Business owners rocked by retirement option intricacies

Small business owners, take note: the new Qualified Business Income deduction has added a new layer of complexity to self-employed retirement plans.

The Tax Cuts and Jobs Act of 2017 was a massive rewrite of the US Tax Code; the largest such effort in 30 years. On balance, our new tax plan reduces individual income taxes, increases the standard deduction, and negates the need to itemize deductions for many of us. Result: simpler tax prep.

> Small business owners saving for retirements must beware of this potential "Deduction Reduction."

Along the way, though, the IRS created some unintended consequences.

A new section, (IRC Section 199A), entitles most small business owners to a new tax deduction equal to 20% of their qualified business income.

But this creates a conundrum for savers with simplified employee pension (SEP) IRAs and solo 401(k)s. A contribution to these unique plans will actually reduce your Qualified Business Income. Contributions also reduce the amount of your "free" deduction, see above, 20% of your income. Effectively you only get to deduct 80% of your Solo 401(k) or SEP contributions.

For some, a contribution to an employer sponsored plan will effectively result in just a partial deduction. Down road, the entire contribution (and its future earnings) will be subject to income tax at distribution time.

I am still a huge fan of tax-deferred retirement programs! Getting a deduction today, and paying tax on future withdrawals and earnings, is still preferable to investing in a taxable account, where you are penalized now as well as on future gains.

I counsel my clients as follows:

- If your spouse works at a separate business with a 401(k) plan of his/her own, contribute the maximum to that plan first, before contributing to your own. He/she will be able to deduct the full amount of their contribution.
- If you can contribute to a tax-deductible IRA, contribute the maximum to that plan. Your contribution here will not affect your Qualified Business Income.
- If you have a Solo 401(k), (specifically for employers with no full-time employees, covering only the business owner and spouse) check to see if you can contribute to a Roth option. This will not reduce your taxable income; too, it will not affect the 20% QBI deduction.

Our familiar world with few retirement planning options has gotten complex! Over the years, retirement has added many investment choices. To determine the best choice for your business, and your personal retirement investing, it's good to look at all of the options. Let's talk about your unique situation: schedule an appointment with me, Andrew B. Ellis, CPA, CFP, CFA Financial Advisor 865.288-2123

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