EAGLE RETIREMENT GROUP, LLC

15441 Knoll Trail Dr. Suite 100 Dallas, TX 75248
972.458.1222 tel 866.276.2594 fax
www.EagleRetirement.com

Choosing the Right Retirement Plan for Your Business

You're an entrepreneur and you're not looking back. You've opened your own business, whether alone or with partners, and you've achieved success. Now you're thinking about retirement, not just for you, but also for your employees. Offering a retirement plan can help your business attract and retain employees, while making it easier for you to save for your own retirement. Here are some of the options available to business owners:

SEP IRA: The Simplified Employee Pension (SEP) is an IRA-based plan that is funded solely by the employer. Employees are fully vested in the plan from the time they join. Business owners do, however, have the flexibility to vary contributions to a SEP from year to year, or make none at all. The SEP is often a good choice for sole proprietors or businesses in a less secure financial position. Contributions can be set at the lesser of 25% of the employee's compensation or $53,000 in 2015. The limit for self-employed taxpayers is 20% of earned income.

SIMPLE IRA: Savings Incentive Match Plan for Employees (SIMPLE) IRAs, which are restricted to businesses with 100 or fewer employees, are usually funded by both the employer and the employee. The employer must make matching contributions on behalf of eligible participants, either in the form of a 2% non-elective contribution to all eligible participants or in the form of a matching contribution that is generally 100% of the first 3% of compensation. Because employers are required to contribute a set amount each year, this plan is best suited to businesses with consistent earnings. Employees may defer as much as $12,500 in 2015 to a SIMPLE plan, and those who are age 50 or older may contribute an additional $3,000.

Profit-Sharing: Profit-sharing plans are relatively easy to administer and tend to be popular with small businesses. The plans are funded by the employer on a pre-tax basis, and contributions are discretionary. Employers may require workers to remain with the company for a certain number of years before they become fully vested in the plan, by setting one of the allowable vesting schedules. With profit-sharing plans, the employer and employees may be able to take out loans against the value of the funds in their account, subject to certain limits and restrictions.

401(k): The 401(k) is an employer-sponsored plan that allows employees to make salary deferral contributions on a pre-tax basis. Earnings in 401(k) accounts accrue on a tax-deferred basis, but distributions are subject to income tax upon withdrawal. While employers have the option of matching a percentage of their employees' contributions to 401(k) accounts, they are not required to do so. The employer can set a vesting schedule for the portion of the funds contributed by the employer, within limits. The employee is responsible for selecting from the investments available within the plan.

Employers may permit 401(k) plan participants to take out loans against their accounts, but this adds to the complexity of a plan. Employee contribution limits for 2012 are $18,000 for most workers or $24,000 for those aged 50 or older. Adding a Roth option to a traditional 401(k) allows employees to make after-tax contributions to a Roth account that offers tax-free distributions at retirement. However, matching contributions by employers must be made to a traditional 401(k) account, not a Roth.

Safe Harbor 401(k): The Safe Harbor 401(k) offers the same benefits as the traditional 401(k), but it may allow employers to maximize contributions and still satisfy nondiscrimination rules. With a Safe Harbor 401(k), employers must make matching contributions for employees, but they have two options: Companies can make contributions for each eligible employee (even if the employee does not contribute) of 3% of annual compensation, or the company can match 100% of the first 3% of employees' deferred contributions, plus 50% of the next 2% of employees' contributions. While the mandatory employee match is larger with a Safe Harbor 401(k) than with most other plan types, the Safe Harbor may permit employers to make more pre-tax contributions on their own behalf.

Defined Benefit Plans: With the rise in popularity of 401(k) plans, defined benefit plans have faded from the spotlight. However, they can still be an attractive option, particularly for business owners with few employees who are looking to accelerate their personal savings. Using a defined benefit plan, business owners may be able to set aside significantly more than they could with a defined contribution plan. In 2015, the maximum annual benefit is $210,000. On the other hand, defined benefit plans can be more complex and costly to administer than other options, and they are usually more expensive to fund than defined contribution plans.

If you're an entrepreneur, now is the time to look ahead. Besides attracting and retaining quality employees, a retirement plan can make it easier to save for your own retirement. Give these options some thought. Whether you are thinking about a SEP, SIMPLE, a 401(k), a Safe Harbor 401(k), or a profit-sharing plan, be sure to consult a qualified financial professional for specific guidance.

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