

An Incentive to Save:

# Lower Your Taxes with a 401(k) Plan

401(k)s are designed with some great tax advantages that can benefit you this year and well into the future. In fact, it may even cost your business less than not having one at all.

share**BUILDER** 401**K**

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401(k) plans are: Not FDIC insured · Not Bank guaranteed · May lose value

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## How much you might save

In the simplest scenario, when an owner contributes the 2012 maximum of \$17,000, she or he protects \$4,250 from taxes this year! Keep more money for yourself while putting money to work for tomorrow. That tax savings more than covers the cost of a ShareBuilder 401k—to the tune of 2.8 to 4.4 times for companies with 25 or fewer employees. The savings cover the cost by a lot more for an owner-only business.

## Less taxing, more saving: 3 scenarios

Yes, 401(k) tax advantages can really add-up. To expose the ins and outs of both the business and personal savings, we created three scenarios.

We based these very real scenarios on our experience working with businesses owners. The three scenarios simply consider a business with seven employees (including the owner) that offers:

1. No 401(k) Plan
2. A 401(k) Plan with no company match
3. A 401(k) Plan with a 4% match for participating employees ([Safe Harbor](#))

So how do these scenarios compare at the end of Year One? Pretty great if you have a plan. The owner who matches is much better off than the owner without a plan. Even the owner with a plan who does not match is better off than the owner without a plan.

While your after-tax pay will be lower—the owner that matches gains:

- \$2,729 more than an owner without a plan
- \$7,465 reduction in federal taxes, and
- \$22,087 in tax-deferred income!

That's just Year One. Tax credits, deductions of any match and plan expenses, and receiving a match can all have powerful effects on your bottom line.

### Tax Breaks at-a-Glance

- \$500 tax credit if it's your first 401(k) plan & you have employees
- Matching, profit sharing and admin fees are deductible for your business
- Contribute up to \$17,000 tax-deferred in 2012 plus any matching you receive
- You can choose to contribute after-tax into [Roth 401\(k\)](#)—no income limits—which will not be taxed again when withdrawn after age 59½

Year One Comparison	No 401(k) Plan	401(k) Plan No Match	401(k) Plan with Match
After-Tax Income + Retirement Savings	\$108,893	\$110,800	\$111,622
Total Tax Liability (business + personal)	\$41,107	\$38,060	\$33,638
Retirement Savings	-	\$8,932	\$22,087

Assumptions:

This is a mouthful, so get ready (see the Appendix for scenarios breakouts).

- Proprietorship's net income is \$150,000
- Owner is in the 25% tax bracket (using 2010 tax tables)
- 4 employees, including the owner, participate in the plan
- Average participating employee salary is \$30,000, not including owner
- Owner is married, taking standard deduction and exemptions
- Owner in No Match plan can only contribute up to 6% of salary
- Owner in Matching plan puts in the \$17,000 maximum, plus receives the 4% match

### Why Doesn't the "No Match" Owner Contribute More?

Great question! One reason is obvious: the owner doesn't receive any matching. Another is based on 401(k) rules. Owners who don't match often have their contributions restricted within their individual account by how much the participating employees contribute on average (more specifically, by those employees who earned less than \$115K in the previous year).

Since our example assumes participating employees give 4% of salary, the owner can contribute up to 6% of his or her own salary.

## Tax savings swell over time

Look ahead a few years to see how tax savings can stack up. The chart below demonstrates that your tax savings grow even without changing the amount owners save and keeping their tax rates constant. Granted, tax rates will likely change or expire, which could very likely increase your tax liabilities.

Taxes Add Up	Year One Taxes	Cumulative Taxes over 5 Years	Cumulative Taxes Over 10 Years
No 401(k)	\$41,107	\$205,533	\$411,066
401(k) no match	\$38,060	\$190,299	\$380,597
401(k) w/match	\$33,638	\$168,189	\$336,378

Includes personal and business tax savings

In just 10 years, the owner with a match saves \$74,688 in business and personal taxes compared to the owner without a 401(k).

## Become a millionaire in 25 years or less

Tax savings are a powerful reason to start a 401(k) today. But the real secret sauce is putting your money to work building a healthy nest egg. As compelling as tax advantages are today, combining compounding interest and the high contribution amounts allowed in a 401(k) may be the biggest helping hand you ever get. A genius in understanding forces and time, Albert Einstein declared, "the most powerful force in the universe is compound interest."

So let's see what the nest eggs might look like for our scenarios. Assume the owner's contribution remains the same each year and the contributions attain a 7% net return over time.

For one last perspective, we added a scenario for the "No 401(k)" owner who puts some money in a Traditional IRA (individual retirement account).

See the following chart to find your million.

Nest Egg Comparison*	Year 1	Year 10	Year 25
No 401(k) – Not saving	-	-	-
No 401(k) – putting \$5K a year in an IRA	\$5,000	\$69,082	\$316,245
401(k) no match (\$8,932 contributed/year)	\$8,932	\$123,403	\$564,915
401(k) w/match (\$16,500 contributed + \$5,587 match per year)	\$22,087	\$305,163	\$1,396,977

The owner who matches is sitting pretty with a cool \$1.4M in 25 years.

Less taxes, more savings. Does it get much better in the world of business? Helping customers succeed may be about the only thing that can top it.

\*This example compares how savings and returns placed in the same investment with different contribution amounts can grow over time and will differ over time. It assumes a 7.0% fixed annual rate of return. Your account may earn more or less. This is a hypothetical example only, and not a guarantee of future returns (we wish we had a crystal ball too, unfortunately nobody does). Actual experience will vary with portfolio selections and changing market conditions. The total account balance does not take into account federal and state income taxes, which will be due upon withdrawal. Assets withdrawn before 59½ may incur a 10% tax penalty.

You see the difference above in the owner using an IRA versus a 401(k). The advantages of a 401(k) compared to a traditional IRA are substantial. Take a close look at how an IRA compares.

### 401(k) towers over IRA

	401(k)	IRA
2012 Contribution Limit	\$17,000	\$5,000
Age 50+ Catch-Up Amount	\$5,500	\$1,000
Roth Income Limit	None	\$125K*
Penalty-free access if needed	Yes, loan	No

\* Beginning at \$110K, the amount you are allowed to contribute begins to decrease, hitting \$0 at \$125K.

## More resources

- **Tax Advantage Breakdown:** To dive into the details of the tax comparison, check out the next two pages which walks through important assumptions and goes line by line through the Year One tax comparisons. It's always a good idea to speak with a tax advisor about your unique situation.
- **401(k) Loans:** Some nice advantages over other loan options. They also have some real poison pills to watch out for. Get the whole scoop in [401\(k\) Loans: the Good, the Bad and the Ugly](#).
- **[The Real Cost of Employee Turnover](#):** Good times or bad, the cost to replace your most valuable employees is higher than most people think. Check out how a 401(k) may help keep these costs in check.

We're always happy to help. Call us today at **1.800.943.6108**, option 1, or visit [www.sharebuilder401k.com](http://www.sharebuilder401k.com).

This guide is intended only as general information for your convenience, and should not be construed as investment advice by ShareBuilder. You should consult your tax advisor regarding specific tax strategies.

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## Appendix: Tax advantage breakdown

The following chart gives a breakdown of tax savings for three identical, hypothetical companies.

### Sample company profiles

- All are proprietorships.
- All have seven employees including the owner.
- All have an owner earning \$150,000 salary annually.
- Companies with a 401(k) have three employees plus the owner participating.
- Average participating employee (not including owner) earns \$30,000 annually.

### Assumptions

- Tax calculations are based on 2010 tax rates and rules.
- You'll consult a tax specialist to assess your business and personal situation.

### No-Match Plan = Owner Restrictions

401(k) rules limit how much an owner (and any other highly compensated employee) can contribute to their own plan. In the "No Match" scenario, the owner can only contribute 6% of his or her salary into the 401(k) account. In a "Safe Harbor" plan, which requires a match, the annual contribution limit of \$17,000 is the only restriction.

## Tax breakdown: 3 scenarios

Taxes and 401(k) ownership	No 401(k) plan	401(k) plan No match	401(k) plan Safe Harbor Match
<b>Owner's Net Income</b>	\$150,000	\$150,000	\$150,000
401(k) Plan Annual Administration	-	(\$1,140)	(\$1,140)
401(k) Matching for Employees	-	-	(\$3,600)
401(k) Matching to Self / Owner	-	-	(\$5,587)
<b>Adjusted Net Income (paid as distribution to owner)</b>	150,000	\$148,860	\$139,673
<b>401(k) Plan Tax Deductions</b>			
401(k) Owner Savings	-	(\$8,932)	(\$16,500)
<b>Net Income After Schedule C Retirement Plan Expenses</b>	\$150,000	\$139,928	\$123,173
Self-Employment Tax up to limit \$106,800 (15.3%)	\$16,340	\$16,340	\$16,340
Self-Employment Tax after limit (2.9%)	\$1,252	\$1,219	\$953
Minus One Half of Self Employment Tax	\$141,203	\$131,148	\$114,526
Standard Married Deduction and Exemptions	(\$17,900)	(\$17,900)	(\$17,900)
Income Subject to Federal Income Tax	\$123,303	\$113,248	\$96,626
Federal Income Tax Amount	\$23,513	\$20,999	\$16,844
Federal Tax Credit for New Retirement plans (available first 3 years of plan)	-	(\$500)	(\$500)
Total Cash Available after Taxes not including retirement savings	\$108,893	\$101,869	\$89,535
<b>Total Remainder After Taxes (including retirement savings)</b>	<b>\$108,893</b>	<b>\$110,800</b>	<b>\$111,622</b>
Total Tax Liability (Self Employment + Federal Income Tax - Credit)	\$41,106	\$39,060	\$33,637
Personal Retirement Savings	-	\$8,932	\$16,500
Company Match for Self	-	-	\$5,587
<b>Total Retirement Savings for 2010</b>	<b>-</b>	<b>\$8,932</b>	<b>\$22,087</b>

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