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Certified Public Accountants

Boost Your Company's Tax Deductions With a Workplace Retirement Plan

If your business still needs a 2020 federal income tax deduction, one option to consider is retroactively adding a broad-based retirement plan that is tax-qualified. This can include options such as discretionary profit sharing, cash balance or traditional pension plans. By making contributions as an employer prior to the extended due date for your 2020 income tax return, you can add 401(k) or 403(b) plans with profit-sharing contributions for last year.

Adopting a Workplace Retirement Plan

When the Setting Every Community Up for Retirement Enhancement (SECURE) Act started in 2019, businesses were provided with more time to adopt a retirement plan to make retirement contributions than has been available in the past. The new IRS Code Section 401(b)(2) lets you make retroactive contributions that are tax-deductible into the prior tax year. This allows you to contribute through the extended due date of your tax return. This is a big change that allows not only the funding of the retirement plan but also the adoption of the retirement plan in the year following the tax year.

However, due to the chaos of 2020, many companies that had planned on adopting a new retirement plan are not aware of these changes. Because of a range of state and federal stimulus and relief programs, your business may have had a better year than you may have expected, such as the Paycheck Protection Program, Employee Retention Credit and delayed payroll tax deposits under the CARES Act.

Further, under the Families First Coronavirus Relief Act (FFCRA) which provided paid child care and sick leave, the Fed's Main Street Lending Facility, the Restaurant Relief Fund, the Shuttered Venues program and the SBA's expanded Economic Injury Disaster Loan (EIDL) option, there is still some relief available for the 2020 tax year, which your business can take advantage of even in 2021.

Because the SECURE Act law change applies to tax years starting on or past January 1, 2020, it's not linked to COVID-19 disaster relief, and applies to all tax years following that date. This makes it a great option for tax planning long into the future. However, be aware that the retroactive adoption of qualified retirement plans will require filing an annual Form 5500 for the plan year that had already closed. Because the adoption can take place after the Form 5500 is due, employers may want to consider preemptively filing for a 2.5-month extension using Form 5558.

New plans with 100 or greater participants at the beginning typically need an independent auditor's report filed with your Form 5500, which can take months to prepare. However, a special rule lets you defer your auditor's report for the next year if the plan had a short year of seven months or under. To take advantage of this, set up a short initial plan year.

There are still limitations on how much funding you can invest under IRC Sections 404 and 430, as there would be with regular retirement plans. For the 2020 tax year, the limit is usually

$57,000 for each participant. Funding must be completed by September 15, 2021, which is 8.5 months following the end of the tax year. Failure to do so can cause you to pay excise taxes through IRC Section 4971, despite the extended federal income tax return due date not falling until October 15. The plan is required to have an Employer Identification Number (EIN) for the trust that handles the retirement plan as well as the related bank account. These items must be taken care of so that the contribution can be received before the deadline.

To avoid issues that can be raised by IRS field agents, make sure that all retirement plan documents are signed. Unsigned or undated documents can bring up concerns about whether the plan was adopted in a timely manner. Additionally, small employers are allowed to recoup specific expenses that are related to creating your newly adopted retirement plan through start-up tax credits up to three years. However, if you already have an existing Savings Incentive Match Plan for Employees (SIMPLE) plan, adopting your new plan in a retroactive fashion would void that plan, because the SIMPLE plan must exist in the absence of any other retirement plan.

By adopting your broad-based workplace retirement plan that is tax-qualified following the tax year's end, you'll be able to use this tool to take advantage of significant tax savings both now and long into the future. It's a helpful option for companies that couldn't focus on year-end tax planning due to the pandemic and are now faced with a high tax bill. If you've filed an extension for your 2020 business taxes, you may want to consider whether a retroactively-adopted tax-qualified retirement plan can help you offset your expected tax liability. If you've already filed your taxes for this year, you could use this technique down the road.

If you have any questions or if you're ready to make a change to improve your tax liability, please contact Frankel Zacharia, LLC at 402.496.9100.