

# **Retirement Plan Options for Small Business Owners**

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Starting a business requires lots of money, sweat, and tears. Many small business owners spend years financing their businesses while neglecting to save for their own retirement. Indeed, only 49% of companies with fewer than 100 employees have a retirement plan, according to a 2011 U.S. Labor Department survey.

But working solo or running a small company doesn't have to mean putting off retirement planning. Tax law changes in recent years have made it easier to establish retirement plans with increased contribution limits.

## **Tax Advantages**

An attractive feature of retirement plans is that individual contributions are tax deferred and company contributions are tax deductible. In addition, the contributions have the potential to grow tax-deferred until they are withdrawn, generally at retirement. Withdrawals taken prior to age 59 ½, may be subject to an additional 10% federal tax penalty and possibly state income taxes.

Contributions to a Roth IRA or a Roth 401(k) plan are made with after-tax dollars. Qualified distributions of earnings from a Roth IRA are tax-exempt after five years from the contribution date and after age 59 ½. Earnings taken prior to age 59 ½, may be subject to a 10% federal tax penalty and possibly state income taxes.

Retirement plans generally consist of defined-benefit plans or defined-contribution plans. Defined-benefit plans pay a specific amount to a person at retirement based on pay and years of service. These are generally funded by employers. Defined-contribution plans entail contributions from employees or their employer—or both—to individual employee accounts at mandated limits.

## The Right Fit

Different plans have different features, so it pays to shop around. Here are some options.

- **Simplified Employee Pension Plan (SEP IRA).** With these plans, there are few, if any, requirements to file with the IRS. Contributions are made by the employer, and all eligible employee accounts must have the same salary percentage contribution. The 2014 maximum contribution level is up to 25% of income (20% for self-employed income), or a \$52,000 maximum. Vesting is immediate. You can make full contributions in profitable years, and cut back in lean years.
- **Savings Incentive Match Plan for Employees (SIMPLE IRA).** These plans are relatively inexpensive, and combine employee contributions with an employer match. But yearly contributions are capped at \$12,000, plus catch-up contributions of \$2,500 for employees 50 and up. The employer match can be up to 3% of compensation up to \$12,000, depending on certain factors.
- **401(k).** Here, both employers and employees can contribute (employers aren't required to). The maximum annual employee contribution is \$17,500, plus a \$5,500 catch-up provision for workers over 50. Employers can contribute up to 100% of compensation not exceeding \$50,000 (or \$55,000 with the catch-up provision). The drawback is there more reporting requirements and administrative overhead with these plans.

Self-employed individuals or small business owners with no full-time employees can contribute to a solo 401(k) – a combination 401(k) and profit-sharing plan. The total contribution limit for a solo 401(k) is \$52,000, or \$55,000 for those age 50 or older.

- **Profit-Sharing Plan.** As the name implies, this plan enables you to reap the rewards of profitable years by distributing profits according to a pre-arranged formula set by the employer. Contributions are up to 100% of compensation, or \$50,000 maximum.
- **Defined-Benefit Plan.** Defined-benefit plans may be better suited for people closer to retirement age who want to catch up on their savings, who own a profitable small business with few employees and where the owner is at least fifty years old or within 10 years of retirement and is older than any of the firm's employees. Contributions in 2014 can result in a retirement benefit of no more than either \$210,000, or 100% of the average pay during the three highest-paid income years.

Sit down with a qualified retirement plan specialist to determine the best plan for your business.

\*Licensed, not practicing.