

Payroll Deduction IRAs: A Retirement Plan for Your Businesses

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Tags: Investing | Retirement | Tax Benefits | Employer-Sponsored Plan

Introduction to the Payroll Deduction IRA

The Payroll Deduction IRA is the simplest type of retirement plan a business can establish for its employees. This type of plan can encourage and facilitate tax-advantaged investing for employees, and bolster their retirement savings. With no financial obligation and very little administrative burden, a Payroll Deduction IRA can be a great addition to your small business.

Why Should I Consider a Payroll Deduction IRA for My Business?

There are many reasons you should consider a Payroll Deduction IRA retirement plan for your business. Depending on the profile of your business, the Payroll Deduction IRA rules may be the most beneficial to you and your employees.

Tax-Deferred Growth for Employee Portfolios

Like other retirement account types, the Payroll Deduction IRA allows assets invested in the account to grow on a **tax-deferred** basis. This means account owners won't incur any tax liability until withdrawing the assets in retirement, at which point the withdrawals are taxed as ordinary income. Employees can also choose to contribute to a Roth account, which allows for **tax-free** growth, instead. Either way, the impact of tax-advantaged growth is massive in the long-term.

Reduced Administrative Burden on the Business

Retirement plans that utilize Payroll Deduction IRAs are simple to set up and avoid mandatory annual compliance testing and filings required by other retirement plan types. While businesses are required to provide certain notifications to employees regarding a SIMPLE IRA plan, overall requirements and filings are typically less burdensome than other plans.

No Financial Obligation for the Business

Unlike with other retirement plan types, employers cannot make contributions to employee accounts in a Payroll Deduction IRA plan; all contributions are made by the employee directly. For businesses who would like to offer a retirement plan to employees without the obligation of annual contributions, this type of plan could be beneficial.

How Does a Payroll Deduction IRA Work?

Starting a Payroll Deduction IRA plan is simple.

First, choose a financial institution to work with to establish your Payroll Deduction IRA program. Then, have each employee who wishes to participate in the plan open an IRA at that

institution. The account can either be a Traditional IRA or a Roth IRA. Either way, the account is owned and controlled by the employee directly.

Next, discuss with each employee how much they would like to contribute from their paycheck to their IRA. Once an amount is chosen, update your payroll software or manual payroll process to ensure employee contributions are deducted from paychecks and forwarded to the financial institution for the benefit of the employee.

Payroll Deduction IRA contributions are restricted to **earned income** only. Ultimately, it is the employee's responsibility to manage their contribution amounts to the account and confirm total IRA contributions throughout the year. The employer's role is simply to facilitate the contributions through payroll deductions.

How Much Can Be Contributed to a Payroll Deduction IRA?

In 2025, the maximum contribution to a Payroll Deduction IRA is \$7,000. Those who are at least 50 years old are eligible for an additional "catch-up" contribution of up to \$1,000, increasing their contribution limit to \$8,000. These limits are occasionally revised in order to adjust for cost of living and inflation.

One thing to keep in mind, however, is that contributions are restricted to earned income only, which may be lower than the \$7,000 (or \$8,000 for 50+) contribution threshold.

What are the Withdrawal Rules of a Payroll Deduction IRA?

Payroll Deduction IRAs are subject to specific withdrawal rules that, when not followed, could result in a substantial penalty. Starting at age 59½, you may take distributions from your IRA at any time and in any amount without incurring a penalty. These distributions are included in your taxable income for the year in which you take them.

Those who withdraw funds before age 59½ are subject to penalty in an amount of 10% of the distribution, unless the distribution qualifies for an exception. The most common exceptions include distributions related to first-time homebuyers (up to \$10,000), birth or adoption expenses (up to \$5,000 per child), emergency personal expenses (up to \$1,000 per year), higher education expenses, federally declared disasters (up to \$22,000), certain unreimbursed medical expenses, and death or disability of the IRA owner.

Separately, Payroll Deduction IRA account owners must abide by required minimum distribution (RMD) rules. Starting at age 73, account owners are required to withdraw a certain amount from their account each year to avoid a penalty (up to 25% of the value) on the missed RMD. The amount of the RMD is calculated based on life expectancy and account balance.

Can Account Owners Borrow Against the Balance of Their Payroll Deduction IRA?

No. Assets held in a Payroll Deduction IRA cannot be used as collateral for loans.

What Types of Assets Can Be Invested in with a Payroll Deduction IRA?

A Payroll Deduction IRA allows its account owner to invest in a fairly broad spectrum of assets. Stocks, exchange-traded funds (ETFs), mutual funds, bonds, money market funds, and certificates of deposit (CDs) are all permitted assets in an IRA. Examples of investments that are prohibited in a Payroll Deduction IRA include life insurance, artwork and collectibles, S corporation stock, and real estate for personal use, among others.

It is important to establish an allocation of assets in your IRA that best matches your financial objectives and risk tolerance. A dynamic portfolio that evolves over time can help you meet your financial needs, wants, and wishes.

What Other Forms of Retirement Plans Exist for Businesses Like Mine?

There are many other forms of retirement plans that may be a fit for your business, including:

- 401(k) / Roth 401(k) – A tax-deferred retirement plan commonly offered to the employees of large, private employers.
- Solo 401(k) / Roth Solo 401(k) – A 401(k) for self-employed individuals that allows for higher contribution limits.
- Safe Harbor 401(k) – A 401(k) that avoids the regulation requirements and expenses of Traditional 401(k)s and specifies that all employer contributions are immediately vested.
- SIMPLE 401(k) – A 401(k) plan with more flexibility and less administrative burden for self-employed individuals or small business owners.
- SEP IRA – An IRA with special perks for self-employed individuals or small business owners.
- SIMPLE IRA – Another IRA with special perks for self-employed individuals or small business owners.

How Can I Start a Payroll Deduction IRA Retirement Plan for my Business?

To get started with a Payroll Deduction IRA plan for your business, reach out to us at **FreeMind Financial Advisory** and we would be happy to provide a **free strategy session** personalized for your business. We can help determine if a Payroll Deduction IRA is the best retirement plan for your business, and if it is, we can assist in setting up accounts and onboarding employees.

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