Morgan Stanley

Wealth Wisdom: Smart Moves for Powersports Dealers – Part 1

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Ask ten ‘wealth managers’ to define wealth management, and you’ll likely receive ten different answers, mostly centered around investing. However, in this article series, we aim to present an alternative, comprehensive definition on wealth management that encompasses a full spectrum of strategies which we call Advanced Planning. While proper investment consulting is crucial for generating portfolio returns, what if we include tax minimization, thoughtful estate planning, and wealth protective strategies as well, to propel your wealth forward? We classify these strategies into four pillars: Wealth Enhancement, Wealth Protection, Wealth Transfer and Charitable Giving. Join us for a four-part article series where we delve into strategies for wealth planning in each of these crucial areas.

Wealth Management

INVESTMENT CONSULTING	ADVANCED PLANNING	RELATIONSHIP MANAGEMENT
Asset allocation Portfolio management Performance analysis	***Wealth Enhancement***: minimizing tax and optimizing debt. ***Wealth Transfer***: exit planning and proper transfer of wealth to those you care about. ***Wealth Protection:*** strategies to help protect against entities and individuals that unjustly want to get at your money. ***Charitable Giving***: for those that would like to give back, insights on how to maximize the impact of the money you give.	Regular communication and scheduled review calls. Team of professionals, including legal, tax, insurance, and financial advisors, actively quarterbacked for meaningful progress.

WEALTH ENHANCEMENT: LEVERAGING YOUR 401(K) PLAN

Numerous powersports dealers we engage with have established 401(K) plans for their businesses yet haven't revisited them recently. These plans serve not only as an excellent employee retention tool, but also provide tax advantages – such as tax credits, tax deductions, and benefits to the organization's principals. Let's take a closer look at the benefits they offer to owners, employees, and the company overall.

Employee Retention

Despite historically low unemployment rates, currently at 3.8%[1] , many powersports dealers express ongoing difficulties in retaining and hiring new employees. Implementing a well-designed 401(K) plan for your business can help establish a competitive employment and compensation package. In addition, providing a retirement plan can significantly alleviate employee financial concerns, particularly when it includes a 401(K) safe harbor plan provision.

But what exactly is a safe harbor provision?

A safe harbor provision usually entails a fixed, mandatory employer contribution that is typically 100% vested. This aspect is particularly attractive to employees since it ensures that any employer match becomes fully owned by the employee as soon as contributions are made, as opposed to being invested gradually over time. Benefits to using a safe harbor provision include:

Simpler Plan Administration

The safe harbor provision streamlines the 401(K) administration for the company and its principals. When the plan is designed as a safe harbor, it is relieved of many of the intricate compliance and testing requirements associated with traditional 401(K) plans.

Maximum Contributions Allowed

One of the significant advantages for principals and the company's Highly Compensated Employees (HCEs), or employees earning $155,000+ in 2024[2] , is that they can maximize their annual plan contributions.

In a non-safe harbor plan, if 60% or more of the assets in the 401(K) plan originate from owners or Highly Compensated Employees, it can restrict the amount these individuals can contribute.

Conversely, with a safe harbor plan, this compliance test is waived, enabling owners and HCEs to maximize their 401K contributions. Contributions made to the plan on a pre-tax basis reduce taxable income, providing another tax benefit to participating principals and employees.

You can contribute up to $23,000 to your 401(K) plan in 2024[3] . If you are 50 years of age or older, you can also make an additional catch-up contribution of $7,500, for a total of $30,500 in 2024[4] . As most dealer principals have the majority of their wealth concentrated in their business and business real estate, the 401(K) can be a great tool to diversify and grow your wealth outside the business.

Notes:

[1] U.S. Bureau of Labor Statistics. https://www.bls.gov/opub/ted/2024/unemployment-rate-changed-little-at-3-8-percent-in-march-2024.htm
[2] IRS. https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions
[3] IRS. https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions
[4] IRS. https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions

Tax Deductions

Up to this point, we've explored the tax benefits that a 401(K) plan can offer both you and your employees. Now, let's examine it from a corporate perspective. If you opt to provide matching contributions (like the safe harbor employer match we discussed earlier), these contributions can qualify as tax deductible business expenses[5] . They can increase your Profit & Loss operating expenses and reduce your bottom line, or Taxable Net Income.

We frequently engage in discussions with powersports dealer principals to weigh the pros and cons. Would you rather incentivize your employees with an employer match? Or end the year with a higher net profit that will increase your taxes due at year-end? While the answer is not the same for all, many dealers choose to reward their employees instead of the IRS.

Discretionary Profit Share

The final tax-advantaged suggestion we'd like to present is the inclusion of a discretionary profit-sharing provision in your 401(K) plan. Before we delve further, it's important to highlight the term discretionary, indicating that while you can incorporate this provision into your plan, there's no obligation to use it every year.

So, what exactly is the discretionary profit share?

Discretionary profit-sharing contributions offer employers the flexibility to allocate additional funds, particularly in years of high business profitability. These contributions allow employers to designate a portion of the company profits to be distributed to all employees, including principals, on a pre-tax basis. Profit sharing contributions are a tax-deductible business operating expense and can help manage your Net Income amount throughout the year[6] .

Among the three common profit-sharing allocation formulas are pro rata, permitted disparity, and new comparability. We most frequently see 'new comparability' used in your industry as it allows the company to segment employees into different groups to determine their share of profit. One of the simplest groupings is owner vs. non-owner. For example, your powersports dealership can take $100,000 of profit and allocate a percentage to owners, say 80%, and 20% to non-owners. Such grouping allows principals to keep most of the profits on a pre-tax basis but provides additional profit reward to employees.

The total permitted annual contribution limit for 2024 is $69,000, plus an additional $7,500 for individuals 50 or older, for a total of $76,500[7] .

Lastly, if you are worried about putting too much money into your 401(K) plan, please know that 401(K)s (as well as other ERISA-qualified retirement plans) are usually fully protected from creditors, giving you another layer of wealth protection.

Notes:

[5] IRS. https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview

[6] IRS. https://www.irs.gov/retirement-plans/choosing-a-retirement-plan-profit-sharing-plan

[7] IRS. https://www.irs.gov/retirement-plans/cola-increases-for-dollar-limitations-on-benefits-and-contributions

Conclusion

As highlighted earlier in our article, powersports dealers are encouraged to review and revisit their 401(K)-plan adoption agreement to ensure the plan benefits your employees, you as the principal, and your company.
Our team offers a complimentary service, the Second Opinion Service, a 360-degree review of your dealership and personal financial situation, which includes a review of your company 401(K) plan.

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