REDUCE YOUR TAX BURDEN WITH RETIREMENT PLANS

As another tax season comes to an end most business owners are feeling the burden of an ever escalating tax environment and in most cases are asking, “How can I reduce my tax liability next year?” Two solutions that could help alleviate some of their next “tax bill” are starting a 401(k) plan or reviewing their current plan design to see if it can be enhanced.

Start a 401(k) Plan

Starting a retirement plan can help with deferral of income for all employees that contribute and would allow the plan sponsor to make additional match or profit sharing contributions to participant accounts. If the plan utilizes a Safe Harbor Match or Safe Harbor Non-elective contribution arrangement all participants would be eligible to defer $18,000 (or $24,000 if age 50+) during the plan year. This, of course, could help alleviate personal income tax for all participants, including business owners.

Re-Evaluate the Current 401(k) Plan Design

In many cases a retirement plan gets established with an initial goal in mind, but the efficacy of the plan design never gets reevaluated as business objectives change. Employer contribution strategies like Safe Harbor contributions, New Comparability and Stretch Match, for example, can in many cases have a significant impact on employee deferral levels and the amount of contributions that can be contributed by plan sponsors. Also, in certain situations simply restructuring the contribution method that has historically been provided by the plan sponsor can have a significant impact for not only the amount the participants can defer, but also in regard to the varying levels of employer contributions that can be made to each participant, which could be very beneficial to business owners and highly compensated employees. The thought process in this evaluation……“If the typical employer contribution was allocated in a different manner, what could be accomplished?”

Change from SEP IRA or SIMPLE IRA to 401(k) Plan

SEP IRA and SIMPLE IRA plans are typically established to create tax deferral opportunities for employees and business owners; however, there are significant tax advantages that are often overlooked when compared to establishing a 401(k) plan.

- SEP IRAs do not allow for employee deferrals and the plan sponsor contribution percentage is required to be the same for all participants, including business owners. 401(k) plans allow for deferral income for participants and the plan sponsor allocation can be customized to permit for varying levels of contributions to employees. In many cases SEP IRAs are great candidates for evaluating the feasibility of New Comparability and possibly even a DC/DB combination plan. SEP IRAs can be terminated at any time during the year if looking to change to a 401(k) plan.

- SIMPLE IRA plans allow for pre-tax deferrals and plans sponsor contributions, but have a much lower threshold limit on deferrals ($12,500 vs. $18,000, $15,500 vs. $24,000 if age 50+) and there is not much flexibility in the plan sponsor contribution. SIMPLE IRA plans also do not permit after-tax Roth contributions. A 401(k) plan can incorporate Roth contributions and also provides much more flexibility in regard to plan sponsor contributions. One consideration to keep in mind if looking to make a change is that SIMPLE IRA plans cannot typically be terminated mid-year, so a 401(k) would have to be started the next plan year.

A 401(k) plan is a great vehicle to help create tax efficiencies for business owners and for allowing deferral of income. If you are looking to start a 401(k) plan, or wanting to evaluate the efficacy of a current retirement plan design, please contact our office. BPP specializes in strategic plan design and will work hard in finding a solution that best fits your needs!

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