REINVENTING RETIREMENT

Your Retirement Planning Newsletter

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401(k) or IRA? Finding the Right Plan for Your Business

The types of retirement plans that are available to small-business owners today may rival those used by large corporations. If you're a small-business owner, take a few minutes to compare the features and benefits associated with some of your options.

401(k) Plans

Named after the section of the tax code that created them, traditional 401(k) plans are funded largely through employee payroll deduction. Employee contributions are made on a pre-tax basis, which reduces a participant's taxable income. Investment returns potentially compound on a tax-deferred basis until qualified withdrawals, which are taxable, are made during retirement. Maximum employee contributions for 2014 are $17,500, plus a $5,500 catch-up contribution for those aged 50 and older. Employers may offer a matching contribution, which is tax-deductible by the business, although they are not required to do so.

There is also a Roth 401(k), in which contributions are taxable but qualified withdrawals during retirement are tax-free. Most plan sponsors offer either a traditional 401(k) or a 401(k) with a Roth 401(k) feature.

SEP IRAs and SIMPLE IRAs

If you have employees in addition to yourself and want a plan that's relatively easy to administer, you may want to consider a SEP (simplified employee pension plan), IRA, or a SIMPLE IRA. In general, employees who are expected to earn at least $550 in 2014, have worked for you for three of the preceding five years, and are age 21 or older are eligible to participate. The maximum annual contribution, which is tax-deductible, is up to 25% of compensation or $52,000, whichever is less.

SIMPLE IRAs are limited to companies with 100 or fewer employees earning at least $5,000 in the preceding year. Employees may contribute up to $12,000 in 2014, plus a $2,500 catch-up contribution for those aged 50 and older.

There are two types of SIMPLE IRAs: a matching plan and a nonelective contribution plan. With a matching plan, the employer provides a matching contribution up to 3% of annual salary. With a nonelective contribution plan, employers contribute a fixed amount of 2% of an eligible employee's salary (up to $5,000) regardless of whether the employee contributes.

Note that a SIMPLE IRA can be set up in conjunction with a 401(k) plan. When it is, employee contributions cannot exceed the $17,500 annual limit.

There's more to learn about each of these plans. Your financial advisor can help you sort through the facts and select a plan or a combination of plans that fits your needs. You should also consult with your tax professional, who can help you determine which solution may be the most appropriate for your situation.

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