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EXPENSIVE

Employers serve an important role in preparing themselves and employees for retirement and the accompanying tax deferrals. After all, offering retirement benefits is a great way to attract and retain good talent. Here is some information you can pass ...

Mike D'Avolio • May. 21, 2018

According to a study, 42 percent of self-employed people and small business owners are not preparing for retirement. It's understandable that a new business owner has bigger fish to fry than planning for retirement, such as getting the business off the ground. However, once a business does turn the corner, establishing a retirement plan for the owner and employees should be considered. The plan can be simple to start up and contribution amounts can be commensurate with the business' profits.

Employers serve an important role in preparing themselves and employees for retirement and the accompanying tax deferrals. After all, offering retirement benefits is a great way to attract and retain good talent. Here is some information you can pass on to your self-employed and small business clients to help them understand the retirement plan options available to them and their employees:

General

There are a variety of retirement plans available to small businesses (the IRS treats self-employed folks as small businesses) that allow the employer and employee a tax favored way to save for retirement. In general, contributions made by the owner for himself or herself and for employees can be deducted. Furthermore, the earnings on the contributions grow tax free until the money is distributed from the plan. Withdrawals from these plans prior to retirement age will carry penalties.

Generally, contributions to these retirement plans can be made up until the due date

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SEP IRAs are for small businesses with any number of employees, and there are no significant administration costs. Tax-deductible contributions are made only by the employer, and contribution percentages for the employer and employee must match.

Deductible contributions are limited to the lesser of 25 percent of the participant's compensation or net self-employment earnings (up to \$270,000) or \$54,000.

Distributions in retirement are taxed as income. This plan type is best suited for small business owners with no or few employees.

Savings Incentive Match Plan for Employees (SIMPLE IRA)

SIMPLE IRAs are available to employers with 100 or fewer employees and are funded from contributions from the employer (tax deductible) and employee (pretax dollars). The contribution limit is \$12,500 (per employer or employee) with an additional catch-up contribution limit of \$3,000 for those who are age 50 or older.

The employer can either match the contribution up to 3 percent of compensation or make a non-elective contribution of 2 percent of compensation. This plan type allows for employees to contribute through salary deferrals and is fairly easy to set up.

Solo 401(k)

This tax-deferred plan for small businesses offers generous contributions limits but is not suitable for businesses with no common law employees or anyone working for the company without an ownership interest (unless the employee is your spouse). The owner can contribute and deduct up to 25 percent of compensation plus an additional \$18,000 salary deferral up to a \$54,000 maximum. An additional \$6,000 catch-up contribution for those age 50 or over is available.

Please note: The standard 401(k) plan allows employees to contribute amounts to the

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retirement are tax-free.

These are plans for individuals, and owners and employees can set up and contribute to their own plan. The limit on annual contributions to an IRA is \$5,500, with an additional catch-up contribution limit for those aged 50 of \$1,000.

These plans are very easy to set up by opening an IRA account through a brokerage firm. Contributing to a Roth IRA instead of a traditional IRA tends to be more beneficial earlier in life when your tax rate is lower than when you pull the money out.

Closing Thoughts

Overall, you should evaluate the attributes of each plan and determine which one works best for your business. Most brokerage firms allow you to open any of the four most common types of retirement plans (SEP IRA, SIMPLE IRA, solo 401(k) and IRA), and a broker will help you through the process. It's also smart to consult a financial advisor or accountant before deciding on a plan.

If you can afford to, you should think about maxing out your own contributions and tax deferrals. Building wealth provides security and the ability to expand your business.

Small Business

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