Choosing a Retirement Solution for your Small Business

(U.S. Department of Labor)

Starting a retirement savings plan can be easier than most business owners think. What's more, there are a number of retirement programs that provide tax advantages to both employers and employees.

Why Save? Experts estimate that Americans will need 70 to 90 percent of their preretirement income to maintain their current standard of living when they stop working. So now is the time to look into retirement plan programs. As an employer, you have an important role in helping America's workers save.

By starting a retirement savings plan, you will help your employees save for the future. Retirement plans may also help you attract and retain qualified employees, and they offer tax savings to your business. You will help secure your own retirement as well. You can establish a plan even if you are self-employed.

Any Tax Advantages? A retirement plan has significant tax advantages:

- Employer contributions are deductible from the employer's income.
- Employee contributions (other than Roth contributions) are not taxed until distributed to the employee.
- Money in the plan grows tax-free.

Any Other Incentives? In addition to helping your business, your employees and yourself, it is easy to establish a retirement plan, and there are additional reasons for doing so:

- High contribution limits so you and your employees can set aside large amounts for retirement.
- "Catch-up" rules that allow employees aged 50 and over to set aside additional contributions. The "catch-up" amount varies, depending on the type of plan.
- A tax credit for small employers that enables them to claim a credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE, or certain other types of plans (more on these later). The credit equals 50 percent of the cost to

set up and administer the plan, up to a maximum of $500 per year for each of the first 3 years of the plan.

- A tax credit for certain low-and moderate-income individuals (including self-employed) who make contributions to their plans ("Saver's Credit"). The amount of the credit is based on the contributions participants make and their credit rate. The maximum contribution eligible for the credit is $2,000. The credit rate can be as low as 10 percent or as high as 50 percent, depending on the participant's adjusted gross income.
- A Roth program that can be added to a 401(k) plan to allow participants to make after-tax contributions into separate accounts, providing an additional way to save for retirement. Distributions upon death or disability or after age 59½ from Roth accounts held for 5 years, including earnings, are generally tax-free.

A Few Retirement Facts. Most private-sector retirement vehicles are either Individual Retirement Arrangements (IRAs), defined contribution plans, or defined benefit plans.

People tend to think of an IRA as something that individuals establish on their own, but an employer can help its employees set up and fund their IRAs. With an IRA, the amount that an individual receives at retirement depends on the funding of the IRA and the earnings (or losses) on those funds.

Defined contribution plans are employer-established plans that do not promise a specific amount of benefit at retirement. Instead, 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). At retirement, an employee receives the accumulated contributions plus earnings (or minus losses) on the invested contributions.

Defined benefit plans, on the other hand, promise a specified benefit at retirement, for example, $1,000 a month. The amount of the benefit is often based on a set percentage of pay multiplied by the number of years the employee worked for the employer offering the plan. Employer contributions must be sufficient to fund promised benefits.

Small businesses may choose to offer IRAs, defined contribution plans, or defined benefit plans. Many financial institutions and retirement plan practitioners make available one or more of these retirement plans that have been pre-approved by the IRS.