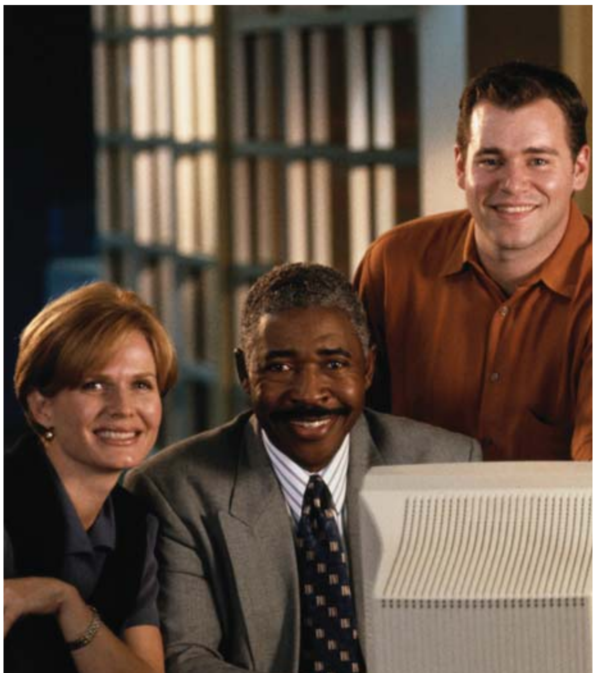
CHOOSING
A RETIREMENT SOLUTION
for Your Small Business



This pamphlet is a joint project of the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) and the Internal Revenue Service. Its publication does not constitute legal, accounting, or other professional advice. It does, however, constitute a small entity compliance guide for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

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1-866-444-EBSA (3272)

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It is also available from the IRS by calling
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Starting a small business retirement savings plan can be easier than most business people think. What's more, there are a number of retirement programs that provide tax advantages to both employers and employees.

Why Save?

Experts estimate that Americans will need 70 to 90 percent of their preretirement income to maintain their current standard of living when they stop working. So now is the time to look into retirement plan programs. As an employer, you have an important role to play in helping America's workers save.

By starting a retirement savings plan, you will help your employees save for the future. Retirement plans may also help you attract and retain qualified employees, and they offer tax savings to your business. You will help secure your own retirement as well. You can establish a plan even if you are self-employed.

Any Tax Advantages?

A retirement plan has significant tax advantages:

- ❑ Employer contributions are deductible from the employer's income,
- ❑ Employee contributions are not taxed until distributed to the employee, and
- ❑ Money in the program grows tax-free.

Any Other Incentives?

In addition to helping your business, your employees and yourself, recent tax law changes have made it easier than ever to establish a retirement plan. They include:

- ❑ Higher contribution limits so your employees (and you) can set aside even larger amounts for retirement;
- ❑ "Catch-up" rules that allow employees aged 50 and over to set aside additional contributions. The amount varies, depending on the type of plan;
- ❑ Tax credit for small employers that would enable them to claim a tax credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE, or certain other types of plans (more on these later). The credit equals 50 percent of the cost to set up and administer the plan, up to a maximum of $500 per year for each of the first 3 years of the plan; and
- ❑ Tax credit for certain low- and moderate-income individuals (including self-employed) who make contributions to their plans ("Saver's tax credit"). The amount of the credit is based on the contributions participants make and their credit rate. The maximum contribution eligible for the credit is $2,000. The credit rate can be as low as 10 percent or as high as 50 percent, depending on the participant's adjusted gross income.
- ❑ A Roth 401(k) program that can be added to a 401(k) plan to allow participants to make after-tax contributions into separate accounts, providing an additional way to save for retirement. Distributions upon death or disability or after age 59½ of amounts held for 5 years in Roth accounts, including earnings, are generally tax free.

A Few Retirement Facts

Most private-sector retirement vehicles are either Individual Retirement Arrangements (IRAs), defined contribution (DC) plans or defined benefit (DB) plans.

People tend to think of an IRA as something that individuals establish on their own, **but** an employer can help its employees set up and fund their IRAs. With an IRA, the amount that an individual receives at retirement depends on the funding of the IRA and the earnings (or income) on those funds.

Defined contribution plans are employer-established plans that do not promise a specific amount of benefit at retirement. Instead, employees or their employer (or both) contribute to employees' individual accounts under the plan, sometimes at a set rate (such as 5 percent of salary annually). At retirement, an employee receives the accumulated contributions plus earnings (or minus losses) on such invested contributions.

Defined benefit plans, on the other hand, promise a specified benefit at retirement, for example, $1000 a month at retirement. The amount of the benefit is often based on a set percentage of pay multiplied by the number of years the employee worked for the employer offering the plan. Employer contributions must be sufficient to fund promised benefits.

Small businesses may choose to offer IRAs, DC plans, or DB plans. Many financial institutions and pension practitioners make available one or more of these retirement plans that have been pre-approved by the IRS.

On the following two pages you will find a chart outlining the advantages of each of the most popular types of IRA-based and defined contribution plans and an overview of a defined benefit plan.

	IRA BASED PLANS			
	Payroll Deduction IRA	**SEP**	**SIMPLE IRA Plan**	**Safe Harbor 401(k)**
Key Advantage	Easy to set up and maintain.	Easy to set up and maintain.	Salary reduction plan with little administrative paperwork.	Permits high level of salary deferrals by employees without annual discrimination testing.
Employer Eligibility	Any employer with one or more employees.	Any employer with one or more employees.	Any employer with 100 or fewer employees that does not currently maintain another retirement plan.	Any employer with one or more employees.
Employer's Role	Arrange for employees to make payroll deduction contributions. Transmit contributions for employees to IRA. No annual filing requirement for employer.	May use IRS Form 5305-SEP to set up the plan. No annual filing requirement for employer.	May use IRS Forms 5304-SIMPLE or 5305-SIMPLE to set up the plan. No annual filing requirement for employer. Bank or financial institution handles most of the paperwork.	No model form to establish this plan. Advice from a financial institution or employee benefit advisor may be necessary. A minimum amount of employer contributions is required. Annual filing of Form 5500 is required.
Contributors to the Plan	Employee contributions remitted through payroll deduction.	Employer contributions only.	Employee salary reduction contributions and employer contributions.	Employee salary reduction contributions and employer contributions.
Maximum Annual Contribution (per participant) See ***www.irs.gov/ep*** for annual updates	\$4,000 for 2007; \$5,000 for 2008. Additional contributions can be made by participants age 50 or over up to \$1,000 in 2007.	Up to 25% of compensation[1] but no more than \$45,000 for 2007.	***Employee:*** \$10,500 in 2007. Additional contributions can be made by participants age 50 or over up to \$2,500 in 2007. ***Employer:*** Either match employee contributions 100% of first 3% of compensation (can be reduced to as low as 1% in any 2 out of 5 yrs.); or contribute 2% of each eligible employee's compensation.[2]	***Employee***: \$15,500 in 2007. Additional contributions can be made by participants age 50 or over up to \$5,000 in 2007. ***Employer/Employee Combined***: Up to the lesser of 100% of compensation[1] or \$45,000 for 2007. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.
Contributor's Options	Employee can decide how much to contribute at any time.	Employer can decide whether to make contributions year-to-year.	Employee can decide how much to contribute. Employer must make matching contributions or contribute 2% of each employee's compensation.	Employee can decide how much to contribute pursuant to a salary reduction agreement. The employer must make either specified matching contributions or a 3% contribution to all participants.
Minimum Employee Coverage Requirements	There is no requirement. Can be made available to any employee.	Must be offered to all employees who are at least 21 years of age, employed by the employer for 3 of the last 5 years and had compensation of \$500 (for 2007).	Must be offered to all employees who have earned income of at least \$5,000 in any prior 2 years, and are reasonably expected to earn at least \$5,000 in the current year.	Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.
Withdrawals, Loans and Payments	Withdrawals permitted anytime subject to federal income taxes; early withdrawals subject to an additional tax (special rules apply to Roth IRAs).	Withdrawals permitted anytime subject to federal income taxes, early withdrawals subject to an additional tax.	Withdrawals permitted anytime subject to federal income taxes, early withdrawals subject to an additional tax.	Withdrawals permitted after a specified event occurs (e.g., retirement, plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.
Vesting	Contributions are immediately 100% vested.	Contributions are immediately 100% vested.	Employee salary reduction contributions and employer contributions are immediately 100% vested.	Employee salary reduction contributions and most employer contributions are immediately 100% vested. Some employer contributions may vest over time according to plan terms.

[1] Maximum compensation on which 2007 contribution can be based is \$225,000.

[2] Maximum compensation on which 2007 employer 2% non-elective contributions can be based is \$225,000.

[3] After 2007

DEFINED CONTRIBUTION PLANS			Defined Benefit
Automatic Enrollment Safe Harbor 401(k)[3]	**401(k)**	**Profit Sharing**	
Permits high level of salary deferrals by employees without annual discrimination testing (after 2007).	Permits high level of salary deferrals by employees.	Permits employer to make large contributions for employees.	Provides a fixed, pre-established benefit for employees.
Any employer with one or more employees.	Any employer with one or more employees.	Any employer with one or more employees.	Any employer with one or more employees.
No model form to establish this plan. Advice from a financial institution or employee benefit advisor may be necessary. A minimum amount of employer contributions is required. Annual filing of Form 5500 is required.	No model form to establish this plan. Advice from a financial institution or employee benefit advisor may be necessary. Annual filing of Form 5500 is required. Requires annual non-discrimination testing to ensure plan does not discriminate in favor of highly compensated employees.	No model form to establish this plan. Advice from a financial institution or employee benefit advisor may be necessary. Annual filing of Form 5500 is required.	No model form to establish this plan. Advice from a financial institution or employee benefit advisor would be necessary. Annual filing of Form 5500 is required. An actuary must determine annual contributions.
Employee salary reduction contributions and employer contributions.	Employee salary reduction contributions and maybe employer contributions.	Annual employer contribution is discretionary.	Primarily funded by employer.
Employee: See annual update for 2008 dollar limit. Additional contributions can be made by participants age 50 or over. ***Employer/Employee Combined:*** Up to the lesser of 100% of compensation or the dollar limit for 2008 (see annual update). Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	***Employee***: $15,500 in 2007. Additional contributions can be made by participants age 50 or over up to $5,000 in 2007. ***Employer/Employee Combined***: Up to the lesser of 100% of compensation[1] or $45,000 for 2007. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Up to the lesser of 100% of compensation[1] or $45,000 for 2007. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Annually determined contribution.
Employees, unless they opt otherwise, 3% salary reduction contributions, with automatic annual increases for 3 years. The employer must make either specified matching contributions or a 3% contribution to all participants.	Employee can decide how much to contribute pursuant to a salary reduction agreement. The employer can make additional contributions, including matching contributions as set by plan terms.	Employer makes contribution as set by plan terms. Employee contributions, if allowed, as set by plan terms.	Employer generally required to make contribution as set by plan terms.
Generally, must include all employees who have not already opted out and who are at least 21 years of age who worked at least 1,000 hours in a previous year.	Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.	Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.	Generally, must be offered to all employees at least 21 years of age who worked at least 1,000 hours in a previous year.
Withdrawals permitted after a specified event occurs (e.g., retirement, plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.	Withdrawals permitted after a specified event occurs (e.g., retirement, plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.	Withdrawals permitted after a specified event occurs (e.g.,retirement, plan termination, etc.) subject to federal income taxes. Plan may permit loans and hardship withdrawals; early withdrawals subject to an additional tax.	Payment of benefits after a specified event occurs (e.g. retirement, plan termination, etc.). Plan may permit loans; early withdrawals subject to an additional tax.
Employee salary reduction contributions vest immediately and most employer contributions must be 100% vested after 2 years of service. Some employer contributions may vest over longer period according to plan terms.	Employee salary reduction contributions are immediately 100% vested. Employer contributions may vest over time according to plan terms.	May vest over time according to plan terms.	May vest over time according to plan terms.

Payroll-Deduction IRAs

Even if an employer does not want to adopt a retirement plan, it can allow its employees to contribute to an IRA through payroll deductions, providing a simple and direct way for eligible employees to save. The decision about whether to contribute, and when and how much to contribute to the IRA (up to $4,000 for 2007, $5,000 in 2008, increasing thereafter) is always made by the employee in this type of arrangement.

Many individuals eligible to contribute to an IRA do not. One reason is that some individuals wait until the end of the year to set aside the money and then find that they do not have sufficient funds to do so. Payroll deductions allow individuals to plan ahead and save smaller amounts each pay period. Payroll deduction contributions are tax-deductible by an individual, to the same extent as other IRA contributions.

Simplified Employee Pensions (SEPs)

A SEP allows employers to set up a type of IRA for themselves and each of their employees. Employers must contribute a uniform percentage of pay for each employee, although they do not have to make contributions every year. For the year 2007, employer contributions are limited to the lesser of 25 percent of pay or $45,000. (Note: the dollar amount is indexed for inflation and will increase.) Most employers, including those who are self-employed, can establish a SEP.

SEPs have low start-up and operating costs and can be established using a two-page form. And you can decide how much to put into a SEP each year – offering you some flexibility when business conditions vary.

SIMPLE IRA Plan

This savings option is for employers with 100 or fewer employees and involves a type of IRA.

A SIMPLE IRA plan allows employees to contribute a percentage of their salary each paycheck and requires employer contributions. Under SIMPLE IRA plans, employees can set aside up to $10,500 in 2007 by payroll deduction. For years after 2007, annual cost-of-living updates can be found at www.irs.gov/ep. Employers must either match employee contributions dollar for dollar – up to 3 percent of an employee's compensation – or make a fixed contribution of 2 percent of compensation for all eligible employees.

SIMPLE IRA plans are easy to set up. You fill out a short form to establish a plan and ensure that SIMPLE IRAs (to hold contributions made under the SIMPLE IRA plan) are set up for each employee. A financial institution can do much of the paperwork. Additionally, administrative costs are low.

Employers may either have employees set up their own SIMPLE IRAs at a financial institution of their choice or have all SIMPLE IRAs maintained at one financial institution chosen by the employer.

Employees can decide how and where the money will be invested, and keep their SIMPLE IRAs even when they change jobs.

401(k) Plans

401(k) plans have become a widely accepted retirement savings vehicle for small businesses. Today, an estimated 44 million American workers participate in 401(k) plans that have total assets of about $2.5 trillion.

With a traditional 401(k) plan, employees can choose to defer a portion of their salary. So instead of receiving that amount in their paycheck today, the employee can contribute such amount into a 401(k) plan sponsored by their employer. These deferrals are accounted separately for each employee. Generally, the deferrals (plus earnings) are not taxed by the federal government or by most state governments until distributed.

401(k) plans can vary significantly in their complexity. However, many financial institutions and other organizations offer prototype 401(k) plans, which can greatly lessen the administrative burden on individual employers of establishing and maintaining such plans.

Safe Harbor 401(k) Plans

A safe harbor 401(k) plan is intended to encourage plan participation among rank and file employees and to ease administrative burden by eliminating the tests ordinarily applied under a traditional 401(k) plan. This plan is ideal for businesses with highly compensated employees whose contributions would be limited in a traditional 401(k) plan.

A safe harbor 401(k) plan allows employees to contribute a percentage of their salary each paycheck and requires employer contributions. In a safe harbor 401(k) plan, the mandatory employer contribution is always 100 percent vested.

Automatic Enrollment Safe Harbor 401(k) Plans

Beginning in 2008, automatic enrollment safe harbor 401(k) plans can increase plan participation among rank-and-file employees and ease administrative burden by eliminating the tests ordinarily required under a traditional 401(k) plan. This plan is for employers who want a high level of participation, and also have highly compensated employees whose contributions might be limited under a traditional plan.

All employees are automatically enrolled in the plan and contributions are deducted from their paychecks, unless they opt out after receiving notice from the plan. There are set employee contribution rates, which rise incrementally over the first few plan years, although different amounts can be chosen. Employer contributions are also required. In addition, there is a safe harbor for the default investment options provided under the plan that relieves the employer from liability for the investment results. Where contributions are invested following the safe harbor, state payroll withholding law is preempted, so plans may automatically deduct contributions from employees' wages unless they opt out.

Profit-Sharing Plans

Employer contributions to a profit-sharing plan are discretionary. Depending on the plan terms, there is often no set amount that an employer needs to contribute each year.

If you do make contributions, you will need to have a set formula for determining how the contributions are allocated among plan participants. The funds are accounted separately for each employee.

As with 401(k) plans, profit-sharing plans can vary greatly in their complexity. Similarly, many financial institutions offer prototype profit-sharing plans that can reduce the administrative burden on individual employers.

Defined Benefit Plans

Some employers find that defined benefit (DB) plans offer business advantages. For instance, employees often value the fixed benefit provided by this type of plan. In addition, employees in DB plans can often receive a greater benefit at retirement than under any other type of retirement plan. On the employer side, businesses can generally contribute (and therefore deduct) more each year than in defined contribution plans. However, defined benefit plans are more complex and, thus, more costly to establish and maintain than other types of plans.

To Find Out More...

The following jointly developed publications are available for small businesses on the DOL and IRS Web sites and through the toll-free numbers listed below:

- ❑ *401(k) Plans for Small Businesses* (Publication 4222)
- ❑ *Payroll Deduction IRAs for Small Businesses* (Publication 4587)
- ❑ *SIMPLE IRA Plans for Small Businesses* (Publication 4334)
- ❑ *SEP Retirement Plans for Small Businesses* (Publication 4333)
- ❑ *Retirement Plan Correction Programs* (Publication 4224)
- ❑ *Retirement Plan Correction Programs* CD-ROM (Publication 4050)

DOL Web site: **www.dol.gov/ebsa**
Publications request number: **1-866-444-EBSA (3272)**

IRS Web site: **www.irs.gov/ep**
Tax form and publication ordering number:
1-800-TAX-FORM (1-800-829-3676)
(You can place your order 24 hours a day, 7 days a week.)

Also available from the U.S. Department of Labor:

- ❑ *Meeting Your Fiduciary Responsibilities*
- ❑ *Understanding Retirement Plan Fees and Expenses*
- ❑ *Small Business Retirement Savings Advisor: www.dol.gov/elaws/pwbaplan.htm*

Also available from the Internal Revenue Service:

- ❑ Publication 560, *Retirement Plans for Small Business* (*SEP, SIMPLE,* and *Qualified Plans*)
- ❑ Publication 590, *Individual Retirement Arrangements (IRAs)*
- ❑ Publication 4530, *Designated Roth Accounts under a 401(k) or 403(b) Plan*

IRS

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