

Fire Alarm for the Small Business

From a financial planning standpoint, who is better off – a Montgomery County firefighter earning \$100,000 a year or a small business owner making \$170,000 a year?

If you think it's the small business owner, think again.

Being a profitable small business owner in Montgomery County is most certainly not as risky as charging into a burning building to save lives and property. Yet the small business owner does have significant tax hurdles to overcome. At the same time, paid Montgomery County firefighters are the beneficiaries of an attractive union pension package with defined benefits.

I recently prepared financial plans for two individuals in their mid-50s who are both earning \$100,000 per year. One was a Montgomery County firefighter and the other was a small business owner. Let's examine the comparative financial numbers.

Social Security Payments: The firefighter pays his share of the 7.6 percent Social Security tax while the small business owner pays double the Social Security tax – her personal 7.6 percent share plus the employer share of 7.6 percent. That's a difference of \$7,600 a year in favor of the firefighter.

Health Insurance: The firefighter can buy pre-tax health insurance, \$200 of which is subsidized by the county each month. The small business owner pays the full \$1,000 per month. If the business is a Subchapter S corporation or a sole proprietorship, health insurance is not tax deductible. This means the after-tax cost of the health insurance for the small business owner is actually 33 percent higher. That's \$13,400 per year more than the firefighter is paying.

Meals and Entertainment Expenses: The county firefighter does not pay for meals he eats

at the fire station. If a small business owner spends \$500 per month entertaining current and potential clients, under IRS rules, those expenses are only 50 percent deductible, an additional cost of \$3,000 per year.

Pension Costs: The county firefighter can retire at 55 with 30 years of service on an \$80,000 annual pension that is indexed for inflation. Conversely, to fund a private annuity that will yield a lifetime pension of \$80,000 a year, the small business owner must contribute \$40,000 to \$50,000 per year.

That's a total additional annual cost of \$69,000 for the small business owner. In the eyes of a financial planner, because of the tax disadvantages, a small business owner earning almost \$170,000 a year is no better off than a firefighter earning \$100,000 a year.

Again, don't get me wrong. The issue is not whether Montgomery County firefighters are overcompensated. There is no doubt that a county firefighter who serves 30 years needs to be fairly compensated on the job and in retirement. But we need a taxation environment that is fairer to small business owners, with more incentives to equalize the financial disparities caused by the tax system. That explains why, according to *Bloomberg*, 80 percent of entrepreneurs who start businesses fail within the first 18 months.

It's time to ask the question: what can our political leaders at the federal, state and local levels do to encourage small businesses to thrive? Until the unfair disadvantages facing small business owners change, the alarm bell will continue to sound for this key sector of the nation's economy. MM

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