Retirement Plan Options For Small Businesses

According to the US Small Business Administration, small businesses employ half of all private sector employees in the United States. However, a majority of small businesses do not offer their workers retirement savings benefits.

If you're like many other small business owners in the United States, you may be considering the various retirement plan options available for your company. Employer-sponsored retirement plans have become a key component for retirement savings. They are also an increasingly important tool for attracting and retaining the high-quality employees you need to compete in today's competitive environment.

Besides helping employees save for the future, however, instituting a retirement plan can provide you, as the employer, with benefits that enable you to make the most of your business's assets. Such benefits include:

- Tax-deferred growth on earnings within the plan
- Current tax savings on individual contributions to the plan
- Immediate tax deductions for employer contributions
- Easy to establish and maintain
- Low-cost benefit with a highly-perceived value by your employees

Types of Plans

Most private sector retirement plans are either defined benefit plans or defined contribution plans. Defined benefit plans are designed to provide a desired retirement benefit for each participant. This type of plan can allow for a rapid accumulation of assets over a short period of time. The required contribution is actuarially determined each year, based on factors such as age, years of employment, the desired retirement benefit, and the value of plan assets. Contributions are generally required each year and can vary widely.

A defined contribution plan, on the other hand, does not promise a specific amount of benefit at retirement. In these plans, employees or their employer (or both) contribute to employees' individual accounts under the plan, sometimes at a set rate (such as 5 percent of salary annually). A 401(k) plan is one type of defined contribution plan. Other types of defined contribution plans include profit-sharing plans, money purchase plans, and employee stock ownership plans.

Small businesses may choose to offer a defined benefit plan or any of these defined contribution plans. Many financial institutions and pension practitioners make available both defined benefit and defined contribution "prototype" plans that have been pre approved by the IRS. When such a plan meets the requirements of the tax code it is said to be qualified and will receive four significant tax benefits.

1. The income generated by the plan assets is not subject to income tax, because the income is earned and managed within the framework of a tax-exempt trust.
2. An employer is entitled to a current tax deduction for contributions to the plan.
3. The plan participants (the employees or their beneficiaries) do not have to pay income tax on the amounts contributed on their behalf until the year the funds are distributed to them by the employer.
4. Under the right circumstances, beneficiaries of qualified plan distributors are afforded special tax treatment.

It is necessary to note that all retirement plans have important tax, business and other implications for employers and employees. Therefore, you should discuss any retirement savings plan that you consider implementing with your accountant or other financial advisor.

Here's a brief look at some plans that can help you and your employees save.

SIMPLE: Savings Incentive Match Plans for Employees of Small Employers

A SIMPLE plan allows employees to contribute a percentage of their salary each paycheck and to have their employer match their contribution. Under SIMPLE plans, employees can set aside up to $11,500 in 2012 (and 2011) by payroll deduction. If the employee is 50 or older then they may contribute an additional $2,500. Employers can either match employee contributions dollar for dollar - up to 3 percent of an employee's wage - or make a fixed contribution of 2 percent of pay for all eligible employees instead of a matching contribution.

SIMPLE plans are easy to set up - you fill out a short form, administrative costs are low, and much of the paperwork is done by the financial institution that handles the SIMPLE plan accounts. Employers may choose either to permit employees to select the IRA to which their contributions will be sent, or to send contributions for all employees to one financial institution. Employees are 100% vested in contributions, get to decide how and where the money will be invested, and keep their IRA accounts even when they change jobs.

SEPs: Simplified Employee Pensions

A SEP allows employers to set up a type of individual retirement account - known as a SEP-IRA - for themselves and their employees. Employers must contribute a uniform percentage of pay for each employee. Employer contributions are limited to whichever is less: 25 percent of an employee's annual salary or $50,000 in 2012. SEPs can be started by most employers, including those that are self-employed.

SEPs have low start-up and operating costs and can be established using a single quarter-page form. Businesses are not locked into making contributions every year. You can decide how much to put into a SEP each year - offering you some flexibility when business conditions vary.

401(k) Plans

401(k) plans have become a widely accepted savings vehicle for small businesses. Today, an estimated 25 million American workers are enrolled in 401(k) plans that hold total assets of about $1 trillion.

A 401(k) Plan allows employees to contribute a portion of their own incomes toward their retirement. The employee contributions, not to exceed $16,500 in 2011 ($17,000 for 2012), reduce a participant's pay before income taxes, so that pre-tax dollars are invested. If the employee is 50 or older then they may contribute another $5,500 in 2011 and 2012. Employers may offer to match a certain percentage of the employee's contribution, increasing participation in the plan.

While more complex, 401(k)plans offer higher contribution limits than SIMPLE plans and IRAs, allowing employees to accumulate greater savings.

Profit-Sharing Plans

Employers also may make profit-sharing contributions to plans that are unrelated to any amounts an employee chooses to contribute. Profit-sharing Plans are well suited for businesses with uncertain or fluctuating profits. In addition to the flexibility in deciding the amounts of the contributions, a Profit-Sharing Plan can include options such as service requirements, vesting schedules and plan loans that are not available under SEPs.

Contributions may range from 0% to 25% of eligible employees' compensation, to a maximum of $49,000 in 2011 ($50,000 for 2012) per employee. The contribution in any one year cannot exceed 25% of the total compensation of the employees participating in the plan. Contributions need not be the same percentage for all employees. Key employees may actually get as much as 25%, while others may get as little as 3%. A plan may combine these profit-sharing contributions with 401(k) contributions (and matching contributions).

Your Goals for a Retirement Plan

Business owners setup retirement plans for different reasons. Why are you considering one? Do you want to:

- Take advantage of the tax breaks, to save more money than you'd otherwise be able to?
- Provide competitive benefits in addition to - or in lieu of - high pay to employees?
- Primarily save for your own retirement?

You might say "all of the above." Small employers who want to set up retirement plans generally fall into one of two groups. The first group includes those who want to set up a retirement plan primarily because they want to create a tax-advantage savings vehicle for themselves and thus want to allocate the greatest possible part of the contribution to the owners. The second group includes those who just want a low-cost, simple retirement plan for employees.

If there were one plan that was most efficient in doing all these things, there wouldn't be so many choices. That's why it's so important to know what your goal is. Each type of plan has different advantages and disadvantages, and you can't really pick the best ones unless you know what your real purpose is in offering a plan. Once you have an idea of what your motives are, you're in a better position to weigh the alternatives and make the right pension choice.

If you do decide that you want to offer a retirement plan, you are definitely going to need some professional advice and guidance. Pension rules are complex, and the tax aspects of retirement plans can also be confusing. Make sure you confer with your accountant before deciding which plan is right for you and your employees.