Why Are Retirement Plans Such A Great Opportunity?

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Retirement plans are a tax planning opportunity for employers, owners and employees in addition to being one of the best fringe benefits around to help attract and retain valued employees. By enabling participants to defer taxable income (wages) in accounts that earn money (dividends, interest, capital gains and unrealized appreciation in invested assets) that is also tax deferred, they have more money to invest. For many, this is their best opportunity to set aside money for their future. Employers get deductions currently for their contributions and they are not subject to social security and Medicare taxes. Depending on the plan, employees may voluntarily defer part of their wages. Employers can wait to fund their annual contribution until their extended tax return due date (as late as 8.5 months for corporations).

What Type of Retirement Plan Should I Have for My Business?

The type of plan that makes the most sense for your business will depend on a number of factors including:

- Age of owner vs. age of employees
- Number of employees
- Stage of the business, i.e. start-up versus mature business
- Desire to use plan to attract/retain talent

If You Have Employees

Defined Benefit (DB) Plans are coming back in vogue as they usually allow for larger deductible contributions. The new DB Plans (sometimes called Target Benefit or Cash Balance Plans) are more flexible than the old style plans and therefore have less funding issues. However, based on the benefits being offered under the plan, you may be required to make an annual contribution even in a low profit year. These types of plans make a lot of sense if your business has a consistently high income stream and the right age demographics. Often, this type of plan is combined with a traditional 401(k) Plan to allow for even larger contributions for you and your employees.

Defined Contribution Plans such as 401(k) Plans are frequently utilized by companies because they allow participants to save taxes by deferring wages. Owners (and other highly compensated employees) are often limited to the amount that can be deferred if there is insignificant other employee participation. The use of matching contributions and safe-harbor plan elements can mitigate or eliminate this problem. Variations can include a profit sharing element, a Roth 401(k) component, a defined benefit plan (as discussed above), or using a cross-tested plan to maximize owner contributions.

If You Do Not Have Employees

Self Employed Pension (SEP) Plans are simple and easy to use. While any size business can adopt an SEP Plan, they are one of the most popular options for small businesses as there are minimal costs and no tax filing requirements. This is the only type of retirement plan that can be set up after the end of the tax year.

For one person plans, there is a Solo or Individual 401(k) Plan. This allows an individual to maximize contributions by utilizing both a deferral component and a company contribution component. For example, if you have a sole proprietorship that nets $30,000 for the year, an SEP Plan would only allow you to contribute $6,000. In contrast, you could contribute $24,000 with this type of plan ($6,000 company contribution plus $18,000 deferral). This would be increased to $30,000 if you are 50 or over and eligible for catch-up contributions.

Savings Investment Match Plan for Employees (SIMPLE) Plan – Don't be fooled by the name. SIMPLE Plans are anything but simple. SIMPLE Plans allow employees to make annual deferrals (maximum of $12,500 for 2015) and require the employer to make a mandatory 2% contribution or 3% match. However, employees expected to earn at least $5,000 in the current year (including part-time or temporary employees) are REQUIRED to be included. While there is no tax filing requirement, this type of plan can result in administrative headaches and potential penalties if the requirements are not properly followed.

Open an IRA Instead

For owners of some small businesses and start-ups, an IRA (while not a company retirement account) is the best and easiest option, assuming you meet the applicable requirements. Considerations include whether to contribute to a Roth IRA versus a traditional IRA. While this can be a complicated analysis, there are some basic items to keep in mind.

- Roth IRAs are great vehicles for young adults as they are often currently in a lower tax bracket so they don't need the tax deduction as much now as later. Young adults also have many years of tax deferred growth to look forward to. During hardships, a distribution can be taken up to the total amount of contributions already made without incurring tax or penalties.
- A Roth IRA is also a good option for older taxpayers if one doesn't need the retirement account to live on. With a Roth IRA, distributions are not required when you turn 70½ as they are with traditional IRAs. A Roth IRA may not make sense if you expect to be in a lower tax bracket when you retire. Instead, a current IRA deduction may be worth more today.
- Regardless of whether you have a company plan, it may make sense to make a Roth IRA contribution assuming you meet the applicable requirements.

Beware of the New IRA Rollover Rules

Beginning in 2015, you can make only one rollover from one IRA to the same or a different IRA in any 12-month period, regardless of the number of IRAs owned. This is a change from the rules in effect in prior years. A violation of this rule costs dearly as the second rollover will be 100% taxable and subject to the 10% early withdrawal penalty.

Please keep in mind that the IRAs established under SEP and SIMPLE Plans are included with your traditional IRAs for purposes of this rule. The good news is that direct trustee-to-trustee transfers between IRAs do not count as a rollover and therefore, are not subject to this new rule.

Establishing a retirement plan or account for you and/or your business takes planning and proper timing. The end of year is not too late to consider an appropriate plan, whether it is implemented in 2015 or 2016.

Let the professionals at Michael Silver & Company CPAs help you determine which plan is best for you and your business and how to implement it in the most efficient manner.