How to Save for Retirement If You Have Your Own Business

By Joanna Furlong, Contributing Writer June 19, 2019 07:42 am EST

Small business owners and gig economy workers may enjoy freedom and often benefit from increased flexibility. However, they miss out on the retirement plans and contributions that many full-time workers receive. So, how should a small business owner plan for retirement in the absence of company-sponsored plans? Angela Park Sheldon of Tortuga Wealth Management, based in Los Angeles, offers some tips.

What is the biggest challenge for small business owners and retirement?

In short, a lack of information. Many small businesses operate with no HR department. The owners may be allocating their budget right back in the business, failing to set aside funds for retirement plans or a financial consultant. Sure, you get to call your own shots, but you don't know what you don't know. This is where many small business owners take their biggest misstep: They either fail to invest in a retirement strategy or make critical mistakes on the front end that could cost them in fees and taxes in the long run.

What is a SEP IRA?

First, consider opening a SEP IRA, shorthand for simplified employee pension plan. These plans allow you to pack away a lot more money than traditional IRAs do. The amount of money you can put into your SEP is based on your earnings. Whereas with a traditional IRA, you can only put in $6,000 if you're under age 50 (for 2019), you can do up to $56,000 or 25% of your earnings – whichever is less – with a SEP.

"A SEP is also highly desirable because it's easy to achieve," Sheldon said. "You don't need a third-party administrator; you can open a SEP IRA and start saving immediately."

But note: only the *employer* contributes. If you're a business of one – say, a freelancer – this is a no-brainer. However, if you're a business with 10 employees, your contribution rate must be the same for all employees, and you're the only contributor to the account; your employees cannot contribute. This is where things can get more complicated, and it's highly recommended to hire a plan administrator.

What is a solo 401(k)?

The solo 401(k) is also known as a one-participant 401(k). This 401(k) plan is only inventive in that it's for a business of one. With the solo 401(k), you get to make contributions to the account from both roles – as an employer and employee. You can contribute elective deferrals up to $19,000 for 2019 ($25,000 for age 50 or older), as well as 25% of compensation for employer contributions, maxing out at $56,000 per year. For a single, self-employed individual, you must calculate how much you can contribute, but you'll typically benefit far more than you would from a SEP IRA, saving much more money and significantly reducing your tax liability.

Is a traditional 401(k) right for your business?

A traditional 401(k) is appealing – you can make employee deferrals, plus anyone over age 50 can play catch-up with additional contribution allowances. However, before going this route, consider what will benefit your employee base most. Do they understand the benefits of a 401(k), and are they willing to contribute? Is this a benefit they want?

Some businesses may want to consider a safe harbor 401(k) plan. These plans are designed to ensure that no employee is discriminated against. Safe harbor plans do not have to undergo the annual nondiscrimination tests, usually required by law, that evaluate how employees of various compensation levels use your 401(k) plans.

Hire a professional (it's worth the investment).

Just like your business, retirement plans can be more complex than they appear. Hiring a Certified Financial Planner (CFP) and a third-party administrator is a smart investment in the longevity of your business.

"It's a good idea to find someone from a referral," said Sheldon. "Find someone who has had many years of experience."

It's not uncommon, Sheldon noted, to see business owners want to save the money they would spend on a retirement strategy and use it for other things – including putting it back into the business. But just like it's critical to hire a reputable bookkeeper or attorney, small business owners should spend the money and hire an experienced CFP, someone who is trustworthy and who will support your business as you grow.

Experienced professionals can advise you on your unique situation and goals, and construct a strategy for you based on a variety of plans.

Don't bank on selling your business for a retirement strategy.

Sheldon said small business owners often think that selling their business will set the foundation for their retirement plan. This can become especially complicated in family-owned and -operated businesses, as the direction of the company can get a bit tricky with so many passionate owners involved.

"The idea of selling your business when you retire is great in theory," Sheldon said. "But you are likely not going to get the value out of it that you are hoping for. If you do, great. But planning for it is not a great exit plan. You don't want to play games with retirement."

But how much is enough for retirement?

"There is no one-size-fits-all," Sheldon said. "It's not like typical budgeting. Everyone has a different time horizon and risk tolerance and lifestyle. Each of these factors matters."

Retirement is personal. Business owners must also take other things into account, such as their desires to possibly hold another job in their later years, travel, time with family, health concerns and so on. But Sheldon reminds us that with smart planning and conservative choices, business owners can have a lot of flexibility.

"The millionaire next door is real," she said. "I have clients who retire early, who earned a modest income throughout their careers. They just made wise choices and investments. And now they can securely retire for a modest amount per month. It's amazing to see."

Editor's note: This information was developed as a general guide to educate plan sponsors, but is not intended as authoritative guidance or tax or legal advice. Each plan has unique requirements, and you should consult your attorney or tax advisor for guidance on your specific situation. In no way does advisor assure that, by using the information provided, plan sponsor will be in compliance with ERISA regulations.