2%)	$900 (2%)	$1,800
Total	**$415,000**	**$23,400**	**$14,500**	**$37,900**

Also assume that the dental practice is in South Carolina, is legally structured as an LLC with pass-through taxation, has gross production of $600,000 and business expenses (including salaries) of $500,000. The dentist takes the $100,000 in profit as a distribution (not W-2 wages) from the practice, bringing her total taxable income to $380,000. For the sake of simplicity, an effective tax rate of 30% will be used for all income because the actual tax liability calculations are quite complex. So, without the 401k contributions, the dentist would have a tax liability of $114,000. In contrast, if the dentist and the practice make the 401k contributions, it would reduce the dentist's taxable income to $346,000 ($380,0000 minus the dentist's employee contribution [$19,500] minus total employer contributions [$14,500]). In this scenario, the dentist's tax liability is reduced to $103,800, representing a savings in that year of $10,200.

Compounding growth on tax-deferred savings is a powerful tool to prepare for retirement, as illustrated in the graph below.



Over a 25-year period with 6% annualized returns, saving into a tax-deferred account will give the hypothetical dentist above an account value that is $760,000 higher than a taxable account with the same annual savings amount. Additionally, the dentist gets the double benefit of helping her staff save for retirement while reducing her own taxable income.

Of course, each dental practice and tax situation will be unique, so practice owners should consult a competent advisor prior to establishing a retirement plan or making other decisions that could impact tax liability.