Tax Advanages of a Qualifed Retirement Plan

By choosing to offer your employees a 401(k) plan, you're sending a powerful message that you're more than just their employer, you're invested in their future and committed to helping them work towards financial security in their retirement.

As a business owner, you can also benefit from setting up a retirement savings plan. Not only does it provide you with the opportunity to save money for your own retirement, the right plan and design also enables you to take advantage of tax saving, sometimes significant, thanks to special deductions and tax credits.

Here are four ways that a 401(k) can help you reduce taxes:

#1 Personal tax benefits

Depending on the type of plan you offer, you and your employees can save for retirement in two ways:

Pre-tax: Contributing pre-tax dollars to the 401(k) plan while working reduces your current taxable income and allows you to defer paying taxes until you withdraw the money at retirement.

After-tax (Roth): If you opt for a plan with a Roth feature, you and your employees can save on an after-tax basis. While it doesn't reduce your current tax bill, generally you can take the money out tax-free at retirement This includes your contributions, along with any investment growth.

If you are considered an employee of the business, you can take advantage of these pre- or after-tax savings, too. Moreover, having a 401(k) can provide additional savings opportunities for you. For instance, if your income exceeds the Roth limits that would prohibit you from making contributions to a Roth Individual Retirement Account or taking deductions for traditional IRA contributions, a qualified plan could eliminate these issues because contributions to a pre-tax or Roth 401(k) do not have an income ceiling.

Keep in mind that participants, per IRS limits, can save up to $20,500 in a qualified retirement plan such as a 401(k) in 2021. These contributions can be split between pre-tax and Roth deferrals, much higher than the $6,000 IRA contribution limits. In addition, employees aged 50 and older can make additional catch-up contributions of $6,500

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to a 401(k). These maximum limits exclude any employer matching or profit-sharing contributions'

#2 Tax-deductible employer contributions

Many employers choose to make retirement plan matching contributions, although it isn't required. Offering an employer match can help you attract top talent, making your retirement plan more competitive and improving employee retention.

Plus, company contributions are tax-deductible as a business expense up to certain limits, including both matching and non-elective contributions (those made directly by the employer regardless of whether or not employees contribute to the plan).

#3 Business tax credits

A qualified retirement plan is an employee benefit. Therefore, any plan-related expenses you pay may be tax-deductible, including employer contributions and the administrative costs for running the plan. These could include fees paid to a Third-Party Administrator (TPA), like MAP Retirement, recordkeeper, auditor or other consultants you hire to help with your plan. All of these costs can potentially be written off.

In addition, the IRS has created tax credits to incentivize small business owners to offer 401(k) plans. Employers may claim a tax credit for some of the ordinary and necessary costs of starting a qualified plan.

For 2021 and beyond, employers may qualify for a credit of at least $500. Additional credits may be available, and employers may be able to take the lesser of $250 for each non-highly compensated employee (NHCE) eligible to participate up or $5,000. The credit is available for the first three plan years.

Specific criteria apply, so talk to a tax professional to understand how the credit could impact your specific situation.

#4 Increased tax savings with profit-sharing

You can further customize your 401(k) plan by adding a profit-sharing component. Profit-sharing plans offer similar tax benefits to a traditional 401(k), but they have higher contribution limits, which allow employers to enjoy additional tax savings.

With profit-sharing plans, employers contribute to employees' retirement savings based on the company's profitability within a given year. These plans offer employers a lot of flexibility — you can choose how much you want to contribute and even skip contributions in less-profitable years.

Profit-sharing plans provide an opportunity for you and your employees to save beyond the annual limits. For instance, employees can make salary deferrals up to $20,500 (the annual limit in 2021). However, maximum employer contributions are even higher: up to 100% of an employee's annual salary or $61,000 per year. ($67,500 including catch-up contributions for employees aged 50 and older), whichever is higher.

Combination plan designs go even further for the right company

Organizations with consistent profit looking for further tax saving or retirement savings for ownership and other key employees should consider a Cash Balance Plan in combination with their 401(k) Profit Sharing Plan. Cash Balance Plans, in combination with a 401(k) Profit Sharing Plan may allow for contributions and tax savings significantly higher than a traditional defined contribution plan alone.

The bottom line

The tax laws can be favorable for business owners who offer a 401(k) or similar qualified retirement plan. It's a great way to help you and your employees save for the future while getting tax benefits for doing so. Now is a good time to take a closer look at the options available to your business and consider how providing a competitive benefit can help attract and retain talent, save on taxes and positively impact your bottom line.

For further information please call your MAP Regional Representative. MAP will provide you with a custom illustration for your clients, company, and plan. The illustration will show possible plan design and contribution formulas with possible tax savings.

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