November 2024

2024 Last-Minute Year-End Retirement Deductions

The clock continues to tick. Your retirement is one year closer.

You have time before December 31 to take steps that will help you fund the retirement you desire.

By taking the actions described in this article, you might find several thousand dollars (and maybe much more) in your pocket. But you'll need to act now to get the cash.

Big Picture

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

1. Establish your 2024 retirement plan before December 31 so you can make both an employee and an employer contribution to your account. Yes, you can do this (make both the employee and the employer tax-deductible contributions) even if you are the sole owner/employee in a proprietorship or a corporation.

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 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.

5. Convert to a Roth IRA.

1. Establish Your 2024 Retirement Plan

First, a question: As you read this, do you have your (or your corporation's) 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 2024.

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 a good chunk of money away.

In general, your plan document will define when you can make employee or employer contributions that will produce 2024 tax deductions. Make sure you know exactly when you can make both

- your employer contributions, and
- your employee contributions.

Example. You are the only employee in your business, you operate as a one-owner S corporation, and you want an individual 401(k) plan deduction for the 2024 calendar year. To obtain the maximum 401(k) deduction for this calendar year, you must have your corporate 401(k) plan in place on or before December 31.[1]

If you have your S corporation 401(k) plan in place on or before December 31, 2024, then you can make your personal employee contribution of up $23,000[2] ($30,500 if you're age 50 or older[3]) on or before December 31, 2024.

You also can make the employer contribution of up to 25 percent of your compensation on or before December 31 or at any time before the 2024 S corporation tax return is due, such as on March 15, 2025 (or with extensions, say, on September 15, 2025).[4]

Between you and the S corporation, the total contribution to your account cannot exceed $69,000 ($76,500 if you are 50 or older).

For more on the 401(k) plan and why it's terrific for the solo owner/operator of a business, incorporated or not, see Solo 401(k) Could Be Your Best Retirement Plan Option.

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 plan (such as a profit-sharing plan, a 401(k) plan, or a defined benefit pension plan), a SIMPLE IRA plan, or a SEP, you can qualify for a non-refundable tax credit that's the greater of[5]

- $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.

The credit is based on 100 percent of your "qualified start-up costs," if you have 50 or fewer employees.[6] Employers with 51 to 100 employees can claim the credit based on 50 percent of qualified start-up costs.[7]

Qualified start-up costs mean any ordinary and necessary expenses of an eligible employer that are paid or incurred in connection with

- the establishment or administration of an eligible employer plan, and
- the retirement-related education of employees with respect to such plan.

The credit applies to the year of start-up and for the next two years (capped at $5,000 a year, $15,000 maximum for the three years). You may deduct any costs in excess of the tax credit as ordinary and necessary business expenses.

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.

For purposes of the retirement plan start-up credit, you don't count solo business owner-operators, whether classified as employees or not. Why? The tax code deems them "highly compensated employees" for retirement plan purposes.

Technical correction for multi-employer plans. When the credit was first enacted, it inadvertently precluded the credit for employers that joined multi-employer plans that had been in existence for more than three years. SECURE 2.0, passed in 2022, retroactively fixed that glitch so employers entering a multi-employer plan after 2019 can qualify for the credit.[8]

Key point. If you joined a multi-employer plan and failed to claim the credit, file amended returns for your open years to claim your rightful credits.

3. Claim the New 2024 Small Employer Pension Contribution Tax Credit (up to $3,500 per Employee)

SECURE 2.0 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.[9]

Exception. The credit is not available for employer contributions to a defined benefit plan or elective deferrals under Section 402(g)(3).

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. In subsequent years, the dollar limit remains at $1,000 per employee, but your credit is limited to

- 100 percent in year 2,
- 75 percent in year 3,
- 50 percent in year 4,
- 25 percent in year 5, and
- no credit in year 6 and beyond.

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).

If you have between 51 and 100 employees, you reduce your credit by 2 percent per employee in this range. With more than 100 employees, your credit is zero.

Also, you earn no credit for employees with wages in excess of $100,000 adjusted for inflation in increments of $5,000 in years after 2023.

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

SECURE 2.0 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 qualified employer plan such as a 401(k) or SIMPLE IRA plan.[10]

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.[11] Further, you don't have to spend any money to trigger the credit. You simply need to add the auto-enrollment feature.[12]

In its report on this provision, the U.S. House of Representatives Committee on Ways and Means stated:[13]

Studies show that automatic enrollment increases employee participation in Section 401(k) and SIMPLE IRA plans, resulting in higher retirement savings.

As with the start-up credit described above, you are an employer eligible for the credit if, for the preceding year,[14]

- 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.

Solo business owner-operators with no employees are not eligible for the automatic enrollment credit. Why? The tax code deems them "highly compensated employees" for retirement plan purposes, and they have no other employees (so all of the business's employees are highly compensated).

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.[15]

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.[16])

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.[17]

5. Unlike with the traditional IRA, you don’t have to receive required minimum distributions (RMDs) from a Roth IRA when you reach age 73—or to put this another way, you can keep your Roth IRA intact and earning money until you die.

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.[18]

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

3. Once you turn age 73, the law generally requires you to start taking out money annually—even if you don’t need it or want it.[19]

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.[20]

Planning note 1. If you are going to have a business loss this year, consider converting your traditional IRA to a Roth IRA, as we explain in Five Strategies for Your Business Loss after Tax Reform.

Planning note 2. For additional insights on the pros and cons of Roth IRAs and traditional IRAs, read Roth IRA versus Traditional IRA: Which Is Better for You?

Takeaways

Having a retirement plan is a good money strategy for most business owners because it creates savings that you are unlikely to tap. And those savings compound either tax-deferred (traditional IRA) or tax-free (Roth IRA).

So Step One is to get your plan in place before December 31 so you, the business owner, can make both employer and employee contributions. This is true even when you operate as a one-person corporation or proprietorship.

If you have employees, make sure to take advantage of the tax credits for (a) start-up of the plan, (b) contributions to the plan, and (c) establishment of automatic contributions (opt-outs are available, of course).

Seriously consider converting your existing accumulations to a Roth IRA. The long-term savings here can be huge. Make sure to leave the converted funds in the Roth for at least five years.

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1 The S corporation 401(k) plan is known as a solo 401(k), self-employed 401(k), individual 401(k), or one-participant 401(k).
2 IRC Section 402(g)(1)(B); Notice 2023-75.
3 IRC Section 414(v); Notice 2023-75.
4 IRC Section 404(a)(3)(A)(i)(I).
5 IRC Section 45E.
6 IRC Section 45E(e)(4).
7 IRC Section 45E(a).
8 Pub. L. No. 117-328, SECURE 2.0 Act of 2022, Section 111, p. 835 of the PDF.
9 Pub. L. No. 117-328, SECURE 2.0 Act of 2022, Section 102, p. 819 of the PDF; IRC Section 45E(f).
10 Notice 2020-68; IRC Section 4972(d).
11 IRC Section 45T.
12 Notice 2020-68.
13 H. Rpt. 116–65, p. 51.
14 Ibid. IRC Section 45T does not include the language about one employee who is not highly compensated, but the legislative history has Sections 45E and 45T in the same section, as you see on p. 50 of the House report. This seems to bring the same language to bear—implying you need that one employee in addition to yourself to qualify for this tax credit.

15 Reg. Section 1.408A-6, Q&A-9.
16 Reg. Section 1.408A-6, Q&A-5.
17 IRC Section 408A(d)(2)(A).
18 IRC Sections 408(d)(1); 72(t).
19 IRC Section 401(a)(9).
20 IRC Sections 408(d)(1); 72(t).