

## RETIREMENT PLAN BASICS

The Internal Revenue Code provides that a self-employed small business owner may provide retirement plans for themselves. They may also provide Health Savings Accounts and Self-Employed Health Deductions. This overview will only give you basics to consider for your “Retirement Plans”. Consult your lawyer or financial planner to select the appropriate option for yourself and gain the most from your business.

A self-employed business owner takes a retirement contribution deduction on Line 28, of their Form 1040 for 2011. Remember amounts set aside for your retirement are a deduction from your **Total Income** (salaries, salaries, interest, dividends, capital gains and Schedule C Business Income). IRS Publication #560 covers “Retirement Plans for Small Business”.

The publication provides a worksheet and rate table for self-employed to calculate the maximum you may deduct per year.

An employer’s choices for retirement plans is set forth in Publication 3998 and it is easier than most think. However, an attorney should be consulted in setting up these plans which can have a long term impact on the owner and employees. Advantages of an employers sponsored retirement plan are:

- a. The cost is deductible to the employer as a business expense.
- b. The employee and employer’s contribution are not taxed until distributed.
- c. The money in the retirement plan grows tax free.

Whether you are self-employed or a small business owner, there are a wide range of retirement plans designed to meet your needs. You can save for your retirement and save taxes at the same time. All earning grow tax-deferred until withdrawn. You can include your wife if you are working together.

*As a basis for comparison, assume your Schedule C net profit is \$40,000 and your SE tax is \$6,120 (15.3% of your SE net profit) for a net retirement base of \$33,880 for the employer. These would be your options:*

These plans are summarized as:

1. SEP-IRA – Simplified Employee Pension – Discussed in Publication #4333. A model form 5305-SEP is used to setup the plan. Tax deduction is limited to 25% of SE Income after SE tax. The deduction in our assumed case for 2012 is \$8,470 (25% of \$33,880) with a maximum of \$50,000.

2. Self-Employed 401(K) Plan – There is no model form to setup this kind of plan. The owner’s tax deduction is limited by Self Employment income from Form 1040, Schedule C, less the Self-Employment tax and the result multiplied by 25%. In our assumed case this deduction is \$8,470 and limited to \$50,000 for 2012.
3. Simple-IRA’s – Discussed in Publication 4334. A model form 5304-Simple is used to setup the plan. This is for small businesses with less than 100 employees who have no other retirement plan. Employees or (you) elect to have a percentage of your salary set aside in an IRA plan and the employer (you) can match from 1% to 3% up to \$11,500 per year. Using the \$40,000 net profit base assume you set aside 10% into an IRA for \$4,000. Employers’ (you) matching contribution is 3% or \$1,200 for a maximum of \$5,200 IRA contribution.
4. Standard 401(K)  
Generally appropriate for companies with 20 or more employees. It is similar to a Self-Employed 401(k), except loans are available and there is a provision for ‘hardship’ withdrawals.
5. Qualified Plans for larger employers-
  - a. Defined Benefit Plan – contributions are based upon what is needed to provide a definitely determinable benefits to the participants.
  - b. Defined Contribution Plans
    - i. Profit Sharing Plan – provides a formula for allocation a contribution to the participants and distributing the accumulated funds after they reach a certain age. The annual contribution is discretionary.
    - ii. Money Purchase Plans – contributions are fixed and are not based upon your profit. A plan may require 10% of participants participation.

Many times it is easier to understand the options if they are presented in a table format as you will find on the next page.

**See the comparison of these four plans below.**

<b>Factor</b>	<b>SEP-IRA</b>	<b>Self-Employed 401(k)</b>	<b>Simple-IRA</b>	<b>Std 401(k)</b>
Who is it for?	Self-employed individual or small business owner, including those with employees	Self-Employed individual or business owner with no employees other than a spouse	Businesses with 100 or less employees who do not have or maintain any other retirement plan.	Any type of public or private company Generally most appropriate for companies with 20 or more 'ees.
Key advantages?	Easy to set up and maintain. Flexible annual funding requirements	A 401(k) with potentially higher contribution limits than SEP-IRS	Salary deferral plan with less administration. Electronic funding with customized contribution for each participant	Flexibility in plan design. Plan administrative investment mgmt., and participant education program
	Wide range of Investment choices	Wide range of investment choices	Wide range of investment choices	Wide range of mutual fund option
Fees*	No initial set up or Annual mtnc fee	No initial set up or annual mtnc fee	Low cost with option of annual fee of \$25 per participant or \$350 plan fee	Varies by plan
Who can contribute?	Funded solely by employer contributions.	Funded by employee deferrals & employer contributions.	Funded by employee deferrals & employer contributions.	Funded by 'ee deferrals & 'er contributions.
2012 employee contribution limits?	NA	Up to \$17,500 in salary deferrals, or \$22,500 if age 50 or older.	Up to \$11,500 in salary deferrals, or \$14,000 if age or older	Up to \$17,500 in salary deferrals, or \$22,500 if age 50 or older.
2012 employer contribution limits?	Up to 25% of pay, up to max of \$50,000	'er Up to 25% of pay up to max of \$50,000 Total 'er/'ee contribution cannot exceed \$50,000 (\$55,000 if age 50 or over)	Either match 'ee contribution up to 3% of pay; can be reduced to 1% in any 2 of 5 years or contribute 2% of 'ees pay up to \$5,000	Employers may make a matching contribution or profit sharing – up to 25% of pay, max of \$50,000
Administrative responsibilities	No employer tax filings. 'ee notifications, if 'er contribution made.	Annual form 5500 filing when plan exceeds \$250,000	No employer tax filings. 'ee notifications.	Form 5500 and IRS testing so plan does not favor high pay 'ees

Access to Assets	Withdraw any time, but 10% penalty may apply if less 59 ½ .	Cannot make withdrawal until a 'trigger', 59 ½, disability or plan termination.	Withdraw any time, but penalty of 25% in first 2 years and 10% if under 59 ½ .	Withdraw upon a 'trigger', like age 59 ½. disability, termination or plan termination. Loans may be avl.
Setup deadlines	by 'er tax deadline usually April 15.	by Dec 31 or fiscal year.	by October 1	Deadline depends upon plan.

\*No normal bank or brokerage fees, but normal account expenses may apply. Ask your Financial Institution.

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