Choosing a Retirement Plan that Fits Your Business

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One survey found that the most pressing financial concern facing 42% of small business owners is developing a retirement plan and exit strategy.[1] If you have yet to develop a retirement plan for your business, or if you're not sure the plan you've chosen is the right one, here are some things to consider.

How much can my business afford to contribute?

The cost of contributions may be managed by the plan type.

A simplified employee pension plan (SEP) is funded by employer contributions only. SEP contributions are made to separate IRAs for eligible employees.[2]

Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) IRAs blend employee and employer contributions.[3] Employers either match employee contributions up to 100% of the first 3% of compensation, or contribute 2% of each eligible employee's compensation.

A 401(k) is primarily funded by the employee; the employer can choose to make additional contributions, including matching contributions.[4]

A defined benefit plan is entirely funded by employer contributions.[5]

What plan accommodates high employee turnover?

The cost of covering short-tenured employees may be reduced by eligibility requirements and vesting.

With the SEP-IRA, employees at least 21 or older and employed in three of the last five years must be covered.

The SIMPLE IRA must cover employees who have earned at least $5,000 in any prior two years and are reasonably expected to earn $5,000 in the current year.

The 401(k) and defined benefit plan must cover all employees at least 21 years of age and who worked at least 1,000 hours in a previous year.

Vesting is immediate on all contributions to the SEP-IRA, SIMPLE IRA and 401(k) employee deferrals, while a vesting schedule may apply to 401(k) employer contributions and defined benefits.

Do I want to maximize contributions for myself (and my spouse)?

The SEP-IRA and 401(k) offer higher contribution maximums than the SIMPLE IRA. For those business owners who are starting late, a defined benefit plan may offer even higher levels of allowable contributions.

My priority is to keep administration easy and inexpensive.

The SEP-IRA and SIMPLE IRA are straightforward to establish and maintain. The 401(k) can be more onerous, but complicated testing may be eliminated by using a Safe Harbor 401(k). Generally, the defined benefit plan is the most complicated and expensive to establish and maintain of all plan choices.

1. ThinkAdvisor.com, April 27, 2015
2. Like a traditional IRA, withdrawals from a SEP-IRA are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty. Generally, once you reach age 70½, you must begin taking required minimum distributions (RMDs).
3. Like a traditional IRA, withdrawals from SIMPLE IRAs are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty. Generally, once you reach age 70½, you must begin taking required minimum distributions (RMDs).
4. Distributions from 401(k) plans are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty. Generally, you must begin taking required minimum distributions no later than April 1 of the year after you reach age 70½.
5. Distributions from defined benefit plans are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty. Generally, once you reach age 70½, you must begin taking required minimum distributions.