Accounting for Success

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Choosing a Retirement Plan for Your Small Business

As retirement plan auditors, we sometimes get questions from our tax colleagues regarding retirement plan options available to their small business clients. Offering a retirement plan benefits small businesses in the short run and the long run. By offering a retirement plan, small businesses can attract and retain qualified employees, while getting a tax deduction for the employer contribution. At the end of their careers, employees who have taken advantage of the savings opportunities are financially able to retire, which also benefits the employer. When retirement-eligible workers cannot afford to retire, it can lead to higher labor costs due to higher compensation and increased health and disability claims, while potentially causing promotion blockage for younger employees. Small businesses should consider the available options in conjunction with their accountant, third-party administrator, and/or their investment advisor. Some retirement plan options include:

IRA-Based Plans

• Payroll Deduction IRAs – Employers who set up payroll deduction IRAs must allow all employees to contribute an amount of their choice from each paycheck to a traditional or Roth IRA. There is generally no cost to the employer and there are no IRS forms to complete, making it the simplest and most inexpensive way to facilitate retirement savings without fiduciary liability, since the arrangement is not considered an employer-sponsored retirement plan. The program can be discontinued at any time without penalty.

• Simplified Employee Pensions (SEPs) – SEPs provide business owners a simplified method to make employer contributions to a SEP-IRA set up for each plan participant. A SEP-IRA account is a traditional IRA and follows the same investment, distribution, and rollover rules as traditional IRAs, but has a higher contribution limit. Employers must contribute a uniform percentage of pay for each eligible employee, limited to the lesser of 25% of pay or $54,000 for 2017. The discretionary contribution can be a different percentage each year.

• SIMPLE IRAs – To set up a Savings Incentive Match Plan, a small business must have 100 or fewer employees who earned $5,000 or more during the preceding calendar year. SIMPLE IRAs allow eligible employees to contribute up to $12,500 of their 2017 compensation through payroll deduction. Employers must either match employee contributions dollar-for-dollar up to 3% of compensation or make a fixed contribution of 2% of compensation for all eligible employees, even if the employees choose not to contribute. SIMPLE IRA plans are easy to set up and administrative costs are low.

Defined Contribution Plans

• Profit Sharing Plans and 401(k) Plans with an Employer Match – There are abundant contribution and eligibility options for employers who set up defined contribution plans. Small businesses work with several service providers, including recordkeepers, third-party administrators, investment advisors, accountants, and ERISA attorneys, to design the contribution formula that best fits their business. Generally, the maximum addition to a person's account (including the maximum employee deferral of $18,000 for 2017 plus the maximum deductible employer contribution of 25% of plan compensation) is the lesser of 100% of compensation or $54,000 for 2017 and $53,000 for 2016 subject to additional limits resulting from discrimination tests required by law. Discrimination tests can be avoided with a safe harbor plan formula or improved with automatic enrollment/automatic escalation designs. Employers must work closely with experts to properly administer qualified plan arrangements while also achieving their financial goals. This plan requires annual filing of IRS Form 5500.

With a large population of Baby Boomers reaching retirement age in what some call a "silver tsunami," it is important for employers to promote retirement readiness to achieve an ideal balance of experienced workers and new talent.