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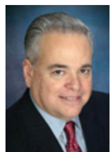
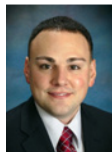

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Retirement Planning for Small Business Owners

Small business owners often struggle to find the time and the resources to set up and start contributing to a retirement plan. But no matter how small the business, chances are owners and their employees would benefit from saving in a tax-advantaged retirement plan. Self-employed individuals and business owners who do not yet have a retirement plan, or are thinking about making changes to their current plan, have a number of options to choose from, from Individual Retirement Accounts (IRAs) to 401(k)s to defined benefit plans.

When selecting a retirement plan, there are a number of questions to consider. Is the plan intended to cover just the business owner and the employees, or also the owner's spouse? How many of the firm's employees should be covered? What level of investment is the business willing to make in setting up a plan? Will the contributions to the retirement plan come solely from the business owner, or will employees also be asked to contribute? Is the priority higher contributions or ease of administration? Is the purpose of the plan primarily to attract and retain employees who want to work for a company with retirement benefits, or for the owner or the employees to lower their taxes? Is it important that the plan contributions are deductible as a business expense? What are the owner's personal retirement savings goals?

The Simplified Employee Pension (SEP) IRA is often chosen by small business owners who want a low-cost plan with a minimal administrative burden. Any business owner, including a self-employed individual, can establish a SEP. Owners can contribute up to 25% of their compensation, up to a maximum amount of $54,000 in 2017 and $55,000 in 2018, to their own SEP IRA account, but they are required to contribute the same percentage to the accounts of their employees. Contributions are only made by the employer, not the employees, and are tax-deductible as a business expense.

In a Savings Incentive Match Plan (SIMPLE) IRA, the employee as well as the employer contribute to employee accounts. To be eligible to start a SIMPLE IRA plan, the business must have fewer than 100 employees. Employer contributions are tax-deductible, and employees' contributions can be made pre-tax. Employees are permitted to make salary deferral contributions to their IRA of up to 100% of compensation up to a limit of $12,500 (with a $3,000 catch-up contribution for employees aged 50 and older) in 2017 and 2018. The employer also contributes to the account, either by

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Roth IRAs for Kids

It may be difficult to convince your teenagers to participate in their financial futures, but if you can persuade them to contribute at least part of their babysitting or after-school job money to a Roth Individual Retirement Account (IRA), they may thank you later.

Anyone with earned income below $135,000 for single filers and $199,000 for married joint filers in 2018 can open a Roth IRA retirement account. Contributions are nondeductible, but earnings and qualifying distributions accumulate tax free. Because children seldom make enough to owe income tax, they are usually better off with a Roth IRA than a tax-deferred traditional IRA. For 2018, your child can contribute up to $5,500 (or earned income, whichever is less) to a Roth IRA.

Saving for retirement early can generate substantial results. Suppose your 14-year-old daughter uses $1,000 to open a Roth IRA. If she makes no additional contributions and the funds grow at 8% annually, she will have more than $50,000 to withdraw tax free at age 65. Or suppose your son opens a Roth IRA with $2,000 when he is 15-years-old, and then he contributes $2,000 annually for the next 10 years. The estimated value of his tax-free fund balance at age 65 will exceed $700,000, if the annual growth rate is 8%.*

A Roth IRA offers the greatest growth potential if the account is left untouched until the holder reaches the age of 59½. At that age, the holder can withdraw earnings tax free, provided he or she has owned the account for five years. The IRS does permit penalty-free early withdrawals to pay for education or to help with a first-time home purchase. However, taxes will be owed on nonqualified early withdrawals.

Before you open a Roth IRA for your child, keep in mind that you cannot stop your child from withdrawing money from the account whenever he or she wants after reaching the age of majority, which is 18 in most states. If you are uncertain about your child's ability to handle money, opening an account in his or her name may not be the best choice.

Also, be aware that only taxable compensation income can be contributed to a Roth IRA. In general, paying your children for doing chores around the house does not qualify as compensation income, as this is an intrafamily transaction not usually reported to the IRS. However, if you own your own business, you are permitted to hire your minor children to do certain jobs. Provided you pay your children a fair market wage for the services performed, their earnings would be considered compensation income and could be invested in a Roth IRA.

It is essential to keep detailed records of how the money placed in a Roth IRA was earned, even if a teenager's working arrangements were informal (e.g., babysitting or mowing the lawn for neighbors) and he or she did not earn enough to owe income tax. Penalties could apply if the IRS determines the funds contributed to a Roth IRA were not compensation income.

The good news is that if, for example, your teenage son goes out and blows his paycheck on a new smartphone and skateboard, all is not lost. If he earned $2,500 over the summer but spent all the money, you could still contribute the amount equivalent to his taxable earnings into a Roth IRA on his behalf, thereby helping to ensure that at least some funds have been set aside for his retirement, when skateboarding days are behind him.

**These hypothetical examples are for illustrative purposes only. They are not intended to reflect an actual security's performance. Investments involve risk and may result in a profit or a loss. Seeking higher rates of return involves higher risks.*

Evaluating 401(k) Loans

Many **401(k) plans** allow participants to borrow a portion of their account balances, up to a specified limit, as governed by the plan document. If you are thinking about taking a loan from your retirement savings account, be sure you carefully consider the pros and cons.

First, look at the pros. When you repay the loan, you are, in effect, paying interest to yourself. As long as the interest rate equals or exceeds the rate of return on other savings in the account, you are not hindering the long-term growth of the funds.

Next, be aware of the cons. The interest portion of the repayment is generally not tax deductible. In addition, loans are usually short term, and amounts not repaid on time are considered taxable withdrawals and may be subject to penalties. Should you leave the company, your employer may demand full repayment within 60 days.

Although you have the option to borrow from your 401(k), remember that the main purpose of a qualified retirement plan is to *save for your retirement*. The longer the money is left in your plan account to grow, the more likely you are to accumulate retirement income. Tapping into your 401(k) may appear to be the solution in an emergency or financial hardship situation, however, it is important to evaluate all the pros and cons before making a withdrawal. ■

retirement planning for small business owners

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matching employee contributions dollar-for-dollar up to 3% of compensation, or by contributing 2% of each employee's compensation. The set-up costs and administrative burden associated with SIMPLE IRAs are again minimal, though fees may be charged by financial service providers.

A SIMPLE 401(k) is similar to the SIMPLE IRA in terms of its features and its set-up costs, but also has some characteristics of standard 401(k) plans. Businesses with fewer than 100 employees can start a SIMPLE 401(k) plan. Employees can elect to contribute, but unlike in a traditional 401(k), the employer is required to make a matching contribution up to 3% of each employee's salary, or a non-elective contribution of 2% of each employee's salary. Participants are permitted to borrow against the funds in their 401(k) account and make penalty-free withdrawals due to financial hardship. The employer is required to file a Form 5500 each year, but is not obliged to perform non-discrimination testing, as is the case for a traditional 401(k). Moreover, unlike in a traditional 401(k) plan, in a SIMPLE 401(k) plan contributions made to the account vest immediately.

A Solo or One-Participant 401(k) is a retirement savings plan that is just for a business owner and his or her spouse, and not for employees. Unlike in a SEP plan, business owners with One-Participant 401(k) plans are allowed to maximize their contributions and tax deferrals by making both employee and employer contributions to their own account. Administering this type of plan can be more time-intensive, as the owner is required to file a Form 5500 with the IRS if the plan's assets exceed $250,000. However, the contribution limits are also high: as an employee, the owner can make salary deferrals of up to $18,000 in 2017 and $18,500 in 2018; while as an employer, the owner can contribute up to 25% of compensation, up to a total of $54,000 in 2017 and $55,000 in 2018 (with a catch-up contribution of $6,000 for those aged 50 and older). A spouse employed by the business can contribute the same amounts. The contributions are considered a business expense if the business is incorporated; otherwise, the business owner can deduct the contributions from personal income.

A traditional pension plan can be a highly effective way for business owners to save for retirement on a tax-deferred basis, and for attracting and retaining employees. But the costs of setting up, administering, and funding a defined benefit plan are high, and the employer must be prepared to take on the investment risk associated with providing a fixed benefit to participants. A defined benefit plan is likely to be of greatest interest to high-income business owners who want to make very large contributions to a tax-advantaged plan over a short period of time. Depending on the structure of the plan, a business owner may be able to contribute $215,000 in 2017 and $220,000 in 2018 a year to a defined benefit plan. ■

Unpaid Student Loans May Result in Docked Social Security Checks

When an individual ceases making payments toward his or her student loan, the loan falls into default. The consequences of someone defaulting on a student loan can be severe and include damage to his or her credit report, the inability to build savings or apply for other loans, and wage garnishment. Recently, many retirees have discovered that defaulting on Federal student loans can result in their Social Security benefits being docked.

The Consequences

According to Debt.org (January 2018), Americans owe $1.4 trillion in student loans, which is significantly more than credit card debt or car loans. The student loan delinquency rate is 11.2%. Federal student loans account for approximately 85% of all student-loan debt; private student loans made up the rest. However, private lenders can garnish wages only—they do not have the authority to dock Social Security benefits.

The Federal government is withholding a portion of Social Security benefits from recipients who have fallen behind on their Federal student loans. According to the most recent report from the Treasury Department, while there were only 6 such cases in 2000, by 2007 there were 60,000 cases, and in the first seven months of 2012, approximately 115,000 individuals had their Social Security checks docked due to unpaid Federal student loans.

Although the amount of money the government withholds from Social Security varies, it can be as much as 15%. Supposing an individual receives a monthly Social Security benefit of $1,000, he or she could have as much as $180 docked from each check, which can be significant for retirees on a fixed budget.

While some retirees may still be carrying debt from the student loans they took out in their youth, others relied on Federal loans when they returned to college or went to graduate school for a mid-life career change. In many instances, the debt retirees are now carrying was not for their own education, but to help their children, grandchildren, or other dependents fund an education.

Loan Balance Collection

The Department of Education provides Federal student loans to students and provides payment plans to accommodate borrowers who fall behind. It would take nearly two years of non-payment before an account is sent to a collection agency. If the collection agency fails to collect the money, the loan balance is transferred to the Treasury Department, which has the power to garnish Social Security checks. The Treasury Department generally sets up payment plans with borrowers on two separate occasions before dipping into their Social Security checks. However, the Treasury does not withhold money from monthly Social Security checks totaling $750 or less.

The Aftermath

A variety of extenuating circumstances can lead to student loan default, such as an uncertain economic climate coupled with the rising cost of college tuition. As a result, students in all age groups are incurring more debt than previous generations. Nontraditional students, along with their college-enrolled dependents, may equally have trouble finding jobs after graduation.

If you are considering student loans for yourself or a family member, think carefully before you sign on the dotted line. Remember, unlike other types of debt, student loans cannot be discharged by declaring bankruptcy. It can quickly become a burden for even the most financially responsible Americans, and you could be paying student loan debt down well into your retirement years.

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