# How Small Business Retirement Plans Compare

In recent issues of the Sapient CPA Client Bulletin, various small business retirement plans were described. If your company does not have a retirement plan, or if you're not pleased with the one you have, this summary can help you see how these choices stack up.

## Safe Harbor 401(k)s

As 401(k) plans have gained popularity, many employees or prospective employees expect to have such a plan at the company where they work. Therefore, offering a 401(k) may help your business attract and retain talented people. Employers commonly like the fact that 401(k) plans are largely self-funded from employees' tax deferred contributions from their earnings.

However, 401(k)s have drawbacks, too. One key issue is the requirement that they don't discriminate in favor of highly-compensated employees. Testing is required, and failing such tests may result in limiting the retirement contributions of owner-employees.

With the safe harbor versions of a 401(k), employers make certain contributions to employees' accounts. Anti-discrimination testing isn't required, and owner-employees can maximize contributions to their own retirement funds if they wish. The downside to such plans is that the required employer contributions can be expensive.

Bottom line: These plans can appeal to business owners who want to offer a 401(k) retirement plan yet avoid nondiscrimination testing.

## Solo 401(k)s

Yet another variety of a 401(k) is available to companies without any common-law employees. If the only people working at the firm are owners, business partners, shareholders, and their spouses, a solo 401(k) can be used. (Independent contractors hired by the company, as well as part-time workers who are paid for less than 1,000 hours a year, can be excluded.)

Solo 401(k)s allow business owners and their employed spouses to make relatively large contributions. With a standard 401(k), the 2017 maximum is $18,000 a year, or $24,000 for those 50 or older. Solo 401(k)s permit both employee and employer contributions, so the maximums this year can be $54,000 or $60,000.

Bottom line: If your company qualifies, these plans can allow you (and your employed spouse) to make substantial retirement plan contributions.

**SIMPLE IRAs**

Compared with other retirement plans, savings incentive match plan for employees (SIMPLE) IRAs allow relatively low contributions: no more than $31,000 a year. That number is for participants 50 or older receiving both employer and employee contributions, so the maximum is much lower for many participants.

On the other hand, SIMPLE IRAs are designed to be easy on the paperwork. Companies fill out a short form to establish the plan and ensure that IRAs are set up for each employee. To be eligible, your company must have no more than 100 employees and must not sponsor another retirement plan.

Going forward, there is no annual filing requirement, and nondiscrimination testing is not necessary. Administrative costs usually are low. However, certain contributions to employees' SIMPLE IRAs are required.

Bottom line: If you want to offer a retirement plan that requires little administration and you are content with the contribution limits to your own account, a SIMPLE IRA can be a viable choice.

**Profit-Sharing Plans**

The name of these plans might help motivate employees. They may believe that if they help the company do well (make significant profits), the company will make a meaningful contribution to their retirement accounts.

Actually, your company has no obligation to give a certain percentage of any profits to its employees. As an employer, you can raise or lower annual contributions as you wish or even skip them altogether. Still, companies with profit-sharing plans may peg their contributions to the firm's results, so employees will learn that their successful efforts will produce tangible rewards.

In addition, profit-sharing plans come in different forms. Some will contribute a certain percentage of compensation to all participants, and other plan designs may skew contributions to certain

individuals, according to various formulas. Such sophisticated profit-sharing plans can be expensive to create and administer.

Bottom line: If your company can afford substantial tax-deductible contributions to employees' retirement accounts, a well-publicized profit-sharing plan can be a potent motivator.

**ESOPs**

As the name indicates, employee stock ownership plans (ESOPs) are designed to transfer some, or sometimes all, of company ownership to employees. Shares are transferred to the ESOP, valuations are implemented, and departing participants receive a cash payout equal to the value of the shares allocated to their accounts.

Again, employees are motivated to perform well. Higher profits generally equal higher share values and a larger buyback when they retire or change jobs. For business owners, ESOPs may offer tax advantages that go beyond deductible contributions as well as an appealing exit strategy.

That said, it can be expensive to comply with regulatory requirements for ESOPs. Some companies offer an additional retirement plan because a reliance on an ESOP means a lack of investment diversification.

Bottom line: Adopting an ESOP should not be taken lightly because these plans can be complex, but they may offer an attractive mix of employee appeal, unique tax benefits, and company continuity.

**Defined Benefit Plans**

Traditional pension plans are defined benefit plans. They commit employers to certain contributions each year and to certain payouts to retirees. They may be too costly to administer and too inflexible for most small companies.

Nevertheless, they can appeal to companies whose owners want the largest possible contributions to their retirement funds. In some circumstances, annual contributions to the principal's account can reach well into six figures and are tax deductible. Large contributions must be made to the plan to provide a sizable pension to participants.

Bottom line: Defined benefit plans may work well for companies when the owner or owners are planning to retire in 5–10 years. Assuming that there are other employees who are younger and modestly paid, the owners might build up a large pension fund in a few years while relatively few dollars go to fund other employees' retirements.

**Final Thought**

The preceding list is not exhaustive, as other retirement plans may be adopted by small businesses and professional practices. Our office can go over your goals for an employer-sponsored plan and suggest options that will help you meet them.