The **Definitive** Small Business Guide to Retirement Planning

Part 1

ABOVE THE CANOPY

Running a small business can be an extremely rewarding experience. But the benefits are hard earned, and it often feels like you're working several full time jobs at once. Most business owners and executives tend to focus their attention on growing their business and being more efficient, profitable, and competitive.

As a result, many people running small businesses often neglect their personal finances. And while there are great opportunities to build their retirement savings through a company sponsored retirement plan, few have the bandwidth to devote much of their attention.

Even if they did have some free time, retirement plans can be confusing. Understanding how to choose the right retirement plan, put it into action, integrate it into your systems, and manage the additional responsibility can be a daunting task.

This guide will show you:

- **Exactly** how to choose & set up the **best** retirement plan for you & your company
- Your **responsibilities** when sponsoring a retirement plan
- How to maximize tax **deductions** and **credits** when setting up & contributing to a company retirement plan
- How to **integrate** a retirement plan into your company
- How to **educate** your employees about your retirement plan

Contents

Benefits of Sponsoring a Retirement Plan

There are numerous benefits to maintaining a retirement plan through your business, to both you and your employees.

First and foremost, retirement plans offer you a way save for your retirement on a tax advantaged basis. While many business owners assume that the equity in their business will provide a sufficient retirement, illiquidity and other unforeseen circumstances often become barriers. Company sponsored retirement plans offer a great way to diversify and strengthen your asset base.

Retirement plans are also attractive to current and future employees. A strong retirement & benefits package can make retaining your existing staff **and** hiring future talent far easier.

Additionally, not only are your personal and employee contributions tax *deductible*, but you can actually earn tax *credits* and other incentives for starting a retirement plan.

The Life Cycle of a Retirement Plan

Just like businesses, retirement plans have life cycles. The four phases in a retirement plan's life cycle are:

- Choosing
- Establishing
- Operating
- Terminating

Each of these steps comes with certain to-do's and responsibilities. Some of these are required by law and the tax code, while others are procedural and I recommend only to make the process easier and less complex. Whichever path you choose, remember that by sponsoring retirement plan through your business you take on certain legal responsibilities toward your employees.

1. Choosing

First, you'll need to decide which plan and which structure best suits your personal and business goals. Retirement plans vary in terms of flexibility, employee contribution requirements, administrative cost, and your own contribution limits, so there can be a high degree of customization if you choose.

Be sure to think long term when making this decision. Making changes to some plans can be cumbersome, and hopefully your plan will be in place for many years. Rather than pulling the trigger on option #1 and then making changes later, it's often easier and less expensive in the long run to be thoughtful from the start.

How to Pick the Right Plan:

The right plan for you will depend on several variables:

Personal & Organizational Goals
A good starting point is to consider exactly what you want your plan to accomplish. Most people running a business seek to maximize their own benefits while minimizing the costs of required contributions for their employees. Others might not be as concerned about maximizing their own contributions, and instead want to provide a fortified retirement plan in order to attract new employees. These factors are all important when deciding which plan fits your needs.

Income Variability
Many plans, including defined benefit pension plans, require businesses to make annual contributions regardless of your company's profitability. If your business is in the early stages and has profits that tend to fluctuate, you'll probably want a plan that doesn't compel you to make contributions each and every year.

Eligible Employees
Does your business have employees now? Do you plan to hire in the future? How might your growth aspirations affect your retirement plan? Some options have strict eligibility requirements, meaning that new employees become eligible for your plan shortly after or

immediately upon coming on board. This can increase the cost of hiring new employees, and is a factor you should consider.

Employee Deferrals

Some plans allow employees to contribute to their own retirement benefits by deferring funds from their own paychecks, while others rely solely on employer contributions. If your employees are knocking down your door for retirement plan options or you want your employees to be responsible for their own contributions, you'll probably want to provide a plan that offers employee deferrals. This will give your employees the ability to make their own contributions and take more control of their own benefits.

Employee Census

The variables above will give you a good grasp on how you want your plan to work. The next step is to narrow the field of potential options. And since different plans use different methods to calculate contribution requirements, you'll need to take an employee census. A census is a roster of everyone on the payroll at your business, along with their age, tenure, and compensation.

Here's an example:

John owns an S-Corp, earns $250,000 per year in W-2 wages, and has four employees. Here is his employee census:

Name	Age	Tenure	Compensation
John	57	10 Years	$250,000
Sally	48	Six Months	$250,000
Betty	50	2 Years	$40,000
Jason	35	10 Years	$30,000
Sharon	25	4 Years	$20,000

Let’s also assume that John wants to start a profit sharing plan for his S-Corp, to save additional tax deferred money and incentivize his employees based on the profitability of the company. There are three basic types of profit sharing plans he could choose:

Traditional Profit Sharing Plan

Traditional profit sharing plans follow a salary ratio method. This means that employer contributions are made to all eligible participants on a uniform basis. Let’s say that John wants to contribute $25,000 on his own behalf. This constitutes 10% of his W-2 compensation, so he’d also be required to contribute 10% of each of his employees’ compensation.

Name	Compensation	Contribution
John	$250,000	$25,000
Sally	$250,000[1]	$25,000
Betty	$40,000	$4,000
Jason	$30,000	$3,000
Sharon	$20,000	$2,000
	Total	**$59,000**

1 *Sally has only been an employee for six months. This example assumes she is eligible to participate in the profit sharing plan.*

Age-Weighted Profit Sharing Plan

The age-weighted method allocates contributions based on both age and compensation of eligible employees. This method is similar to a defined benefit pension plan, but gives employers the option of making discretionary contributions. Since this method incorporates participants’ ages and length of time until retirement, it favors older participants disproportionately to younger participants and is often “top heavy”. With an age-weighted plan, John could make the following contributions:

Name	Compensation	Contribution
John	$250,000	$36,967
Sally	$250,000	$17,739
Betty	$40,000	$3,340
Jason	$30,000	$737
Sharon	$20,000	$217
	Total	**$59,000**

Note here that the S-Corp would still be making $59,000 in total contributions, but a larger portion would allocated to John's account.

New Comparability Plans

New comparability plans (also known as cross tested plans) allow employers to divide employees into different classifications for the purpose of allocating contributions. Like age-weighted plans, new comparability plans use projected benefits at retirement in their non-discrimination testing. This allows them to be top heavy. If John wanted to favor older, or highly compensated employees, a new comparability plan might be the best option. John could include himself and Sally in group one, and Betty, Jason, and Sharon in group 2.

Name	Group	Compensation	Contribution
John	1	$250,000	$27,830
Sally		$250,000	$27,830
Betty	2	$40,000	$1,484
Jason		$30,000	$1,113
Sharon		$20,000	$743
		Total	**$59,000**

Although we haven't gone into the exact contribution calculations for the three types of profit sharing plans, this is a good example of how customizable different retirement plans can be. Here, John's could allocate a contribution of $59,000 in a number of different ways. The age-weighted plan would benefit himself the most, while the traditional method would be more equitable give his employees an incentive to focus on company profitability. To decide which plan is the best fit, he'd need to match up his census with the plan type that best fits his goals:

Name	Compensation	Traditional	Age-Weighted	New Comparability
John	$250,000	$25,000	$36,967	$27,830
Sally	$250,000	$25,000	$17,739	$27,830
Betty	$40,000	$6,500	$3,340	$1,484
Jason	$30,000	$6,500	$737	$1,113
Sharon	$20,000	$4,500	$217	$743

Remember that this is just one example, using only a profit sharing retirement plan. There are numerous types of other retirement plan options to John – and to you. Defining your personal and business goals for a plan is the first step. Developing an employee census will then help you compare the implications of different plan types.

Defined Contribution vs. Defined Benefit

Along with your personal & organizational goals, you'll need to consider exactly how you want to deliver benefits to your employees. Retirement plans generally fall into two main categories: defined *contribution* and defined *benefit* plans.

In a **defined contribution** plan, you'd make a specific contribution on behalf of your employees. Your employees may or may not have control over how their portion of your contribution is invested. Upon retiring, the assets in their account can be withdrawn as they choose.

For example, a defined contribution plan might contribute $100 per month on behalf of an employee. The employee might then direct the investment of these contributions, and be free to withdraw the balance as they choose when retiring. The *contribution* to the plan would be defined and subject to limitations, but the retirement *benefits* are limitless.

In a **defined benefit** plan, employee retirement benefits are predetermined by their compensation, years of service, and their age. You would be responsible for investing the plan's assets in order to provide these benefits, and would be required to contribute a specified amount each year based on actuarial assumptions.

For example, a company might determine that employees will receive 3% of their average salary over their last five years of employment for every year of service with the company. Employees working for 30 years would then receive 90% of their last few year's salary throughout retirement as a pension benefit. The company would then be required to contribute *whatever amount was necessary* each year to support its employees' retirement benefits. While the employee retirement *benefit* is defined and subject to limitation, the *contribution* is limitless.

The main difference between defined contribution and defined benefit plans comes down to **who bears the investment risk**. In defined contribution plans, employers are only responsible for putting money into the plan. Employees are responsible for their account's investment growth and how they draw income in retirement.

Alternately, *employers* carry the investment risk in a defined benefit plan. They agree to pay out a certain amount of benefits to retired employees each year, and must make enough contributions to the plan to be able to pay out future benefits. If investment returns are higher than expected, a company would need to make a smaller contribution because the plan is "ahead of schedule." If investment returns are lower than expected, it would be required to "catch up" by making a larger contribution.

Many defined benefit plans have experienced significant investment losses over the last 20 years, which puts great stress on the sponsoring company. Because of this, companies across the U.S. are trending strongly toward defined *contribution* plans over defined *benefit* plans to better control their expenses.

We will dive into the specific types of defined contribution and defined benefit plans in parts 2 and 3 of this guide. For now, let's stay focused on the life cycle of retirement plans.

2. Establishing

After deciding which plan is optimal for your business, it's time to get it up and running. Your first step is to establish & sign a **plan document**. All retirement plans have plan documents, which describe what the plan is, how it works, who is eligible to participate, and other roles and responsibilities. Your plan document is the foundation of your plan, and must comply with applicable laws and the internal revenue code.

Some types of small business retirement plans, like SEP-IRAs and SIMPLE IRAs, tend to use very "boilerplate" plan documents. These types of plans have rigid operational rules, so there doesn't need to be much variation in their plan documents. Others, like profit sharing and 401(k) plans, can be completely customized. This means that one plan document for a profit sharing plan might be very different from another.

In either case, establishing & maintaining a plan document that adheres to applicable law is the first step toward operating a compliant retirement plan. **Third party administrators (TPAs)** are professionals that provide and maintain plan documents. While simple retirement plans (again, think SEP-IRAs and SIMPLE IRAs) can be provided by a brokerage firm, most organizations decide to use a TPA for complex and customized arrangements.

After adopting & signing a plan document you'll need to figure out how you're set up to fund the plan and make contributions. Employee deferrals (if your plan allows them) can be directed through payroll, and employer contributions can come directly from your company's bank account.

Recordkeepers are often hired by retirement plans to help streamline this process. Recordkeepers allocate contributions and earnings among different investment alternatives that employees choose. They also calculate vesting amounts and generate participant statements. While not required, many organizations prefer to use recordkeepers to help keep the plan running smoothly.

Some plans will allow employees to allocate their contributions to a menu of available investments. This menu of investments is an important function, and is often handled by a financial professional. Remember that whenever you operate a retirement plan, you have a legal responsibility to act in your employees' best interests. This means that **you are their fiduciary**. When it comes to building the menu of investments, you'll need to make sure that:

- The available investments are not overly expensive, and
- Your participants can build a sufficiently diversified portfolio with the options. This means there should be *at minimum* three investment options: a cash or stable value option, a stock option, and a bond option. Most plans with investment menus have at least a dozen different investments to choose from.

Finally, you'll need to notify your employees. Different plans have different eligibility requirements, and everyone who meets your eligibility requirements must be given notice about what the plan is and how they can participate. Live educational meetings are usually the most helpful here, which financial professionals often provide. However you decide to communicate information about your plan, it's best to distribute some kind of written notice electronically or physically so that you can save a copy for your records.

Most retirement plans must be enacted by December 31st of the tax year. Since many firms that support retirement plans tend to get busy toward the end of the year, most will impose a deadline to submit paperwork closer to the beginning of the fourth quarter. As such, it's best to get the ball rolling early to ensure you can make tax deductible contributions in your current tax year. Most financial professionals can help get your plan started, or at least refer you to someone who can.

3. Operating

Once you've got your retirement plan up and running, there will be certain operating requirements in order to comply with the law. Every retirement plan has different rules, but in general they will cover the following areas:

Employee Eligibility

Every retirement plan must define what does and does not make an employee eligible to participate in the plan. Age and tenure with your company are the most commonly used factors.

A big concern to the Department of Labor and IRS is that retirement plans are operated **equitably** and do not discriminate in favor of certain owners or employees.

While most types of retirement plans give sponsors some discretion over eligibility standards, each has minimum requirements. For qualified plans subject to ERISA, the minimum requirement is **21 and 1**, meaning that any full time employee age 21 or older, with at least one year of service must be allowed to participate in the plan.

Contributions

Contributions can come from both employee deferrals from payroll (if your plan allows) and your business's contributions on their behalf.

Employer contributions can come in the form of a **matching contribution**, where the business matches employee elective deferrals, or a **non-elective contribution** based on a flat percentage of employee compensation or company profitability.

While there is some latitude as to when employer contributions must be deposited in your plan, employee elective deferrals must be made as soon as possible.

Keeping the Plan Up-to-Date

Tax laws change every few years, which always subjects retirement plans to new and different rules. In order to stay compliant, you'll need to make sure your plan document stays current and reflects the most recent rules.

Qualified plans subject to ERISA must be officially **restated** when new amendments are passed. For example, the most recent legislation requiring restatement is the Pension Protection Act (PPA) of 2006. Prior to this legislation, qualified retirement plans were required to comply with the Economic Growth Tax Relief Reconciliation Act (EGTRRA) of 2001. Because of the new law in 2006, all qualified plans must be restated to comply with the PPA by April 30th of 2016.

Communicating With Employees

You'll need to communicate to your employees any time you start, make changes to, or terminate a retirement plan. There are also certain annual disclosures you must make.

While these can indeed be onerous for larger and more intricate plans, other plans best suited for small business don't require more than a disclosure notice or two once a year.

Distributing Benefits

Unless you hire someone else to operate retirement plan, you'll need to handle disbursements from the plan when employees request them. Disbursements can come in several forms depending on how your plan is set up, including qualified retirement distributions, loans, and hardship withdrawals.

Processing retirement plan distributions normally isn't a massive job for small businesses. But remember – you're the gatekeeper for your employees' retirement funds, and are responsible for processing any distributions in a timely fashion.

Managing plan assets

Retirement plans have varying amounts of responsibility when it comes to managing assets.

Some plans, like SIMPLE IRAs and SEP-IRAs allow your employees total control over what they invest in as account balances are held in an **individual retirement account**. Others, like 401(k) plans, might require that you offer a menu of investments for your participants to choose from. In defined benefit arrangements, you have total control and responsibility over managing and investing funds.

Any time you or your organization has the discretion to manage assets on behalf of your employees, you have a **fiduciary responsibility** to act in their best interests. This means that you'll need to make prudent investment choices and exercise care. In qualified plans, the Department of Labor defines this responsibility as:

- Acting solely in the best interest of plan participants & beneficiaries
- Carrying out duties prudently
- Following the plan documents
- Diversifying plan assets
- Paying only reasonable plan expenses

In practice, this means you'll need to monitor the investments in your plan periodically (optimally, several times per year). This can be done by comparing expenses & performance to other options you may have available. The department of labor also suggests that you compare the costs of operating your plan to other plans of similar size every 3-5 years. This will help you ensure your plan's administrative and operating costs aren't overly expensive.

A Note on Financial Advisors and Fiduciary Responsibility

Unfortunately, many small business owners mistakenly assume that hiring a financial advisor to help select investments **absolves** them of their fiduciary duty to monitor investments. In other words, they think that since an advisor helps them manage their plan's investments, that advisor is liable if any problems arise in the future. Even though an advisor might help you select investments, very few actually take fiduciary responsibility off your plate. This means that if your participants decide to sue you down the road because your plan's investment options are too expensive, you are still liable – not your advisor.

It is possible to delegate this responsibility. ERISA has two sections that allow you delegate investment selection & monitoring responsibilities to professionals: section 3(21) and section 3(38). Section 3(21) allows you hire a financial professional as a **co-fiduciary.** This means that your advisor would help you make decisions about plan investments, and be a co-defendant if you run into certain legal troubles.

Hiring a professional under section 3(38) enables you to delegate your investment selection & monitoring responsibilities **entirely**.

When hiring a professional under section 3(38), they have total authority to make changes to your plan's investments. They'd also be the sole defendant if your participants bring suit related to plan investment choices later on. Keep in mind that even if you hire a 3(38) investment manager and delegate your investment responsibilities, you would still be responsible for monitoring the investment manager.

It's important to take fiduciary responsibilities seriously. This area has been the source of much litigation in recent years[2], and should not be neglected. And while not every small business will need the help of an advisor, those that do should understand whether theirs is sharing your plan's ongoing responsibilities. Few advisors actually do.

2 *For more information, see three recent cases at the time of this writing: 1) Austin vs. Union Bond & Trust Co., Morgan Capital Management, and Principal Life Insurance, 2) Teets vs. Great-West Life & Annuity Insurance Company, and 3) Tibble vs. Edison International*

Don't Be Intimidated!

If this sounds like a lot, **don't fret**. Fiduciary liability sounds scary, but there are simple options available. SIMPLE IRAs and SEP-IRAs are two great solutions for small businesses and circumvent this issue. Both are easy to implement and neither requires you manage assets on behalf of your employees.

4. Terminating

Finally, it's possible the time may come when your retirement plan no longer suits your business. Your business may grow and require a more robust plan, or you may wish to end the plan altogether upon your own retirement.

To do so you'll need to terminate your plan officially, as opposed to abandoning it by walking away. Terminating a plan is relatively simple, but again requires specific communications to your employees. Keep this in mind as your business and retirement needs change.

Summary

Sponsoring a retirement plan through your business is a wonderful way to build your personal wealth. It can also lower your company's and personal tax liabilities, improve employee engagement & morale, and attract top employees to help your business thrive.

And while operating a plan can seem like a big task, there are plenty of solutions with low annual maintenance requirements and professionals you can outsource to.

In this section we addressed the life cycle of a retirement plan and how to find the best option for your needs. Tomorrow in part 2, we'll dive into the various defined contribution options for small businesses.

Closing

In my practice I help people running small businesses across the country build retirement plans that are cost effective and customized for their needs. My objective is to help my clients reach their personal & business objectives in the lowest risk and most efficient manner possible.

If, after reading this, you have further questions about retirement planning for small businesses, feel free to reach out.

Just click the link below, and I'd be happy to point you in the right direction.

Email Grant Today

The **Definitive** Small Business Guide to Retirement Planning

Part 2

ABOVE THE CANOPY

In Part 1 we reviewed how to identify your personal and business objectives. This is an important first step, and the results will help you zero in on which retirement plan best fits your needs. To refresh your memory, here are a few of the variables we considered:

- How much you plan to contribute each year
- When you plan to retire
- How you want to involve your employees
- Consistency of your business's cash flow
- How much flexibility & customization you need
- How to produce an employee census

In part 2, we will dive into **defined contribution plans** and which options are best for small businesses.

Contents

Small Business Plans

For small businesses starting their first plan, it's likely that one of the following three will be the best fit for your organization. These plans are easy to implement and administer, low cost, and can be opened at nearly any brokerage firm. While these three plans are technically defined contribution plans, I've sectioned them off because of their unique ease of use.

Solo 401(k)

Solo 401(k) plans are also known as solo-k's, individual k's, one participant k's, and a few other names. What's great about them is their flexibility and potentially large contribution limits. The catch is that you **can't** have any eligible employees other than your spouse.

Solo 401(k) plans have minimum employee eligibility requirements of 21 years of age, 1,000 or more work hours per year, and at least one year of service. This means that if you have employees that meet all three of these standards, you may **not** contribute to a solo 401(k) plan. You could maintain contributions to a solo 401(k) by hiring part time employees and keeping them under 1,000 hours per year.

With solo 401(k) plans, business owners wear two hats: one as an employee and one as an employer. In 2016, employees can contribute up to $18,000 per year as an employee, plus an additional $6,000 catch up contribution if you're over 50.

As an employer, you may make profit sharing contributions to a solo 401(k) plan as well. Sole proprietors and single member LLCs can make profit sharing contributions of up to 20% of self-employment income. Partnerships, multi member LLCs, S-Corps, and C-Corps may contribute 25% of your compensation. The total limit between employee and employer contributions is $53,000 ($59,000 with a catch up contribution).

Example:

Let's say that John from our example in part 1 collects $125,000 in W-2 wages from his S-Corp, and doesn't have any employees. Each year he could make:

- $18,000 in employee deferrals
- $6,000 in catch up contributions (remember he's over age 50)
- $125,000 * 25% = $31,250 in profit sharing contributions[1]
- $55,250 total per year

1 *If his S-Corp were instead a sole proprietorship, he'd only be allowed to make $25,000 in profit sharing contributions from his business, and $49,000 in total.*

The solo 401(k) is usually the best option for solo business owners. The plan provides for larger annual contributions than SEP-IRAs, and gives you total flexibility in how you invest your retirement assets.

From an administrative standpoint, it's also pretty simple. There are no disclosures or annual filings required for solo 401(k) plans with under $250,000 in assets. When your plan grows to over this amount, you must file a form 5500 with the department of labor each year.

Simplified Employee Pension (SEP-IRA)

The SEP-IRA is another popular plan for small businesses due to its low cost and ease of administration. SEP-IRA plans also accommodate employees.

The SEP-IRA allows business owners to contribute up to 25% of their own compensation each year on a tax deferred basis, with a max of $53,000. Contributions go into an account similar to a traditional IRA, where the owner has flexibility over how to invest the assets.

Additionally, business owners are required to make contributions on behalf of their employees. They must contribute the same percentage of their employees' compensation that they contributed on their own behalf. Employees may not make contributions on their own, but have full discretion to invest their accounts how they wish.

Example:

Using our previous example, let's say John sponsors a SEP-IRA in his S-Corp and has his original four employees. If he makes $125,000 per year, he can contribute a max of $31,250 per year on his own behalf ($125,000 * 25%).

Instead, let's say John contributes $18,750 to his SEP-IRA this year. This constitutes 15% of his compensation, so he must therefore contribute 15% of each of his employees' compensation to each of their respective SEP-IRA accounts (assuming they're all eligible employees):

Name	Compensation	SEP Contribution
John	$125,000	$18,750
Sally	$100,000	$15,000
Betty	$65,000	$9,750
Jason	$65,000	$9,750
Sharon	$45,000	$6,750

The SEP-IRA doesn't allow for contributions as large as a solo 401(k) but it does allow John to have employees. When it comes to employee eligibility, SEP-IRAs differ from solo 401(k) plans. Businesses with SEP-IRAs must include any employee who:

- Is at least 21 years old;
- Worked for your business in 3 of the last 5 years; and
- Received at least $600 in compensation from your business in each of the last two tax years

The requirement to work in 3 out of the last 5 years has no minimum hours or compensation. This means you could have an employee work for one day three years ago, one day two years ago, and one day last year. As long as your employee earned $600 in each of the last two years, they must be included in your plan.

Keep in mind that these are the most restrictive eligibility requirements allowed. Your SEP plan can always be more accommodative. For example, you could lower your age requirement from 21 to 18 and your compensation minimum from $600 to $300 if you choose.

SEP-IRAs are great options for businesses with variable cash flow, since you are not required to make contributions each year. They're also good for anyone who wants to limit annual administrative requirements. While you must notify your employees whether you'll make a contribution each year and how much it will be, there are no additional forms, notices, or disclosures required.

SIMPLE IRAs

While SEP-IRAs accommodate businesses with employees, they don't offer much flexibility when it comes to making contributions on their behalf.

Enter the SIMPLE IRA. SIMPLE IRAs can be sponsored by companies with 100 or fewer eligible employees that don't have another retirement plan.

Unlike the SEP-IRA, SIMPLE IRAs allow for employee salary deferrals. Employees may defer up to $12,500 from their salary, and an additional $3,000 catch up contribution if they're 50 or older.

In turn, employers are required to make one of two types of contributions on behalf of employees:

1) A matching contribution, where employers match employee deferrals dollar for dollar, up to 3% of each employee's compensation. This matching contribution may be reduced to 1% of employee compensation in two out of any five years.

2) Employers may also opt for a 2%, non-elective contribution. Regardless of whether employees contribute to the plan, the business must contribute a flat 2% of employee compensation to their account.

The SIMPLE IRA does require slightly more administrative work than SEP-IRAs. Businesses may change their contribution method from year to year, but must disclose their decision to employees each year in an annual notice.

Additionally, employees must be given the opportunity to change their contribution levels to the plan each year. This is called an *election period*, and must last for at least 60 days at the end of each year, from November 2 to December 31.

Example:

Let's say that John from our example opts for a SIMPLE IRA instead of a SEP-IRA. He also elects to make matching contributions for this tax year, and communicates that to his employees. Here are his required matching contributions.

Name	Compensation	Employee Contribution	Required Match
John	$125,000	$10,000	$3,750 (3% of $125,000)
Sally	$100,000	$5,000	$3,000 (3% of $100,000)
Betty	$65,000	$1,000	$1,000
Jason	$65,000	$1,000	$1,000
Sharon	$45,000	$500	$500

Essentially SIMPLE IRAs offer businesses more flexibility in employee contributions than SEP-IRAs, but come with lower annual limits. They are usually best for small businesses with growing employee ranks, that don't mind the mandatory annual matching or non-elective contribution.

Comparison:

Features	Solo 401(k)	SEP-IRA	SIMPLE-IRA
Who it's for	Self-employed individuals or business owners with no employees other than a spouse.	Self-employed individuals or small business owners, including those with employees.	Companies with 100 employees or fewer.
Key Advantages	Generous contribution limits.	Easy to set up and maintain.	Salary reduction plan with less administration.
Who Contributes	Employer and employee (assuming employee is the business owner or spouse).	Employer only	Employer and employee
Employer Contribution Limits	Up to 20% (sole props and single member LLCs) or 25% (multi member LLCs, partnerships, S-Corps, C-Corps) of compensation up to an aggregate maximum of $53,000 in 2016 ($59,000 with catch up contributions).	Up to 25% of employee compensation, maxing out at $53,000 in 2016. Employer must contribute the same percentage to employee accounts in the years he or she contributes to his or her own account	Mandatory business contribution of either: 1) 100% match on first 3% deferred (match may be reduced to 1% in two out of every five years), or 2) a 2% non-elective contribution on behalf of all eligible employees.
Employee Contribution Limits	$18,000 per year in 2016, plus $6,000 catch up contribution if 50 or over	No employee contributions	$12,500 in 2016, plus $3,000 catch up contribution if 50 or over

Features	Solo 401(k)	SEP-IRA	SIMPLE-IRA
Administration	Annual form 5500 filing after plan assets exceed $250,000.	No form 5500 filing. Employee notification of employer's contribution, if made	No form 5500 filing. Certain annual employee notifications
Access to assets	Cannot take withdrawals from plan until a "trigger" event occurs, such as plan termination or termination of service. Withdrawals are subject to current federal income taxes and possibly to a 10% penalty if the participant is under 59 1/2	Withdrawals at any time, which are subject to current federal income taxes and possibly a 10% penalty if the participant is under 59 1/2	Withdrawals at any time. If employee is under 59 ½, withdrawals may be subject to a 25% penalty if taken within the first two years of beginning participation, and possibly to a 10% penalty if taken after that time period.

Qualified Plans

While the first three plans we reviewed were simple, cost effective, and meant for smaller businesses, other **qualified plans** are far more complex.

"Qualified" means that a retirement plan must comply with ERISA, which was passed in 1974 to protect employees and their retirement income. As such, ERISA contains strict rules that prevent qualified plans from discriminating against any employee that doesn't meet the law's definition of "highly compensated."

To prove that qualified plans adhere to ERISA's non-discrimination rules, most have significant annual compliance requirements. This most often comes in the form of compliance testing, which can add significant complexity and cost.

Complexity can be a good thing though, since qualified plans are also far more flexible. A qualified plan can be custom tailored exactly for your needs, so long as your plan document complies with ERISA's minimum standards.

Profit Sharing Plans

Profit sharing plans are typically used for sharing profits from the company with employees. That said, employers are allowed to make contributions regardless of whether the business made money in any particular year.

Normally contributions are discretionary, giving employers the choice over whether to contribute each year. This is helpful for businesses with fluctuating cash flow. Employer contributions may also vest over a period of time, meaning that employees departing soon after receiving a profit sharing contribution may not be entitled to take the entire contribution with them. The maximum vesting period allowed in defined contribution plans is over a six year period, with 20% vesting each year starting in year 2.

Whatever the contribution schedule, businesses must be sure not to allow too many consecutive years to pass without making a contribution. The IRS requires profit sharing plans to make substantial and recurring contributions, but does not specify exactly what is or isn't acceptable.

Stock Bonus Plans

Stock bonus plans are a type of profit sharing plan where corporations use their own stock to make contributions and distributions. While not available for sole proprietorships or partnerships, stock bonus plans allow businesses to share profits with employees without any actual outflow of cash.

401(k) Plans

Likely the most recognizable type of profit sharing plan, 401(k) plans allow employees to defer their own compensation toward their retirement. These elective deferrals may or may not be matched by the employer. 401(k) plans are best suited for companies who want their employees to take part in funding their retirement benefits, which is a very popular idea throughout the U.S. 401(k) plans are often combined with profit sharing, money purchase, or other defined contribution plans.

Money Purchase Plans

In a money purchase plan, employers agree to contribute a fixed amount each year on behalf of eligible employees. This is often calculated as a percentage of compensation. Employees receive an annual contribution regardless of the company's performance on the year, so they're better suited for employers with stable cash flow.

Employee Stock Ownership Plans (ESOPs)

ESOP plans are great options for entrepreneurs who want to incentivize employees by sharing ownership. Essentially, shares are either gifted or bought on behalf of employees as an incentive. Stock grants can then vest over time, and all earnings and profits within the plan grow tax free as in other profit sharing plans. Because of the tax incentives, ESOPs are great for entrepreneurs who have significant wealth tied up in their business. They are only available for S-Corps and C-Corps though, as the company must have stock to gift.

Summary

Defined contribution plans are by far the most popular throughout the U.S. Since investment risk is borne by ***participants***, as opposed to the ***employer*** in a defined benefit plan, businesses can stabilize their contribution expenses regardless of investment performance and market conditions.

While we didn't cover each and every type of defined contribution plan, the three best options for small businesses are typically solo 401(k)'s, SEP-IRAs, and SIMPLE IRAs. These three are easy to establish and operate, and leave business owners with less fiduciary risk to keep them up at night.

Tomorrow in part 3, we'll dive into the alternative to defined contribution plans: **defined benefit plans**.

Closing

In my practice I help people running small businesses across the country build retirement plans that are cost effective and customized for their needs. My objective is to help my clients reach their personal & business objectives in the lowest risk and most efficient manner possible.

If, after reading this, you have further questions about retirement planning for small businesses, feel free to reach out.

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Email Grant Today

The **Definitive** Small Business Guide to Retirement Planning

Part 3

ABOVE THE CANOPY

Welcome back to **The De initive Small Business Guide to Retirement Planning**. In Part 2 we reviewed defined contribution plans and the most popular options for small businesses. To refresh your memory, here are the plans we reviewed:

- Solo 401(k)
- SEP-IRA
- SIMPLE IRA
- Profit Sharing
- Stock Bonus
- 401(k)
- Money Purchase
- Employee Stock Ownership

In part 3, we'll dive into **defined benefit plans** — the cousin of defined contribution plans.

Contents

Defined Benefit Plans

Employees often value defined benefits plans because of the certainty of their retirement benefits. Businesses can generally contribute (and therefore deduct) more to defined benefit plans than defined contribution plans, but they also have less flexibility over contributions year to year.

Defined benefit plans are also far more complex than defined contribution plans due to the actuarial assumptions involved. This means that they are typically more labor intensive and costly to administer.

Defined benefit plans need to calculate how much retirement benefit each employee accrues each year. Then, plan administrators must calculate (using the actuarial assumptions) how much they'll need in order to pay these benefits when the employee retires in the future.

For example, say that Mike is 45 years old and has accrued a $40,000 annual retirement benefit in his company's plan. His administrators might determine that they'll need to have $550,000 in the plan when Mike retires in order to pay his benefits throughout a 30 year retirement.

They'll also need to make a contribution each year (based on even more assumptions) to ensure that the plan will have sufficient assets to pay out this benefit. In this example, the result might be that they need to contribute $24,500 this year based on Mike's benefit accrual.

Needless to say, defined benefit plans can become complicated and administratively expensive quickly.

Pros of Defined Benefit Plans:

- Substantial benefits can be provided and accrued within a short time – even with an early retirement
- Employers can contribute and deduct more than under other retirement plans
- Provide a predictable benefit to employees
- Vesting can follow a variety of schedules from immediate to spread out over seven years
- Benefits are not dependent on asset returns
- Plan can be used to promote certain business strategies by offering subsidized early retirement benefits

Cons of Defined Benefit Plans:

- Most costly type of plan
- Poor investment returns can hamstring company cash flow
- Most administratively complex plan
- An excise tax applies if the minimum contribution requirement is not satisfied
- An excise tax applies if excess contributions are made to the plan

Even though defined benefit plans can be costly to administer, small businesses shouldn't immediately discard them. Because the benefits are subject to limitation, there is **no cap on annual contributions**.

Planning Opportunity:

Business owners nearing retirement trying to maximize their retirement savings should strongly consider defined benefit plans due to the large potential contributions.

Here's An Example:
Using our example from parts 1 and 2 of the guide, let's consider John. John is a 55 year owner of an S-Corp. Let's assume that he has no employees, has $0 saved for retirement thus far, and earns $500,000 per year.

Let's also assume that John wants to retire in ten years, and can earn 7% each year on his investments.

If he contributed to a 401(k) or solo 401(k) plan, he would be limited to contributions of $59,000 per year according to the IRS. If John contributed $59,000 to a 401(k) plan each year for ten years, and earned 7% on his investments, John's total account balance after ten years would be $815,170.

If John retires in ten years, he would be 65 when he stops working. Mortality tables today show a 65 year old male's life expectancy at 84.3. So, if we assume that John withdraws an equal amount each year over a 20 year retirement (84.3 – 65), he could withdraw up to $71,912 per year before depleting his nest egg[1].

Now let's assume that John sets up a personal defined benefit plan instead. Remember, we're neglecting the effects of having employees. Rather than be

1 *This example is used to compare tax advantaged savings options and does not incorporate the longevity risk that John lives beyond age 84.3. If these savings were John's only source of retirement income, it would be foolish to neglect the possibility that John live for more than 20 years. This assumption is used solely for comparison purposes.*

constrained by a $59,000 annual contribution limit, John is constrained by a $210,000 annual defined benefit limit according to the IRS. This means he can contribute an unlimited amount of money each, so long as his projected annual retirement benefits (based on the same actuarial assumptions) don't exceed $210,000.

If John wanted to maximize his tax advantaged savings, he could specify a $210,000 annual benefit starting at age 65. His life expectancy would still be 84.3, meaning he would still be planning for a 20 year retirement.

Assuming John still earns 7% on his assets, his nest egg would need to be $2,224,743 at retirement to fund a $210,000 annual benefit for 20 years. To accumulate such a nest egg in ten years, he'd need to contribute $161,021 per year until then[2].

2 *Again, this analysis does not incorporate longevity risk or accurate actuarial IRS rules. It is only for illustrative purposes.*

Here's a comparison of the two options. As you can see, the defined benefit plan allows for much larger tax deferred contributions than the defined contribution plan.

	Annual Contribution	Tax Deferred Savings After 10 Years	Annual Retirement Benefits
Defined Contribution	$59,000, capped by IRS rules	$815,170	$71,912 (derived from investment assumptions)
Defined Benefit	$161,021 limitation, derived from actuarial assumptions	$2,224,743	$210,000, capped by IRS rules

Keep in mind that if he pursued a defined benefit plan, John would be **obligated** to make the annual contributions of $161,021. In a defined contribution plan he would not.

Comparison: DB vs. DC Plans:

Considerations	Defined Benefit	Defined Contribution
Employees Most Benefitted	Longer-tenure and/or older employees	Shorter tenure and/or younger employees
Job Tenure Patterns Encouraged	Longer-tenure because employees receive greatest benefit accruals at end of long-time service. May lock people into jobs they'd otherwise leave.	Although employees receive benefits based on salary, not tenure, may encourage employees to change jobs in order to receive access to lump-sum distribution from their retirement accounts.
Influence on Retirement Patterns	Can be designed to encourage early retirement; may financially penalize workers for working additional years beyond the normal retirement age. May pressure workers who wouldn't otherwise retire to do so.	Cannot be designed to encourage early retirement but instead rewards employees for working additional years.
Cost Variability & Risk	Employer assumes investment and possibly preretirement inflation risk and therefore annual plan costs are less predictable. While costs might be higher than anticipated, pension costs in a booming stock market may be zero because of investment returns on past contributions.	Employer assumes none of the investment risk on retirement fund assets. As a result, annual costs are more predictable although the employer cannot take advantage of high stock market or other investment returns on retirement plans assets.

Considerations	Defined Benefit	Defined Contribution
Annual Funding Flexibility	However, there tends to be more flexibility as to when employer may meet these costs contributions in defined benefit plans.	However, money purchase and some types of profit sharing plans have less flexibility in when those costs are to be paid. In addition, defined contribution accounts can be designed to entail no employer contributions at all, unlike defined benefit plans.
Termination Benefits	Termination benefits are usually small for employees with less job tenure.	Termination benefits equal account balances, when vested, based on both salary and years of plan participation. Tend to be larger than those for defined benefit plans.
Plan Termination	Can be very costly if plan is underfunded.	Not applicable, because defined contribution plans are by definition never underfunded.
Administrative Costs	Managing a large pool of funds is less expensive than managing individual accounts, but there may be more overall expenses because of the provision of annuities (which can be relatively complex to administer) and the need for professional actuarial and investment advice to ensure compliance with regulations.	While actuarial services are not required to the extent necessary for defined benefit plans, the provision of participant investment education and the cost of administering many individual funds for loans, hardship, and/or retirement benefits may make defined contribution plans more expensive. Generally, however, dc plans are less expensive to administer, especially for smaller employers.

Considerations	Defined Benefit	Defined Contribution
Administrative Complexity	More	Less
Integration With Social Security Benefits	Employers fulfill a specific retirement income objective (e.g., to replace 60% of preretirement income with social security and pension benefits), and therefore social security integration is accomplished more efficiently under defined benefit plans.	Integration can be accomplished, but the process focuses on the disparity in contributions and doesn't attempt to target a specific replacement ratio.
Providing Substantial Benefits Over a Short Time Period	Employees can be grandfathered into a new defined benefit system so as to provide special benefits that are not possible under a defined contribution approach (e.g., the quick accumulation of benefits to participants who have not participated in the system for a substantial period of time).	Unless grandfathered into a defined benefit plan, shorter tenured workers leave service with more substantial benefits under a defined contribution arrangement.

Non-qualified Retirement Plans

While qualified retirement plans can offer robust benefits packages, they must be delivered in a way that's non-discriminatory. Many businesses have executives or groups they want to incentivize beyond what's allowed in a qualified plan – including ownership.

Non-qualified retirement plans are not restrained by ERISA, and are designed to meet the specialized retirement needs of key executives and other select employees.

Deferred Compensation Plans (or NQDCs) are the most common form of executive benefit. They free participants & businesses to contribute additional amounts beyond what qualified plans allow and defer the taxes until they are received. At that point, the benefits are deductible to the business and taxable to the executive.

To preserve this tax advantage, the accrued benefits must be "at risk". This means that if an executive's company goes bankrupt, the executive compensation benefits must be forfeitable to creditors. If the benefits are protected in another form of trust, the IRS would consider them "constructively received" by executives, and immediately taxable.

Executive Bonus Plans can also provide additional benefits to key employees. In this plan, companies provide executives with a bonus that's taxable as income to the recipient and usually deductible to the company. Then, the executive may choose to use the bonus to purchase an insurance policy that grows on a tax deferred basis. There is then a death benefit available to the executive's beneficiaries, and a cash balance for the executive that builds over time.

Group Carve Out Plans are an extension of an employer sponsored life insurance policy. Typically, group term life insurance coverage is limited to $50,000 on a tax advantaged basis. A group carve out plan supplements this amount by tacking on a universal life insurance policy for executives. This policy is portable and can create supplemental income through its cash value.

Split Dollar Life Insurance Plans help defray the cost of life insurance. Companies offering such a plan essentially share a life insurance policy on the life of key employees, offering coverage at a sizable discount. Premiums paid by the business are deductible, and the business normally retains total control over the arrangement.

Summary

Defined benefit plans are not as popular in the U.S. today as they were 25 years ago. This is mainly because businesses sponsoring defined benefit plans have very little flexibility when it comes to their annual contributions.

That said, defined benefit plans should not be discarded by default. They make sense for many businesses with executives nearing retirement, since they allow for greater tax deductible contributions than defined contribution plans.

Additionally, non-qualified plans can be a great way to compensate executives beyond ERISA restrictions. As you can tell, small businesses have numerous options when it comes to retirement planning. In part 4 we'll cover exactly how to get started establishing a new plan, and how to save taxes on your implementation costs.

Closing

In my practice I help people running small businesses across the country build retirement plans that are cost effective and customized for their needs. My objective is to help my clients reach their personal & business objectives in the lowest risk and most efficient manner possible.

If, after reading this, you have further questions about retirement planning for small businesses, feel free to reach out.

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Email Grant Today

The **Definitive** Small Business Guide to Retirement Planning

Part 4

ABOVE THE CANOPY

Hello again! Welcome back to **The Definitive Small Business Guide to Retirement Planning**. Part 3 we reviewed defined benefit and non-qualified plans. To refresh your memory, here are a few of the topics we explored:

- Defined benefit plans for those nearing retirement
- A comparison of defined contribution and defined benefit plans
- Deferred compensation plans
- Executive bonus plans
- Group carve out plans
- Split dollar life insurance plans

Today, we're going to dive into exactly what you need to do to **get started with a new retirement plan**.

Contents

How to Get Started With a New Retirement Plan

Service Providers

Now that we've reviewed the life cycle of retirement plans, how to produce an employee census, and the major types of retirement plans, let's discuss **how to get started**. There are thousands of service providers around the U.S. in the retirement plan industry. And while small businesses might not need a full committee of professionals to help operate their plan, they'll at least need to select a **financial institution**.

Otherwise known as a custodian or brokerage firm, a financial institution maintains your retirement plan's assets in one or more accounts. They also typically make trades and allow you to select investments for the plan. Banks, mutual funds, insurance companies, and trust companies all offer this service.

For the "do it yourselfers" in the crowd, establishing a solo 401(k), SEP-IRA, or SIMPLE IRA will only require the help of a financial institution. Nearly all brokerage firms offer these types of accounts, and have plan documents ready for you to sign and put in motion. Charles Schwab & Co., TD Ameritrade, and Fidelity all have online platforms that are effective and cost efficient.

Other qualified and non-qualified plans can be far more complex, and might require an intimate understanding of ERISA in order to stay compliant. While larger companies may have staff on hand devoted to their retirement and health benefits, small businesses typically hire professionals when operating a more complex plan:

Third Party Administrator (TPA): TPA firms help sponsors with their plan document. They make sure that your document fits your needs, complies with the law and stays current. This is an important function, and TPAs can often keep small businesses out of legal trouble. TPA firms come in all shapes and sizes, and most areas have numerous national and local firms to choose from.

Recordkeeper: Recordkeepers are most often used in qualified defined contribution plans. They keep track of contributions for each participant, and often provide an online portal for participants to make investment choices and request withdrawals. Recordkeeping firms are not required in order to operate a plan, but help streamline operations and make plan fiduciaries lives easier.

Financial Advisor: Some business owners prefer to manage retirement plan investments themselves, and don't require a financial advisor. But for most, a relationship with an advisor is an easy way to delegate important work to a professional and keep things simple.

Financial advisors can help you operate the less complex plans (SEP-IRA, SIMPLE IRA, etc.) without requiring other specialized professionals like a TPA or recordkeeper. With these plans, any advisor can help you get set up through their broker or custodian.

With more complex plans that do require additional support, advisors often act as the quarterback in your relationship with other service providers. Your financial advisor is often the party that best understands your personal and business needs, and can therefore help you create and manage a retirement plan that supports them.

Also, keep in mind that if your plan must comply with ERISA, you have some additional fiduciary responsibilities. In Part 1, we discussed how many advisors to 401(k) plans help sponsors select and monitor investments. **Remember** — unless your advisor explicitly accepts responsibility as a 3(21) or 3(38) fiduciary in writing, you will be responsible for their work.

A Note on Hiring Financial Advisors:
Beyond the concept of delegating your fiduciary duty, many financial products today create large commissions for sales people — especially annuities, insurance products, and some mutual funds. Because of this, you'll never find a shortage of professionals ready to offer you one.

In general, I find that the bigger the potential commission for the salesman, the more expensive and worse the product is for you. When considering hiring an advisor to help with your retirement plan, make sure you know four things about them:

1) How they are compensated;
2) What the total fees to operate the plan will be;
3) Whether they are a fiduciary to you and your plan; and most importantly
4) **Whether they are selling you a product or offering their objective and unbiased advice**

Because of the large commissions generated by selling financial products, many advisors today are incentivized to push their clients into products they don't need. Be sure that your advisor is acting in your best interests and accepts responsibility for their own work if something goes wrong with your plan.

Bundled Plans

The trend in the small business retirement plan industry, particularly in 401(k) and other defined contribution plans, is to offer bundled services. Insurance, brokerage, and mutual fund companies often package together retirement plans by offering all of the services listed above under one roof.

Many small businesses use this arrangement because it seems like the only option available and very convenient. In reality, it is often extremely expensive when the alternatives are considered.

The costs of bundled retirement plans are usually deducted directly from assets in the plan. This isn't a bad arrangement per se, but bundled plans are often very complex and difficult to understand. And since fees are deducted from plan assets as opposed to being invoiced directly to the business, many don't realize what their costs are.

In my humble opinion, bundled retirement plans are another opportunity for large financial companies to make extremely complex products that few people understand. Given this lack of understanding and the fact that businesses don't actually cut a check for these services (remember, fees are paid directly from plan assets), bundled service providers are free to charge far greater fees.

Additionally, it's rare that professionals selling bundled plans act as a fiduciary to the retirement plans they represent.

> *Here's an example:*
> You implement a bundled 401(k) plan for your business, and open the plan with a sales rep for an insurance company. You allow the rep to choose the investment options in the plan. Every year or so your rep check in on you, and makes recommendations about which funds you might want to replace.

Ten years down the road, several of your employees consult an attorney. They do some digging, and realize that your 401(k) plan is far more expensive than it could be, and that the excessive fees are depressing their retirement savings. They form a class and sue you for the overly expensive investment options within the plan.

It never occurred to you to check your plan's fees, since you never received an invoice from your sales rep. You were sent an annual disclosure notice each year, but the document was confusing and you were too busy to spend time digging and asking questions. Many people would assume that the business can deflect the lawsuit, since their financial rep made the suggestions about the investment options.

Not true. Unless your financial rep acknowledges in writing that they're a fiduciary to your retirement plan (as a 3(21) or 3(38) fiduciary), you bear all the responsibility for the plan and investment expenses. Your financial rep in this situation would wipe their hands clean and step away, leaving you to clean up the mess.

This is a growing issue in the U.S., as 401(k) lawsuits are becoming more common as our society becomes increasingly litigious. Fiduciary liability should not be taken lightly, and minimized wherever possible.

In Sum

Even though many companies are content consolidating their retirement plan to one relationship, this is the actual result:

1) Their plan is very expensive
2) The higher costs reduce their employees' retirement nest egg
3) Their plan has limited investment options
4) Ownership is left with additional legal risk, since the financial professional shares no fiduciary responsibility for the plan

Unbundled Plans

The alternative to a *bundled* retirement plan is an *unbundled*, or open architecture retirement plan. Rather than rely on one insurance, brokerage, or mutual fund company to provide everything, in an unbundled arrangement the business hires service providers individually.

Open architecture plans have no limitation on products or investment options. Businesses are free to build customized retirement plans that match their needs exactly and have transparent fee structures.

An unbundled and customized retirement plan may sound like a lot of work, since you'd need to find a TPA, recordkeeper, and custodian individually. Fortunately, independent financial advisors can do this work for you. An independent advisor is one who is not held "captive" within an organization, meaning they have no allegiance to a specific company's products. Instead, they find the best and lowest cost solutions based on their clients' needs.

Cost differences between the two structures vary by plan size. For small businesses, bundled plans are typically far more expensive than unbundled plans. In my experience small businesses with under $3 million in plan assets can actually save anywhere from 20%, up to as much as 75% per year in fees by simply moving to an unbundled plan.

The difference between the two typically decreases for larger plans. Large plans that hold $100 million or more have a higher degree of scrutiny over costs and negotiate fees aggressively. Because of this there is not much cost difference between the two structures in larger plans.

Finally, as a sponsor of a qualified retirement plan you will take on certain responsibilities as a fiduciary to your participants. As we've discussed, one of these responsibilities is making sure that your plan's assets are invested prudently and are not overly expensive.

Financial professionals offering bundled plans to small businesses will rarely act as a fiduciary to yours. In the eyes of ERISA, financial professionals must acknowledge their role as a fiduciary in writing. And unfortunately, few are willing to do so.

Independent advisors are far more likely to take a fiduciary responsibility for their services to your plan. Since they have no preference toward specific products, their role is to build a customized plan based on your needs. This is a far more **objective** philosophy. On top of this, it is far more common to find independent advisors willing to work as a 3(21) or 3(38) fiduciary. Remember, hiring one of these types of fiduciaries allows you to delegate some of your fiduciary responsibilities and liabilities.

This is a **major** difference. Many businesses struggle to understand how their bundled plan is put together and how their advisor is compensated. As such, they're left wondering whether the plan their advisor recommended is actually a good fit.

Unbundled plans are created specifically for your needs. And rather than wonder whether your advisor is acting in your best interests, *you can actually offload some of your fiduciary liability to them*. If your 401(k) participants sue you years down the road for overly expensive investment options, *your advisor is on the hook instead of you*. Add this to the fact that you have more options, better customization, at a much lower cost, and the open architecture framework should be strongly considered by anyone starting a 401(k) plan.

Comparison for Small Businesses:

	Bundled	Unbundled
Service Providers	Insurance, brokerage, mutual fund companies	Several independent service providers
Set Up	Off the shelf, boilerplate plan	Customized to business & ownership needs
Fee Collection	Deducted from plan assets	Customizable: deducted from plan assets or paid externally
Fee Structure	Confusing	Transparent
Cost	Often very high for small businesses	Usually lower than bundled plans
Investment & Product Options	Limited to company availability	No limitations as plan is structured independently
Fiduciary Liability	Few financial professionals offering bundled plans take fiduciary responsibility	Many financial professionals offering unbundled plans take fiduciary responsibility

Tax Saving Opportunities

The deductibility of contributions can be a massive incentive to maintain a retirement plan through your business. But beyond making deductible contributions, the IRS offers tax **credits** for businesses starting a retirement plan and participants contributing to one.

Businesses

You may be able to defray some of the costs of starting a retirement plan with the **Retirement Plans Startup Costs Tax Credit**. Businesses incurring expenses to administer a SEP-IRA, SIMPLE IRA, or qualified plan might be eligible for this credit.

Requirements:

- You must have 100 or fewer employees receiving at least $5,000 in compensation in the previous year
- You must have at least one non-highly compensated employee
- Your employees can't have received benefits from another plan sponsored by you in the last three tax years[1]

Amount of the Credit:
The credit is 50% of the ordinary and necessary eligible startup costs, up to a maximum of $500 per year. Eligible startup costs include any costs necessary to set up and administer the plan or educate your employees about the plan.

Eligible Tax Years
You can claim the credit for each of the first 3 years of your plan, and can start claiming it in the tax year before your plan becomes effective. The credit is also part of the general business tax credit, meaning that you can carry it forward to other tax years, or as far back as January 1 of 2002.

1 *The IRS describes this limitation as follows: "In the 3 years before the first year you're eligible for the credit, your employees weren't substantially the same employees who received contributions or accrued benefits in another plan sponsored by you, a member of a controlled group that includes you, or a predecessor firm." Consult your tax advisor to verify eligibility for this credit.*

Deduction Limitation
If you decide to claim this tax credit, you can't also deduct the startup costs.

To claim the tax credit, sponsors need to file form 8881 along with their annual return.

Participants

Any time taxpayers make eligible contributions to their IRA or employer sponsored retirement plan, they might be eligible to take the **Retirement Savings Contributions Tax Credit.**

Anyone 18 or older, who's not a full time student and not claimed as a dependent on someone else's tax return is technically eligible. BUT, the credit phases out quickly according to your adjusted gross income:

2016 Saver's Credit			
Credit Rate	**Married Filing Jointly**	**Head of Household**	**All Other Filers**
50% of your contribution	AGI $37,000 or less	AGI $27,750 or less	AGI $18,500 or less
20% of your contribution	$37,001 - $40,000	$27,751 - $30,000	$18,501 - $20,000
10% of your contribution	$40,001 - $61,500	$30,001 - $46,125	$20,001 - $30,750
0% of your contribution	Over $61,500	Over $46,125	Over $30,750

Rollover contributions are not eligible for the Saver's Credit, and eligible contributions may be reduced by distributions you take from your retirement plan. Also, only contributions to certain types of plans are eligible for the credit:

- Traditional or Roth IRA
- 401(k)
- SIMPLE IRA
- SARSEP
- 403(b)
- 501(c)(18)
- Governmental 457(b)

To claim the credit, you'll need to file form 8880 along with your annual return.

Summary

Sponsoring a retirement plan through your business is a wonderful way to build your personal wealth. It can also lower your company's and personal tax liabilities, improve employee engagement & morale, and attract top employees to help your business thrive.

And while operating a plan can seem like a big task, there are plenty of solutions with low annual maintenance requirements and professionals you can outsource to.

I hope you've found this guide helpful. We've covered a lot of information, and you are now armed to take the next step toward establishing a retirement plan.

As I've mentioned the other sections of this guide, I help entrepreneurial people and small business owners across the country build and operate retirement plans in my practice. My objective is to help my clients reach their personal & business objectives in the lowest risk and most cost efficient manner possible.

If, you have further questions about retirement planning for you small business, feel free to reach out.

Just click the link below, and I'd be happy to point you in the right direction.

Email Grant Today

About the Author

Grant Bledsoe is the founder and president of Three Oaks Capital Management, where he helps entrepreneurial people and small businesses organize and optimize their finances. Grant opened Three Oaks Capital in 2014, after spending seven years with Charles Schwab & Co., Inc. as a trader and senior manager in their securities lending group.

Thanks for Reading!

This guide is a recent release, and I hope you are find its contents informative and helpful. If you have any feedback or suggestions for improvement, please send your comments to

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