Wealth Planning **Update**

Choosing the right retirement plan for your business

Understanding the benefits of IRAs, 401(k)s and defined benefit plans for you and your employees.

As a business owner, you naturally focus your energy, time and resources on growing and sustaining your business, while fostering an environment where your employees can thrive and support your vision. As you set your priorities, planning for retirement may fall to the bottom of your list.

In fact, according to a 2016 BMO Wealth Management survey of more than 400 business owners, 75% had saved less than $100,000 for their retirement. This illustrates that most business owners prioritize their business over retirement planning.

Whether you don't see the benefit of planning now or simply have not had the time for it, failing to plan for retirement can come at a high cost. You may forego the tax and wealth planning opportunities that a well-structured retirement savings strategy can provide, while your employees may miss an important benefit that can help them prepare for their futures.

Below, we review three categories of retirement savings plans available to business owners—Individual Retirement Accounts ("IRAs"), 401(k)s and defined benefit/pension plans. We identify pros and cons of each and provide specific ideas to help you put a plan in place. We've also included a detailed comparison chart to help you decide which may be right for you.

Do you really need a retirement plan?

If your business is thriving and generating a steady income, you may not see the benefit of putting retirement money aside today. Perhaps you are overwhelmed by the options available or are hesitant to add another responsibility to your already lengthy list. If the value of your business has been growing, you may plan to sell it and monetize the value later in life, essentially considering the business to be your retirement plan. However, unforeseen factors may impact the value of your business and your ability to continue running it, such as health, family or economic changes. In such cases, a separate retirement plan can help provide an important safety net.

With a retirement plan, you can:

- Take control of your future, particularly if you don't have the benefit of a company pension or stock plan.
- Realize tax benefits today and in the future that can save you money every year.
- Earn compound growth on your nest egg, giving you greater flexibility to work as much or as little as you want as you approach retirement.
- Retain valuable employees by providing an important benefit to them that may be of minimal cost to you.

IRAs: The easiest way to start saving

Both you and your employees can take advantage of the benefits of an Individual Retirement Account, at little to no cost to your business.

Traditional or Roth IRA. Anyone with earned income can open an IRA (though there are income limits for Roth IRAs). Although these types of IRAs have the lowest contribution limits, you can set one up in conjunction with another retirement plan to increase savings.

SIMPLE IRA. Designed for small businesses with fewer than 100 employees, a SIMPLE IRA allows employees and employers to make contributions. Employees can choose whether or not to contribute, but as the employer, you must make matching contributions up to 3% of compensation or 2% nonelective contributions, so you will need to be committed to the plan year after year. In addition, the business (generally) cannot maintain another retirement plan in conjunction with a SIMPLE plan.

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SEP IRA. With this plan, the contribution limits are higher than with any other type of IRA; you can potentially put away up to $55,000 per year for yourself, depending on your income. In addition, you have the flexibility to contribute or not each year, depending on the cash flow needs of your business. The percentage of salary contributed to all plans must be equal, so if you have employees, you're required to invest the same percentage of their salary in their accounts as your own salary.

TIP If you need to set up a new plan and contribute for the prior year, a SEP IRA may be your only solution.

Employer-sponsored IRA. Designed to help your employees save faster, this plan allows them to contribute to an IRA through payroll deductions.

Self-directed IRA. These plans allow you to direct your retirement savings to an area of investing in which you're particularly savvy, such as real estate, private equity or hard money lending. Traditional and Roth tax benefits and contribution limits apply.

TIP Use self-directed IRAs with care; according to IRS self-dealing rules, if you make a transaction that benefits you or a "disqualified person"(such as funding a repair on a real-estate investment), the account could become taxable. You're responsible for understanding and complying with these rules.

Pros and cons of IRAs	
+ Low cost and very easy to start + No plan administrator required + No annual compliance testing + Flexible contributions (except SIMPLE IRAs)	– May have lower contribution limits than defined benefit or 401(k) plans – No loan options

401(k)s: Greater savings ability with greater flexibility

In general, 401(k) plans may be a bit more complex and costly to set up than IRAs. However, most plans will allow both you and your employees to set aside more money for retirement.

Solo 401(k). This solution allows a sole proprietor with no employees (except a spouse) to make contributions as both the employer and employee, potentially up to $55,000 (plus $6,000 catch-up if you're over age 50), depending on your income. Contributions as employee and employer may be fully tax-deductible, further reducing your income taxes. You can also establish the plan as a traditional 401(k) or Roth 401(k), depending on your goals.

TIP Consider hiring your spouse to boost household savings.

Work with your CPA to determine if a SEP IRA or Solo 401(k) will allow for higher contributions based on your salary and business income. In many cases, particularly for an S Corp owner with flexibility in wage distributions, a Solo 401(k) can allow for higher contributions with less income. This is because SEP IRA contributions are only profit-sharing (generally limited to 25% net self-employment income up to $55,000), whereas a Solo 401(k) includes both an employee deferral of compensation (up to $18,500) and profit sharing (up to a combined $55,000).

Traditional 401(k). Employees can contribute up to $18,500 pretax per year, commonly through payroll deductions. Business owners can make matching contributions to encourage employee participation, or profit sharing contributions based on cash flow each year, all of which are tax deductible for the business.

Roth 401(k). Like a Roth IRA, there is no up-front tax savings, but any growth and subsequent withdrawals are tax-free in retirement. Contributions to a Roth 401(k) are not subject to the income limits that apply to Roth IRAs. Employer matching contributions are pretax and may not be directed to the Roth portion.

TIP If you believe your taxes will be higher when you retire, consider directing all or part of your contributions to this option.

Ask your plan administrator about including a Roth savings option in a traditional 401(k) plan to allow for after-tax savings.

Pros and cons of 401(k)s	
+ Higher tax-deferred contribution limits + Employer matching of employee contributions allowed + End-of-year profit sharing to incentivize employees allowed + Tax-free loans up to IRS limits	– More costly than IRAs – Additional forms for bigger plans

Defined benefit/pension plans: maximum retirement savings

These plans allow you to sock away more than any other type of retirement plan. An actuary uses statistics, such as the age of the participants (you and your employees), salary levels and years until retirement to calculate the contribution limits. Older business owners with younger employees can potentially maximize benefits to their own accounts based on these calculations, in some cases resulting in allowable contributions of $100,000 or more. Contributions are fully

Retirement Plan Options for Business Owners

	SEP IRA	Traditional/Solo 401(k)	SIMPLE IRA	Traditional/Roth IRA	Defined Benefit Plan
Generally Best For	**Sole Proprietor** Few to no employees. Wants flexibility and ease of administration.	**Solo 401(k): Sole Proprietor.** No employees (except spouse). Wants to maximize contributions. **Traditional 401(k):** Wants to provide more saving option for employees.	**Business with less than 100 employees.** Want ease of administration & employee participation.	**Any Individual.** Wants to increase tax deferred savings and 1) is already contributing to a qualified plan or 2) only wants to contribute minimal amount.	**Business owner who wants to maximize contributions above any other plan limits.** Values maximum savings ability over administrative costs.
Deadline to Establish	Tax filing plus extensions for year of contribution.	December 31 for year of contribution.	October 1 for year of contribution.	Tax filing (not including extensions) for year of contribution.	December 31 for year of contribution.
Deadline to Contribute	Tax filing plus extensions.	Tax filing plus extensions.	**ER Contribution:** Tax filing plus extension. **EE Contribution:** 30 days after month for which contribution is elected.	Tax filing (not including extensions) for year of contribution.	15 days after each quarter (contributions usually made quarterly).
Income to Qualify	**Employee:** W-2 wages. **Owner:** Sch C or SE income.	**Employee:** W-2 wages. **Owner:** Sch C or SE income.	**Employee:** W-2 wages. **Owner:** Sch C or SE income.	Earned income (wages; net earnings from self-employment; taxable alimony).	**Employee:** W-2 wages. **Owner:** Sch C or SE income.
Maximum Employee Contribution	N/A Employer only contributions.	100% "earned income" up to $18,500 + $6,000 catch up over 50.[1]	$12,500 + $3,000 catch up over 50.	$5,500 + $1,000 catch up over 50.	N/A Employer only contributions.
Maximum Employer Contribution	**Owner:** 20% Net adjusted profits (sole prop, partnership)/25% compensation (corporation) up to $55,000.[1] **Employee:** 25% compensation up to $55,000.	**Owner:** 20% Net adjusted profits (sole prop, partnership)/25% compensation (corporation) up to $55,000.[1] **Employee:** 25% compensation up to $55,000.	Dollar for dollar match up to 3% compensation or fixed 2% of compensation.	N/A	Annual benefit cannot exceed smaller of $220,000 or 100% Highest 3 years avg. compensation.[5]
Effect on Income Tax: Employee	Owner can deduct on 1040.	EE Contributions are pre-tax (Traditional). Reduce taxable Income.	Owner can deduct on 1040. No deduction for employee, but contribution pre-tax.	**Traditional IRA:** Deductible Contributions. Taxable Withdrawals **Roth IRA:** NonDeductible Contributions. Tax Free Withdrawals.[3]	N/A Employer only contributions.
Effect on Income Tax: Employer	100% deductible contributions.[2]	100% deductible contributions.[2]	100% deductible contributions.[2]	N/A Funded by individual.	Deductible contributions - limit based on actuary computation.
Income Limitations	N/A	N/A	N/A	**Traditional IRA:** N/A.[4] **Roth IRA:** $120,000 to $135,000 (Single); $186,000 to $196,000 (MFJ).	N/A
Loan Provisions	None.	Allowed.	None.	None.	None.
Other Benefits	Only plan that can be established and funded after the tax year.	Employee Contributions Pre-Tax. Owner can make both employee contributions and employer "profit sharing" to maximize contribution. Solo 401(k) filing requirements are minimal compared to traditional 401(k) plans.	May incentivize employees to participate with matching employer contribution requirements.	Can set up spousal IRA for non working spouse.	Depending on age of employer/employees, owner can potentially defer large sums annually to increase tax deduction for business and savings for employer/employees. May combine with profit sharing plan to increase further.
References	IRS Pub 4333 (SEPs for small business)	IRS Pub 560. IRC Sec 401. www.irs.gov/retirement-plans/one-participant-401k-plans	IRS Pub 560. IRS Pub 4334 (SIMPLE Plans)	IRS Pub 590A and 590B	IRS Pub 560

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tax deductible. If you're looking to put away as much as possible, and have the cash flow to do so, a defined benefit plan may be right for you.

Pros and cons of defined benefit/pension plans

Pros	Cons
+ Save more than any other type of plan	− Most expensive option to maintain
+ Can be paired with a 401(k) or profit sharing plan to maximize contributions	− Requires annual reporting and actuary calculations
	− Must have consistent income available to cover IRS minimum funding requirements

Getting started

Establishing a retirement plan does not need to be complicated or time-consuming. Your financial professional can help by handling the setup, directing you to investment options that are appropriate for your situation, and sending you annual reports to share with your accountant. Start by engaging your financial and tax professionals to help you:

- Project your retirement needs and define how much you can safely put away to meet those needs.
- Project the annual tax savings possible given your personal and business situations.

You may find it makes sense to fully fund a tax-deferred plan up to IRS limits, split savings between pretax and after-tax vehicles, or save a portion to a tax-deferred account and put the rest back into the business. Working with your advisors will enable you to make the best decision for you and your business.

Just as a business plan sets your company up for success, a retirement plan can help both you and your employees prepare for a better future. Ask your financial professional for help understanding and choosing the right business retirement plan for you.

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[1] Use IRS Pub 560 Chapter 4 and 5 to calculate Plan Contribution for Owner. "Compensation" is equal to Net Earnings from Self Employment, reduced by deductible portion of S/E Tax and owner's plan contribution.

[2] Deduction limited to Lesser of 25% Participants Compensation or 100% of contribution. Self-employed: use computation as mentioned in (1) above.

[3] Roth Withdrawals are tax free ("qualified") if taken after 59 1/2 & account has been open for 5 years. See IRA Pub 590-B for additional rules.

[4] If owner or spouse can participate in a workplace plan, deductibility of Traditional IRA contributions subject to Income Limits.

[5] Actuary calculates contribution allowed within those limits based on factors such as age of owner and employees, income and years to retirement.

Annual Compensation limit of $275,000 applies to all qualified plans when calculating contribution and benefit limits. Example: if plan provides for matching up to 5% of compensation, only $275,000 can be used.

All combined contributions to Defined Contributions Plans are limited to a lesser of $55,000 or 100% Compensation. This includes SEP IRAs, 401(k).

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