Small business retirement plans

By Paul Breslau, Breslau Insurance & Benefits Inc.

Many small business retirement plans are needlessly paying taxes because of an inefficient 401(k) plan design or no plan at all. Are you falling victim to extra taxes?

Large employers typically have a 401(k) plan because it is a relatively low-cost employee benefit that a large business is expected to have. Small employers with less than 20 employees typically have a completely different motivation (or they should). Small employers have more flexibility to design their retirement plan to accomplish significant tax savings that favor the business owner.

Are you missing tax deductions?

Most people know that retirement plans offer tax savings, but most don't really understand how the tax deductions work. For example, a 401(k)-deferral contribution is still subject to FICA taxes. Yet profit sharing contributions are not subject to FICA taxes. Let's look at an example for the owner of the business.

Effect of a 401(k) contribution	Effect of a profit sharing contribution
Gross flow through profit $100,000	Gross flow through profit - $81,500
Less FICA taxes of 15.3% - $15,300	FICA taxes of 15.3% - $12,470
Less federal & state tax - $15,256	Federal & state tax - $15,256
Less 401(k) deferral - $18,500	Company profit sharing contribution - $18,500
Net pay - $58,594	Net pay – $60,009

The difference between the two scenarios is $1,415 in less FICA taxes paid just by classifying a retirement contribution differently. Both scenarios have the business owner taking $100,000 from the business and having $18,500 of retirement contributions. Profit sharing contributions are not considered a wage first and therefore not subject to FICA taxes. Why pay the extra FICA taxes?

The retirement plan industry is dominated by mutual fund companies, payroll firms, and insurance companies. They all provide an integral part to servicing the retirement plan, but unfortunately all of those firms lack a tax focus. It may not be their fault. They don't talk taxes with their clients because it's not their niche. These firms can easily point to the client's accountant or CPA and claim they should be getting that sort of advice from the tax advisor. Retirement plans are a very small specialized niche and accountants don't typically know all the rules. Is your accountant just taking data from the payroll company or retirement plan provider and putting it on a tax form?

Did you know?

- Retirement plans can provide contributions for a business owner personally of $18,500 (+$6,000 more if over 50 years old) and up to $55,000 in a 401(k) plan? Adding a pension plan can push the contributions over $200,000.
- With a properly designed retirement plan, it's feasible for the business owner to receive more than 80 percent of the contributions.
- There is no income phase out for ROTH contributions inside of a retirement plan.
- Bonuses paid to employees could be reclassified as a retirement plan contribution and no longer subject to FICA taxes.
- The tax savings achieved from a properly designed retirement plan typically pays for the cost of setting up and maintaining it, and in many cases, any employee contribution costs. This makes a retirement plan a zero-net cost benefit.
- The new Tax Cuts and Jobs Act of 2017 has implications for small business owners, making a properly designed retirement plan more attractive.
- There is an IRS Retirement Plans Startup Costs Tax Credit.

Remember – retirement plans' main reason for existing is the tax savings they provide. Are your current retirement plan service providers giving you the proper tax planning advice? We work with local specialists to ensure that your retirement plan is optimized for your goals. Give me a call to at 602-692-6832 to review your retirement plan to see how it can be improved.

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