



Comparison of Retirement Plan Options Impacts for Business Owners

Qualified retirement plans present significant advantages for business owners. The ability to save significant amounts for retirement on a pre-tax basis combined with newly enacted tax credits provide significant opportunities for business owners and make qualified plans more attractive than other retirement vehicles in many situations.

Scenario 1: Sole Proprietor, No Employees

Qualified plans often permit owners to save more towards retirement on a pre-tax basis than other retirement vehicles due to higher contribution limits. In addition, a \$1,000 tax credit is available even for an owners-only plan. These benefits more than offset the additional expense of maintaining a qualified plan in many cases, as shown here.

| | IRA | SEP IRA | 401(k) Plan |
|-------------------------------------|------------|------------|-------------|
| Owner Revenue | \$ 250,000 | \$ 250,000 | \$ 250,000 |
| Admin Expenses for Plan | - | \$ 500 | \$ 750 |
| Tax Credit for Admin Expenses | - | - | - |
| Owner Contribution | \$ 6,000 | \$ 62,500 | \$ 66,000 |
| Tax Credit for Company Contribution | - | - | \$ 1,000 |
| Earnings Before Tax | \$244,000 | \$ 187,000 | \$ 184,250 |
| Tax Before Credits | \$ 58,560 | \$ 44,880 | \$ 44,220 |
| Total Tax Credits | - | - | \$ 1,000 |
| Net Earnings | \$ 185,440 | \$ 142,120 | \$ 141,030 |
| Owner Retirement Benefit | \$ 6,000 | \$ 62,500 | \$ 66,000 |
| Net Retained Benefit | \$ 191,440 | \$ 204,620 | \$ 207,030 |

Important Elements in Decision:

- Contribution Tax Credit available for self-employed owners
- A qualified plan has higher deferral limits than an IRA.
- Total contributions permitted may be higher than SEP because deferrals don't count toward deduction limit.

Scenario 2: Two Partners, 5 Employees

Owners with employees also significantly benefit from 401(k) plans. While SEP IRAs, SIMPLE IRAs, and 401(k) plans all may generate tax credits, the flexibility and significantly higher limits of a 401(k) plan often make the 401(k) more valuable to the business owner than the IRA options — more than offsetting the marginally higher cost, as shown in this example.

| | SEP IRA | SIMPLE IRA | 401(k) Plan |
|-------------------------------------|------------|------------|-------------|
| Owner Revenue | \$ 500,000 | \$ 500,000 | \$ 500,000 |
| Admin Expenses for Plan | \$ 1,000 | \$ 2,250 | \$ 3,500 |
| Tax Credit for Admin Expenses | \$ 1,000 | \$ 1,250 | \$ 1,750 |
| Owner Contribution | \$ 125,000 | \$ 46,000 | \$ 132,000 |
| Non-owner Wages | \$ 241,000 | \$ 241,000 | \$ 241,000 |
| Non-owner Company Contribution | \$ 60,250 | \$ 7,230 | \$ 12,050 |
| Tax Credit for Company Contribution | \$ 7,000 | \$ 7,000 | \$ 7,000 |
| Earnings Before Tax | \$ 321,750 | \$ 453,770 | \$ 362,950 |
| Tax Before Credits | \$ 77,220 | \$ 108,905 | \$ 87,108 |
| Total Tax Credits | \$ 8,000 | \$ 8,250 | \$ 8,750 |
| Net Earnings | \$ 252,530 | \$ 353,115 | \$ 284,592 |
| Owner Retirement Benefit | \$ 125,000 | \$ 46,000 | \$ 132,000 |
| Net Retained Benefit | \$ 377,530 | \$ 399,115 | \$ 416,592 |

Important Elements in Decision:

- Contributions to a SEP and SIMPLE IRA are dictated by law; 401(k) plans provide more flexible contributions.
- SEP and SIMPLE IRAs must cover nearly all employees and cannot have vesting provisions.
- Owners may make significantly higher contributions to a 401(k) plan than to a SIMPLE IRA – and the tax savings often offsets any additional cost of the 401(k).

Scenario 3: Corporation, One Owner, 51 Employees

SIMPLE IRAs often are attractive to businesses with employees because of the lack of annual reporting. However, these plans have significantly lower contribution limits than 401(k) plans. The tax savings of the 401(k) plan can more than offset the cost of the 401(k), as shown in this example. The qualified plan also would give the business owner more flexibility to manage the cost of contributions for employees.

| | SIMPLE IRA | 401(k) Plan |
|-------------------------------------|--------------|--------------|
| Owner Revenue | \$ 600,000 | \$ 600,000 |
| Admin Expenses for Plan | \$ 2,250 | \$ 4,500 |
| Tax Credit for Admin Expenses | \$ 1,125 | \$ 2,250 |
| Owner Contribution | \$ 33,500 | \$ 32,400 |
| Non-owner Wages | \$ 5,053,890 | \$ 5,053,890 |
| Non-owner Company Contribution | \$ 151,617 | \$ 151,617 |
| Tax Credit for Company Contribution | \$ 40,000 | \$ 40,000 |
| Earnings Before Tax | \$ 454,883 | \$ 455,983 |
| Tax Before Credits | \$ 109,172 | \$ 109,436 |
| Total Tax Credits | \$ 41,125 | \$ 42,250 |
| Net Earnings | \$ 386,836 | \$ 388,797 |
| Owner Retirement Benefit | \$ 33,500 | \$ 32,400 |
| Net Retained Benefit | \$ 420,336 | \$ 421,197 |

Important Elements in Decision:

- 401(k) plan has more flexible coverage, contribution, and vesting rules, which may permit the business owner to reduce the cost of employer contributions
- Owners may make significantly higher contributions to a 401(k) plan than to a SIMPLE IRA – and the tax savings often offsets any additional cost of the 401(k).

Scenario 4: Corporation, Owner and Spouse, 5 Employees, Defined Benefit-401(k) Combo Plan

Owners with steady income may see significant benefits from a defined benefit-401(k) combination plan. Business owners may save significantly more, and the tax savings can more than offset the additional expense of the combo plan as shown here. In addition, the more generous contributions for employees may be a significant tool to attract and retain a valuable workforce in this competitive job market.

| | SIMPLE IRA | 401(k) Plan | Combo Plan |
|-------------------------------------|------------|-------------|------------|
| Owner Revenue | \$ 500,000 | \$ 500,000 | \$ 500,000 |
| Admin Expenses for Plan | \$ 2,250 | \$ 3,500 | \$ 8,500 |
| Tax Credit for Admin Expenses | \$ 1,250 | \$ 1,750 | \$ 1,750 |
| Owner Contribution | \$ 46,000 | \$ 132,000 | \$ 332,000 |
| Non-owner Wages | \$ 240,000 | \$ 240,000 | \$ 240,000 |
| Non-owner Company Contribution | \$ 7,200 | \$ 12,000 | \$ 18,000 |
| Tax Credit for Company Contribution | \$ 5,000 | \$ 5,000 | \$ 5,000 |
| Earnings Before Tax | \$ 451,800 | \$ 361,000 | \$ 155,000 |
| Tax Before Credits | \$ 94,878 | \$ 75,810 | \$ 32,550 |
| Total Tax Credits | \$ 6,250 | \$ 6,750 | \$ 6,750 |
| Net Earnings | \$ 363,172 | \$ 291,940 | \$ 129,200 |
| Owner Retirement Benefit | \$ 46,000 | \$ 132,000 | \$ 332,000 |
| Net Retained Benefit | \$ 409,172 | \$ 423,940 | \$ 461,200 |

Important Elements in Decision:

- Combo plans allow owners to save significantly more for retirement.
- Combo plans require ongoing funding over several years, so steady revenue is necessary.

These examples show the cost savings that qualified plans create when first established. This is only one benefit of a qualified plan. These examples do not factor in the myriad of additional benefits – such as the benefits of tax-deferred accumulation of savings, the financial benefits to a company of ensuring employee funds remain in the plan so that employees are financially able to retire, the benefits of a financially-secure employee workforce, and the benefits of the plan attracting and retaining employees.

Business owners can take advantage of the new tax credits factored in above, starting with their taxable year that begins in 2023. Therefore, **now** is a great time for business owners to establish plans.