Dec 21, 2020, 12:06pm EST | 388 views

For Small Business Owners Only: Advanced Retirement Plan Options

Chris Carosa Senior Contributor

Retirement

I help families/small businesses discover wealth-building strategies.

GETTY

You're a small business owner. What are you more constantly thinking about? Sales or profits? Both are critical. One provides the lifeblood to your business. The other provides the lifeblood to your, well, living.

It's a tough decision. If you're like most small business owners, this is a constant pushmi-pullyu struggle. But something more important is left out of this equation. What is it?

You.

Your business represents a mere means to an end. And that end is your retirement. As you get closer to retirement, that "end" starts to consume more of your attention. As well it should.

"Many self-employed small business owners have put more of their money in their business than in their retirement plans," says Steve Parrish, Co-Director of the Center for Retirement Income at The American College of Financial Services PNC -0.6% in King of Prussia, Pennsylvania. "To catch up, there are two key strategies for building up retirement capital. First, a qualified plan can allow much more effective retirement savings than just putting money in the bank. The tax advantages of a qualified plan allow more money to begin compounding right away. Usually, the two most lucrative plans for an older self-employed business owner would be a Solo 401(k) or a defined benefit plan. The second way to generate retirement capital is to get the business ready for a sale at retirement."

As a small business owner, you're fortunate to be in a position to control your own destiny in many ways. That includes retirement. "There are many risks and benefits to owning a small business," says Sten Morgan, President of Legacy Investment Planning in Franklin, Tennessee. "One of the upsides is the various options you have to save for retirement. Earning income for yourself opens up additional retirement savings options."

"Taxpayers who earn self-employment income can consider establishing either a defined benefit plan (similar to a pension) or a defined contribution plan (such as a SEP-IRA) to shelter the self-employment income from current taxation," says John Voltaggio, Managing Director at Northern Trust Wealth Management in New York City. "Defined benefit plans can be more complicated to establish and require more administration to maintain, but they can allow for larger contributions (which can shelter more income from current taxation) than a defined contribution plan."

If you've found yourself quite successful in your business, there's no reason to limit your retirement options to relatively easy IRA-based solutions. You can, and your accountant might suggest you should, consider more advanced options. You don't have to have a supersized company to have a supersized retirement plan.

If you're thinking of a 401(k) plan, then you're thinking in the right direction "The 401(k) will allow the highest level of contribution and the most flexibility; however, there may be administrative expenses that other plans do not have," says Randy Carver, President and CEO of Carver Financial Services in Mentor, Ohio.

While you may be familiar with this popular defined contribution vehicle, what you may not know is that recent legal changes may have made them even more attractive to you.

"Under the SECURE Act, the small employer plan start-up tax credit is now tenfold higher—up from $500 to $5,000 per year," says

Diana Torzewski, Product Manager at Human Interest in San Francisco. “It’s now more affordable than ever to launch a 401(k) plan to benefit yourself and any team members when you take advantage of this credit.”

Of course, there are greater administrative fees with a 401(k). If your company is more of a solo effort, there’s a special version of the 401(k) just for you. It might not surprise you to discover it’s called the Solo 401(k).

“A Solo 401(k) plan could be an option if the business only employs the owner and spouse or has no employees who would be eligible to participate (i.e., they work too few hours to qualify),” says Cindi Turoski, a managing director at The Bonadio Group in Albany, New York. “The plan would need to be established by year-end. The owner’s deferral contribution might be limited if they already deferred some salary into an employer retirement plan before being laid off by a predecessor employer. They might also be eligible to make a profit-sharing contribution.”

Just because you might qualify for a Solo 401(k) as an “advanced” option doesn’t necessarily mean it’s more complicated.

“A Solo 401k sounds more intimidating than it is,” says Morgan. “These accounts have become more efficient over the years to set up and administrative expenses have fallen dramatically. The benefit of this account is that the amount you can contribute is not a percentage of income. So, if you earn $15,000, there is a good chance you could contribute $15,000. Make sure you have sound guidance when setting up a plan like this.”

You’ll need to speak with your tax advisor to see how a Solo 401(k) works in your specific situation. What you should know, though, is that it can give you an opportunity to stash away a large contribution into either a tax-deferred retirement account or the equivalent of a Roth option.

“Solo 401(k) plans are for a business owner or self-employed person with no employees (except a spouse, if applicable),” says Rafael Rubio, president of Stable Retirement Planners in Southfield, Michigan. “The contribution limit is up to $57,000 in 2020 (plus a $6,000 catch-up contribution for those 50 or older) or 100% of earned income, whichever is less.”

While you may be most familiar with defined contribution plans, don’t overlook defined benefit plans. These are more complicated, so you’ll definitely want to seek the advice of a professional.

“A defined benefit plan is for the self-employed person with no employees who has a high income and wants to save a lot for retirement on an ongoing basis,” says Rubio. “Contribution limits are calculated based on the benefit you’ll receive at retirement, your age and expected investment returns. This is basically setting up a pension plan for yourself. They are costly and have high set up fees.”

Another interesting alternative is a Cash Balance Plan. This could complement other retirement vehicles you might choose to use.

“A Cash Balance Pension Plan might be a good option for eligible self-employed people who have a high income from self-employment because it allows for very high contribution limits for maximum tax-deferral and retirement savings, especially for people in the 45-65 age range,” says Whitney Nash, President & CEO at Nashional Self-Directed in McKinney, Texas. “It can also be layered on and done in tandem to a Self-Directed Solo 401(k). The business owner will want to speak with their tax professional and a retirement plan specialist regarding their specific situation and needs, and to confirm eligibility for both types of plans."

You have plenty of great options to save for retirement if you're a small business owner. So, take a moment away from sales and profits and look into your own retirement strategy.

Anthony Pellegrino, Founder of Goldstone Financial Group in Oakbrook Terrace, Illinois, says, "If you are self-employed, talk with your accountant and analyze your business to determine the best option for your company and your situation."

Why not have it top your list of New Years' resolutions?

Follow me on Twitter or LinkedIn. Check out my website.

Chris Carosa

Follow

I am a nationally recognized award-winning writer, researcher and speaker. Among the seven books I've written include *From Cradle to Retire: The Child IRA, Hey! What's My...* **Read More**