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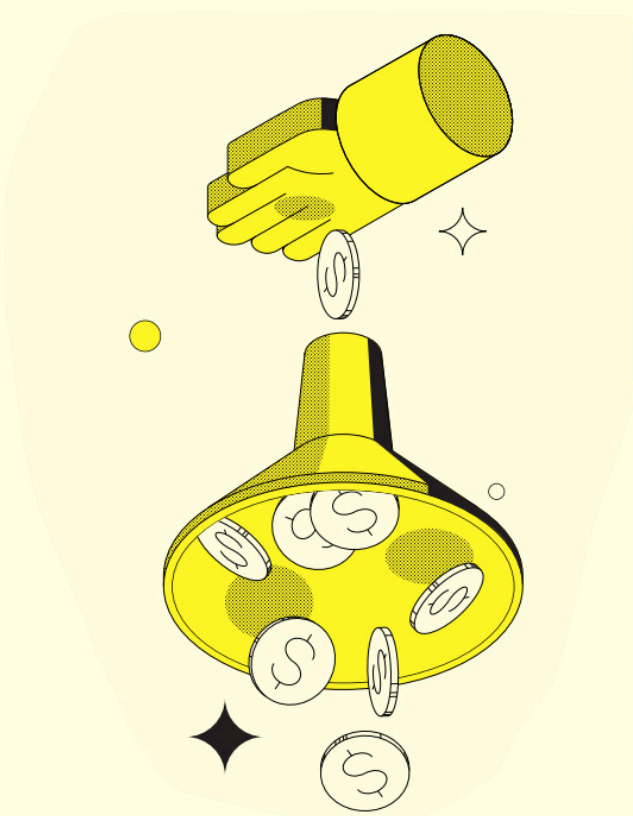
RETIREMENT SAVINGS FOR S-CORP



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MAXIMIZE YOUR TAX SAVINGS

WITH YOUR RETIREMENT PLAN

You do what you love, and yet a time will come when it makes sense to wind-down your business. It's important that you stash some money away in preparation. Because you are drawing a salary through your business as an S-Corp owner, you have the distinct advantage of being both the employer and the employee, which, with the right account set up, may allow you to maximize overall contributions.

Specific to S-Corporations, there are three retirement plans we recommend. These are the SEP-IRA (Simplified Employee Pension Individual Retirement Account), Solo 401(k), and Defined Benefit Cash Balance plan. There are benefits and drawbacks to each plan and we'll share information on each plan so that you can be equipped to know the correct plan for you!

KEY EVALUATION CRITERIA

These are the primary criteria that Self-Employed Professionals need to consider when choosing a Retirement Saving Option:

FLEXIBILITY

Your business is ever-changing, as is your cash flow. You need a Retirement Saving Option that can adjust along with it.

INCOME LEVEL

Your income plays a key role in how much you can (and should) save toward retirement each year.

WORKING YEARS REMAINING

Catch-up contributions become increasingly important as you approach retirement.

SET UP & MAINTAINACE COST

Balance the overhead of maintaining the account with the gross expected returns to avoid negative impacts on your overall growth potential.

RECOMMENDED PLANS

Simplified Employee Pension SEP-IRA

A SEP-IRA has low-income requirements and low costs, making it accessible to anyone who is Self-Employed. However, it's one of the least flexible account types and has contribution restrictions that limit catch-up contributions.

SOLO 401(k)

The Solo 401(k) plan offers the highest flexibility in a retirement savings option and only requires a moderate income (over $60K). It provides optimal tax efficiency when paired with an S-Corp, flexible ways to increase retirement contributions (including catch-up and spousal contributions) and can be funded through pre-tax or after-tax dollars..

Defined Benefit/Cash Balance Plan

This highly-involved retirement savings option is designed for high earners ($300K+ annually) looking to maximize their retirement savings. Be aware of the cost to setup and maintain compliance, which will range from $2k-$5k per year.

IN GENERAL, WE RECOMMEND OUR CUSTOMERS USE A SOLO 401(K)

There are additional opportunities that aren't available with a SEP-IRA. 401(k) is not as cost or labor intensive as a Defined Benefit plan.

THE SEP-IRA
(Simplified Employee Pension Individual Retirement Account)

The SEP-IRA is different from other IRAs because it is not the individual employee contributing funds out of their wages, but the employer making the contributions to the employee's account. The employer can contribute up to 25% of the employee's annual wages, up to a maximum of $69,000 for 2024.

Since you are the employer and the employee, you can effectively boost your annual salary by the amount contributed to the SEP-IRA while minimizing your self-employment taxes. For example, you can pay yourself a salary of $50,000 and contribute 25%, or $12,500, to your SEP-IRA. You have now effectively paid yourself $62,500 but only paid self-employment taxes on $50,000.

SEP contributions are deductible on the business tax return, reducing overall profits and potential federal taxes on the amounts that flow through to the shareholder(s). Because the tax benefit is given in the contribution year, withdrawals from a SEP-IRA are taxable.

SEP-IRAs require minimum distributions starting at the age of 73. Fiduciary insurance is not required, and there are minimal maintenance fees, if any. It should also be noted that you can contribute to the SEP-IRA as the employer and still contribute the annual limits to a traditional or ROTH-IRA as an employee.

THE SOLO 401(K)

The Solo 401(k), also referred to as the Individual 401(k) or the Self-Employed 401(k), works like a regular 401(k). There are two types of contributions. The employee makes an elective deferral, also known as an employee contribution, and the employer makes a profit-sharing, or employer, contribution.

For 2024, the employee contribution is limited to the lesser of $23,500 or total compensation. A catch-up contribution of $7,500 is permitted if age 50 or older. The combined employee and employer contribution cannot exceed $69,000 for 2023. For corporations, the profit-sharing contribution is limited to 25% of gross income or the annual limit. For sole proprietors and partnerships, the maximum contribution is limited to 20% of net income or the annual allowed limit.

One advantage of the Solo 401(k) is that the plan also allows you to make post-tax ROTH contributions. Contribution deadlines for the Solo 401(k) are the same as your tax filing deadline, so an LLC being taxed as an S-Corp would have to make the contributions by March 15th to apply to the prior tax year or September 15th with a properly filed extension. Minimum distributions are required at the age of 72.

Employer Contribution and Profit-Sharing are the same thing! This tends to be confusing, but professionals tend to use the phrases interchangeably so it is good to note.

DEFINED BENEFIT/ CASH BALANCE PLAN

The main benefit of a Cash Balance Plan is the ability to fund retirement at an even higher rate than is allowed under other plans. The top range of the plan is over $300,000. Furthermore, the plan can be used in conjunction with a 401(k) for even further maximizing of savings. All contributions are pre-tax contributions, meaning immediate tax savings for all contributions.

The additional opportunity comes with additional requirements.
A cash balancing plan has higher costs to implement, with annual costs between $2,000-$5,000 being required. These costs comes from needing actuarial reviews and constant reviewing of the plan requirements being met.

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DIRECT COMPARISON SEP-IRA VS. SOLO 401(K)

As a business owner and a self-employed individual, there are several options available for funding your retirement. The SEP-IRA and the Solo 401(k) are both great options and while the benefits are similar, there are certain differences that may make one a better option for you. Both are widely available through most major brokerage firms and are simple to set up.

There are minimal overhead costs, if any, associated with managing these accounts. The SEP-IRA is ideal for companies with one or more employees and any business with one or more employees is eligible to open a SEP. A Solo 401(k) is only available for self-employed individuals and, potentially, a spouse if the spouse works at least part-time.

Having even just one employee, other than the owner and the spouse, means you are no longer eligible to use a Solo 401(k) to save for retirement. And, switching from a Solo 401(k) to a SEP-IRA in the future if you add employees can be complicated.

One difference between the SEP-IRA and the Solo 401(k) is that only the employer can make contributions to the SEP account. Employees are not permitted to make contributions.   Another difference between these two accounts is that the SEP-IRA does not allow a catch-up contribution but the Solo 401(k) does. Individuals over the age of 50 can contribute an additional $7,500 a year to the Solo 401(k).

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TLDR

TOO LONG DIDN'T READ

SEP-IRA

Pros: Lower cost than other options, available if company has more than one employee that is not family

Cons: Ability to fund the account is less flexible and tends to be the least possible, no catch-up contributions

FLEXIBILITY: LOW	INCOME: LOW	COSTS: LOW

SOLO 401(K)

Pros: More flexibility than a SEP-IRA, less cost than a Defined Benefit Plan, allows after-tax contributions to fund post tax accounts

Cons: Set-up cost vary, can not be used if there are employees outside of the owner and their family

FLEXIBILITY: HIGH	INCOME: MODERATE	COSTS: LOW

DEFINED BENEFIT/ CASH BALANCE PLAN

Pros: Maximum ability to fund retirement, highest potential tax saving opportunity, can be used in conjunction with a 401(k)

Cons: Highest cost, highest complexity, lack of flexibility, requires more consistent income and funding

FLEXIBILITY: HIGH	INCOME: HIGH	COSTS: HIGH

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DEADLINES TO OPEN & FUND ACCOUNTS

- A SEP-IRA must be established by the tax filing deadline of the business to contribute for that year and deduct the contributions on the business tax return
- The Solo 401(k) is recommended to be established by December 31st. The employer profit-sharing contribution for the Solo 401(k) can be made up until the filing deadline for the business tax return. A Solo 401(k) can be set up after the year-end, but you would be unable to do employee contributions for the prior year
- A Cash Balancing plan's deadline is by September 15 of the following year as long as the company follows a calendar year. Otherwise, it is 8 ½ months after year end

At the end of the day, the goal is to put aside money for your retirement and to have that money grow. Each of the retirement accounts listed here will serve that function, but one may be better suited to your specific situation.

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NEVER OVERPAY ON TAXES AGAIN

BEING AN S-CORP HAS ITS PERKS

401(k) and SEP-IRA are the S-Corporation structure's real “magic bullet." When opened under the company name, specific retirement plans will enable you to contribute a portion of your W2 salary to your retirement plan AND allow the company (you) to match those contributions as a business expense. This has the effect of taking income you would normally pay self-employment taxes on and putting it in a tax-deferred retirement account. More on retirement options for the self-employed here.

EXAMPLE:

You make $200k in net income in a given year. You pay yourself $100k in wages, which is then reduced to about $92k net income (after payroll taxes). You then put $25,000 into your retirement account: half from you as the employee and half from the business as a match. You’ve saved $25,000 in taxable income and saved payroll taxes on $92k!

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QUESTIONS?

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