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For Your 2018 RMD, Why Not a QCD?

By *Eric Nager, CRPS®*

This question sounds like alphabet soup, but there is a simple explanation. An RMD is a Required Minimum Distribution from a traditional IRA, and those who reach age 70.5 and own one of these accounts must take an annual distribution. The reason for this is that the money in these accounts has never been taxed and an RMD is the government's way of getting some return on allowing this money to be tax-deferred for many years.

A QCD is a Qualified Charitable Distribution whereby an individual can contribute to a qualified charity directly from an IRA. In a regular IRA distribution, the money is treated as ordinary income and subject to taxation. With a QCD, the money goes directly to the charity and is not considered taxable income. With the new changes to the tax law taking effect in 2018, QCDs might become more popular.

One of the biggest changes affecting charitable contributions is the doubling of the standard deduction. This means that for those who itemize expenses, there will be no deduction available for charitable contributions until the higher deduction level is met. However, even if a QCD does not qualify for a deduction under the new tax law, it DOES still qualify as untaxable income because it is passing directly to a charity.

To illustrate with a quick example, let's suppose an individual in 2017 took a $3,000 RMD and made a deductible $3,000 contribution to charity. Assuming she is in a 33% tax bracket to include state and federal taxes, she would owe the government $1,000 in taxes.

Under the new 2018 rules, she likely would not get the $3,000 deduction but with a QCD, she would not owe anything in taxes either.

Every fall, we personally call each of our clients who still needs to take an RMD to make sure it is done before year's end. We want to make sure this is done because the penalty for not doing so is half of the amount of the RMD. This year we will be keeping the QCD in mind, and hope it will be a useful tool for you.

Retirement Planning for Small Businesses

Small business owners often struggle to find the time and the resources to set up and start contributing to a retirement plan. But no matter how small the business, chances are owners and their employees would benefit from saving in a tax-advantaged retirement plan. Self-employed individuals and business owners who do not yet have a retirement plan, or are thinking about making changes to their current plan, have a number of options to choose from, from Individual Retirement Accounts (IRAs) to 401(k)s to defined benefit plans.

When selecting a retirement plan, there are a number of questions to consider. Is the plan intended to cover just the business owner and the employees, or also the owner's spouse? How many of the firm's employees should be covered? What level of investment is the business willing to make in setting up a plan? Will the contributions to the retirement plan come solely from the business owner, or will employees also be asked to contribute? Is the priority higher contributions or ease of administration? Is the purpose of the plan primarily to attract and retain employees who want to work for a company with retirement benefits, or for the owner or the employees to lower their taxes? Is it important that the plan contributions are deductible as a business expense? What are the owner's personal retirement savings goals?

The Simplified Employee Pension (SEP) IRA is often chosen by small business owners who want a low-cost plan with a minimal administrative burden. Any business owner, including a self-employed individual, can establish a SEP. Owners can contribute up to 25% of their compensation, up to a maximum amount of $54,000 in 2017 and $55,000 in 2018, to their own SEP IRA account, but they are required to contribute the same percentage to the accounts of their employees. Contributions are only made by the employer, not the employees, and are tax-deductible as a business expense.

In a Savings Incentive Match Plan (SIMPLE) IRA, the employee as well as the employer contribute to employee accounts. To be eligible to start a SIMPLE IRA plan, the business must have fewer than 100 employees. Employer contributions are tax-deductible, and employees' contributions can be made pre-tax. Employees are permitted to make salary deferral contributions to their IRA of up to 100% of compensation up to a limit of $12,500 (with a $3,000 catch-up contribution for employees aged 50 and older) in 2017 and 2018. The employer also contributes to the account, either by matching employee contributions dollar-for-dollar up to 3% of compensation, or by contributing 2% of each employee's compensation. The set-up costs and administrative burden associated with SIMPLE IRAs are again minimal, though fees may be charged by financial service providers.

A SIMPLE 401(k) is similar to the SIMPLE IRA in terms of its features and its set-up costs, but also has some characteristics of standard 401(k) plans. Businesses with fewer than 100 employees can start a SIMPLE 401(k) plan. Employees can elect to contribute, but unlike in a traditional 401(k), the employer is required to make a matching contribution up to 3% of each employee's salary, or a non-elective contribution of 2% of each employee's salary. Participants are permitted to borrow against the funds in their 401(k) account and make penalty-free withdrawals due to financial hardship. The employer is required to file a Form 5500 each year, but is not obliged to perform non-discrimination testing, as is the case for a traditional 401(k). Moreover, unlike in a traditional 401(k) plan, in a SIMPLE 401(k) plan contributions made to the account vest immediately.

A Solo or One-Participant 401(k) is a retirement savings plan that is just for a business owner and his or her spouse, and not for employees. Unlike in a SEP plan, business owners with One-Participant 401(k) plans are allowed to maximize their contributions and tax deferrals by making both employee and employer contributions to their own account. Administering this type of plan can be more time-intensive, as the owner is required to file a Form 5500 with the IRS if the plan's assets exceed $250,000. However, the contribution limits are also high: as an employee, the owner can make salary deferrals of up to $18,000 in 2017 and $18,500 in2018; while as an employer, the owner can contribute up to 25% of compensation, up to a total of $54,000 in 2017 and $55,000 in 2018 (with a catch-up contribution of $6,000 for those aged 50 and older). A spouse employed by the business can contribute the same amounts. The contributions are considered a business expense if the business is incorporated; otherwise, the business owner can deduct the contributions from personal income.

A traditional pension plan can be a highly effective way for business owners to save for retirement on a tax-deferred basis, and for attracting and retaining employees. But the costs of setting up, administering, and funding a defined benefit plan are high, and the employer must be prepared to take on the investment risk associated with providing a fixed benefit to participants. A defined benefit plan is likely to be of greatest interest to high-income business owners who want to make very large contributions to a tax-advantaged plan over a short period of time. Depending on the structure of the plan, a business owner may be able to contribute $215,000 in 2017 and $220,000 in 2018 a year to a defined benefit plan.

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