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CIVITAS STRATEGIES

Learn how to compare retirement plan options for your child care business.

RETIREMENT PART 2: How Do I Choose the Right Retirement Plan?

There are many options for retirement plans—both for you personally and your business, but how do you choose the right one? Selecting the right type of plan for your business is simpler than you think. Understanding how a few key details impact your retirement needs can help you narrow down the list from which to choose.

HOW CAN I NARROW DOWN MY OPTIONS?

Based on our work advising thousands of providers across the nation, you can follow recommendations for identified four common scenarios based on the size of your organization. If it is just you, or just you and your spouse, you will want to consider how your age will impact your retirement plan. If you are a business with employees, decide whether or not you want to vary your employer contribution (if you intend to contribute) to help narrow down the options to choose from.

FOUR COMMON RETIREMENT SCENARIOS

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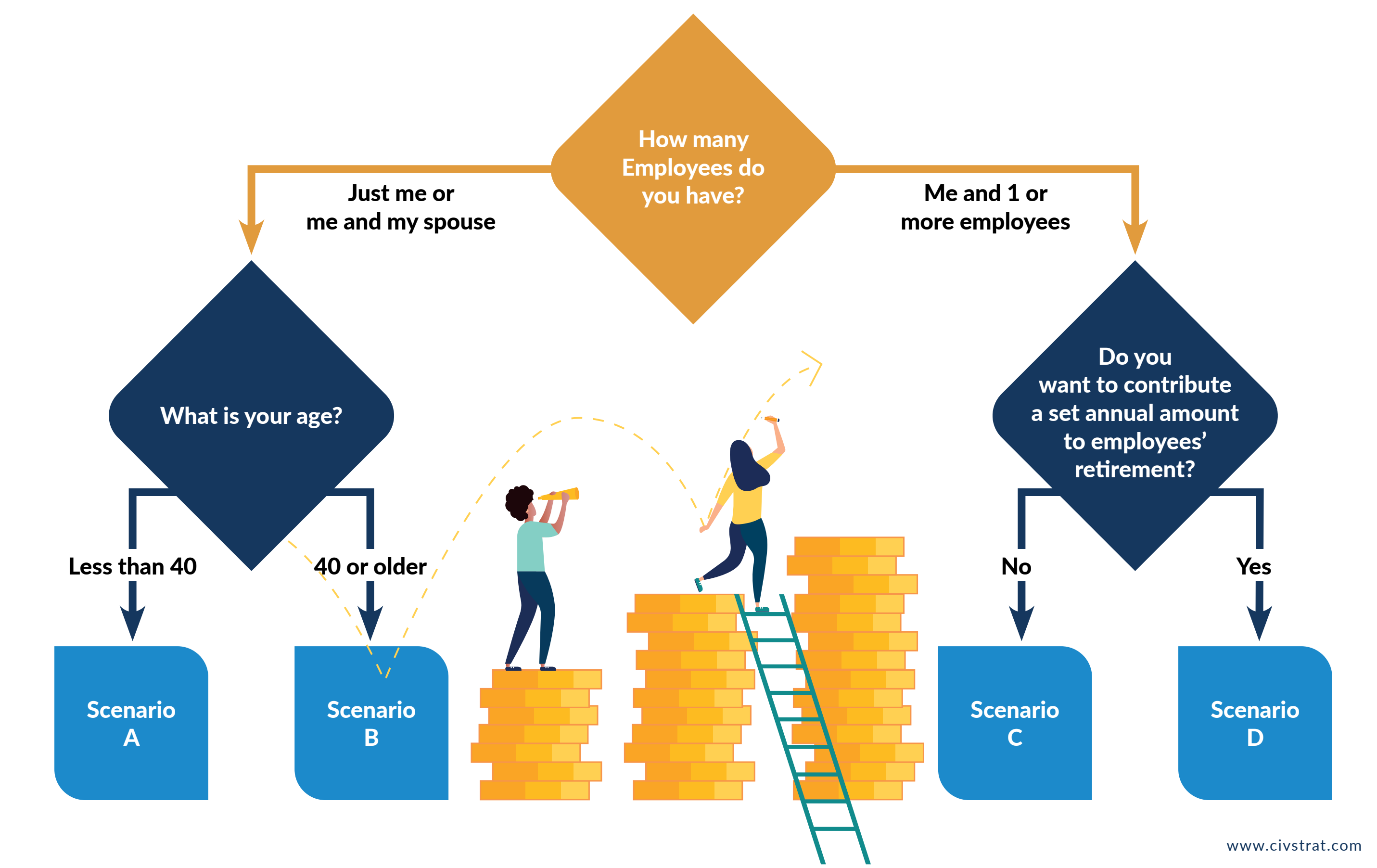
Retirement Scenarios



By following the flowchart on page 1, you can find the scenario that most closely resembles your situation to aid in your decision-making:

1. **Scenario A:** It is just me or me and my spouse and I'm under 40
2. **Scenario B:** It is just me or me and my spouse and I'm 40 or older
3. **Scenario C:** You want to be able to vary the employer contribution (if any) every year
4. **Scenario D:** You want a set contribution level every year

SCENARIO A: It is just me or me and my spouse and I'm under 40

When you are younger and only considering retirement options for you and your spouse, there are several options to maximize the benefits you have from saving for a longer period of time than those starting their retirement when they are older.

> If you are above these Roth IRA annual income thresholds, you can talk to your investment company about a "backdoor" Roth conversation which can help you legally contribute to a Roth IRA even if you are above the income limits.

1. **Roth IRA**

   If you are earlier in your career, starting with a **Roth IRA** can be a great way to focus your retirement savings. Though the money you put in a Roth today is taxed this year, the compounded interest is not taxed—so all your gains over the years will be tax-free in retirement. You can contribute up to $6,500 ($7,500 if you are 50 or older) in 2023. If your spouse is working—in your business or any other—they can also contribute to their own Roth. If you are single or a head of household, you need to make $153,000 or less to participate. Taxpayers filing married, jointly can contribute if they are making $228,000 or less.

2. **SEP IRA**

   If you want to contribute additional savings, you may want to add a **SEP IRA**. These plans are very easy and fast to set up and rarely have fees. Also, there are no annual filing requirements making it easy to manage. SEP IRA contributions are considered to be made by the business (not you individually) so these contributions are all allowable business expenses. The contribution limit differs based on the type of company you have:

   - For sole proprietors and owners of single member LLCs, you can contribute up to 20% of your net profit.
   - For S corporation owners and those with LLCs declared as S corporations, you can contribute up to 25% of your W-2 wages (not your owner's draw or distribution).
   - Regardless, you cannot exceed total contributions of $66,000 in 2023.

> Make sure you ask your tax preparer about the **Savers Credit**. If your adjusted gross income is less than $73,000 if you are married or $54,750 if you are a head of household, you may be able to get up to $1,000 back in tax credits.

3. **401(k)**

   If you want to be able to contribute more, an **Individual or Solo 401(k)** can be a good next choice. They may take a little more time to set up but they rarely have fees. What's appealing about the Solo 401(k) is not only is it inexpensive and easy to implement, but you can also contribute as an employer and employee—creating the ability to save quickly if needed. For 2023, you can contribute as an employee up to $22,500 ($30,000 if you are over 50) and as an employer up to 20% of your employment income. All of these funds won't be taxed in the year the contribution will be made, but you will be taxed in retirement.

If your spouse works with you, they can also participate in either the SEP IRA or Solo 401(k).

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SCENARIO B: **It is just me or me and my spouse and I'm 40 or older**

As you get older, it makes more sense to maximize the deduction in the current year since you are making more money and there is less time until you retire for the accumulation of compound interest. For those over 40 without employees, we suggest flipping your strategy.

1. **SEP IRA**

   Start with contributions to a **SEP IRA**—they are easy to set up, rarely have fees, and have no annual filing requirements. The SEP IRA only has employer-side contributions and they are limited to:

   - 20% of your net profit, for sole proprietors and owners of single member LLCs.
   - 25% of your W-2 wages (not your owner's draw or distribution) for S corporation owners and those with LLCs declared as S corporations.

Regardless, you cannot exceed total contributions of $66,000 in 2023.

Make sure you ask your tax preparer about the **Savers Credit**. If your adjusted gross income is less than $73,000 if you are married or $54,750 if you are a head of household, you may be able to get up to $1,000 back in tax credits.

2. **401(k)**

   If you want to contribute higher amounts of pre-tax income, look at an **Individual or Solo 401(k)**. Solo 401(k)s are now much easier to have and the fees are low or none at all. They also have the potential for some of the largest contributions of any retirement plan—you can contribute as an employer and employee. For 2023, you can contribute as an employee up to $22,500 ($30,000 if you are over 50) and as an employer up to 20% of your self-employment income. The contributions made now won't be taxed, but you will be taxed in retirement. If your spouse works with you, they can also participate in your Solo 401(k).

If you are above these Roth IRA annual income thresholds, you can talk to your investment company about a "backdoor" Roth conversation which can help you legally contribute to a Roth IRA even if you are above the income limits.

3. **Roth IRA**

   If you want to diversify your retirement savings or you have maxed out your Solo 401(k) contributions, you should consider a **Roth IRA**. Contributions are taxed this year, but all of the gains you have will be tax-free at retirement. You can contribute $6,500 ($7,500 if you are 50 or older) in 2023, however, you need to make $153,000 or less if you are single or head of household or less or $228,000 or less if you are married filing jointly to participate.

SCENARIO C: **You have employees and you want to be able to vary the employer contribution (if any) every year**

If you want to be able to vary the employer contribution you are making toward your employees' retirement accounts, a good choice for you is a SEP IRA.

If your plan is new, don't forget to ask your tax preparer about the **Retirement Plan Startup Costs Tax Credit**. This will enable you to get up to $5,000 in administrative costs covered and get a credit of up to $1,000 per employee in the first year of the plan and additional credits for the next three years.

1. **SEP IRA**

   The SEP is an easy-to-implement, inexpensive retirement plan, where you can contribute up to 25% of employees' salary per year. The SEP allows you to contribute any level up to 25% in a year or none at all. For example, Marta could provide employees with a contribution of 3% of their salary in 2020, none in 2021, 8% in 2022, and then 3% again in 2023.

   Employees are vested in a SEP IRA from day one, so if they leave, they get all the contributions you made. Also, there's no way for employees to do their own contributions—everything is provided by the employer only.

SCENARIO D: **You want a set contribution level every year**

Alternatively, you may wish to provide the same contribution every year. In this case, there are two retirement plans that we recommend you consider.

1. **Simple IRA**
   The first option to consider is a **Simple IRA**. They are low-cost and require no annual filings or other paperwork. Employees can make contributions directly from their payroll up to $15,500 in 2023 (employees over 50 can contribute an additional $3,500 more). The employee contributions are pre-tax, so they don't pay tax now, but will when they withdraw the funds.
   Employers must choose one of two options for their match:

   - 2% non-elective contributions—this means that you must provide contributions for 2% of an employee's salary whether they save any money themselves or not.
   - A one-for-one match between 1% and 3% of an employee's salary. This means that you only contribute as the employee contributes up to the maximum. The match can only be 1% for two of every five years. For example, if you offered only 1% in the first two years you would have to match at a higher rate in the third year.

Here are examples of each option:

- Erin opts for the 2% non-elective contributions. She has an employee who makes $45,760, so Erin will need to contribute $915.20 regardless of how much the employee contributes if anything at all.
- Joanna decided to offer a 3% match. Her employee also makes $45,760. The employee contributes $2,288 each year (5% of her salary). Joanna will need to match the full amount up to the 3% ($1,372.80). If the employee made no contributions, Joanna would not contribute either.

You can change the amount you are contributing but you must notify employees 60 days ahead of time.

2. **401(k)**
   If you want to contribute more as an employer or have vesting options (that is, you require employees to stay a certain amount of time in order to keep the employer retirement contributions) you should look at a **401(k) Plan**. This is probably the best-known business retirement plan. Though it is versatile, it can take time and money to set up and maintain since annual filings and other documentation are typically required.
   To their advantage, they offer:

   - Higher contribution limits—up to $22,500 in 2023 (with an additional $7,500 for employees over 50);
   - Higher employer contribution limits—depending on the plan you can contribute or match up to 100% of an employee's salary to a total of $66,000;
   - Greater versatility—for example, some plans allow you to make both pre- and post-tax contributions.

Whether you go with a Simple IRA or a 401(k) ask your tax preparer about the **Retirement Plan Startup Costs Tax Credit**. This will enable you to get up to $5,000 in administrative costs covered and get a credit of up to $1,000 per employee in the first year of the plan and additional credits for the next three years.

ARE THERE OTHER TYPES OF RETIREMENT PLANS TO CONSIDER?

There are several retirement programs that you may have heard about which are not included in the above scenarios, by design. For a few reasons, they are not commonly selected, however, it is important to understand how they work to determine whether or not they are right for you:

- **Traditional IRAs** can be great for the individual investor but for individuals, the annual contribution limits are lower than an Individual or Solo 401(k), which means you can't save as much per year. Also, though contributions from your personal income are considered tax-deductible, these dollars are still taxed as they "leave" your company (for example, through self-employment tax). In contrast, contributions to a Solo 401(k) made directly from your business are not taxed when they leave your company. As such, it is less common for businesses to select a Traditional IRA over an Individual or Solo 401(k).

- **Mega Roth backdoor conversions, profit sharing, and defined benefit plans** are quite complicated, typically involve the commitment of large amounts of funds over time, and recommendations to use them are based very much on your personal financial situation. If you have an interest in these, you should consult with your investor or financial manager.

> Though a 401(k) generally offers more savings benefits, one traditional IRA to consider is a **Spousal IRA**, which is the only plan that will allow your spouse to have their own retirement account if you are working and they are not.

I'VE SELECTED A PLAN TYPE, HOW DO I GET STARTED?

Now that you've determined what option or options to consider, what do you do next? Depending on your comfort level and the size of your organization, it may be as simple as signing up for a plan online. Most of the major plan providers such as Fidelity, Charles Schwab, Guideline, and Vanguard, have made it very simple to set up a plan yourself, usually in just a few minutes. They will even help you select or suggest investments so you can start building your savings.

However, you may wish to receive support from a financial advisor to review your options. Financial advisors may be helpful in making choices on retirement, but make sure you ask the right questions as you are selecting who to use. Because there are often hidden fees that may not be made apparent up front, be sure to ask about how the advisor receives compensation. It is also recommended that you understand how you can request the paperwork for your accounts, which is extremely important to have since sometimes it can be difficult to change from one advisor to another. You will also want to know if they are credentialed, most typically they will be a Certified Financial Planner®, which requires study, passing rigorous exams, and adhering to a code of professional ethics.

Regardless of whether you start your own account online or use an advisor, you'll want to take the following steps:

- **Ask friends, family, and other business owners for recommendations.**
  This can be the best way to find a trustworthy financial advisor or a reputable vendor. Ask around to see who others use, what they have liked, and what they have disliked about their experience.

- **Search online for more options.**
  The internet can be very useful in discovering options that you would not have known about otherwise. Perform a search through a search engine and/or social media site to broaden your choices.

- **Read reviews on customer satisfaction.**
  Oftentimes, online reviews or recommendations can be the most telling in selecting a financial advisor or retirement plan vendor. Are there common themes mentioned by those leaving reviews? Consider the pros and cons that were expressed to help you decide which option is right for you.

- **Review the details.**
  Once you've found a few options that interest you, explore the various details associated with the service. How much support are you looking for? Is it difficult to get in touch with someone when needed? How customizable are the plans? Is there an app or a user-friendly platform where you can access your plan details? Ask as many questions as you need to feel comfortable. When talking with a financial advisor you are considering, do they talk down to you or are they taking your business seriously?

- **Determine the cost.**
  At the end of the day, make sure that you can afford the option you've selected. Compare several options that you liked best to see if one seems to offer a greater value for the price.

Selecting the right retirement plan can help you maximize retirement for yourself and/or support the long-term retention of your employees. To understand more about the next steps, see ***Retirement Part 3: How do I maximize my savings?***

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