Leaving to Start Your Own Business?

Don't Leave Your Retirement Behind.

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SO YOU'VE DECIDED TO START YOUR OWN BUSINESS. You've named your LLC and picked out office space, and the big day is approaching. Now, on the precipice of this new chapter of your career, you realize that something critical has slipped your mind, namely, your retirement plan.

Now that you can no longer contribute to your former employer's sponsored retirement plan:

- What should you do with your now inactive 401k?
- What should you do to continue saving for retirement as you strike out on your own?
- How can you sock away as much money as possible for your retirement?

One of the most important benefits of an employer-sponsored 401k is the dollar-for-dollar match of a certain percentage that many employers offer. However, after you leave, you will most likely no longer be able to contribute.

Roll those retirement funds into your own, employer-sponsored plan or IRA.

But you do have options. In some cases you can leave your 401k account where it is being held, that is with the custodian your employer selected to hold account funds. You can still make rebalancing trades among the plan options, take loans, and eventually pull your required minimum distributions when that time comes. But leaving your account where it is not usually a good idea because of higher-than-average plan fees, the limited investment options that come with employer-sponsored 401ks, and that your retirement program remains in the hands of your former employer. In a worst-case scenario, that company goes belly-up, and though the money in your account is protected and remains available to you, plan maintenance shuts down.

A better move: Roll those retirement funds into another plan, your own employer-sponsored plan or an IRA. There are variations of the IRA, but the most common is the traditional IRA. You can open an IRA at any number of custodians relatively easily, or you can work with a financial advisor to open one. As a startup business, you might wait to roll your funds until you decide which account you plan to open for your new business.

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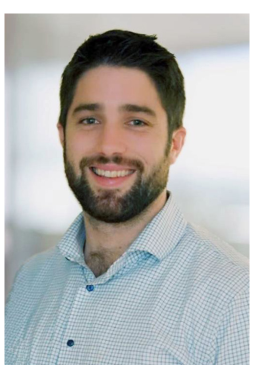
RETIREMENT PLAN OPTIONS

There are several types of retirement accounts for self-employed individuals, and each comes with its own benefits and drawbacks. I'll limit my discussion here to the pre-tax variations, though most plans have a Roth after-tax component available.

- The traditional IRA allows you to contribute $6,500 per year (2023 amount) pre-tax with a catch-up contribution of $1,000 for individuals who are more than 50 years old. The benefit of this type of plan is its simplicity. Anyone with employment income can set up an IRA; there is no income limit. The main drawback is the lack of tax savings, $6,500 being rather paltry compared to the savings associated with other types of accounts.
- A Simplified Employee Pension (SEP) IRA is just that — simple. It lets you put away a combination of employee and employer deferrals up to the lesser of 25 percent of your income or $66,000 per year (2023 amount), which generates a much larger deduction than the $6,500 ceiling for a traditional IRA. The drawback of a SEP IRA is that it is only beneficial if you do not have W-2 employees on your payroll. If you do, you can still contribute to a SEP IRA, but whatever percentage you contribute as owner you must match for any employee. A common practice for those with SEP IRAs is to contract 1099 workers to avoid having to contribute to employee SEP IRAs.
- If you do or will have employees, you might consider opening a Savings Incentive Match PLan for Employees (SIMPLE) IRA. These plans are designed for businesses with a hundred or fewer employees. The SIMPLE IRA is slightly more complicated than the SEP, and has a smaller maximum deferral amount, but it is cheaper than a 401k as a basic retirement plan for your employees that can include an employer match. SIMPLE plans can be thought of as smaller 401ks without the testing requirements and 401k administration costs. The employer can elect to match up to 3 percent of compensation of contributing employees or contribute 2 percent across the board whether or not an employee decides to contribute to their plan. This allows you to attract talent with a match program, but one in which both employees and you as employer share the responsibility for their retirement savings.
- The solo 401k is another option for the self-employed. The plan functions similarly to a SEP IRA, but cannot be used if the employer has W-2 employees (other than a spouse) regardless of matching. One added benefit of a solo 401k is that, regardless of your income level, you can put away the employee 401k maximum, $22,500 per year plus any catch-up contribution and not be restricted to the 25 percent income cap of SEP IRAs. Once the employee max is accounted for, you can contribute up to 25 percent of your income up to a combined total of $66,000 (for 2023). Another benefit is that, unlike the SEP IRA, a solo 401k allows for a Roth component.

- As a small business owner, you could also set up a cash balance plan, which can be used in conjunction with a solo or employer-sponsored 401k. This option can supercharge your retirement savings if your business is as successful as you believe it will be. The 401k plus cash balance plan option will help you save more pre-tax money. Your contribution ceiling can be well over $200,000 per year in deferred income. But it comes at a price. Cash balance plans, as do 401ks, need to be tested and administered by a third party administrator (TPA), which comes with an additional layer of fees the other options don't incur. The TPA will be responsible for preparing tax documents and the state and federal testing the other options do not require. Cash balance plans also require annual maintenance fees due to their complex designs and regulations. Again, these are much more complicated plans, so it is highly recommended that you talk with a financial professional before venturing down this path.

There are many options available to you when it comes to retirement savings as a business owner, and you can often revisit and adjust your retirement plan as your business grows. Whatever you decide, we can help guide you. We've developed retirement planning for many new business owners like you, and would be happy to work with you and be part of your journey.



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Chris Nagel is a Financial Advisor in the Philadelphia office of HBKS. He leverages his investment expertise to tailor advice to successful individuals and families looking to build their wealth and retire comfortably. Since joining HBKS in early 2020, Chris has helped foster relationships with current clients and continues to expand the firm's reach to new regions and networks. He can be reached at 215-735-9530, or by email at cnagel@hbkswealth.com.