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VOYA FINANCIAL ADVISORS

Retirement Plans for Small and Mid-Sized Businesses

In general, the amount of employee compensation that can be taken into account when determining employer and employee contributions is limited to $280,000 in 2019.

If you are self-employed or own a small business and you haven't established a retirement savings plan, what are you waiting for? A retirement plan can help you and your employees save for the future.

Tax advantages

A retirement plan can have significant tax advantages:

- Your contributions are deductible when made
- Your contributions aren't taxed to an employee until distributed from the plan
- Money in the retirement program grows tax deferred (or, in the case of Roth accounts, potentially tax free)

Types of plans

Retirement plans are usually either IRA-based (like SEPs and SIMPLE IRAs) or "qualified" (like 401(k)s, profit-sharing plans, and defined benefit plans). Qualified plans are generally more complicated and expensive to maintain than IRA-based plans because they have to comply with specific Internal Revenue Code and ERISA (the Employee Retirement Income Security Act of 1974) requirements in order to qualify for their tax benefits. Also, qualified plan assets must be held either in trust or by an insurance company. With IRA-based plans, your employees own (i.e., "vest" in) your contributions immediately. With qualified plans, you can generally require that your employees work a certain numbers of years before they vest.

Which plan is right for you?

With a dizzying array of retirement plans to choose from, each with unique advantages and disadvantages, you'll need to clearly define your goals before attempting to choose a plan. For example, do you want:

- To maximize the amount you can save for your own retirement?
- A plan funded by employer contributions? By employee contributions? Both?
- A plan that allows you and your employees to make pre-tax and/or Roth contributions?
- The flexibility to skip employer contributions in some years?
- A plan with lowest costs? Easiest administration?

The answers to these questions can help guide you and your retirement professional to the plan (or combination of plans) most appropriate for you.

SEPs

A SEP allows you to set up an IRA (a "SEP-IRA") for yourself and each of your eligible employees. You contribute a uniform percentage of pay for each employee, although you don't have to make contributions every year, offering you some flexibility when business conditions vary. For 2019, your contributions for each employee are limited to the lesser of 25% of pay or $56,000. Most employers, including those who are self-employed, can establish a SEP.

SEPs have low start-up and operating costs and can be established using an easy two-page form. The plan must cover any employee aged 21 or older who has worked for you for three of the last five years and who earns $600 or more.

SIMPLE IRA plan

The SIMPLE IRA plan is available if you have 100 or fewer employees. Employees can elect to make pre-tax contributions in 2019 of up to $13,000 ($16,000 if age 50 or older). You must either match your employees' contributions dollar for dollar — up to 3% of each employee's compensation — or make a fixed contribution of 2% of compensation for each eligible employee. (The 3% match can be reduced to 1% in any two of five years.) Each employee who earned $5,000 or more in any two prior years, and who is expected to earn at least $5,000 in the current year, must be allowed to participate in the plan.

SIMPLE IRA plans are easy to set up. You fill out a short form to establish a plan and ensure that SIMPLE IRAs are set up for each employee. A financial institution can do much of the paperwork. Additionally, administrative costs are low.

Profit-sharing plan

Typically, only you, not your employees, contribute to a qualified profit-sharing plan. Your contributions are discretionary — there's usually no set amount you need to contribute each year, and you have the flexibility to contribute nothing at all in a given year if you so choose (although your contributions must be nondiscriminatory, and "substantial and recurring," for your plan to remain qualified). The plan must contain a formula for determining how your contributions are allocated among plan participants. A separate account is established for each participant that holds your contributions and any investment gains or losses. Generally, each employee with a year of service is eligible to participate (although you can require two years of service if your contributions are immediately vested). Contributions for any employee in 2019 can't exceed the lesser of $56,000 or 100% of the employee's compensation.

401(k) plan

The 401(k) plan (technically, a qualified profit-sharing plan with a cash or deferred feature) has become a hugely popular retirement savings vehicle for small businesses. With a 401(k) plan, employees can make pre-tax and/or Roth contributions in 2019 of up to $19,000 of pay ($25,000 if age 50 or older). These deferrals go into a separate account for each employee and aren't taxed until distributed. Generally, each employee with a year of service must be allowed to contribute to the plan.

You can also make employer contributions to your 401(k) plan — either matching contributions or discretionary profit-sharing contributions. Combined employer and employee contributions for any employee in 2019 can't exceed the lesser of $56,000 (plus catch-up contributions of up to $6,000 if your employee is age 50 or older) or 100% of the employee's compensation. In general, each employee with a year of service is eligible to receive employer contributions, but you can require two years of service if your contributions are immediately vested.

401(k) plans are required to perform somewhat complicated testing each year to make sure benefits aren't disproportionately weighted toward higher paid employees. However, you don't have to perform discrimination testing if you adopt a "safe harbor" 401(k) plan. With a safe harbor 401(k) plan, you generally have to either match your employees' contributions (100% of employee deferrals up to 3% of compensation, and 50% of deferrals between 3% and 5% of compensation), or make a fixed contribution of 3% of compensation for all eligible employees, regardless of whether they contribute to the plan. Your contributions must be fully vested.

Another way to avoid discrimination testing is by adopting a SIMPLE 401(k) plan. These plans are similar to SIMPLE IRAs, but can also allow loans and Roth contributions. Because they're still qualified plans (and therefore more complicated than SIMPLE IRAs), and allow less deferrals than traditional 401(k)s, SIMPLE 401(k)s haven't become popular.

Defined benefit plan

A defined benefit plan is a qualified retirement plan that guarantees your employees a specified level of benefits at retirement (for example, an annual benefit equal to 30% of final average pay). As the name suggests, it's the retirement *benefit* that's defined, not the level of contributions to the plan. In 2019, a defined benefit plan can provide an annual benefit of up to $225,000 (or 100% of pay if less). The services of an actuary are generally needed to determine the annual contributions that you must make to the plan to fund the promised benefit. Your contributions may vary from year to year, depending on the performance of plan investments and other factors.

In general, defined benefit plans are too costly and too complex for most small businesses. However, because they can provide the largest benefit of any retirement plan, and therefore allow the largest deductible employer contribution, defined benefit plans can be attractive to businesses that have a small group of highly compensated owners who are seeking to contribute as much money as possible on a tax-deferred basis.

As an employer, you have an important role to play in helping America's workers save. Now is the time to look into retirement plan programs for you and your employees.

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