Qualified Retirement Plans for Small Businesses

For the small-business owner, attracting and retaining valuable employees can be a daunting challenge. One way to make working for your business more attractive to current and potential employees alike is to implement a qualified retirement plan for you and your employees. Besides greater appeal to your workers, qualified plans can also provide you with numerous tax advantages, including:

Contributions for all participants are 100% tax-deductible to the business up to certain limits.

Annual contributions by the business are not considered taxable income to the plan participants.

Capital gains and interest earned are deferred from taxation during the accumulation years. Income taxes are payable upon withdrawal.

At retirement, favorable tax treatments may apply such as spreading payments over the participant's lifetime and special averaging formulas.

Non-Tax Advantages

In addition to the obvious tax and employee hiring/retention advantages, there are many other, equally important, reasons to implement a qualified plan. For example, plan assets are creditor-proof. The assets of the plan are not subject to malpractice lawsuits or bankruptcy rulings.

These and other advantages combine to help improve morale as the participants realize that their company provides the mechanism to help secure their retirement.

Types of Plans

The two most common types of qualified retirement plans are pension and profit-sharing plans. A business can also sponsor an IRA or SEP (simplified employee pension plan).

Pension Plans. There are three major types of pension plans -- defined benefit, money purchase, and target benefit.

1. A defined benefit plan is one where the retirement benefit is determined by a plan formula - usually based on years of service.

2. A money purchase pension plan is one where the plan formula specifies the percentage of each participant's compensation that will be contributed each year.

3. A target benefit plan is a hybrid. It starts out as a defined benefit plan, which determines the benefit. Once the benefit is calculated, the plan converts to a defined contribution or money purchase plan.

Profit-Sharing Plans. The most popular type of profit-sharing plans is 401(k) plans. Elective deferrals to these plans are limited to $15,000 for the year 2006 ($20,000 for people 50 years of age and older, including catch-up provisions). Annual contributions to a profit-sharing plan are generally not required; instead, they can be discretionary each year.