hooker & holcombe

5 ways business owners can optimize retirement savings

As a business owner, you have the ability to pull certain levers to increase retirement savings while controlling tax consequences. By understanding how different qualified plans can deploy savings and tax strategies, you can optimize cash flow for your retirement future.

$20,500 retirement savings and tax strategies

A safe harbor 401(k) is a type of retirement plan that allows employers to max out their annual salary deferral. As the owner, you can defer up to $20,500 in salary in either:

- **Pre-tax 401(k).** Take the income tax deduction today and push the taxes to the future.
  PRO TIP: If your marginal tax bracket is near a threshold that could affect other tax liabilities, take the salary deduction to stay below the cut off.
- **Roth contribution.** Pay the taxes now. Your account grows tax-free; and when you access your account in retirement, it is also tax-free. Of course, the 401(k) plan would need to allow for a Roth contribution.
  PRO TIP: Having access to tax-free money in retirement allows you to adjust your taxable income up and down based on your future needs.

For people over 50 years old, you can also add a "catch-up" contribution of $6,500 annually to your account.

To get these benefits, employers are required to make a contribution for employees. Generally speaking, a Safe Harbor contribution costs the employer between 3 – 4% of gross eligible salaries. From a tax planning perspective, employer contributions are deductible on the company's federal income tax return.

For employers that want to max out their own 401(k) annual deferral and avoid certain plan design tests and provide an incentive for employees, a Safe Harbor 401(k) Plan may be right for you.

$61,000 retirement savings and tax strategies

For owners looking to save around $61,000 per year, there is a 401(k) **cross tested/new comparability plan** option. This calculation method combines the 401(k) with a profit share. Profit sharing employer contributions are generally tax deductible.

What makes these plans unique is that business owners can select certain groups of employees to participate in the profit sharing portion of the plan, but the plan will need to be tested so the benefits do not discriminate in favor of highly-compensated employees.[1]

Employers can set when and how much to contribute to these plans, which can be changed annually. Contributions limits are the lesser of 100% of compensation or $61,000 for 2022 (and $67,500 if over 50 years old).[1] Advanced plan design is necessary, and these plans typically cost more to administer.

Taxed now, flexibility later

If the ability to adjust your taxable income sounds interesting, then a **Roth conversion** may be worth exploring.

With respect to 401(k) plans, it is the transfer of funds from a traditional pre-tax 401(k) into a Roth 401(k). Account owners pay tax on the money they convert and are eligible to make tax-free withdrawals from the account in the future. From a tax planning perspective, this approach requires taxes to be paid up-front versus when you retire. This can be helpful if you expect to be in a higher tax bracket at retirement.

> PRO TIP: If your taxable income is between marginal tax brackets, consider converting the amount that reaches the upper limit. This strategy doesn't trigger a higher tax bracket and may help with future tax planning.

From an estate planning perspective, Roth IRAs are not subject to required minimum distributions.[2]

$200,000 retirement savings and tax planning

Looking for large tax deductions and rapid retirement plan savings? A **Cash Balance** plan may be an option. The pre-tax account is an above-the-line tax deduction.

Cash Balance plans are best for owners who:

- Have a steady and consistent revenue
- Already contribute 5% or more towards employee retirement benefits
- Are comfortable with advanced plan design

Keep in mind, the investment risks are borne solely by the employer, so it's very important that you understand the details of a Cash Balance plan before implementing one.

Triple tax savings

For employers offering a high-deductible health plan, you can also setup a Health Savings Account (HSA). These accounts are funded with pre-tax dollars, the account grows tax-free and the money is income tax-free (when spent on qualifying medical expenses).

For 2022, the HSA limit for is $7,300 for families and $3,650 for individuals. HSA dollars can be invested in the stock market, which means they could grow over time. Therefore, if you start saving through your HSA as part of a retirement planning strategy, you could have access to another bucket of tax-free money for medical expenses. When the average American's health care costs are $300,000, wouldn't it be nice if the money was triple tax-free?[3]

Worth a conversation

With so many different retirement savings options available for business owners, it's important to work with a qualified investment advisor. We can help you set up the right plan(s), discuss tax planning strategies and help you find the best option to optimize your retirement savings. Connect with us to learn more: **hhconsultants.com**

[1] Internal Revenue Service, "Choosing a Retirement Plan: Profit-Sharing", 2022

[2] Julia Kagan, "Roth IRA Conversion", Investopedia, 5 March 2022

[3] "How to Plan for Rising Health Care Costs", Fidelity, 25 May 2022