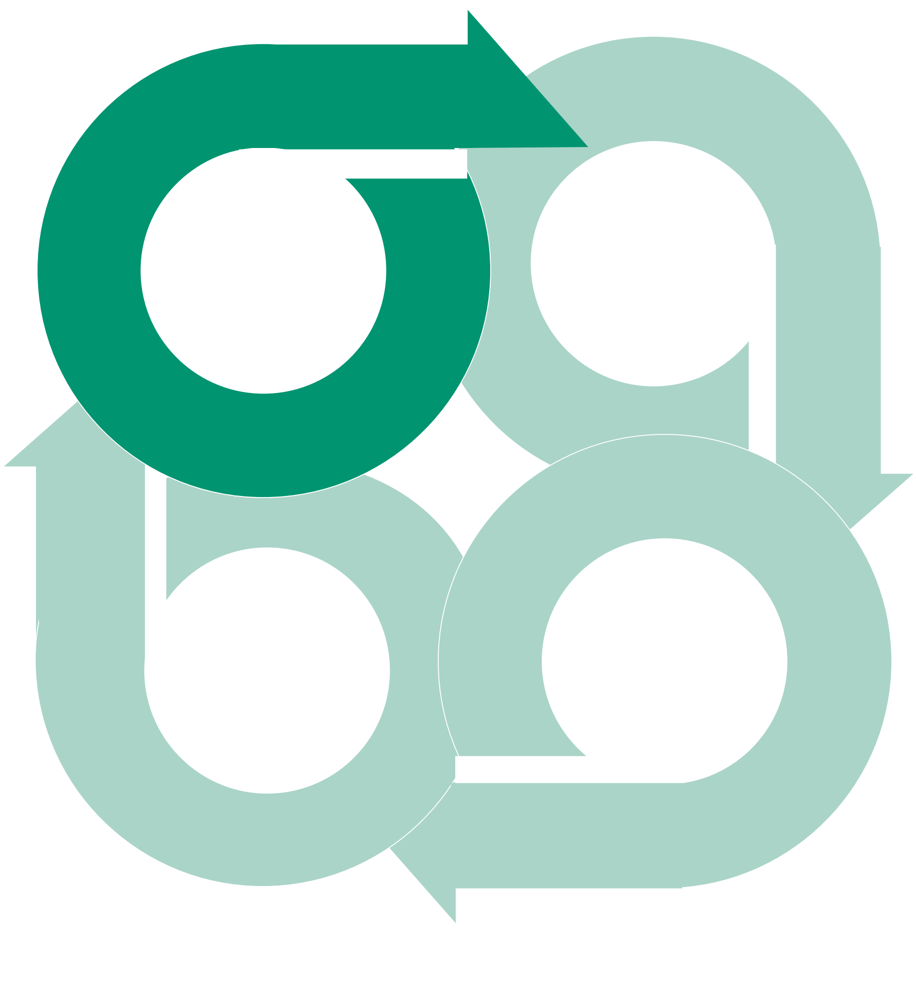
CHOOSING A RETIREMENT SOLUTION

for Your Small Business



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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 60 to 80 percent of their pre-retirement income – lower income earners may need up to 90 percent – 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. Better yet, you will join more than one million small businesses with 100 or fewer employees that offer workplace retirement savings plans.

Any Tax Advantages?

A retirement plan has significant tax advantages:

- Contributions are deductible by the employer when contributed;
- Employer and employee contributions are not taxed until distributed to the employee; and
- Money in the retirement 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 larger amounts for retirement;
- "Catch-up" rules that allow employees age 50 and over to set aside an additional $500 (or $1,000, depending on the type of plan) for 2002;
- 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 Few Retirement Plan Facts

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

An IRA is the most basic sort of retirement arrangement. 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, $1,000 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 prototype 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.

	Payroll Deduction IRA	SEP	SIMPLE IRA Plan	Defined Contribution Plans			Defined Benefit
				401(k)	Profit-Sharing	Money Purchase	
Key Advantage	Easy to set up and maintain.	Easy to set up and maintain.	Salary reduction plan with little administrative paperwork.	Permits higher level of salary deferrals by employees than other retirement vehicles.	Permits employer to make large contributions for employees.	Permits employer to make large contributions for employees.	Provides a fixed, pre-established benefit for employees.
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.	Any employer with one or more employees.	Any employer with one or more employees.	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.	Set up plan by completing IRS Form 5305-SEP. No annual filing requirement for employer.	Set up plan by completing IRS Form 5304-SIMPLE or IRS Form 5305-SIMPLE. No annual filing requirement for employer. Bank or financial institution processes most of the paperwork.	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. Also may require annual nondiscrimination 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 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.
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/or employer contributions.	Annual employer contribution is discretionary.	Employer contributions are fixed.	Primarily funded by employer.
Maximum Annual Contribution (Per participant)	$3,000 for 2002 – 2004; $4,000 for 2005 – 2007; $5,000 for 2008. Additional contributions can be made by participants age 50 or over.	Up to 25% of compensation [1] or a maximum of $40,000.	Employee: Up to $7,000 (for 2002) with $1,000 annual incremental increases until the limit reaches $10,000 in 2005. Additional contributions can be made by participants age 50 or over. 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: $11,000 in 2002 with $1,000 annual incremental increases until the limit reaches $15,000 in 2006. Additional contributions can be made by participants age 50 or over. Employer/Employee Combined: Contributions per participant up to the lesser of 100% of compensation[1] or $40,000. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Contributions per participant up to the lesser of 100% of compensation[1] or $40,000. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Contributions per participant up to the lesser of 100% of compensation[1] or $40,000. Employer can deduct amounts that do not exceed 25% of aggregate compensation for all participants.	Actuarially determined contribution.
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. [2]	Employee can elect how much to contribute pursuant to a salary reduction agreement. The employer can make additional contributions, including possible 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 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.
Minimum Employee Coverage Requirements	Should be made available to all employees.	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 earned income of $450 (for 2002).	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.	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, Loans and Payments	Withdrawals permitted anytime subject to Federal income taxes; early withdrawals subject to tax penalty.	Withdrawals permitted anytime subject to Federal income taxes; early withdrawals subject to tax penalty.	Withdrawals permitted anytime subject to Federal income taxes; early withdrawals subject to tax penalty.	Withdrawals permitted after a specified event occurs (e.g., retirement, plan termination, etc.). Plan may permit loans and hardship withdrawals; early withdrawals subject to tax penalty.	Withdrawals permitted after a specified event occurs (e.g., retirement, plan termination, etc.). Plan may permit loans; early withdrawals subject to tax penalty.	Payment of benefits after a specified event occurs (e.g., retirement, plan termination, etc.). Plan may permit loans; early withdrawals subject to tax penalty.	Payment of benefits after a specified event occurs (e.g., retirement, plan termination, etc.). Plan may permit loans; early withdrawals subject to tax penalty.
Vesting	Contributions are immediately 100% vested.	Contributions are immediately 100% vested.	Employer and employee contributions are immediately vested 100%.	Employee salary deferrals are immediately 100% vested. Employer contributions may vest over time according to plan terms.	Employer contributions may vest over time according to plan terms. Employee contributions, if any, are immediately 100% vested.	Employer contributions may vest over time according to plan terms. Employee contributions, if any, are immediately 100% vested.	Right to benefits may vest over time according to plan terms.

[1] Maximum compensation on which 2002 contribution can be based is $200,000.

[2] Maximum compensation on which 2002 employer 2% non-elective contributions can be based is $200,000.

All forms noted on the chart can be downloaded from the IRS Web Site at: www.irs.gov or ordered over the phone at 1-800-TAX-FORM (1-800-829-3676).

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 $3,000 per year for 2002 through 2004, 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 2002, employer contributions are limited to the lesser of 25 percent of pay or $40,000. (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 Plans

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 $7,000 in 2002 (increasing by $1,000 increments each year thereafter until the limit reaches $10,000 in 2005) by payroll deduction. 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 42 million American workers are enrolled in 401(k) plans that have total assets of about $2 trillion.

With a 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 go into a separate account for each employee. Generally, the deferrals (plus earnings) are not taxed by the Federal government or by most state and local 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.

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 go into a separate account 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.

Money Purchase Plans

Money purchase plans are defined contribution plans that require fixed employer contributions (contributions are not discretionary). With a money purchase plan, the plan document specifies the employer contribution that is required each year. For example, let's say that your money purchase plan requires a contribution of 5 percent of each eligible employee's pay. The employer needs to make a contribution of 5 percent of each eligible employee's pay to a separate account within the plan for each employee each year.

Many financial institutions offer prototype money purchase plans that can lessen the administrative burden on individual employers.

Defined Benefit Plans

Defined benefit plans provide a fixed, pre-established benefit for employees.

Some employers find that defined benefit 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 often more complex and, thus, more costly to establish and maintain than other types of plans.

To Find Out More...

The following pamphlets and other retirement-related information are available for small businesses:

From the U.S. Department of Labor:

- *Simplified Employee Pensions (SEPs) – What Small Businesses Need to Know*
- *Savings Incentive Match Plan for Employee of Small Employers (SIMPLE) – A Small Business Retirement Savings Advantage*

From the Internal Revenue Service

- Publication 560, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*
- Publication 590, *Individual Retirement Arrangements*

U.S. Chamber of Commerce
Business Information and Development
(202) 463-5381
www.uschamber.com

DOL/U.S.Chamber/SBA Web site
www.selectaretirementplan.org

U.S. Department of Labor
Pension and Welfare Benefits Administration
www.dol.gov/pwba

PWBA publication request line:
1-866-275-7922

DOL Small Business Advisor
www.dol.gov/elaws

Internal Revenue Service
Tax Exempt/Government Entities
(877) 829-5500
www.irs.gov/ep

You can order IRS forms and publications 24 hours a day, 7 days a week, by calling:
1-800-TAX-FORM (1-800-829-3676)

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Answer Desk
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