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Retirement Issues for Small Businesses in 2024-25

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Introduction

- Owners of small businesses face many obstacles, including but not limited to
  - Recovery from the pandemic,
  - Competition,
  - Government intervention
  - Economy fluctuations, and
  - Employee benefits, including retirement income

Introduction

- Today, we look at
  - The changing landscape of operating a business considering changing government rules,
  - The contribution opportunities resulting from SECURE 2.0 and Treasury regulations,
  - The requirements to establish certain small business retirement plans in 2024 and 2025, and
  - Some tax opportunities for small business owners.

Introduction

- With respect to small business owners, the following are plans generally considered:
  - Defined Benefit (DB) plans

  - Defined Contribution (DC) plans, including
    - SEP (Simplified Employee Pension) plans,
    - SIMPLE plans,
    - Keogh plans,
    - Profit sharing plans, and
    - Various 401(k) plans,

  - Sale or transfer of the business

Introduction

- With respect to employees of small businesses, the following are some of the retirement opportunities available to them:
  - IRAs and Roth IRAs (cursory review),
  - Social Security, and
  - Portfolio income and passive income

SEP Plans

- **Sole Proprietor Businesses and Family Owned and Operated Businesses**

- **SEP plans** A written arrangement (a plan) that permits an **employer** to contribute to the employees' retirement plan.
  - Contributions are made directly to the employee's traditional IRA or annuity IRA.
  - Because it is an IRA, a 5% owner must take an RMD at age 73 even if the owner is still working.

- **Eligible Employees**
  - At least 21 years old, and
  - Has performed "service" for the employer in at least 3 of the immediately preceding 5 years, and
  - Has received compensation of at least $750 in 2024.

  - Note: An employer can establish less restrictive eligibility requirements, but not more restrictive ones.

Contributions to SEP Plans

- **Contribution Limits for 2024**
  - Maximum annual deductible contribution is the lesser of
    - $69,000, or
    - 25% of employee’s compensation (limited to $345,000) or employer’s self-employed net earnings
      - Contributions must be cash, check, or money order; it cannot be property
  - Employee cannot make a contributions to SEP-IRA plan
  - Employee cannot make a catch-up contribution to SEP-IRA plan
  - Employer is not required to make annual contributions but if made, they must be same percentage for all participants.

Contributions to SEP Plans

- **Contribution Limits for 2024 for Self-Employed**
  - As given on the previous slide, the maximum annual deductible contribution is the lesser of
    - $69,000, or
    - 25% of employer's self-employed net earnings
  - However, the calculation for the self-employed is as follows:
    - Net profit of business less ½ of the self-employment tax less the SEP contribution.
    - The deductions for the owner's contributions and their net earnings depend on each other. Hence, the owner determines the self-employment rate for their contribution by means of the following calculation:
      - Plan contribution rate divided by (plan contribution rate plus 1.0)

Contributions to SEP Plans

Contribution Limits Example for 2023 for Self-Employed

Facts: A sole proprietor (SP) has no employees. The terms of their SEP plan provide that the SP contribute 8 ½% (0.085) of his compensation to the plan. The SP's net profit from Schedule C (Form 1040), line 31, is $200,000. In addition, the SP has no elective deferrals or catch-up contributions. The SP's self-employment tax deduction on line 15 of Schedule 1 (Form 1040) is $11,792.

Response: The SP's maximum deduction for the employer contributions is 7.8% and it is calculated as follows:

0.078 (or 7.8%) = 8 ½% (0.085 or the plan contribution rate) divided by 1.085 (plan contribution rate + 1.0)

Note: To show the worksheet associated with this example, tax year 2023 is used for illustrative purposes.

Source: IRS Publication 560 (2023), pages 36-39.

Calculating the Contributions Amount

- **SP can deduct $14,616 as computed on Schedule C.**

Deduction Worksheet for Self-Employed

Step 1 Enter your net profit from Schedule C (Form 1040), line 31; Schedule F (Form 1040), line 34;* or Schedule K-1 (Form 1065),* box 14, code A.** For information on other income included in net profit from self-employment, see the Instructions for Schedule SE (Form 1040) * Reduce this amount by any amount reported on Schedule SE (Form 1040), line 1b. ** General partners should reduce this amount by the same additional expenses subtracted from box 14, code A, to determine the amount on line 1a or line 2 of Schedule SE (Form 1040).	$200,000
Step 2 Enter your deduction for self-employment tax from Schedule 1 (Form 1040), line 15	12,611
Step 3 Net earnings from self-employment. Subtract step 2 from step 1	187,389
Step 4 Enter your rate from the Rate Table for Self-Employed **or** Rate Worksheet for Self-Employed	0.078
Step 5 Multiply step 3 by step 4	14,616
Step 6 Multiply $330,000 by your plan contribution rate (not the reduced rate)	28,055
Step 7 Enter the **smaller** of step 5 or step 6	14,616
Step 8 Contribution dollar limit	$66,000
• **If you made any elective deferrals to your self-employed plan, go to step 9**	

SEP Plans – Additional Issues

- **SEP Adoption:** File Form 5305-SEP
  - No IRS approval or determination letter is required
  - **Deadline** to adopt is tax return due date (including extensions)
  - All eligible employees must
    - Receive Form 5305-SEP and any other pertinent information, and
    - Have an SEP-IRA established before plan is set

Form **5305-SEP**
(Rev. December 2004)
Department of the Treasury
Internal Revenue Service

Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement

(Under section 408(k) of the Internal Revenue Code)

OMB No. 1545-0499

Do not file with the Internal Revenue Service

______________________________ (Name of employer) makes the following agreement under section 408(k) of the Internal Revenue Code and the instructions to this form.

Article I—Eligibility Requirements (check applicable boxes—see instructions)

The employer agrees to provide discretionary contributions in each calendar year to the individual retirement account or individual retirement annuity (IRA) of all employees who are at least ________ years old (not to exceed 21 years old) and have performed services for the employer in at least ________ years (not to exceed 3 years) of the immediately preceding 5 years. This simplified employee pension (SEP) ☐ includes ☐ **does not** include employees covered under a collective bargaining agreement, ☐ includes ☐ **does not** include certain nonresident aliens, and ☐ includes ☐ **does not** include employees whose total compensation during the year is less than $450*.

Article II—SEP Requirements (see instructions)

The employer agrees that contributions made on behalf of each eligible employee will be:

A. Based only on the first $205,000* of compensation.
B. The same percentage of compensation for every employee.
C. Limited annually to the smaller of $41,000* or 25% of compensation.
D. Paid to the employee's IRA trustee, custodian, or insurance company (for an annuity contract).

SEP Plans – Additional Issues

- **Deduction Reporting:** Employer's contributions for employees are deductible on
  - Schedule C (contributions made on behalf of the employees) (Line 19)
  - Schedule F (contributions by a farmer) (Line 23)
  - Form 1065 (contributions by a partnership)
  - Schedule 1 (contributions for sole proprietor) (Line 16)
  - No amount is reported on the employee's W-2 form.

SEP Plans – Additional Issues

- **Distributions:**
  - Once a contribution is made to the plan by the employer, the employee is free to take withdraw any or all parts of the plan's investments
  - Withdrawals become taxable income to the employee and may be subject to the 10% additional tax.
- **RMD requirement:**
  - RMD rules are not applicable to DC plans of the employer, if the employee is still working, but are applicable to the IRAs, including SIMPLE and SEP IRAs once a person attain age 73 beginning in 2023 even if they are still employed in their company.

SIMPLE Plans

- **SIMPLE plans**
  - Limited to businesses of 100 or less employees.
  - Permits contributions to an employee's SIMPLE IRA.
    - Made by the employee, treat it as an elective salary reduction, and
    - Made by the employer as an annual matching arrangement or non-matching arrangement

SIMPLE Plans

- **Who are Eligible Employees?**
  - Anyone receiving compensation of at least $5,000 during any 2 preceding calendar years
  - A self-employed individual who received earned income qualifies
  - **Note**: The above eligibility criteria are the minimum criteria, which means an employer can establish less restrictive eligibility requirements. They just can't set more restrictive eligibility requirements.
    - For example, you can't set the necessary compensation amount to $8,000.

SIMPLE Plans – Additional Issues

- **SIMPLE Adoption:** File Form 5305-SIMPLE –
  - No IRS approval or determination letter is required
  - **Deadline** to adopt is October 1 of the plan year.
    - Note: To have a plan begin in 2024, we need to set everything up by October 1, 2024.

Form **5305-SIMPLE**
(Rev. March 2012)
Department of the Treasury
Internal Revenue Service

Savings Incentive Match Plan for Employees of Small Employers (SIMPLE)—for Use With a Designated Financial Institution

OMB No. 1545-1502

Do not file with the Internal Revenue Service

______________________________ establishes the following SIMPLE
Name of Employer

IRA plan under section 408(p) of the Internal Revenue Code and pursuant to the instructions contained in this form.

Article I—Employee Eligibility Requirements *(complete applicable box(es) and blanks—see instructions)*

1 **General Eligibility Requirements.** The Employer agrees to permit salary reduction contributions to be made in each calendar year to the SIMPLE individual retirement account or annuity established at the designated financial institution (SIMPLE IRA) for each employee who meets the following requirements (select either 1a or 1b):

a ☐ **Full Eligibility.** All employees are eligible.

b ☐ **Limited Eligibility.** Eligibility is limited to employees who are described in both (i) and (ii) below:

(i) **Current compensation.** Employees who are reasonably expected to receive at least $ __________ in compensation (not to exceed $5,000) for calendar year.

(ii) **Prior compensation.** Employees who have received at least $ __________ in compensation (not to exceed $5,000) during any ______ calendar year(s) (insert 0, 1, or 2) preceding the calendar year.

2 **Excludable Employees**

☐ The Employer elects to exclude employees covered under a collective bargaining agreement for which retirement benefits were the subject of good faith bargaining. **Note:** *This box is deemed checked if the Employer maintains a qualified plan covering only such employees.*

SIMPLE Plans Contributions

- **Contributions:** The SIMPLE plan requires the contributions to be expressed as a percentage of compensation. It also requires the employer to select either an elective or a nonelective plan.

  - An elective contribution plan, is one whereby,

    - The employer matches the employee contribution on a dollar-for-dollar basis up to 3% of compensation for the taxable year as set forth in IRC §401(a)(17), and

  - A nonelective contribution plan, is one whereby,

    - The employer must contribute 2% of compensation for each eligible employee, regardless of their contribution.

SIMPLE Plans Contributions

- There is an exception to the 3% contribution rule. That is,
  - An employer can elect an applicable matching percentage of less than 3% (but not less than 1%) for any year. This election must satisfy both of the following conditions:
    - The employers must notify all employees of the lower percentage within a reasonable period before the 60-day election period for such year, and
    - This election can be made for only two of the most recent five years, which includes the proposed election year.
    - Source: IRC §408(p)(2)(C)(ii)

SIMPLE Plans – Additional Issues

- **Reporting the Contributions:**

- Employer's contributions are deductible on:

  - Schedule C for employee's contributions

  - Schedule F (farmer)

  - Schedule 1 for sole proprietor's contribution

- Employee's contributions are:
  - Not reported in box 1 (the "Wages, tips, other compensation" box) of Form W-2. Rather, they are included in the "Social security wages" and "Medicare wages and tips" boxes and in box 12. In addition, box 13 ("Retirement plan" checkbox) is checked.

Contributions to SIMPLE Plans

- **Contribution Limits for 2024**
  - Maximum annual contribution is the lesser of
    - $16,000, or
    - A set percentage of employee’s compensation or employer’s self-employed net earnings.

  - Employee can make a catch-up contribution up to $3,500 to their SIMPLE plan if age 50 or older.

Contributions to SIMPLE Plans

- **Other Contribution Issues**
  - Note 1: If an employee makes elective contributions to any other qualified plan, overall limit is $23,000.
  - Note 2: Employee can make a catch-up contribution up to $3,500 if age 50 or older.
  - Note 3: Employer is required to match employee’s contribution up to 3% of the employee’s compensation.
  - Note 3A: Employer can choose a lower percentage (but not less than 1%) for no more than 2 years during a 5-year period.
  - Note 3B: Employer can provide a 2% non-elective contribution.

SIMPLE Plan Contributions for 2024
SECURE 2.0

- **Modification 1: Contribution limits for 2024:** Elective contributions by small business owner increased to $16,000 but the catch-up contribution remain at $3,500 for 2024 per Notice 2023-75.

- However, SECURE 2.0 provides higher contribution limits beginning in 2024
  - The contribution limits increase by 10% (or $17,600) as compared to the limit that would otherwise apply ($16,000) and the catch-up contribution increases to $3,850:
    - For an employer with no more than 25 employees, and
    - For an employer with 26 to 100 employees if the employer either provides
      - A 4% matching contribution (instead of the 3% rule), or
      - A 3% employer contribution (instead of the 2% rule)

SIMPLE Plan Contributions
SECURE 2.0 Change

- **Modification 2:** An employer can make additional contributions to each employee participating in the SIMPLE plan if the plan provides that the contributions.
  - Are made in a uniform manner, and
  - May not exceed the lesser of up to 10% of compensation or $5,000 (indexed).
- This new provision becomes effective for taxable years beginning after December 31, 2023

- **Modification 3:** An employer can make a matching contribution based on the employee's repayment amount of their higher education student loan.
  - Effective in 2024
- Why?

Review – SEP Plan vs. SIMPLE Plan

- **Comparison of a SIMPLE plan to a SEP plan**

  - A SIMPLE plan allows an employer to make a matched contribution and the employee to defer a portion of their salary, whereas an SEP plan is funded **exclusively** by an employer.

  - The contribution limits of a SIMPLE plan are lower than those of an SEP plan.

  - Employee can make a catch-up contribution to the SIMPLE IRA plan but not to an SEP plan.

  - RMD are required at age 73 for both plans even if still employed in the company.

Other Small Business Plans
Keogh Plans and Profit-Sharing Plans

- **Keogh Plan** (also known as an HR 10 plan): A qualified plan for unincorporated businesses or self-employed persons (& spouse).
  - A Keogh may be a DB plan or a DC plan depending on how the plan is initially structured.
  - Contributions are the same as the SEP plans.

- **Profit-Sharing Plans:** Established and maintained by an employer
  - To provide for the participation in the company's profits by its employees or their beneficiaries, and
  - To provide a definite predetermined formula for allocating the contributions made to the plan among the participants.
  - Contributions are the same as the SEP plans.
  - Some of the differences include longer vesting time (cliff – 3yrs or graded over 6 yrs.), allow loans, exclude employees that work less than 1,000 hours.

Other Small Business Retirement Plans
SIMPLE 401(k) Plan for 2024

- **SIMPLE 401(k) Plan**
  - Limited to businesses of 100 or less employees.
  - Employee must be 21 and have received compensation of at least $5,000 in prior year to participate.
  - Contributions are vested immediately.
  - Employer contributions are mandatory; 3% of employee’s compensation or 2% non-elective
  - Contributions are limited to $16,000; Catch-up contributions to $3,500.
  - Like 401(k) plan rules include:
  - Must file Form 5500 annually using the computerized ERISA filing acceptance system (EFAST2).
  - Deferral notice is required annually to employees.
  - Employee can take a loan or a hardship distribution.
  - Not subject to discrimination or top-heavy rules.

Safe Harbor 401(k) Plan for 2024
SECURE 2.0 Change

- **Safe Harbor 401(k) Plan:** All employees, including HCE, can participate.
  - Maximum contribution by employee is $23,000.
  - Catch-up contributions of $7,500 by employees 50 or older.
  - Higher catch-up limits for employees aged 60 – 63 apply **beginning in 2024**.
  - May have a match contribution by the employer of 3% of compensation and up to 5% on 50% of additional compensation.
  - No discrimination tests are required annually like a SIMPLE 401(k) plan.
  - Form 5500 must be filed.
  - Immediate vesting.

- **Note:** A highly compensated employee (HCE) for 2025 is one who earns more than $155,000 in 2024 & for 2024 is one who earns more than $150,000 in 2023.

Retroactive 1st Year Elective Deferral for Sole Proprietors
SECURE 2.0 Act Change

- **Special Rule** for Unincorporated Sole Proprietors or LLC (sole proprietor).
  - Establish a 401(k) plan by filing date of tax return.
  - Individual must own the entire unincorporated trade or business.
  - Individual is the only employee.
  - Make an elective deferral contribution to the plan before the time for filing their individual tax return.
- **Caution:** This contribution is limited to the plan's first year only, and (by business yearend in later years)

Automatic Enrollment Starter 401(k) Plans
SECURE 2.0 Act Change

- For employers with NO retirement plans, a starter 401(k) plan is permitted for plan years beginning after December 31, 2023

- Automatic elective contributions are made by the employee (not the employer).

- No matching & no non-elective contributions by employer are permitted.

- Minimum annual contribution is 3% and no more than 15% and applied uniformly

- Maximum annual contribution amounts are the same as an IRA and catch-up contributions are applicable for employees 50 or over (COLA apply)

Special Issues

- Beginning in 2024, an employer can replace their SIMPLE IRA with a SIMPLE 401(k) or other 401(k) plans

- Beginning in 2023, a SIMPLE IRA is now permitted to accept ROTH contributions

- Beginning in 2023, an SEP is now permitted to accept Roth contributions from an employer on behalf of an employee.

    - IF the employee elects to have the contribution treated as a Roth contribution. (Act §601)

Small Business Pension Plan Start-Up Costs

- **Pre-SECURE 2.0 Act:** A business owner can claim a tax credit for the plan's **start-up costs** up to:
  - 50% of administrative cost up to $5,000 for
    - The 1st three years of the plan's adoption, and
    - Employers with less than 100 employees

Small Business Pension Plan Start-Up Costs
SECURE 2.0 Act Changes

- A few modifications for the start-up credit are available are currently available, including

  - Increasing the credit to 100% of the company plan's cost
    - For employers with up to 50 employees, and
    - No change for employers with between 51 and 100 employees.

  - Providing an **additional credit for employer contributions** of up to
    - 100% of the employer's contribution (limited to $1,000 per employee for employers with up to 50 employees)
    - Phased out for employers with between 51 and 100 employees (no contribution for employees with wages more than $100,000, indexed for inflation after 2023)

    - The additional credit is phased out over 5 years
      - 100% in years 1 & 2, 75% in year 3, 50% in year 4, and 25% in year 5
      - Act section 102

Catch-Up Limits
SECURE 2.0 Act changes

- Higher Catch-Up Limits Beginning:
  - For participants ages 60, 61, 62, and 63
    - SIMPLE Plans:
      - Catch up contribution is **$5,000 or 50% more than the regular catch-up amount in 2025**
    - Non-SIMPLE (i.e., 401(k) plans) and 457 Plans:
      - Catch up contribution is **$10,000 or 50% more than the regular catch-up amount in ~~2024~~ 2025**
        - (pending Technical Correction Act)
  - Indexed for inflation beginning in 2026
  - The dollar amounts are tentative because the amount may change once the regular catch-up amount is determined for 2025.

Special Issues
Elective Deferrals

- As noted on the previous screen, there are new higher catch-up limits beginning in 2025
  - For Non-SIMPLE and 457 Plans:
    - Catch up contribution is a mandatory Roth contribution IF
      - Individual had wages in the preceding year exceeding $145,000 (COLA) HC is $150k for 2023 & $155k for 2024
      - The HC threshold is applied by each employer independently (if more than one employer)
        - Implementation of this provision falls on employer, not individual
      - Other individuals are not subject to the mandatory Roth contribution provision

- Notice 2023-62 treats 2024 and 2025 as transition years, which means catch-up contributions are not mandatory to a designated Roth plan. Further guidance is expected.

Other Sources of Retirement Income

- **Social Security:**
  - Tricky area for treatment of SS benefits for spouses
  - Taxable up to 85%, which can cause the need to make estimated payments to avoid under withholdings
  - Note: The average retiree today is receiving approximately $21,360 according to the IRS.
    - $15,000 per year if retired at age 62
    - $18,600 per year if retired at age 65
    - $24,800 per year if retired at age 69
    - $26,520 per year if retired at age 70

- **Inherited DC plans & IRAs:** Final regulations clarify the RMD rules for inherited IRAs but not favorably to the taxpayer.

Special Issues
An Annual Summary of Benefits

- All companies offer benefit packages to their employees. But do the employees know what the cost is to the company for providing these benefits. One way to provide such information to the employees is to provide each employee with an annual benefit summary indicating the available benefits offered and the company's financial commitment to those benefits. A few examples include:

Annual Employee Benefit Summary	
Salary	Paid family leave
Medical insurance coverage	Paid time off (PTO)
Dental coverage	Sick time
Vision coverage	Vacation time
Life insurance	Flexible work schedule
Vacation pay	

Sources

- IRC §401(a)(17),
- IRC §408(p)(2)(C)(ii)
- SECURE 2.0 Act of 2022
- Senate Finance Committee report on SECURE 2.0 Act of 2022
- Technical Correction Act
- Notice 2023-75
- Form 5305-SEP and its Instructions
- Form 5305-SIMPLE and its Instructions
- IRS Publications 560
- Statistics of Income

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That's Completes Today's Presentation

Any Questions

Thank You