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HELPING EMPLOYEES PREPARE FOR RETIREMENT

RETIREMENT PLAN OPTIONS FOR SMALL BUSINESSES

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The beginning of the year is a great time to reevaluate your employer-sponsored retirement plan to make sure it continues to meet the needs of your growing business and your employees. You also want to make sure you're optimizing the benefits available to you as a business owner for offering this valuable benefit to your employees. Following is a refresher of the different types of employer-sponsored benefits to help you evaluate your options.

There are two main categories of retirement plans – defined contribution (DC) and defined benefit (DB). The major difference between the two is that a DB plan provides a guaranteed monthly payout at the time of retirement. Often referred to as pension plans, DB plans put the risk of retirement saving and investing on the employer.

In contrast, a DC plan does not offer a guaranteed payout at retirement. These plans are typically funded by a combination of employee contributions and an employer match. In a DC plan, the employee takes on the risk of selecting investments and saving adequately.

Because DC plans are most commonly used by small business owners, we focus on them in this article. There are four main types of DC plans typically used by small businesses:

1. Simplified Employee Pension Plan (SEP-IRA) - A SEP IRA is a type of retirement plan that allows small businesses and entrepreneurs to defer up to $58,000 in 2021 (up from $57,000 in 2020) or 25 percent of an employee's compensation to retirement savings. Contributions can only be made to a SEP IRA by the employer. To be eligible, an employee must be at least 21 years old, work full time for the employer, have worked in the business for three of the last five years and receive at least $650 in annual compensation.

Pros: The benefit of offering a SEP IRA is that it allows the employer to make much larger contributions than an IRA, with lower administrative costs than a 401(k). SEP IRA contributions are tax deductible and discretionary.

Cons: The downside to these plans is that employers must contribute a proportional percentage to all employee accounts, which can make this a pricy option for business owners with multiple employees. Also, employees cannot contribute directly to these plans, which further limits the amount of retirement savings your employees can accumulate in the plan.

2. Savings Incentive Match Plan for Employees (SIMPLE IRA) - Another employer-sponsored retirement plan frequently offered by small businesses is a SIMPLE IRA. In contrast to a SEP IRA, employees are eligible to make tax-deductible contributions to the plan. The employer can match up to 3 percent of an employee's salary or make nonelective contributions of 2 percent to every eligible participant, regardless of his or her participation. The 2021 annual employee deferral limit to a SIMPLE IRA is $13,500. Those age 50 and older can make a catch-up contribution of $3,000, raising their annual deferral limit to $16,500.

To be eligible, the employer must have 100 or fewer employees. Each employee must have earned at least $5,000 in eligible compensation in any two previous calendar years and be on track to earn at least $5,000 in the current year in order to participate. The employer can exclude employees who receive benefits from a union and can also choose less restrictive participation parameters.

Pros: Similar to a SEP IRA, a SIMPLE IRA is relatively easy to establish. The only paperwork required is a plan document and annual employee disclosures. The employer receives a tax deduction for contributions to the plan, and the costs to administer the plan are relatively low.

Cons: These plans have low contribution limits and little flexibility with regard to contribution types, as only pre-tax contributions are permitted, which are taxable when withdrawn. The employer must make contributions to employee accounts every year, regardless of the business's performance.

3. Savings Incentive Match Plan for Employees (SIMPLE 401(k)) - A SIMPLE 401(k) shares characteristics of both a SIMPLE IRA and a traditional 401(k). Similar to a SIMPLE IRA, a SIMPLE 401(k) can be used by employers with no more than 100 employees. To be eligible, each employee must receive at least $5,000 in compensation. Similar to a 401(k), an employer may choose to allow its employees to borrow from the account. Unlike a 401(k), employers are required to make contributions to their employees' SIMPLE 401(k) accounts. The employer can either make a matching contribution of up to 3 percent of the employee's pay or a non-elective contribution of 2 percent of pay.

Pros: SIMPLE 401(k)s are easy to establish and inexpensive to administer. The employer

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receives a tax deduction for contributions to the plan. Loans are permitted.

Cons: These plans have low contribution limits and little flexibility in contribution amounts.

4. 401(k) Profit Sharing Plan - As your business grows and you hire more employees, you may wish to consider upgrading to a 401(k) profit sharing plan. 401(k)s are highly regarded by employees, who are increasingly looking for employers that provide comprehensive benefits plans. This can make a 401(k) profit sharing offering a great differentiator for your business when hiring.

In 2021, employees can contribute up to $19,500 to a 401(k) (plus an additional $6,500 catch-up contribution for those age 50 and older). Employers can make additional contributions, not to exceed $58,000 total for both employee and employer deferrals. (For workers age 50 and older, the maximum amount increases to $64,500 total.) 401(k)s can also be customized to allow Roth contributions, employee loans, larger matching contributions and profit-sharing contributions.

Pros: Viewed by many employees as the gold standard of retirement plans, a 401(k) can be a hiring differentiator. 401(k) profit sharing plans have higher contribution limits than SEP and SIMPLE plans. They also offer more flexibility in contribution types and plan features. With the right plan design, business owners and key managers, can be allocated a higher portion of the total profit sharing dollars.

Cons: The expense and administrative requirements of a 401(k) profit sharing plan are greater than those of other types of retirement plans; however, employers often find that the added work is worth it to give their employees the best possible chance of achieving their retirement goals. As an added benefit, the CARES Act provides tax credits to employers that establish new retirement plans, which can help reduce administrative costs. The administrative costs may also be tax deductible.

One item of note for 401(K) profit sharing plans is that the plan sponsor bears the sole fiduciary obligation of selecting the investments offered to employees. However, this legal burden can be mitigated by partnering with a qualified advisory firm to provide 3(38) fiduciary services.

At Creative Planning, we help clients establish, monitor and optimize their retirement plans, and we help many clients establish 401(k) profit sharing plans. We serve as a partner in ensuring your plan meets the stringent fiduciary standards of objectivity by providing an impartial evaluation of your plan's asset allocation, investment opportunities and plan construction, while also working to minimize fees. We share your goal of offering a savings vehicle to help your employees achieve

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financial independence in retirement while providing you with the peace of mind of knowing you are working with an advisor who supports your plan with ERISA 3(38) fiduciary service.

If you would like help evaluating your employer-sponsored retirement plan options, or for any other financial matter, please contact us.

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