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Ken Berry, JD • Jul. 10, 2014

(This is part of a series of articles on qualified retirement plans for small business owners.)

Once upon a time, an entrepreneur with just a handful of employees wouldn't even think about starting up a 401(k) plan for the business. The administrative costs, as well as the complexity, could turn into a nightmare. But costs have come down in recent years and now the 401(k) is a viable vehicle for an employer of virtually any size.

You're probably familiar with the basics. To begin with, you can elect to defer a portion of salary to a special account set up for yourself. Generally, this contribution is limited to $17,500 for 2014, plus you can add in an extra $5,500 if you're age 50 or over. In addition, as the employer, you may choose to provide a deductible matching contribution, typically equal to fifty cents of each dollar of deferral, up to 6% of compensation. Other tax law limits and requirements for defined contribution plans apply.

The cash in your account is then invested on your behalf. Usually, the plan will offer a wide variety of mutual funds targeted at your retirement or other goals. Depending on your preferences, you can design a 401(k) portfolio that is aggressive or conservative or somewhere in between.

As you can imagine, it's relatively easy to build up a nest egg in short order, as the

On the other side of the fence, you must begin taking annual distributions in the year after the year you turn age 70 ½. The minimum distribution required is based on IRS tables using the account value at the end of the prior year. Until then, you can keep your account humming along, even if you're semi-retired or have called it quits for good (although new deferrals will be limited or nonexistent at that point).

Of course, there are some administrative hassles to deal with, including calculations and tests based on the actual deferral percentage (ADP) for pre-tax contributions and the actual contribution percentage (ACP) for matching contributions. This ensures that the plan doesn't unfairly discriminate in favor of highly-compensated employees. The plan administrator can handle the nitty-gritty – that's what you're paying them for.

Finally, be aware of a recently approved option that might spice up your plan.

You can use a Roth-401(k) feature that provides enhanced benefits in retirement. As with a Roth IRA, contributions are made on after-tax basis, but payouts are 100% tax-free after five years. Contributions can be divided between a regular and Roth account any way you see fit.

Moral of the story: The 401(k) isn't just a pipe dream for small business owners anymore. Wake up and smell the roses.

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