RETIREMENT PART 1: WHY HAVE A RETIREMENT PLAN?

Learn the benefits of offering a retirement plan for your child care business.

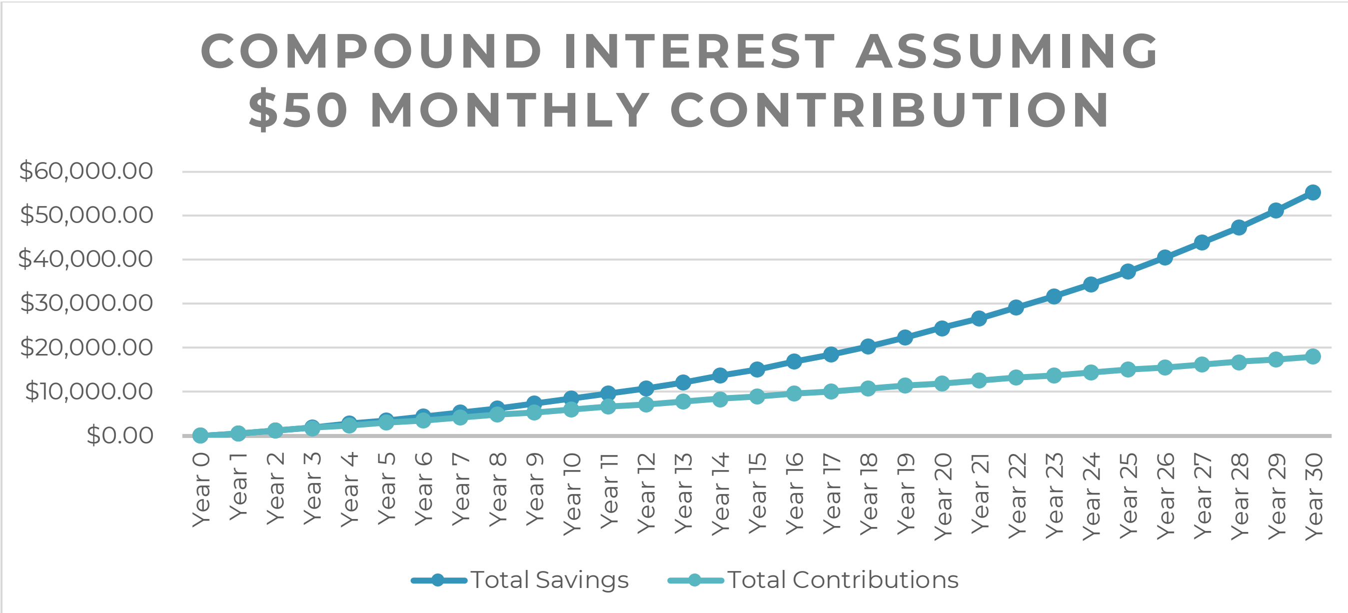
Whether it is just for you as the sole owner or for a large center with many employees, retirement is an increasingly critical benefit for child care businesses. There are three key reasons to start your retirement plan – having enough money to retire, retaining your employees (including yourself), and keeping your hard-earned money.

HOW WILL A RETIREMENT PLAN HELP WITH HAVING ENOUGH MONEY TO RETIRE?

Having enough money to retire takes a great deal of saving. Financial experts estimate that most individuals will need up to 80% of their pre-retirement income to maintain their standard of living once they stop working. That means if you are making $35,000 today, you will need to have $28,000 a year, every year, from when you retire onward. However, the average benefit paid by the Social Security Administration is only $14,400 a year, leaving a large gap for many people to retire comfortably.

The fastest way to get the savings you will need relies on compound interest where the money you make on your savings is reinvested.

Here's how compound interest works. Let's say you decided to have one less meal out a month and you put $50 instead into your retirement savings. Let's also assume you have a 6.5% interest rate (this is the average in 2022 for retirement accounts). In the first year, you will have saved $600 and made $18.20 in interest. Now in the next year, you have $618.20 in savings (your original $600 plus the interest of $18.20) and with interest and the monthly contributions, you'll end the year with $1,277.81. As this continues over 30 years, you'll have saved $18,000 and accumulated $37,308.90 in interest for a total of $55,308.90!



HOW CAN A RETIREMENT PLAN HELP ME TO RETAIN MY EMPLOYEES?

Because retirement savings is critical and can add up over time, it can be a **great tool for retaining** your staff. In a Morgan Stanley 2022 survey, 93% of employees consider retirement programs a draw as they decide where to work. Having a retirement savings program can help you keep the employees you have and attract new ones in this competitive labor market.

Remember, this also includes yourself if you are the sole owner and employee. You need a retirement plan too and many child care providers have been tempted to leave the profession for other jobs with retirement benefits. By providing yourself with the benefits you need you can stay in child care and prepare for your future.

WHAT ARE BUSINESS CONTRIBUTIONS AND MATCHES AND HOW DO THEY WORK?

A key benefit of business retirement accounts is the opportunity for **business contributions or matches** where the child care business makes additional retirement contributions or matches employee contributions to the employee's retirement. As we will discuss further in the next section, most plans allow or even require companies to provide some contribution to the employee's retirement. These contributions can be a set amount, a percentage of the employee's compensation, or a "match", which means that the employer will contribute the same amount that the employee contributes, often up to a certain percentage. For example, an employer may offer to match the money contributed to a retirement account up to 3% of the employee's salary. This could mean that for a person earning

$30,000 a year and contributing $900 annually (3%), their employer would also contribute – or match – the $900, increasing the total contribution to $1,800. This match is essentially free money for the employee and is an incentive for employee retention since they are getting additional funds beyond their regular compensation.

However, the money is oftentimes not available until the employee is **vested**. Vesting is the time it takes for the business portion of the retirement account to be fully "owned" by the employee and can vary from business to business. Businesses can choose for employees to become vested upon hire or require that they are employed for a certain amount of time, up to six years, to become vested. For example, let's say you make a $600 contribution in 2022 and you have a three-year vesting schedule. Typically, that would mean if the employee left your business at the end of 2023, they would only have 1/3 or $200 (the rest would return to the business) because in this case they would be considered "partially vested". If they left at the end of 2024, still only "partially vested", 2/3 or $400 would follow them. It wouldn't be until the end of 2025 that they would have the full $600 if they changed jobs, as at that point they would be "fully vested". Implementing a vesting period can also encourage employees to remain employed at your child care business so that they are able to access 100% of the employer contributions to their retirement.

HOW MUCH SHOULD I CONTRIBUTE TO MY EMPLOYEES' RETIREMENT?

Most business contributions are on average 4.3% of the employee's annual salary. However, there are a few additional considerations. First, you should check what other child care providers are offering in the area. A retirement contribution is like any other form of employee compensation – you want to keep up with or even surpass the other businesses in the area, so employees don't leave. Turnover can be costly, an estimated 1.5-2 times an employee's salary according to LinkedIn, when you factor in the time needed to recruit and hire for the open position, overtime hours needed from other employees to fill the lost capacity, and the time and cost of onboarding. Regularly checking on the retirement plans offered by other area providers can help you keep your staff and reduce the cost of turnover.

Second, the majority of employers in the U.S. (if their retirement plan allows it) opt to require **matching and vesting**. A **match** means that an employer will contribute only if the employee makes one. Typically matches are 50% of the employee's contribution to a certain level. For example, let's assume an employer has a 50% match for up to 3% of the total salary. If an employee makes $35,000 and contributes

3% of their salary for retirement (that is, $1,050), the employer will only contribute $525.

Further, employer contributions are often **vested** where possible. Vesting is the amount of time it takes for an employee to entirely own an employer match or contribution to their retirement. Usually, this is based on how long they continue to work for the business as an incentive to stay. In our example above, if the employee had to wait three years to be vested and left after two years, they may just get a portion of the employer contribution, so maybe 75% of the $525. Through regular contributions and compound interest, this becomes a great incentive for employees to stay with your business.

HOW CAN SAVING FOR RETIREMENT SAVE YOU MONEY?

Finally, you can **keep more of your profit through retirement savings**. Between the tax benefits and potential credits from the federal government, there are savings for employers and employees.

There is an opportunity to save in three ways:

1. **Contributions your business makes to the plan and the costs of maintaining it, even if it is just for yourself, are deductible –** This will cut the amount of revenue taxed by your business which also lands on your personal income tax return.
2. **Retirement plans are tax-favored –** that means that the government gives you tax benefits to encourage you to save. Some retirement uses **pre-tax** money. This means that the money you put in now is taken out of your income, so it isn't taxed today. However, whatever money you make in the account over the increased value of the investment will be taxed. So, the $5,000 you invest in a SEP IRA for example today won't be taxed, but the additional $14,350 you may gain over the next 20 years in investments will be when you retire.

WHY IS A TAX CREDIT BETTER THAN A DEDUCTION?

A **deduction** reduces the amount that is counted as your revenue which decreases your taxable profit. For example, if your business makes $35,000 and you have $30,000 in deductions your profit (which is taxed) is only $5,000. At a tax rate of 22% that means you will pay $1,100 in taxes. If you find another deduction for $2,000, now your profit will be $3,000 and your taxes will be $660 (that is $3,000 x 22%) which means you saved $440.

A tax credit directly lowers the tax you owe, dollar for dollar. There are two types of tax credits – refundable and nonrefundable. A refundable tax credit works the same way as overpayment on taxes you owe for the year where the excess gets returned to you in a payment, or a tax refund. A nonrefundable tax credit can pay up to the full amount that you owe in taxes, but no higher than that amount, so while your tax liability will decrease, you won't receive any excess in the form of a payment. Using the same example, let's say you have $5,000 in profit and owe $1,100 in taxes. I if you have a $2,000 nonrefundable credit it would cover the $1,100 you owed. If you had a refundable credit, it would cover the $1,100 and give

Other retirement plans, like the Roth IRA, use **post-tax** money. In this case, your money is taxed now, but increased value from investing isn't. Let's say in the case above you put that $5,000 in a Roth IRA – you would pay taxes on the $5,000 invested this year, but not on the $14,350 gain you will have while it is invested over 20 years.

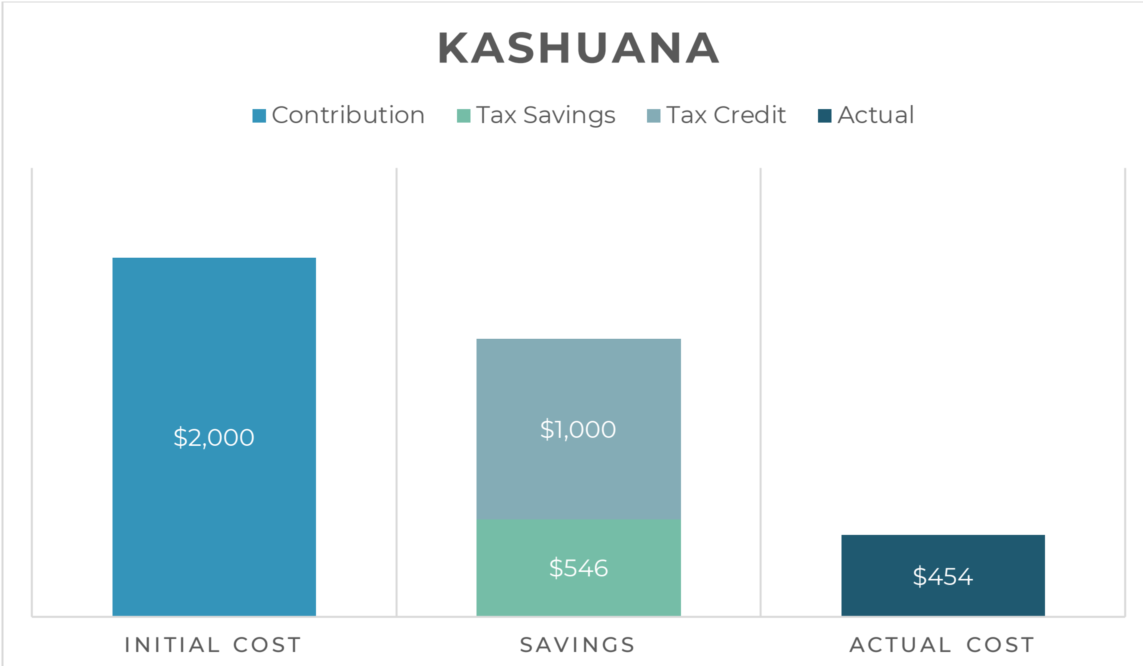
3. **Retirement contributions can get you tax credits** – specifically the Savers Credit and the Retirement Plan Startup Costs Tax Credit.

   The **Savers Credit** is a non-refundable credit available to adults over the age of 18 who are not dependents of someone else or students. The program will give you a credit worth up to 50% of your contributions to your retirement, up to $1,000 in credits, if you are married and have an adjusted gross income less than $73,000 or are a head of household making less than $54,750 or single and making less than $36,500. (Remember, your adjusted gross income is typically less than your total income so even if your salary is higher than the limit, you still may qualify).

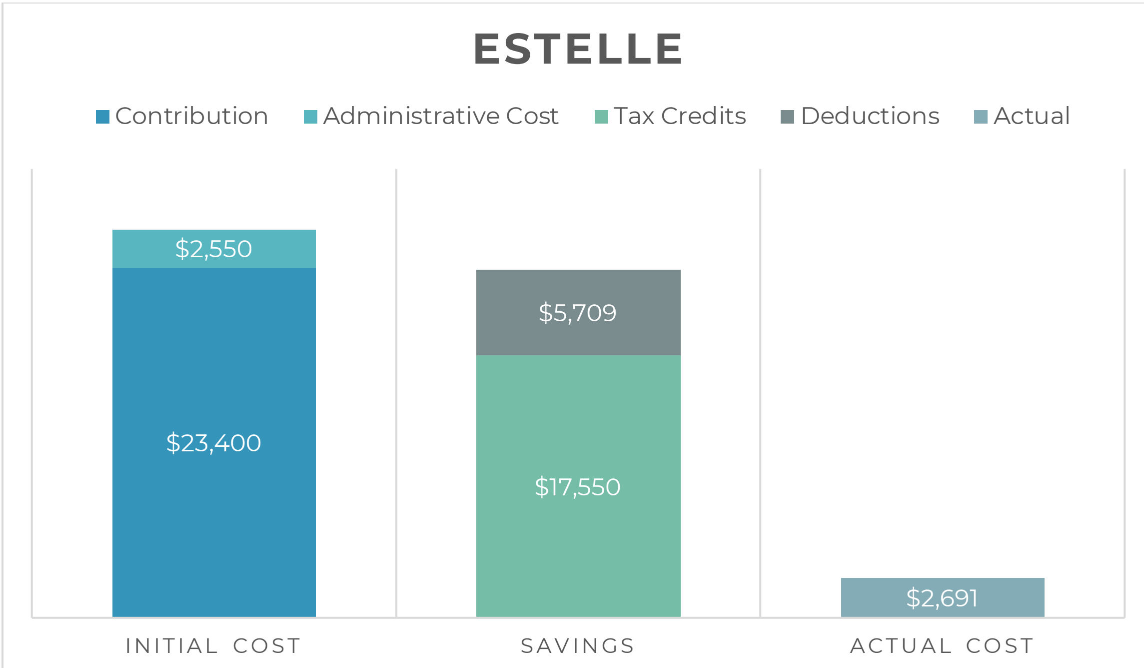
   The **Retirement Plan Startup Costs Tax Credit** is open to employers who have retirement plans that include W-2 employees who are not owners. The credit was just updated in December 2022. If a business has 100 or fewer employees, this credit covers up to $5,000 in administrative costs for the first three years of a new 401k, 403b, profit sharing, SEP IRA, or Simple IRA plan. Additionally, businesses with less than 50 employees can get a credit of up to $1,000 per employee in the first year of the plan for contributions they make for employees who earn less than $100,000. This credit continues for three more years with the credit decreasing by 25% in each subsequent year. So, if you had an employee making $32,000 a year and you contributed $1,000 a year to their retirement over five years, you would get a total credit of $2,500.

Let's look at two examples of how these savings can benefit you:

Kashuana is a family care business owner and sole proprietor who made $38,000 over the course of the year. She put $2,000 into a SIMPLE retirement account (we'll cover the types of plans later in Part 2 of this guide). The $2,000 will save her three times over. First, she'll save 15.3% in self-employment tax and 12% in income tax (a total of $546). Second, she qualifies for the Saver's Credit so she gets a tax credit for 50% of the contribution ($1,000). In this case, Kashuana has $2,000 for her retirement and after the money saved and credits, the cost to her was only $454!



Estelle has a center with 15 employees and she decided to use some of her stimulus money to start a 401k. Her business is an LLC that declared to be treated as an S corporation, so the profit goes on to her personal tax return which is taxed in the 22% bracket. Estelle contributed 5% of the salary of each employee ($1,560 per employee) for a total of $23,400. Between the fees and the costs of her time to set up and have her bookkeeper help with the 401k she paid $2,550. Between her contribution to the retirement and the administrative cost, Estelle paid a total of $25,950. However, Estelle was able to save money in three ways. First, since the 401k is new, she gets 100% of her administrative costs back (that's $2,550). Second, since her employees make less than $100,000, she can get up to $1,000 for her contributions per employee for a total of $15,000, for a total of $17,550 in tax credits. Third, she gets the deduction for the contributions and administrative costs which saves her another $5,709. All in all, Estelle's new benefit cost her $25,950 but she saved or received credits for a total of $23,259, so she really only spent $2,691! Plus Estelle can share information on the Savers Credit for her employees so they will receive their tax credit and greater benefit.



Setting up a retirement plan through your business will help you and your employees prepare for a successful retirement, provide additional retention incentives, and help you save money in the long run. To learn more about selecting a retirement plan, see Retirement Part 2: How do I choose the right retirement plan?

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