Choosing the Right Retirement Plan

You want a retirement plan that will make the most of potential tax advantages and meet other goals you may have for your plan as well. Below we answer questions you may have if you're considering changing or adding a plan.

What choices do I have? You might look at 401(k), profit sharing, SEP (Simplified Employee Pension) or SIMPLE (Savings Incentive Match Plan for Employees) plans.

Why should I consider a 401(k) plan? As you can see in the table below, offering your employees a 401(k) plan gives them the opportunity to save more on a pretax basis than the other types of plans. If your company also chooses to contribute to the plan, those contributions are tax deductible within certain limits.

But because a 401(k) offers flexible features, it may be more costly to administer than some other plans. A 401(k) requires annual reporting and, generally, annual testing to ensure that the plan does not discriminate in favor of highly compensated employees.

What advantages does a SEP or SIMPLE plan offer? SEP and SIMPLE plans are easy to set up and administer. With a SEP plan, your business contributes to individual retirement accounts established for you and your eligible employees. Within tax law limits, you choose how much you want to contribute for the year, if at all. Your employer contributions are tax deductible within certain limits.

SIMPLE plans generally are available to businesses with no more than 100 employees that don't offer another retirement plan. They can be structured as a SIMPLE 401(k) or SIMPLE IRA plan. Employees can contribute to the plan. Although your company must contribute, those contributions are tax deductible.

How about a profit sharing plan? You have a lot of flexibility with a profit sharing plan. Employer contributions may be made according to a formula written into your plan or at your discretion and are tax deductible within limits. Employees usually are not permitted to contribute to a profit sharing plan unless it has a 401(k) feature.

Comparing Retirement Plans

	401(k)	Profit Sharing	SEP	SIMPLE
Employee Contributions[1]	Elective deferrals of up to $17,500 plus catch-up contributions of $5,500 for participants age 50 or older	No	No[2]	Elective deferrals of up to $12,000 plus catch-up contributions of $2,500
Employer Contributions	Allowed but not mandatory	Discretionary contributions	Discretionary contributions	Must match employee contributions up to 3% of pay or contribute 2% of pay for all eligible employees
Maximum Annual Contribution[1]	Smaller of $52,000 or 100% of participant's compensation[3]	Same as 401(k)	Smaller of $52,000 or 25% of participant's compensation	$12,000 (plus $2,500 catch-up) deferral plus employer contribution (see above)
Maximum Deduction	25% of all participants' compensation plus employee deferrals	25% of all participants' compensation	Same as profit sharing plan	Same as maximum contribution

[1] Dollar amounts are the 2014 tax law limits. The IRS adjusts the annual limits for inflation.
[2] Elective deferrals are allowed if the plan is a salary reduction SEP (SAR-SEP) established before 1997.
[3] Compensation is generally limited to $260,000 in 2014.