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WEALTH MANAGEMENT

Retirement Plans for Small Businesses



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As a business owner, you should carefully consider the advantages of establishing an employer-sponsored retirement plan. Generally, you're allowed certain tax benefits for establishing an employer-sponsored retirement plan, including a series of potential tax credits for establishing the plan and a deduction for contributions you make. In return, however, you're required to include certain employees in the plan, and to give a portion of the contributions you make to those participating employees. Nevertheless, a retirement plan can provide you with a tax-advantaged method to save funds for your own retirement, while providing your employees with a powerful and appreciated benefit.

Types of plans

There are several types of retirement plans to choose from, and each type of plan has advantages and disadvantages. This discussion covers the most popular plans. You should also know that the law may permit you to have more than one retirement plan, and with sophisticated planning, a combination of plans might best suit your business's needs.

Profit-sharing plans

Profit-sharing plans are among the most popular employer-sponsored retirement plans. These straightforward plans allow you, as an employer, to make a contribution that is spread among the plan participants. You are not required to make an annual contribution in any given year. However, contributions must be made on a regular basis.

With a profit-sharing plan, a separate account is established for each plan participant, and contributions are allocated to each participant based on the plan's formula (this formula can be amended from time to time). As with all retirement plans, the contributions must be prudently invested. Each participant's account must also be credited with his or her share of investment income (or loss).

For 2026, no individual is allowed to receive contributions that exceed 100% of earnings or \$72,000 (up from \$70,000 in 2025). Your total deduction for all contributions to a profit-sharing plan may not exceed 25% of the total compensation paid to all plan participants. The total compensation limit that may be considered for any one participant is \$360,000 (up from \$350,000 in 2025).

401(k) plans

A type of deferred compensation plan and the most popular type of plan by far, the 401(k) plan allows contributions to be funded by the participants themselves, rather than by the employer. Employees elect to forgo a portion of their salary and have it put in the plan instead — up to \$24,500 in 2026 (up from \$23,500 in 2025), plus an additional \$8,000 in catch-up contributions for those age 50 and over (up from \$7,500 from 2025). Employees who reach age 60 to 63 in 2026 have a special catch-up of \$11,250. Employers may also choose to match an employee's contributions. Total employee and employer contributions may not exceed the \$72,000 annual additions limit (excluding any catch-up contributions).



These plans can be complicated and expensive to administer. Several tests must be met for the plan to remain in force. For example, the higher-paid employees' deferral percentage cannot be disproportionate to the rank-and-file's percentage of compensation deferred.

However, you don't have to perform discrimination testing if you adopt a "safe harbor" 401(k) plan. With a safe harbor 401(k) plan, you are generally required to either match your employees' contributions (100% of employee deferrals up to 3% of compensation, and 50% of deferrals between 3% and 5% of compensation), or make a fixed contribution of 3% of compensation for all eligible employees, regardless of whether they contribute to the plan. You also have the option of making an "enhanced" matching contribution that is at least as generous as the basic match. Safe-harbor contributions must be fully vested.

You can also avoid discrimination testing by adopting a qualified automatic contribution arrangement, or QACA. Under a QACA, an employee who fails to make an affirmative deferral election is automatically enrolled in the plan. An employee's automatic contribution must be at least 3% for the first two calendar years of participation and then increase 1% each year until it reaches 6%. You can require an automatic contribution of as much as 15%. Employees can change their contribution rate, or stop contributing, at any time (and get a refund of their automatic contributions if they elect out within 90 days). As with safe harbor plans, you're required to make an employer contribution: either 3% of pay to each eligible employee, or a matching contribution, but the match is a little different — dollar for dollar up to 1% of pay, and 50% on additional contributions up to 6% of pay. You can also require two years of service before your contributions vest.

Another way to avoid discrimination testing is by adopting a SIMPLE 401(k) plan. These plans are similar to SIMPLE IRAs (see below for limits), but can also allow loans. Because they're still qualified plans (and therefore more complicated than SIMPLE IRAs), and allow less deferrals than traditional 401(k)s, SIMPLE 401(k)s haven't become a popular option.

Yet another way to avoid testing is a starter 401(k) plan. Designed to be low cost and easy to administer, starter 401(k) plans allow only employee contributions. Employees must be auto-enrolled at a minimum contribution rate of 3% of compensations, with a maximum of 15%. Annual employee deferral limits are lower than in a traditional 401(k) plan, at just \$6,000 plus a \$1,100 catch-up contribution for those age 50 and older in 2026.

If you don't have any employees (or your spouse is your only employee) an "individual" or "solo" 401(k) plan may be especially attractive. Because you have no employees, you won't need to perform discrimination testing, and your plan will be exempt from the requirements of the Employee Retirement Income Security Act of 1974 (ERISA).

Note: 401(k) plans are generally established as part of a profit-sharing plan.

Money purchase pension plans

Money purchase pension plans are similar to profit-sharing plans, but employers are required to make an annual contribution. Participants receive their respective share according to the plan document's formula.

As with profit-sharing plans, money purchase pension plans cap individual contributions at 100% of earnings or \$72,000 in 2026 (up from \$70,000 in 2025), while employers are allowed to make deductible contributions up to 25% of the total compensation of all plan participants.

Like profit-sharing plans, money purchase pension plans are relatively straightforward and inexpensive to maintain. However, they are less popular than profit-sharing or 401(k) plans because of the annual contribution requirement.

Defined benefit plans

By far the most sophisticated type of retirement plan, a defined benefit program sets out a formula that defines how much each participant will receive annually after retirement if he or she works until retirement age. This is generally stated as a percentage of pay, and can be as much as 100% of final average pay at retirement.

An actuary certifies how much will be required each year to fund the projected retirement payments for all employees. The employer then must make the contribution based on the actuarial determination. In 2026, the maximum annual retirement benefit an individual may receive is \$290,000 (up from \$280,000 in 2025) or 100% of final average pay at retirement.

Unlike defined contribution plans, there is no limit on the contribution. The employer's total contribution is based on the projected benefits. Therefore, defined benefit plans potentially offer the largest contribution deduction and the highest retirement benefits to business owners.

SIMPLE IRA retirement plans

Actually a sophisticated type of individual retirement account (IRA), the SIMPLE (Savings Incentive Match Plan for Employees) IRA plan allows employees to elect to make pre-tax and/or Roth contributions of up to \$17,000 for 2026 (up from \$16,500 in 2025) of annual compensation by contributing it to an IRA. In addition, employees age 50 to 59 and 64 and older may make an extra catch-up contribution of \$4,000 for 2026 (up from \$3,500 in 2025). Employers are required to match deferrals, up to 3% of the contributing employee's wages or make a fixed contribution of 2% to the accounts of all eligible employees whether or not they defer to the SIMPLE plan.

Employers may make additional non-elective contributions to all employees of up to 10% of compensation or \$5,300, whichever is less. Moreover, employers with no more than 25 employees may allow their employees to contribute \$18,100 (\$21,950 for those age 50 to 59 and 64 and older) in 2026. Employers with 26 to 100 employees may allow these higher limits as long as they provide either a 4% match or a 3% nonelective contribution.

Employees who reach age 60 to 63 in 2026 have a special catch-up limit of \$5,250 in 2026 (unchanged from 2025).

SIMPLE plans work much like 401(k) plans, but do not have all the testing requirements. So, they're cheaper to maintain. There are several drawbacks, however. First, all contributions are immediately vested, meaning any money contributed by the employer immediately belongs to the employee (employer contributions are usually "earned" over a period of years in other retirement plans). Second, the amount of contributions the highly paid employees (usually the owners) can receive is severely limited compared to other plans. Finally, the employer cannot maintain any other retirement plans. SIMPLE plans cannot be utilized by employers with more than 100 employees.

SEP IRAs

A Simplified Employee Pension (SEP) allows you to set up an IRA for yourself and each of your eligible employees. You contribute a uniform percentage of pay for each employee, although you don't have to make contributions every year, offering you some flexibility when business conditions vary. For 2026, your contributions for each employee are limited to the lesser of 25% of pay or \$72,000 (up from \$70,000 in 2025). Most employers, including those who are self-employed, can establish a SEP. You may permit your employees to designate contributions as Roth contributions.

Taxation of Individual Accounts

Traditional employee deferrals are deducted from employee paychecks before federal income taxes are assessed. Accounts typically grow on a tax-deferred basis, which means account owners generally won't owe taxes on either pre-tax contributions or earnings until they take distributions. In addition, 401(k), SIMPLE, and SEP plans can allow employees to designate all or part of their contributions as Roth contributions. Roth contributions are made on an after-tax basis, just like Roth IRA investments. Unlike pre-tax deferrals, there's no up-front tax benefit — employee Roth contributions are transferred to the plan after taxes are calculated. Because taxes have already been paid on these amounts, a distribution of Roth contributions is always free from federal income tax. Moreover, qualified distributions of earnings are tax-free. To be a qualified distribution, the account must be held for at least five years and the distribution is made after the participant reaches age 59½, dies, or becomes disabled.

Keep in mind that withdrawals from tax-deferred retirement savings accounts are taxed as ordinary income (unless they are qualified Roth distributions) and are subject to 10% penalty if the account holder is under age 59½, unless an exception applies.

Other plans

The above sections are not exhaustive, but represent the most popular plans in use today. Current tax laws give retirement plan professionals new and creative ways to write plan formulas and combine different types of plans, in order to maximize contributions and benefits for higher paid employees.

Finding a plan that's right for you

If you are considering a retirement plan for your business, ask a plan professional to help you determine what works best for you and your business needs. The rules regarding employer-sponsored retirement plans are very complex and easy to misinterpret. In addition, even after you've decided on a specific type of plan, you will often have a number of options in terms of how the plan is designed and operated. These options can have a significant and direct impact on the number of employees that have to be covered, the amount of contributions that have to be made, and the way those contributions are allocated (for example, the amount that is allocated to you, as an owner).