THE WALL STREET JOURNAL.

TUESDAY, MAY 19, 2015
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WEALTH ADVISER

Delaying RMDs for a Business-Owning Client

By ALEX COPPOLA

The man was a small-business owner, who despite being in his late 60s, planned on working for at least another decade.

But he was concerned that he'd be forced to take required minimum distributions from his $1.5 million traditional IRA once he reached 70. With an annual salary of over $250,000, the man had no need for those funds and wanted them to continue to grow in his account.

During their first meeting, the man asked adviser Ryan O'Donnell of O'Donnell Group, which manages $100 million for 120 households in Chico, Calif., for suggestions

ILLUSTRATION: BARI GOODMAN FOR THE WALL STREET JOURNAL

Ryan O'Donnell PHOTO: O'DONNELL GROUP

As Mr. O'Donnell began reviewing his new client's assets, he noticed that in addition to his IRA, the man had close to $1 million in a 401(k). The adviser knew that employees who are still working and contributing to a workplace retirement plan can delay their RMDs. The simplest solution, he realized, would be to roll all of the man's retirement assets into that one 401(k) account.

However, with a 90% equity stake in the company, the man was considered an owner of the business, not an employee. That meant his 401(k) distributions were not eligible for deferral. But the adviser wasn't ready to abandon the approach altogether.

"It was clear that the client took great pride in owning his business," says the adviser. "But if only an employee could take advantage of this plan, maybe he would be willing to become one."

The man had expressed his intention to sell the business within seven to 10 years to retire. Given that plan, the adviser suggested the man simply accelerate the timeline of the sale.

The client could divest himself of his ownership stake in the company, selling those shares to his current business partner within the next year. The man could still retain a voting share in the business if he wanted, but with less than 5% ownership, he would now technically be an employee of the company.

The man embraced the idea and began working with his attorney, CPA and business partner to structure the sale. Ultimately, they decided that the client's ownership in the company would be transferred immediately, with $1.5 million paid out to the client in installments over a five-year period. As an employee of the company, the man rolled his IRA assets into his 401(k) and was able to avoid his pending RMDs.

Next, Mr. O'Donnell turned his attention to the management of taxable income from the transaction. The money generated from the sale of the company would be taxed as capital gains, but the man would still earn close to a quarter-million dollars a year in ordinary income as an employee.

"Because the client could live very comfortably off those capital gains alone, he could actually afford to defer all of his other compensation which, from a tax perspective, would save him considerably," says Mr. O'Donnell.

To do that, the adviser encouraged the client and his partner to establish a cash-balance plan for the company. Unlike traditional 401(k) profit-sharing plans, which limit employees to $53,000 in annual contributions, cash-balance or defined-benefit plans can have much higher limits. Functioning like a pension, the plans use the size of a participant's projected retirement benefit to calculate their allowable contributions. In the case of this client, the limit was close to $300,000 a year, which covered all of his income.

With the new ownership in place, the client is planning to cut back his work hours over the next five years to spend more time with his family. He was extremely happy with the results and the adviser was pleased to have provided him with real value.

"As with most high-net-worth clients, portfolio returns aren't going to change this man's life," says Mr. O'Donnell. "But, as an adviser, being able to engineer a solution like this certainly will."

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