

Retirement Plans for Small Businesses

Do you own a small business? Are you self-employed? If you don't have a retirement plan, think about starting one. A retirement plan can provide greater financial security for you and your employees and give your business an edge in its recruitment and retention efforts.

Tax Benefits

A retirement plan also offers substantial tax advantages:

- Employer contributions are tax deductible (within limits)
- Employee contributions are not taxed until distributed (after-tax "Roth" contributions are an exception)
- Money grows tax free while it remains in the plan

To qualify for tax advantages, retirement plans must meet specific requirements.

Choosing a Suitable Plan

Tax-advantaged retirement plans range in administrative complexity and have different features, requirements, and restrictions.

IRA-based plans. A Simplified Employee Pension (SEP) plan allows you to contribute directly to traditional individual retirement accounts (SEP-IRAs) for your employees (and yourself). You don't have to make contributions every year, but when you do contribute, the contributions generally must be uniform for all participants (e.g., the same percentage of compensation).

A SIMPLE IRA plan is another option designed for small employers. Employees may make tax-deferred contributions (up to legal limits) to the plan through payroll deduction. Employer contributions (determined under a specified formula) are required.

Defined contribution plans. With this type of plan, contributions are made to employees' individual plan accounts (held in a plan trust). The retirement benefit payable to each participating employee is based on the accumulated balance (contributions plus earnings or minus losses) in his or her account. Profit sharing plans and 401(k) salary deferral plans are two popular defined contribution plans.

Defined benefit plans. As its name implies, a defined benefit plan promises to pay a specific benefit at retirement. The business must contribute a sufficient amount to fund the promised benefit (as determined by an actuary). Because of their cost and complexity, defined benefit plans are not widely offered by small businesses, but their generous tax-deductible contributions may make them appropriate for some companies and their owners.