

Use Your Business to Pay for Your Retirement

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Every day, you experience the feeling that only a business owner will ever truly understand. Lying awake into the wee hours of the morning, you stare at the ceiling and wonder if the marketing dollars you spend will pay off. You wonder if that new employee will work out. You dread the arrival of credit card statements as they only remind you of the debt you assumed to get the business off the ground. The rent has to be paid every month, those payroll taxes every quarter... and then those surprise bills show up only once per year, always at the worst possible time!

Yet after a while, your perseverance begins to pay off. You build a base of customers who refer more customers and who do more business with you over time. When the bills arrive, there is actually money in your account to pay them - and maybe a little extra to chip away at the debt. The employees that you took a risk on now perform their jobs efficiently, occasionally even running the shop without your constant supervision. Your cash flow improves and you even are able to squeak out a raise for yourself, take a vacation, or replace that old piece of outdated equipment that you've had for years. Eventually, you begin to enjoy the life that you had hoped would result from the risk you took when you started your business! Ahh... the fruited plains!

For many business owners the journey stops here. If their business is very successful, an enjoyable lifestyle follows; if only moderately successful, their business will consume most of their waking hours and take on a life of its own. Either way – at some point, retirement happens. Someday, either by choice, or by circumstance, retirement comes to us all. Retirement is inevitable, and for most, it is viewed as the end of a long journey – the brass ring to be seized and enjoyed once the challenge of running a business is over.

There is truth in the saying that the business owner – that brave soul who risks everything to start up and run a business – takes a deeper drink of life than others will ever know. Sometimes the drink is bitter, marked by nights of worry and uncertainty about the future. However, one of the benefits of living in a capitalist society is that the legislature rewards - sometimes greatly – those who fuel the economy with the risks they take in support of their dreams. Some of those rewards are found in the generous provisions of the various employer retirement plans available to most business owners.

Most people are familiar with the IRA – the Individual Retirement Account- that allows contributions of up to \$5,000 annually, dependent upon age, tax bracket, and earned income. However, a number of employer sponsored retirement plans exist that provide powerful, tax-advantaged vehicles for a business owner to fund their own retirements – and enjoy significant tax savings and employee loyalty along the way. The laws governing the use and flexibility of these plans continuously change, but the current trend is that they are becoming more attractive and user-friendly as the government seeks to ease the nation's dependence upon Social Security and increasingly scarce pension plans.

For most small business owners, the easiest retirement plan to establish and understand is the Simplified Employee Pension Plan – also known as the SEP IRA. The SEP is available for sole proprietors as well as partnerships and corporations. Easy to establish and inexpensive to maintain, the SEP IRA can be a powerful tool for a business owner to fund their retirement. An additional advantage of the SEP IRA is that it can be established *retroactively* – meaning an employer can wait until the tax filing deadline for the previous calendar year before opening an account or making any contributions. This extra time allows the business owner to evaluate their tax situation and tally business profits *before* making a decision on whether to contribute to a SEP for that year.

I often find business owners do not fully understand just how flexible employer retirement plans are – and as a result, many completely forego the benefits available to them. For example, many small business owners mistakenly believe an employer retirement plan is designed to benefit the employees at the expense of the owner. Not so! While retirement plans can be critical elements in recruiting and retaining those employees who contribute greatly to a business' success – most retirement plans actually benefit the *business owner* far more than the employees. Consider it as Congress' way of rewarding entrepreneurs who risk everything to create legacies, dreams, jobs, and ultimately – are the backbone of the American economy.

For example, when establishing a SEP IRA, a business owner does not have to include union employees or those who have been with the business for fewer than 3 years. Yet, by structuring her personal compensation correctly, a business owner may receive up to \$45,500 tax-deductible dollars into her own retirement account! In many cases, small business owners who have only a few employees and can't make hefty contributions to their own accounts will save more than enough tax dollars to pay for any required contributions into the accounts of their employees. In this case, the employee's contributions are actually funded with *tax savings* – not income the business owner had to sacrifice!

For business owners who wish to encourage their employees to save for their own retirements, a Safe Harbor 401(k) plan might be the answer. While a 401(k) plan does require additional administration and costs more to install and maintain, the additional benefits can be well worth the hassle. Similar to the SEP, the maximum allowable annual contribution into a 401(k) tops out at \$45,500 for tax-year 2007 – but the business owner doesn't have to contribute one penny to an employee's retirement plan until the employee chooses to make contributions for themselves. Once contributions are made, the maximum benefit for both the business owner as well as the employee comes from the tax deductible matching dollars the law authorizes the business to make directly.

While contributing up to \$45,500 per year certainly sounds exciting, it is a paltry sum compared to the ultimate benefit a business owner can enjoy by establishing and fully funding a retirement plan for their business. Since retirement plan contributions are not taxed when the dollars are earned, and earnings on the account are not taxable until they are withdrawn, an employer retirement plan is one of the most powerful retirement funding vehicles currently available for a small business owner. Assuming an average

rate of return of only 8%*, maximum annual contributions to a SEP or a 401(k) account may grow to over \$700,000 within 10 years – certainly a powerful step toward a well-deserved retirement for a bedraggled business owner who retires and gets that long-awaited good night’s sleep, knowing their job is finally done.

* For illustrative purposes only, not indicative of any specific investment product.

Investors should be aware that there are risks inherent in all investments, such as fluctuations in investment principal. With any investment vehicle, past performance is not a guarantee of future results.

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