Small Business Retirement Plans: SEP-IRA

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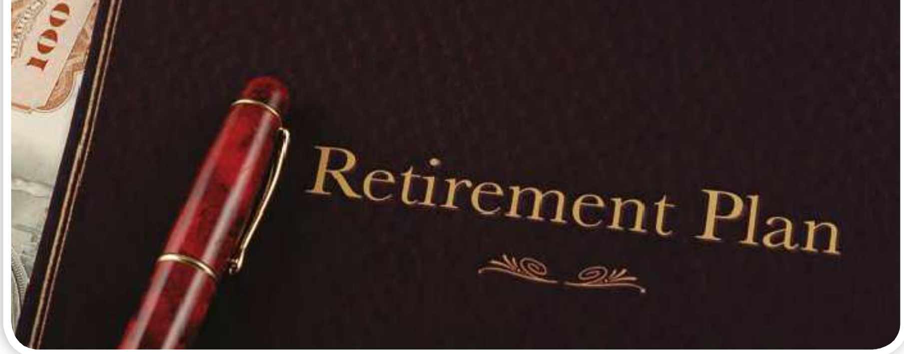
Small business owners can benefit greatly by implementing company retirement plans for themselves and their employees. Business retirement plans not only provide valuable tax benefits to the company but also allow small businesses to attract and retain skilled employees. Small business owners enjoy the luxury of higher annual contributions to business retirement plans in comparison to personal retirement accounts such as traditional and Roth IRAs. This can be particularly advantageous to those who are self-employed with no employees.

A very popular small business retirement plan is the Simplified Employee Pension (SEP) IRA. SEP-IRAs closely resemble the traditional IRA in terms of functionality. Similar to a traditional IRA, self-employed individuals can make tax-deductible contributions to the plan and enjoy tax-deferred growth on the assets inside the account.

The key difference with the SEP-IRA is a higher allowable annual contribution. The IRS allows annual SEP-IRA contributions of the lesser of 25% of compensation (20% of net earnings from self-employment) or $51,000 in 2013. For example, a self-employed individual making $75,000 in net earnings for the year could contribute up to $15,000 to his/her account for the year. That is nearly three times more than what would be allowed if the self-employed individual contributed to a personal IRA for which annual contributions are limited to only $5,500 in 2013.

The SEP-IRA has other important features that make this plan attractive to small business owners. SEP-IRAs are generally easy to set up, have low annual administrative costs, and do not require annual reporting to the IRS as is the case with other business retirement plans. Perhaps the greatest attribute of this retirement plan is funding flexibility. There is no annual funding mandate for the SEP-IRA that provides the small business owner with cash flow flexibility in years in which the business is not profitable or is facing financial distress.

Additionally, in years in which the owner decides to fund SEP-IRAs, contributions do not have to be made until the employer's tax filing deadline, including valid extensions. Suppose a calendar year subchapter S corporation received an automatic six-month extension to file the corporate tax return. The funding for the retirement plan would not have to be consummated until September 15 following the close of the corporation's calendar tax year. The additional time to fund the retirement accounts provides vital cash flow flexibility to the company that would not otherwise be available.



Small business owners should carefully consider some of the potential drawbacks of the SEP-IRA before implementing such a plan, especially if they have employees. Employers with employees must contribute equally to each employee on a percentage of compensation basis in any year in which contributions will be made. Thus, an owner-employee cannot make a large contribution to his/her own plan account while neglecting to make the same percentage contribution to other employee accounts.

Also, employees who have met mandated participation and tenure criteria must be included in the company retirement plan. Employers should be aware that SEP-IRA contributions are generally employer-funded and that contributions are vested to the employee immediately. Thus, employees control the varying aspects of their plan account, including investment decisions. Also, unlike other retirement plans such as a 401(k) plan, loans are not permitted in SEP-IRA plans nor are catch-up contributions allowed for those individuals age 50 or older.

A SEP-IRA can be a valuable business, tax, and financial planning tool for the small business owner, if utilized correctly. Talk to your CPA about the pros and cons of implementing a SEP-IRA for your small business and whether the plan is right for your situation.