Retirement Plan Options for Small Businesses

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My Background

Education:

- B.S. in Business-Finance
- M.S. in Applied Economics
- Accredited Financial Counselor

Work Experience:

- Worked for Janus Mutual Funds
- Worked for REPTECH as a Pension Analyst
- Associate Specialist for MSU Extension

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Why Consider A Retirement Plan for your Workers?

- Form of Compensation
- Retain Workers
- Align Compensation Package with Company Values to Attract the Right Employees
- Tax Benefits: Company, Employee, Owner

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Types of Retirement Plans

- Defined Benefit
  - Common Names: Pension Plan, DB Plan
- Defined Contribution:
  - 401(a)4 Qualified Plans:
    - 401k
    - Profit Sharing
    - Deferred Compensation
    - Employee Stock Ownership Plan (ESOP or KSOP)
    - Simple 401k
  - *403(b): Not Profit Employers*
  - *457: Governmental Employers*
  - Section 408:
    - Simplified Employee Pension (SEP)

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What are the Goals of your Retirement Plan?

- Compete with other employers
- Encourage employees to stay longer
- Help provide for financially stable retirement years for you and your employees
- Defer income to retirement
  - Reduce income taxes now
    - Company and employee

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Retirement Plan Considerations

- How committed are you to this plan?
- What level of employer contributions do you expect to contribute?
- How many employees will be eligible to participate?
- How much time do you as an owner expect to devote to operating this plan?

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Employer Sponsored Plan Overview

- IRS creates broad rules that each plan must operate under.
  - IRS Code section numbers are 401, 403, 457
- Employer determines how their plan will operate within these rules.
  - The "Plan Document" defines how the plan will operate.
  - A "Summary Plan Description" is 1 to 8 page document that is available for employees to help them understand the plan.

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Required Features

- The Plan Document will define:
  - Eligibility to participate in the plan
    - Common Eligibility:
      - Immediate
      - January 1
      - Age 18 or 21
      - XX Months of employment
      - 1st day of the quarter after 1000 hours are worked in a calendar year
  - Compensation

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Employee Contributions

- Contribution must be via payroll deduction
  - Contributions are tax deductible
- IRS Maximum Contribution Amount
  - $20,500 for 2022
  - $6,500 "catch up" contribution
    - Must be age 50 or older

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Employer Contributions

- Employers do not have to contribute
- Employers may change contributions from year to year
- Employer contributions can be made
  - Each pay period
  - Quarterly
  - Annually
    - Can be contributed up to 2.5 months after the year end

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Profit Sharing

- Employees receive profit sharing contributions even if they are not contributing employee funds.
- Often, profit sharing contributions are the same formula every year.
  - Example: 4% contribution or $1,000 to all employees
- Note: The employer does not need to have a profit to make a profit sharing contribution.

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Employer Matching

- Employer contributions that are based on a formula that requires employee contributions
  - Examples:
    - 100% of an employee's contributions up to 4%
      - An employee that contributes 6% of their own funds receives a 4% employer contribution
      - An employee that contributes 3% of their own funds receives a 3% employer contribution
    - 50% of an employee's contributions up to 10%
    - 100% of the first 3% and 50% of the next 2%.

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Vesting

- Employer contributions can be subject to vesting
- For each year of service you earn additional vesting in the employer contributions
- Each plan will choose a vesting schedule
  - Immediate
  - 1/20 Vesting Schedule
    - 20% for 1 year, 40% for 2 year, 60% for 3 years, etc.
  - 3 year cliff vesting schedule:
    - 0% for 1 year, 0% for 2 years, 100% for 3 years

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Vesting Example

- An employee works for a company for 3 years and leaves for a new job.
- The companies vesting schedule is 1/20.
  - He is 60% vested
- The employee's balance is:
  - Employee contributions: $4,600
  - Employer contributions: $2,300
- The employee requests his funds be transferred to an IRA.
  - His transfer is $5,980. ($4,600 + $2,300 * 60%)

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Investments

- Defined Contribution Plan
  - Almost always all participants select their own investments from a "menu" of pre-selected options
    - Typically, 5-20 investment choices
    - Investment choices represent a range of investment types
    - Mutual funds are common options
- Investment returns are the employee's responsibility.

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Questions

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