By Anthony P. Curatola

Retirement Plan Opportunities for Small Business Owners

The SEP and SIMPLE plans are two retirement plan options that small business owners can choose from to help their employees prepare for retirement while also enjoying some tax savings for the business.

As December 31 quickly approaches and year-end tax planning gets into full swing, small business owners looking to reduce federal—and possibly state—income taxes may want to look at some of the retirement plan options available. Two plans that are particularly attractive are the Simplified Employee Pension (SEP) plan and the Savings Incentive Match Plan for Employees of Small Businesses (SIMPLE) plan. These plans not only help employees (and owners, as well) save for their future, but they also help create tax savings for the businesses.

Both SEP and SIMPLE plans are easy to set up and have low start-up and annual maintenance costs. The plans themselves are quite different, however, especially in the timing for establishing the plan and making contributions. The timing of the contribution is particularly tricky for the business owner since he or she is considered both an employer and an employee of the company. And, yes, the contribution dates for employees and employer are different.

SEP Plans

SEP plans were created to give small businesses a method for providing retirement benefits to employees without having to meet the complex requirements associated with other qualified plans. SEPs are established by employers and are funded by employer contributions to employee IRAs. All employees who have attained age 21, worked for the employer during at least three of the immediately preceding five years, and received at least $550 in compensation during the year must be allowed to participate (IRC §408(k)(2)).

For businesses that file as a partnership or a sole proprietorship, an SEP plan can be established for the 2014 calendar tax year as late as April 15, 2015 (including extensions). Businesses that file as a corporation have until March 15, 2015 (including extensions). An SEP plan is established by executing a formal written agreement to provide benefits to all eligible employees. In addition, all eligible employees must be given information about the plan, and an SEP-IRA must be set up for each eligible employee so that contributions can be made to the account. Unlike some other qualified retirement plans, contributions made to the employee's account are vested immediately because each eligible employee has his or her own SEP-IRA.

Contributions to an established SEP plan are based on a written allocation formula and must not discriminate in favor of highly compensated employees. The annual contribution limit for 2014 is the lesser of $52,000 (adjusted annually for inflation) or 25% of the employee's compensation for common law employees or 20% of net earnings from self-employment for self-employed individuals. For example, Teresa is a common law employee who has compensation of $220,000 in 2014. The maximum SEP contribution that her employer can make to her SEP-IRA is $52,000, which is the lesser of $52,000 or $55,000 (25% of $220,000).

Another important aspect of the SEP plan is the last day for the employer to make contributions to the plan. Specifically, an employer is able to make contributions on behalf of employees (and himself or herself as an employee) up to the due date for filing the business tax return, including any extension. Thus, there's some breathing time after the holiday season to fund the plan.

SIMPLE Plans

An employer with 100 or fewer employees can adopt a SIMPLE plan instead of an SEP plan. The SIMPLE plan allows employees to defer a portion of their wages, and it's available to all employees who have received at least $5,000 in compensation from the employer during any of the two preceding calendar years. An employer can choose to allow employees with compensation less than $5,000 to participate, but the bar for participation can't be set higher than $5,000.

The last day to establish a SIMPLE plan for the current tax year isn't as generous as the SEP plan. In fact, it's quite restrictive. A calendar-year business must establish the SIMPLE plan between January 1 and October 1 of the tax year. Thus the plan can't be adopted during the fourth quarter of the tax year or the first quarter of the following year, which is when many small business owners consider such an adoption. The only exception to the October 1 deadline is for new businesses coming into existence after October 1. They may establish a plan as soon as administratively feasible.

The SIMPLE plan also has a significantly lower maximum contribution limit compared to the SEP plan, which makes it less attractive as a retirement investment. The advantage to it is that it's less costly to the employer, which may make it more attractive in terms of its out-of-pocket cost benefit. The employer contribution for the SIMPLE plan is essentially limited to two options. The first is a dollar-for-dollar matching of the employee's contribution up to 3% of the employee's compensation. The second option is a nonelective contribution of 2% of each eligible employee's compensation (regardless of whether the employee contributes). The employee contribution limit is $12,000 (or $14,500 if age 50 or older) by year-end.

Contributions to SEP and SIMPLE plans are deductible for federal and state income tax purposes.

The timing of depositing the contributions to the SIMPLE plan also differs from the SEP plan. The last day to deposit the employee's contributions is 30 days after the end of the month for which the contributions are to be made (i.e., January 30 for a calendar-year taxpayer). The January 30 deadline also applies to the contributions made on behalf of the owner as an employee. The final date for depositing the employer's matching contributions for the employees (including the owner) is the due date for the employer's tax return, including any extension.

Tax Savings

Contributions to SEP and SIMPLE plans are deductible for federal and state income tax purposes. Some states (such as Pennsylvania) don't allow a deduction for employee contributions. There has been some confusion about the timing of the deduction for contributions made after the end of the tax year, i.e., after December 31 of the tax year. The good news is that these contributions are still deductible for the associated tax year. In other words, contributions deposited in 2015 for the 2014 calendar tax year are deductible on the employer's 2014 tax return.

In general, the SEP plan provides more financial security to the employees and small business owner and is easily set up at the last minute for new or established businesses. The SIMPLE plan, on the other hand, can't be set up at the last minute, but the small business owner will have less out-of-pocket costs for providing this benefit to its employees. For a family-owned and -operated business, the SEP plan may be a more attractive option, but that decision should be made by the owners and their tax/investment advisor. **SF**

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