Three Tax Reducing Strategies for Retiring Aerospace & Defense Industry Executives Who Want to Keep Working

Part 1

Nearly every one of the executives I work with that have retired from the Aerospace & Defense Industry in the last five years have continued to work as consultants either as an employee or self-employed. After spending the last 30+ years as an employee, retiring executives who want to keep working may not know about these three tax reducing strategies available to them as self-employed business owners.

Strategy #1 – Reduce Your Payroll Taxes by Changing How You Get Paid

Strategy #2 – Defer Taxes on More Income by Creating Your Own Retirement Plan

Strategy #3 – More Tax Deductions

Strategy #1 – Reduce Your Payroll Taxes by Changing How You Get Paid

As an employee, you pay Social Security taxes of 6.2% and 1.45% for Medicare plus a Medicare surtax of 0.9% if you earn over certain amounts depending on your filing status. Self-employed individuals must pay Social Security tax of 15.3% up to $132,900 of income and then Medicare tax of 2.9% of income over $132,900 plus the Medicare surtax of 0.9% over certain amounts depending on your filing status.

However, owners of a pass-through entity such as a S corporation, can collect profits from the company in the form of shareholder distributions or payroll. Taking profits as shareholder distributions is much more beneficial to the business owner, but there are tax issues that need to be considered.

Shareholder Distributions

Income from pass-through companies flows through to the shareholders and is included on their individual tax returns and taxed at the individual's rate. Income is reported to the shareholder via a form K-1 and is not subject to corporate withholding and is also not subject to self-employment income. Therefore, shareholders can avoid paying self-employment tax by taking as much income as possible as shareholder distributions. However, taking all income this way can be considered tax evasion by the Internal Revenue Service which expects shareholder-employees to take a "fair and reasonable" wage in the form of W2 income or payroll.

Payroll

Income paid to shareholders must take a fair wage that is paid to them as an employee and therefore subject to employee payroll taxes for Social Security and Medicare. While this increases the taxes for the shareholder, it also helps avoid going to jail for tax evasion. The determination of "fair wage" is up to the taxpayer and their tax professional, however it must be reasonably close to what the industry average is for the job.