

## SELF EMPLOYED RETIREMENT PLANS

By Steven W Shirley

If you own a small business or are self-employed — even if you just moonlight to earn extra income — there are some great tools to help with your retirement plan.

Self-employed people have more choices for tax-deferred retirement savings than employees do. Better yet, these savings plans will allow you to deduct contributions to them on your current tax return even if you don't deposit the money until the following year. But to get the deductions, the plans generally must be set up by year-end.

Some plans dictate that you contribute the same amount each year. Those plans would be a bad choice for someone who has significant income swings, but it might be great for a doctor or lawyer who started saving late in life and has a substantial and predictable income.

All of the accounts provide significant tax benefits because each dollar contributed reduces taxable income. For someone who pays 30 percent of his or her income in tax, that means each \$100 contribution requires a net cash outlay of only \$70. Money in the account grows on a tax-deferred basis, becoming taxable when it's pulled out during retirement.

In most instances, the accounts can be funded any time before your business' tax-filing deadline, which can be as late as Oct. 15, and still be deductible in the previous tax year.

Here are the options and the benefits and drawbacks of each:

### Simple' plans

- **Maximum 2007 contribution:** \$10,500 or, if the participant is 50 or older, \$13,000.
- **Advantages:** They're relatively easy to set up, and there are no annual filing requirements. If there are other employees, the employer needs to match only 3 percent of the employee's contributions. (Alternatively, the employer can contribute 2 percent of wages, regardless of whether the employee contributes.)
- **Drawbacks:** Maximum contribution amounts are lower than those for other retirement accounts.

## SEP-IRA

- **Maximum 2007 contribution:** 25 percent of compensation or \$45,000, whichever is less.
- **Advantages:** They're easy to set up and maintain, requiring no annual filing with the IRS. They also allow substantial annual contributions.  
If the self-employed person, or the company, took in \$50,000, for example, he or she could contribute \$12,500 to the plan.
- **Drawbacks:** SEP rules require that the company contribute the same percentage of income to anyone in the plan. So, if you make a generous contribution to your account, and you have employees, you must make the same contribution to the account of each employee.

## Individual 401(k)

- **Maximum 2007 contribution:** Up to 25 percent of the employer's income, plus 100 percent of the employee's income up to \$15,000, with a combined limit of \$45,000. An additional \$5,000 is allowed for those age 50 and over.
- **Advantages:** These accounts often allow bigger annual contributions than SEPs because they let both "employer" and "employee" contribute, even when the two are the same person. That means a business earning \$50,000 could contribute \$12,500, and the employee/owner could contribute an additional \$15,000 (\$19,000 for those 50 and over) for a total annual contribution of \$27,500. The 401(k) also is the only kind of qualified retirement account that allows borrowing. The IRS lets you borrow up to 50 percent of your account value or \$50,000, whichever is less.
- **Drawbacks:** Unlike SEPs and Simple plans, these plans are relatively complicated to set up and administer and require an annual filing with the IRS. That makes them more expensive to operate because the business owner probably needs to pay a tax accountant to help with the forms and filings.

## Profit-sharing plans

- **Maximum 2007 contribution:** 25 percent of compensation or \$45,000, whichever is less.
- **Advantages:** The amount and frequency of contributions are flexible, depending on the business' income.
- **Drawbacks:** Like the 401(k), these plans require annual filings with the IRS, making them more costly to administer.

## Defined-benefit plan

- **Maximum 2007 contribution:** determined by an actuary.
- **Benefits:** For those who are getting a late start in retirement planning, this can allow the biggest annual contributions. That's because they are based on the monthly amount the business owner wants to receive in retirement. An actuary takes that number and projects how much money must be set aside to fund the desired future payments.
- **Drawbacks:** Once it's set up, you're locked into whatever annual contributions are necessary for that future retirement benefit. If your income varies widely, that can be a risky commitment.

If you are still confused about which plan is best for you and your company seek out the advice of a financial professional they can help you better understand your options. Just make sure you do something because without a plan you may wind up with nothing.

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