SMITH
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SERVICES

2023 Last-Minute Year-End Retirement Deductions

Here are the four opportunities for you to explore in this article:

1. If you have employees, establish your 2023 retirement plan before December 31 so you and your employees can make employee contributions for this year. If you are a sole proprietor or single member LLC with no employees, you can establish your solo 401(k) plan and make both your employer and employee elective deferral on your timely filed individual return.

2. Claim up to $15,000 in tax credits by having your business create a retirement plan that covers you and your employees.

3. Claim the new 2023 small employer pension contribution tax credit (up to $3,500 per employee).

4. Claim up to $1,500 in tax credits by enabling the automatic contribution.

1. Establish Your 2023 Retirement Plan

Do you have a retirement plan in place?

If not, and if you have some cash you can put into a retirement plan, get busy and put that retirement plan in place so you can obtain a tax deduction for 2023.

For most defined contribution plans, such as 401(k) plans, you (the owner-employee) are both an employee and the employer, whether you operate as a corporation or as a sole proprietorship. And that's good because you can make both the employer and the employee contributions, allowing you to put more money away.

In general, your plan document will define when you can make employee or employer contributions that will produce 2023 tax deductions. Make sure you know exactly when you can make both your employer contributions, and your employee contributions.

2. Claim the New, Improved Retirement Plan Start-Up Tax Credit of up to $15,000

Two questions:

1. Are you the only employee in your business?

2. Is your business retirement plan in place as you read this?

If you answered no to both questions, consider this: by establishing a new qualified retirement, you can qualify for a non-refundable tax credit that's the greater of

- $500, or the lesser of (a) $250 multiplied by the number of your non-highly compensated employees who are eligible to participate in the plan, or (b) $5,000.

3. Claim the New 2023 Small Employer Pension Contribution Tax Credit (up to $3,500 per Employee)

A recent law change added an additional credit for your employer retirement plan contributions on behalf of your employees. The new up-to-$1,000-per-employee tax credit begins with the plan start date.

The new credit is effective for 2023 and later. In the year you establish the plan, you qualify for a credit of up to 100 percent of your employer contribution, limited to $1,000 per employee.

Example. You establish your retirement plan this year and contribute $1,000 to each of your 30 employees' retirement. You earn a tax credit of $30,000 ($1,000 x 30).

4. *Claim the New Automatic Enrollment $500 Tax Credit for Each* of *Three Years ($1,500 Total)*

A recent law change added a non-refundable credit of $500 per year for up to three years, beginning with the first taxable year (2020 or later) in which you, as an eligible small employer, include an automatic contribution arrangement in a 401(k) or SIMPLE IRA plan.

The new $500 auto-contribution tax credit is in addition to the start-up credit and can apply to both newly created and existing retirement plans. Further, you don't have to spend any money to trigger the credit. You simply need to add the auto-enrollment feature.

As with the start-up credit described above, you are an employer eligible for the credit if, for the preceding year,

- you had no more than 100 employees, each with compensation of $5,000 or more, and
- your plan had at least one employee eligible to participate who is not a highly compensated employee.

The solo business operator with no employees is not eligible for the automatic enrollment credit.

5. *Convert to a Roth IRA*

Consider converting your 401(k) or traditional IRA to a Roth IRA.

If you make good money on your traditional IRA investments and you won't need your traditional IRA money during the next five years, the Roth IRA over its lifetime can produce financial results far superior to those of the traditional retirement plan.

You first need to answer this question: How much tax will you have to pay now to convert your existing plan to a Roth IRA? With the answer to this, you know how much cash you need on hand to pay those taxes.

Here are five reasons you should consider converting your retirement plan to a Roth IRA:

1. Your traditional IRA may have lost some of its value, meaning it will cost you less in taxes to convert to a Roth.

2. You can withdraw the monies you put into your Roth IRA (the contributions) at any time, both tax-free and penalty-free, because you invested previously taxed money into the Roth account.

3. You can withdraw the money you converted from the traditional plan to the Roth IRA at any time, tax-free. (But if you make that conversion withdrawal within five years, you pay a 10 percent penalty. Each conversion has its own five-year period.)

4. When you have your money in a Roth IRA, you pay no tax on qualified withdrawals (earnings), which are distributions taken after age 59 1/2, provided you've had your Roth IRA open for at least five years.

5. Unlike with the traditional IRA, you don't have to receive required minimum distributions (RMDs) from a Roth IRA-or to put this another way, you can keep your Roth IRA intact and earning money until you die. (After your death, the Roth IRA can continue to earn money, but someone else will be making the investment decisions and enjoying your cash.)

Here are four reasons that keeping your money in a traditional retirement plan or IRA (versus the Roth IRA) can cost you:

1. You'll generally pay tax and a 10 percent penalty on withdrawals before age 59 1/2.

2. You could owe big taxes when you withdraw your money from your traditional IRA.

3. Once you reach a certain age, 73 in 2023, the law requires you to start taking out money annually-even if you don't need it or want it.

4. If you die and leave a traditional IRA to your heirs, they could owe big taxes on the accumulated monies as they withdraw them from the inherited IRA.

Make sure you have the cash to pay the tax on the conversion to a Roth IRA. Don't invade your existing 401(k) or traditional IRA for the cash to pay the taxes, because that is likely to trigger the double whammy of paying both income taxes and the 10 percent penalty on the withdrawal.