

## Retirement Plans for Small Businesses Offer Big Benefits

Small businesses owners who do not offer retirement plans are missing out on an opportunity to reduce their taxes, prepare for their future, and help attract and retain employees.

Many may hesitate because they perceive retirement plans as being costly and difficult to administer. However, several plan options exist that can be affordable and easy to manage, including SEP-IRAs, SIMPLE-IRAs, profit-sharing plans and self-employed 401(k) plans.

In each case, plan contributions are tax deductible and earnings on contributions are tax deferred, although penalties apply if funds are withdrawn before age 59½. Offering a retirement plan can help small businesses compete for employees with larger employers that offer retirement plans as an employee benefit.

**SEP-IRAs.** A Simplified Employee Pension (SEP-IRA) is an IRA that can serve as a retirement plan for self-employed individuals and very small businesses. It is inexpensive to set up and requires little effort to maintain. The plan document can be a single page.

The SEP-IRA's greatest advantage, though, is that it allows business owners to invest up to 25% of their compensation in the plan, up to \$44,000, a year for plan year 2006.

SEP-IRAs are also flexible. Owners can contribute any amount up to the limit in any given year and can even choose to contribute nothing. They can also make contributions after the tax-year ends, up to the tax-filing deadline (including any extensions).

The downside for employers is that they must contribute the same salary percentage for all eligible employees based on their W2 wages that they contribute for themselves. Employees are eligible if they have worked for the business for three of the past five years and earned at least \$450 in the past year.

**SIMPLE-IRA.** The Savings Incentive Match Plan for Employees (SIMPLE IRA) is designed for businesses with up to 100 employees who earned over \$5000 the preceding year and do not have another plan in place.

The contribution limit for each employee, including business owners, is \$10,000 a year, so employers cannot contribute as much for themselves as they can with a SEP-IRA.

Employers are required to make matching contributions, but can choose between two alternatives. Each employee can be given a non-elective contribution equal to 2% of salary, up to \$4,400. Employers who choose this alternative must notify employees at least 60 days before the beginning of a new year. The other alternative is to match the

first 3% of deferred salary for a minimum of three out of five consecutive years and 1% in the other two years.

Those who are age 50 or older as of Dec. 31, 2005 can contribute an additional \$2,500. Withdrawal before age 59½ carries a penalty of 25% during the first two years of participation, after which the penalty drops to 10%.

Like a SEP-IRA, the SIMPLE-IRA creates little administrative burden. Discrimination testing is not required and plan documents do not need to be filed with the IRS. The deadline to establish a SIMPLE-IRA plan is Oct. 1 of the current tax year, but there's an exception for businesses established after that date.

Employees are eligible if they earn more than \$5,000 in either of the two preceding years and earn at least that much in the current year.

**Profit-Sharing Plans.** Employers using profit-sharing plans determine a percentage of profits they wish to contribute to a retirement plan. The limit is 20% of profits and individually up to 25% of salary up to \$44,000 for plan year 2006. Employees cannot contribute to profit-sharing plans.

Profit-sharing plans create an incentive for employees to make the business more profitable, since the more money the business makes, the greater the amount that goes into their plan. If the business is not profitable in a given year, of course, no contributions are necessary.

Eligibility is based on the company's vesting schedule. If there is none, employees are eligible after two years of employment. To be eligible, an employee must be at least 21 years of age and work at least 1,000 hours in the previous year. Professional assistance is typically needed for account administration.

**Self-Employed 401(k) Plans.** Businesses with no employees other than the owner, a spouse or members of the immediate family can establish self-employed 401(k) plans. Businesses with part-time or seasonal employees can also participate, but those employees are ineligible. Unincorporated businesses can deduct contributions from personal income and incorporated businesses can deduct them as expenses.

Employers with self-employed 401(k) plans can contribute up to \$15,000 a year per employee. The plan can be set up to allow a profit-sharing contribution of up to 25% of compensation as well, as long as the combined total does not exceed \$44,000. Those over 50 can add a catch-up contribution of up to \$5,000, for a total of \$49,000 for plan year 2006.

Self-employed business owners who have a 401(k) account from a previous employer can consolidate those funds into their new plan. They can also contribute to both plans

simultaneously, as long as total contributions do not exceed more than \$44,000 and \$49,000 for those age 50 and over.

A drawback of self-employed 401(k) plans is that, if new employees are added, the plan is treated the same as any other 401(k) plan. It will be subject to the complex non-discrimination tests and other requirements that apply. A business with a small number of employees is most likely to have difficulty meeting non-discrimination requirements. Failure to meet the requirements can result in the plan losing its tax advantages.

The deadline for opening a self-employed 401(k) plan is Dec. 31 or the end of the fiscal year, but profit-sharing contributions can be made up to the tax-filing deadline, plus any extensions.

Which of these four options is best for you depends on your business, your retirement needs and your goals, but one thing is certain: Any small business that does not have a retirement plan is missing out on what may be the best tool available for reducing taxes and planning for the future.

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