AFFORDABLE RETIREMENT PLANS FOR SMALL BUSINESSES

Many small businesses may be missing out by not offering retirement plans to their employees or not encouraging their employees to participate if they do have a plan. A recent survey by the Employee Benefit Research Institute (EBRI) found that only one out of five employees who work for a small business participate in an employment-based retirement plan.

Part of this lack of participation is due to workers' preferences for wages and other benefits, or their own ignorance about the importance of retirement plans. However, EBRI said that many small employers don't offer plans because they either don't realize the benefits or are simply unfamiliar with affordable retirement plan options.

Establishing a retirement plan for employees offers several benefits for business owners. It can improve recruitment and retention of employees in a tight labor market, improve employee morale and performance, and boost the owner's own retirement savings.

Small-business employers are most familiar with 401(k) and profit-sharing plans. The popular 401(k) is the most commonly offered retirement plan, and for some small employers it is the best choice. But many small employers are put off by the complexity and administrative expense of 401(k) plans. In many cases, alternative options are better solutions. Here are two options EBRI found many small employers aren't familiar with.

SEP-IRAs. The simplified employee pension-individual retirement account plan allows employers to create IRAs for themselves and their employees. They are easy and inexpensive to set up—just fill out a form at a bank, investment company or insurance company.

Under a SEP-IRA, the employer decides each year how much to contribute on a percentage basis to the eligible employees' accounts—or whether to contribute at all. The employer can contribute as much as 15 percent of salary up to $24,000 per employee.

Although the employer doesn't have to contribute in any given year, when contributions are made the same percentage of contributions must be made to all eligible employees. Eligible employees are those who have worked for the employer at least three of the past five years, are 21 years of age or older, and earned more than $400 during the current plan year. Part-time employees are eligible if they meet the above criteria and minimum hours. Contributions are tax deductible to the employer and are not included in the employee's taxable income.

SIMPLE Plan. The newest wrinkle in small-employer retirement plans, the Savings Incentive Match Plan for Employees is designed for companies with 100 or fewer employees who made at least $5,000 the previous year. Under a SIMPLE plan, the employee makes salary-deferred contributions along with the employer's match.

A SIMPLE plan avoids many of the hassles of a 401(k) plan, including top-heavy rules and discrimination testing, but with some drawbacks. Among them, employer contributions are immediately vested and the maximum dollar contribution an employee can make is only $6,000, adjusted for inflation, versus $10,000 under a 401(k).

The SIMPLE plan comes in two flavors. The SIMPLE-IRA establishes an IRA for each eligible employee. Unlike a SEP-IRA, the employer must make contributions every year. The contributions must either match dollar-for-dollar employee contributions up to three percent of salary or a flat two percent of salary for each participant regardless of their contribution. Two out of every five years, the employer can choose to match with only a flat one percent. One employee retention benefit of the SIMPLE IRA is that if the employee withdraws vested money (employer or employee money) within the first two years before age 59½, it's subject to a 25 percent early withdrawal penalty.

The SIMPLE plan can be part of a 401(k) plan, but without the discrimination and top-heavy rules and some of the more complex reporting and fiduciary liability rules. The limited one percent match is not available under this version.

By no means are these all the retirement plan options for employers. Other options include money purchase plans, profit-sharing plans or paring of money purchase and profit-sharing plans. Talk to your Certified Financial Planner practitioner about the pros and cons of each type of plan to see what will best fit the needs of yourself and your employees.

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