Retirement Guide for Small Business Owners

How to Prepare for Your Next Chapter

C.W. O'Conner Wealth Advisors, Inc.

Did you know

40%

of small business owners are **not confident** that they'll be able to retire by age 65?[1]

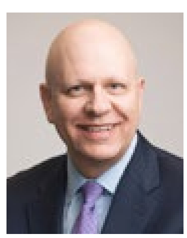
Small business owners devote much of their time and energy to running and growing their businesses that sometimes planning for retirement takes a backseat to the business. And, because they don't work for someone else, they cannot rely on company-provided 401(k)s or other benefits. Instead, they must take control of their retirement planning and savings.

So where do you even begin? One of our goals in working with small business owners is to give them a better understanding of the necessary steps to take in order to reach their retirement goals.

The average age of a small business owner is 50.3 years old.[2] No matter your age, we encourage our clients to start mapping out their retirement today, even if they are years or perhaps decades away from their target retirement age. It takes years of preparation and planning, especially for small business owners.

We hope you find our retirement guide to be a valuable resource as you navigate toward your next chapter in life.

Best,

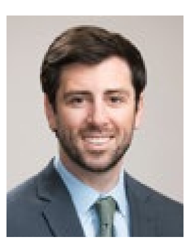


Clifford W. O'Conner

Clifford W. O'Conner, CIMA®, CPWA®, ChFC®

Founder and President,

C.W. O'Conner Wealth Advisors, Inc.



Kevin O'Conner

Kevin O'Conner, CIMA®

Financial Advisor,

C.W. O'Conner Wealth Advisors, Inc.

Understand Your Options

The good news for entrepreneurs is that they have several options when it comes to establishing and growing a retirement plan. Each plan has different requirements and tax advantages. We work with small business owners to find the right plan based on those aspects and each owner's business and retirement goals.

The Self-Employed 401(k) plan is a popular choice for many of our small business owner clients because of its tax advantages and higher contribution limits as compared to other retirement accounts for entrepreneurs.

We know you'll have questions about your retirement, and we are prepared to answer them. We often hear clients ask how their contribution to a Self-Employed 401(k) affects take-home pay, or what's the maximum amount they can contribute to their retirement account.

Our retirement guide will answer these questions and cover:

- Identifying Retirement Goals
- Retirement Plans and Implementation
- Self-Employed 401(k) Plans
- Maximizing Tax Advantages

3 Common Retirement Plans for Small Business Owners

As a small business owner, you are responsible for every aspect of your company – establishing business goals, managing operations and developing solutions to achieve those goals. But have you devoted any time to mapping out your retirement plan?

Since you are working for yourself, you are responsible for choosing and funding a retirement plan. There are multiple options for small business owners. Most people are familiar with employer-sponsored 401(k)s. But did you know that there are 401(k) plans and other options that are specifically for entrepreneurs?

In our experience, there are three common retirement plan options for small business owners. We can help you understand the requirements and tax advantages for each plan to determine which one is best for your business and retirement goals.

1. Self-Employed 401(k)

Who's it for?

This plan is only available to small business owners of sole proprietorships or corporations and their spouses who are employed by the company. You cannot have this type of account if you have any other employees beyond your spouse.

How does it work?

You can set up a Self-Employed 401(k) to operate like a traditional 401(k) or as a Roth 401(k). If you choose a traditional Self-Employed 401(k), contributions are made pre-tax and qualified distributions are taxed as ordinary income. If you set up a Roth 401(k), your contributions are made on an after-tax basis and qualified distributions are tax-free.

Why this plan?
What's beneficial about this type of account is that you can build it up quickly by contributing as both the employee and the employer. Additionally, your spouse can contribute to the plan if they are an employee.

How much can I contribute each year?
As the employee, for the year 2020, you can contribute up to $19,500, or $26,000 if you are age 50 or older. As the employer, you can allot an additional 25 percent of compensation, up to a $57,000 maximum, or $63,500 maximum if age 50 or older. Note that the total combined contributions as employee and employer cannot exceed the $57,000 threshold, or $63,500 threshold if you are age 50 or older.

The contributions by a spouse and on their behalf also are capped at $57,000, or $63,500 if age 50 or older, allowing for total contributions of $114,000 per household (or $127,000 if both are age 50 or older), if both individuals are employed by the company.

What else should I know?
If you plan on hiring employees in the future, you may need to choose another retirement plan option. In addition, you'll pay a 10 percent penalty if you take out funds prior to turning 59 ½ and an annual Form 5500 is required once the plan assets are in excess of $250,000.

2. Simplified Employee Pension (SEP) IRA

Who's it for?
Businesses of any size can establish this type of plan. Many sole proprietors or small business owners with a handful of employees choose to use this type of account.

How does it work?
Only an employer can contribute to this type of account. As the owner, you are counted as an employee.

Why this plan?
You can make substantially higher contributions to a SEP IRA as compared to a traditional IRA. (For 2020, the traditional IRA limit is $6,000, or $7,000 if you are age 50 or older.) Because there is no set amount you must contribute, you can adjust this amount annually based on the cash flow of your business.

How much can I contribute each year?
The employer can contribute up to 25 percent of the employee's eligible compensation or up to $57,000 for 2020. Compensation for the owner is calculated as net earnings on self-employment minus one-half of your self-employment tax and contributions to your own SEP IRA.

Contributions must be made by the small business owner’s tax filing deadline, and the contributions are tax deductible.

Catch-up contributions are not permitted with this type of plan.

What else should I know?
If you offer this account to any employee other than yourself, you must contribute the same percentage of compensation to each account. Also, if you withdraw money before turning 59 ½, you’ll pay a 10 percent penalty.

There is no annual Form 5500 filing required for a SEP IRA.

3. Savings Incentive Match Plan for Employees (SIMPLE) IRA

Who’s it for?
This plan is used by small businesses with 100 employees or less that don’t currently offer other retirement benefits to employees.

How does it work?
A SIMPLE IRA is like a traditional 401(k) account in that both the employer and employees contribute to the employee’s account. Employers are required to match employee contributions, up to three percent of the employee’s pay, or an employer can contribute two percent of the employee’s salary, regardless of employee participation in the plan. You’ll pay taxes on the money when you withdraw it during retirement. A SIMPLE IRA cannot be a Roth IRA.

Why this plan?
Employer contributions are tax deductible and employee contributions are made pre-tax.

How much can I contribute each year?
Employee contributions to a SIMPLE IRA are capped at $13,500 in 2020 ($16,500 if you are 50 or older).

What else should I know?
This plan is best for businesses with a larger number of employees, so if you know you’ll be the only employee, or will only have a couple of employees, consider choosing a Self-Employed 401(k) or SEP IRA instead. Those plans also have higher contribution limits.

If you need access to money in the fund within two years of opening the account and you are under age 59 ½, you may pay a 25 percent penalty. After two years, if you withdraw money before age 59 ½, you’ll pay a 10 percent penalty fee, the same as a Self-Employed 401(k) and SEP IRA.

There is no annual Form 5500 filing required for a SIMPLE IRA.

As you can see, there are many options for small business owners to fund their retirement. Even if you have investments elsewhere, it may be beneficial to have one of these accounts for the tax advantages. In addition, offering an employer-sponsored retirement plan is one way to attract and retain top talent within your company.

It is important to note that all contributions discussed here are based on 2020 limits and could change each year.

The 3 Stages of Retirement Planning for Entrepreneurs

No matter what stage of life you are in or how long you've owned your business, it's always wise to be thinking ahead to retirement. While there are some small business owners who say they don't ever plan to retire, we know many business owners look forward to the day when they will no longer have to work.

We understand that, as an entrepreneur, you are quite busy running your business and it can be difficult to pause and consider when that won't be the norm. But, in order to have a smooth and successful retirement, you need to start planning today.

Retirement unfortunately isn't as simple as waking up and deciding that today is the day to retire. It takes years of planning and preparation, especially for small business owners. What will happen to your business when you decide to retire? Have you saved enough to maintain your current lifestyle or pursue the interests you've put off while running your business?

We want our clients to have the retirement they've always desired. In order to reach your retirement goals as a small business owner, it helps to break down what you should be doing into three stages – early planning, mid-stage evaluations and final preparations.

1. Early Planning

Define retirement goals. If you haven't already done so, this is the time to set your retirement goals. At what age do you want to retire and what does retirement look like for you? Estimate how much income you'll need to maintain your current lifestyle. Perhaps you plan to travel more in retirement, or take up a new hobby, so factor in those additional costs. Also, be sure to consider that certain expenses, such as health care, will cost more as you age.

Protect your assets. Now may be the time to purchase insurance to cover long-term care, as well as life insurance policies or other insurance coverage that can help mitigate risks and protect your assets in your retirement.

Open retirement accounts. If you tend to invest all your money back into your company, this is the stage where you need to investigate various retirement plan options, such as a Self-Employed 401(k) or a SEP IRA. The majority of small business owners have a retirement savings plan, but if you are among the 34 percent who don't have one, it's not too late to start.[3] The earlier you begin contributing to a retirement account, the more time your money can grow. Plus, these accounts help minimize your taxes.

Reasons Why Small Business Owners Do Not Have a Retirement Plan [1]

- **37%** of business owners lack the profits to save for retirement.
- **21%** used their previous retirement savings to invest in their own business.
- **18%** plan to sell their business to fund their retirement.
- **12%** do not have any plans to retire.
- **12%** do not see the need to save for retirement.

What will happen to your business when you retire? For small business owners, retirement isn't just about saving money. You also must consider what will happen to your company once you retire. This is an essential step for all business owners, and one they should take as soon as possible. Does a child plan on taking over the business, or is there another internal successor? Do you want to sell your business? Begin to outline what you want to happen to your business and when so that you have plenty of time to execute the plan.

2. Mid-Stage Evaluations

Evaluate your savings plan. Are you on track to hit your retirement savings goals or do you need to increase the amount that you contribute to your retirement savings plan(s)? If you aren't already contributing the maximum to your retirement accounts, start doing so during this stage.

Diversify. Consider investing in other assets or investments during this stage. Since you are still likely 10 years (or more) away from retirement, you may be less risk adverse right now. We encourage you to fund your retirement from multiple sources of income. You want to make sure that you haven't tied your entire retirement future to the profits from the sale of your business.

Begin implementing your succession plan or exit plan. This middle stage of retirement is when you want to begin to establish an exit strategy for success. If you want to have a family member or current employee take over the business, it can take years to train that person and ensure that they can lead the company and run it properly. You may discover that a certain person isn't the right fit to take over. It's better to come to that realization earlier than later, giving you plenty of time to find a new successor.

If you intend to sell your business, this is the time to determine its value and ensure that it is attractive to potential buyers. Make sure you have the right people in place to manage the business and keep operations running smoothly.

Working with a financial advisor who understands the issues facing entrepreneurs and who has experience in exit planning can help your business receive what it's worth (or more) in a sale while minimizing taxation.

3. Final Preparations

Reevaluate your investments again. Now that your target retirement age is almost here, it may be time to diversify your investments again. Your strategy may need to change based on your lifestyle requirements and market conditions. As you get closer to living on your investments (and no longer drawing a steady income from your business), you'll need to adjust your allocations based on risk.

Wrap up your succession plan or exit strategy. Whether you have a successor in place or are eyeing a buyer, this is the stage where you take the final steps to complete your plan. Remember, finding a buyer can take time, as can identifying and training your successor, so don't delay this process. Also, if you sell your business, you may not receive a lump sum of money, but payments spread out over time. Take that into account when developing and executing your retirement savings strategy.

Don't dip into your retirement funds just yet. While it may be tempting to pull out some money just before retirement to take a trip or renovate your home, don't. Keep that money in your retirement accounts so that it's there when you need it. Look for other ways to fund a home improvement project or trip that doesn't include dedicated retirement assets.

Meet with your advisor. Even though you've been working with your advisor along your path to retirement, it's wise to meet with your advisor during this stage to make sure you are on track to hit your retirement goals and plan for any tax changes that may come with retirement.

Build Retirement Savings Quickly with a Self-Employed 401(k)

Are you a small business owner who wants to quickly grow your retirement funds? If so, you should consider starting a Self-Employed 401(k). Many entrepreneurs with no employees besides a spouse choose this plan because of its higher contribution limits as compared to other retirement plans for small business owners.

Earlier in this guide, we highlighted three common retirement plans for entrepreneurs, including the Self-Employed 401(k). In this section, we'll provide more details about the Self-Employed 401(k) plan so that you can talk with your financial advisor to decide if it's the right plan for your business and your retirement savings goals.

No Employees Except Spouse

The Self-Employed 401(k) plan can go by many names, including Solo 401(k), Individual 401(k) and One-Participant 401(k). The plan can be opened as a traditional 401(k) or as a Roth 401(k).

Self-Employed 401(k) plans are only for small business owners without full-time employees (notwithstanding spouses). You can have part-time employees if they don't work more than 1,000 hours a year. Any person who is self-employed through any type of business entity can open one.

Self-Employed 401(k)s are also a popular choice for independent contractors.

Higher Contribution Limits

Many small business owners choose a Self-Employed 401(k) because it allows the owner and spouse to contribute more on an annual basis than most other retirement plan options, such as a SEP IRA or SIMPLE IRA. It's also easier to reach the maximum contributions under a Self-Employed 401(k) due to the employee salary deferral option.

With a Self-Employed 401(k), you as a small business owner can contribute to the account as both an employee and the employer. As an employee, you can contribute up to $19,500 a year under the 2020 contribution limits. The employer can contribute up to 25 percent of the employee's salary as a profit-sharing contribution for a total maximum of $57,000 per year.

Contributions by your spouse and on his/her behalf as the employer can also total $57,000 a year for 2020, for a total maximum of $114,000 per household.

If you and/or your spouse are 50 or older, you can contribute an additional $6,500 as an employee. This brings the total contribution for an individual to $63,500 and a total maximum of $127,000 per household for 2020. Keep in mind the contribution limits may change each year.

This is a higher limit than what is available with other types of retirement plans, such as the SEP IRA, for example. Contributions to a SEP IRA are only made by the employer. Under this plan, employers can contribute up to 25 percent of the employee's salary, with a maximum contribution of $57,000 for 2019.

In order to reach the full contribution of $57,000 under a SEP IRA, the employee's salary must be $224,000. Under the Self-Employed 401(k) plan, however, you and your spouse can have a lower salary because you can still hit the maximum contribution of $57,000 through employee contributions to the account.

In addition to higher contribution limits, another benefit of a Self-Employed 401(k) is that all funds are fully vested immediately.

Tax Benefits

If your account operates like a traditional 401(k), contributions are made pre-tax, so you are reducing your current tax burden while benefiting your retirement. If you choose to open the account as a Roth 401(k), your contributions will be made with after-tax dollars.

Which account type is right for you?

It may depend on when you want to minimize your tax burden.

Anticipated Retirement Income	Recommended Account Type
Higher than today	Roth 401(k)
Lower than today	Self-Employed 401(k)

Small business owners who believe their income will be higher in retirement may want to opt for the Roth 401(k) account. If you think your income will be lower in retirement, then it may be a smarter option to defer paying taxes on the money now by opening a Self-Employed 401(k) that operates like a traditional 401(k).

As the employer, your contributions, as well as plan costs and maintenance fees, may be tax deductible. For contributions to be deductible for the tax year, they must be made by the small business's tax return due date. Also keep in mind that pre-tax contributions to your Self-Employed 401(k) as the employer reduces your Qualified Business Income (QBI), which therefore, may reduce your QBI deduction.

Small business owners should keep the new QBI deduction created under the Tax Cuts and Jobs Act of 2017 in mind. This deduction could alter how some entrepreneurs save for retirement. To determine the impact of this deduction on your savings, you should plan to work directly with your financial advisor. Your advisor will also be able to help you determine which account structure – traditional or Roth – will maximize your tax savings, both now and in the future.

Paperwork

Various providers offer Self-Employed 401(k) plans, and where you set one up often dictates your investment options. Be aware that some providers, such as a bank, may only promote the products they sell.

To set up an account, you'll be required to complete paperwork about yourself, your business, investment elections and more. Work with your financial advisor to ensure that you design a plan that makes sense for both your business and personal situations, and goals.

You will also need to prepare employee disclosures, even though you (and possibly your spouse) are the only employee participating. The employee disclosure should include plan information, employee rights and responsibilities, and a general 401(k) disclosure.

After initial setup, a Self-Employed 401(k) doesn't require any annual tax filings with the IRS until the total assets in the plan equal $250,000 or more. Once you reach that amount, you'll need to file a Form 5500 EZ.

Self-Directed Plan

For small business owners who want more flexibility than what a traditional bank or brokerage account can offer, a Self-Directed 401(k) may be worth considering. A Self-Directed 401(k) plan lets you invest in alternative investments such as real estate or precious metals. The investor directs the decision-making on buying and selling, but a qualified custodian or trustee must be an administrator.

The IRS has specific rules for Self-Directed 401(k)s, so consult with your advisor to ensure your investments don't run afoul of those rules. If the IRS determines you participated in a prohibited transaction, you will be required to correct it and pay taxes on that transaction, which can be quite costly.

Not all Self-Employed 401(k) plans are the same, so it's important to work with your financial advisor to find a plan that will best serve your business needs and retirement goals.

401(k) Frequently Asked Questions

When discussing Self-Employed 401(k) plans with our clients, we often are asked how the contributions to this type of retirement savings plan will affect take-home pay. The answer to this question, as well as other commonly asked questions related to retirement plans, are below.

Self-Employed 401(k)

Does my 401(k) contribution amount come from my gross pay or net pay? How will my contribution to my Self-Employed 401(k) affect my take-home pay?

Your contribution amount comes from your gross pay (before any taxes and deductions are taken out).

As far as how it will affect your take-home pay, your net paycheck will be reduced by the contribution amount less your marginal tax rate. For example, if you contribute $100 each paycheck to your Self-Employed 401(k) and your marginal tax rate is 22 percent, your net payroll check will only be reduced by $78 ($100 – $22 = $78).

What's the maximum amount I can contribute into the self-employment plan using both a 401(k) and my company-sponsored profit-sharing plan for 2020?

The Self-Employed 401(k) combined with a profit-sharing feature allows someone to contribute up to $63,500 in total for 2020 for those age 50 and older (For 2019, the total is $62,000.) If you are under the age of 50, the maximum amount is $57,000 ($56,000 for 2019).

Required Minimum Distributions

If I'm still working and have a balance in a company-sponsored 401(k) account with my current employer, am I required to begin taking a required minimum distribution (RMD) from the employer-sponsored plan when I turn 72?

No, unless you own more than five percent of the company. RMDs for this employer-sponsored plan don't begin until you retire. However, this exemption doesn't apply to your other retirement plans, such as IRAs and other 401(k) plans from prior employers. You are still required to take RMDs from your other retirement accounts at age 72 (or age 70 ½ if you turned 70 ½ by Dec. 31, 2019).

Can I withdraw a combined RMD amount, which represents the total RMD requirement from all my retirement accounts, from one retirement account?

Not for every type of retirement account. IRAs can be aggregated value-wise, and the RMD withdrawal can be from one individual IRA. However, 401(k) RMDs cannot be combined and are required to be withdrawn annually from each 401(k) account.

It can be tricky to keep up with IRS regulations and the tax code, both of which constantly evolve. Working with a financial professional can help you ensure that you are maximizing your savings while minimizing your tax burden as you prepare for retirement.

Filing Form 5500-EZ For Your Self-Employed 401(k) Plan

When you first created a Self-Employed 401(k) plan for you and/or your spouse, you weren't required to file paperwork with the IRS. That's because the IRS only requires an annual tax filing when plan assets equal $250,000 or more.

Once your plan's assets hit the $250,000 threshold, or if the current year is the final year of your plan, you must file Form 5500-EZ with the IRS. The filing is due by the last day of the seventh month after the end of the plan year.

When filing Form 5500-EZ, you will need to include:

- The type of return you are filing.
- Basic plan information, such as the name of the plan, Employer Identification Number and the plan administrator's name and EIN.
- Financial information, such as total plan assets and liabilities.
- Plan characteristics.
- Answers to compliance and funding questions, such as whether the plan had any participant loans for the plan year.

To find an example of a draft filing, visit IRS.gov.

Although filers of Form 5500-EZ are not required to file schedules or attachments related to Form 5500, filers must still collect and retain these two completed schedules, if applicable:

- Schedule MB (Form 5500), Multiemployer Defined Benefit Plan and Certain Money Purchase Plan Actuarial Information.
- Schedule SB (Form 5500), Single-Employer Defined Benefit Plan Actuarial Information.

Effective for plan years beginning after 2019, you can file Form 5500-EZ with the IRS electronically. A paper form must be mailed for plans before 2019.

In addition, some Self-Employed 401(k) plans (called “one-participant plans” by the IRS) have already been able to file the Form 5500-SF electronically via the Department of Labor’s EFAST2 system. Certain conditions must be met to do so, such as if the filer is required to file at least 250 returns of any type with the IRS during the calendar year. If you meet this requirement, you must file electronically. Filing the paper Form 5500-EZ will not be considered by the IRS as filed.

If you have questions about whether you should file, work with your financial advisor to determine whether your assets have reached the $250,000 threshold for the current plan year. Often, a financial advisor may file the Form 5500-EZ on your behalf, but only if you have your assets with their company.

We Can Help

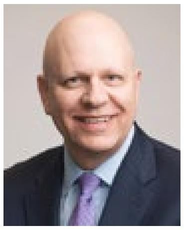
The team at CWO is dedicated to working with small business owners to create action plans that allow them to enjoy retirement without worrying how to fund it. We can continue to help you understand all aspects of retirement, from defining your goals to establishing and growing retirement accounts to creating and executing a succession or exit plan.

If you’d like to review your current retirement plan, or need to create one, please contact us to schedule a meeting.

[1] SCORE, “Infographic: Small Business Retirement – Investing in Your Future,” April 9, 2019
[2] Microsoft, “Small Business Ownership Statistics You Should Know,” Sept. 17, 2018
[3] U.S. Money News & World Report, “7 Reasons Why Entrepreneurs Don’t Save for Retirement,” May 11, 2018

Information provided is current as of June 2020.

About the Authors

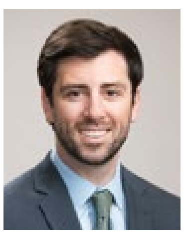


Clifford W. O'Conner, CIMA®, CPWA®, ChFC®
Founder and President of C.W. O'Conner Wealth Advisors, Inc.
cliff@cwoconner.com

Cliff established C.W. O'Conner Wealth Advisors, Inc. in 1995 to provide creative solutions in investment management, wealth management and business services to executives, business owners, individuals and their families.

Time is valuable for Cliff's clients, who are leaders both in their fields and of their families. Cliff breaks down the complexities surrounding business, tax and investment issues so clients and their families thoroughly understand the plans that Cliff and his team have designed for them.

Cliff serves as a fiduciary, which means he provides advice in the client's best interest – not his own. Cliff and his team are constantly seeking to elevate their knowledge base by learning about emerging issues and trends in finance, real estate, business and tax.



Kevin O'Conner, CIMA®
Financial Advisor, C.W. O'Conner Wealth Advisors, Inc.
kevin@cwoconner.com

Kevin joined the firm in 2013 and works closely with clients to establish and meet their business and personal financial goals. He and the team at CWO present clients with concrete action plans to bring inventive opportunities to life. He is involved in all aspects of the firm, including wealth planning, business planning, portfolio management, client reporting and due diligence.

Kevin has earned his Certified Investment Management Analyst® (CIMA®) designation. He works to expand his understanding of financial and business issues important to clients and stays on top of trends and ideas in investments, financial planning and portfolio strategies.

Get in Touch

655 Engineering Drive, Suite 110,
Peachtree Corners, GA 30092
(770) 368-9919

info@cwoconner.com
cwoconner.com
Follow us on LinkedIn