Financing Retirement for Farmers and Other Small Business Owners
Parman R. Green
UO&E Farm Business Management Specialist

For many people financial planning for retirement is one of those topics that gets more lip service than action. Everyone knows it is best to begin funding retirement accounts early in life. However, there are those school loans to be paid off, investments that must be made in the new business, the family needs a new car or house, and then come the expenses of helping the kids with their college education. Too frequently, the funds for investments into retirement accounts just aren't available. Generally at 50 years of age or so, with retirement looming not that far in the future, people begin to seriously invest for retirement. The obvious limitation is the short investment timeframe. The IRS Code contains two investment vehicles that farmers and other small business owners should consider: 1) SEP “Simplified Employee Pension” and 2) SIMPLE “Savings Incentive Match Plans for Employers”. Both of these retirement investment vehicles provide for greater tax-deductible contributions than the traditional IRA “Individual Retirement Arrangement”.

SEP “Simplified Employee Pension”
This is a plan under which the employer makes contributions directly to IRA accounts for employees and themselves. However, the contribution limits are significantly greater than with a traditional IRA.

Employees who must be covered by the plan:
1. attained age 21,
2. performed service for the employer during at least 3 of the immediately preceding 5 years, and
3. received at least $450 in compensation for the current year (2000).

Contributions:
1. are the lesser of $30,000 or 15% of compensation (adjusted net income for the self-employed) and
2. only the employer can contribute to this account.

Other important considerations:
1. While distributions from this plan must begin when participants reach the age of 70½, sole proprietors, partners, and corporate employees can continue making contributions regardless of age.
2. The deadline for establishing and funding a SEP is the due date of the employer’s income tax return, including extensions.
SIMPLE “Savings Incentive Match Plans for Employers”
This retirement vehicle provides for substantial salary reduction of employees. SIMPLEs may be established by employers with 100 or fewer employees who earned compensation of $5,000 or more in the prior year.

Employees who must be covered by the plan:
1. employees that received at least $5,000 in compensation during any two preceding years and
2. are reasonably expected to receive at least $5,000 compensation during the current year.

Contributions:
1. Employee can voluntarily put up to 100% of their compensation into the plan up to a maximum of $6,000 per year.
2. Employer must match employee contribution dollar for dollar up to 3% of compensation for employees who elect to participate in the plan. Or the employer can elect to contribute 2% of compensation to all eligible employees.
3. Maximum total contribution to employee account is $12,000 per year.

Other important considerations:
1. A SIMPLE plan must be established before October 1st for the contributions in the current year.
2. Employer has flexibility of reducing the eligibility “length of employment” and “income level”.
3. A SIMPLE plan offers medium income earners the ability to contribute a greater dollar amount to their account since the salary reduction is not based on a percentage of compensation.
4. A SIMPLE plan avoids high percentage employer matching cost responsibility while providing employees with substantial latitude for contributing toward their retirement.