Hidden in the weeds

Money-saving financial tips for individuals and companies

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There are many opportunities for businesses and individuals to save money — through IRA conversions, Health Savings Accounts (HSA), making a trustee active in the business — but it's critical to work within the legal constraints when considering these opportunities or hefty fines can eliminate the savings.

"There are a lot of opportunities in the weeds," says Jim Sacher, CPA, a partner at Skoda Minotti. "If you find the right one, the savings can be significant. Those savings can be lost, however, if you're not careful to work within the law."

Smart Business spoke with Sacher about hidden savings for businesses and individuals.

How can individuals use a Roth IRA Conversion to their advantage?

The unique feature of a Roth IRA retirement savings vehicle for individuals is that, unlike a traditional IRA, it allows you to withdraw all of the funds in the account tax-free. But there are important caveats.

If, according to your joint tax return, you earn $193,000 or more, you can't contribute to a Roth IRA. These taxpayers can, however, make contributions to a nondeductible IRA, which has no income limit. The disadvantage of a nondeductible IRA is that the income accumulated is taxed at ordinary income rates when withdrawn. But there's a backdoor. You can make contributions to a nondeductible IRA, then convert it to a Roth IRA.

There are a couple of traps, however, that could get you in trouble. For instance, if you convert a nondeductible IRA to a Roth, any IRA you have is considered converted on a pro rata basis, which could create ordinary income. It's best to talk to a professional before executing this strategy to ensure you're not losing the benefits of a conversion because of the added tax burden.

How can HSAs add to an IRA contribution limit?

An HSA can work like an IRA; contributions go into the HSA on a tax deductible basis and can then grow tax-free. The catch with an HSA is it can only be used for medical expenses. If, however, you can afford to pay for your health care expenses out of pocket, the money in the HSA builds up tax-free and will accumulate indefinitely. You can use it to fund your health care through retirement or leave it to beneficiaries and they can use it for medical expenses. In this way you can actually increase money saved for retirement or beneficiaries just like an IRA.

Why should companies consider making trustees active in their business?

The enactment of the Affordable Care Act created the net investment income tax, which applies to all unearned income for couples with income greater than $250,000. As income flows through a business, like an limited liability company to an owner, the owner who is active in the business does not pay net investment income tax on this income, but a passive investor does. If the owner moves company ownership into an irrevocable trust for estate planning, the trust is considered inactive and attracts the net investment income tax, even though the owner is active.

There is, however, a provision in the law that implies that a trustee who is active in the business creates an active connection to the trust. The trust then escapes the net investment income tax. The definition of 'active in the business' is unclear, but it can be assumed that the activity should be regular and continuous although need not be full time.

What documents do companies need to have in place for their health and welfare plans?

Health and welfare plans are benefit plans businesses provide to employees other than qualified retirement benefits — health insurance, dental, disability, life and other voluntary benefits. The law requires these plans to have a plan document, which describes a plan's terms and conditions related to the operation and administration of the plan. Most businesses either don't have plan documents or believe the contract they have with a benefit provider counts as a plan document, which it doesn't.

If the Department of Labor (DOL) audits and these plan documents aren't in place, the DOL will levy a $50,000 fine for each plan that's without a plan document. It's difficult to get around because the DOL is serious about collecting fines. Simple actions now can prevent very costly penalties because of these plans. ●