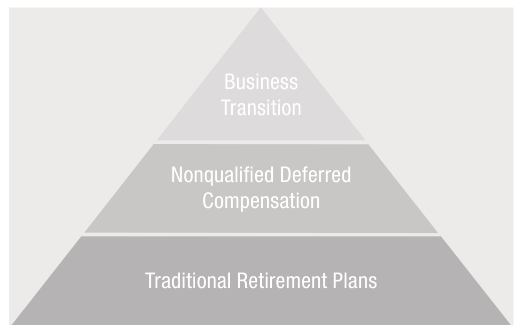
Key Conversations

Retirement Planning for Business Owners: Beyond the Qualified Plan

Many business owners have so many responsibilities that retirement planning often is at the bottom of their list of priorities. But counting on the future sale of their business to fund a comfortable retirement may not be enough.

Business owners have a wide array of retirement planning options available that can be designed to meet the unique needs of both the owner and the business. Many of the available options can help business owners reduce taxes, attract and retain talented employees, and build a more secure retirement. Let's take a look at some of the available planning opportunities.



The retirement planning pyramid

Retirement planning for business owners can often be looked at as a three-tier pyramid.

- The foot of the pyramid includes traditional retirement planning concepts, such as profit sharing plans and defined contribution plans (401(k)s, SEPs, and Simple and traditional IRAs). This level of retirement planning allows for both the business owner and company employees to contribute to retirement savings, often in a tax-efficient manner. These traditional plans are implemented as the first step for building retirement savings.
- The second tier of retirement planning for business owners begins to focus on more crucial key employees, including the business owner. This typically involves more advanced strategies, such as nonqualified deferred compensation.
- The top level of the retirement planning pyramid for business owners is the use of the business assets as a source of income in retirement. This is accomplished through the proper transition or sale of the business. The greatest opportunities for business owners to build a more secure retirement are primarily in the top two tiers. Let's take a closer look at these options.

Key Takeaways

Retirement planning for business owners can be a three-tier process. It's important to look beyond the first tier to maximize retirement savings.

Nonqualified deferred compensation—often overlooked by business owners—can help bridge the gap between traditional qualified plans and business transition or sale strategies to build a more secure retirement.

Business owners should regularly review their retirement plan to ensure all opportunities for saving or growing assets are maximized.

Nonqualified deferred compensation

A nonqualified deferred compensation arrangement is an agreement between the business owner and selected executives to pay them retirement or other benefits in the future. These plans are typically used to bring executive retirement benefits up to desired levels by adding a second tier of benefits to the existing qualified retirement plan.

Nonqualified deferred compensation plans, which are often overlooked by business owners, can offer key employees a strong incentive to remain committed to the company, as well as attract key talent in the future. They can also help business owners to bridge the gap between traditional qualified plans and business sale or transition strategies to help fund a more secure retirement.

This type of plan provides several benefits for the company and key employees, including the business owner. First, it provides additional income during retirement for the key employee. Second, it allows the business to provide an additional benefit to key employees without having to include all employees and incur the administrative costs associated with qualified plans.

Finally, the possible deferral of income taxes to later years may benefit those individuals who are currently in a higher tax bracket.

Several common nonqualified deferred compensation plan designs exist today and can be implemented based on the needs of the business owner and his or her business. These include supplemental executive retirement plans (SERPs), death benefit only plans, salary reduction plans, 162 bonus plans and split dollar life insurance (both which use life insurance as a means of compensation and deferral of taxes on income and earnings), and others.

Business owners should keep in mind that some of these plans are considered corporate assets and are therefore susceptible to creditors in the event of a bankruptcy. The financial stability of the company should be carefully reviewed. The business owner may also want to work with a financial professional who has the knowledge and expertise to help them implement a nonqualified deferred compensation plan based on their objectives and the tax structure of their business.

Funding retirement with the sale or transition of your business

Business owners who would like to fund a portion of their retirement with the sale or transition of their business first need to answer two critical questions: 1) What is the value of the business? and 2) How will the sale of the business occur?

Most business owners generally have an idea of what they think their business is worth. However, unless a valuation has recently been performed, the value may be significantly different from what the owner has in mind. The value of the business is a key component of how much additional income will be available in retirement. As retirement age approaches and a business owner considers the transition of the company, formal valuations of the business are necessary. This information is crucial to the sale and future retirement planning.

Once the decision has been made to sell a business, ensuring the proper transition strategy is in place is essential. Perhaps a buy/sell arrangement was implemented in earlier years or a competitor company is interested in a purchase. Whatever the exit strategy, how the proceeds are used will have a huge impact on a business owner's retirement income. Not only is it important to plan for the sale and use of the sales proceeds, but also to plan for the protection of the newly acquired assets. A liquidity event like a business sale will likely cause estate and income tax issues. Implementing solutions to mitigate tax issues and protect wealth are essential to safeguarding the business owner's retirement.

Conclusion

Business owners all have different ideas about how they want to spend retirement. But most business owners want to have enough to retire when they want to, and want to ensure their money lasts through retirement. Designing a retirement planning strategy early can help ensure a business owner takes advantage of all of the opportunities available to help his or her business succeed and ensure a more secure retirement.

For more information about retirement planning for business owners, contact your Key Private Bank Relationship Manager.