

SIMPLE IRA or Simply a 401(k)?

Taking the Guesswork Out of Decision

October 1 is an important deadline for SIMPLE IRAs and Safe Harbor 401(k) plans alike, as it happens to be the last day of the year these plans may be established for the calendar year in order to take advantage of the benefits these plans provide to increase retirement savings. With that, it's important to evaluate which plan is the best fit in the current year and beyond.

While on the surface, SIMPLE IRAs are more attractive because they are fairly easy to establish and maintain, 401(k) plans typically offer considerably more flexibility in design, contribution range and access to funds, greater tax diversification, provide asset protection, and often help control staff costs better. The table below summarizes key characteristics and distinctions between these two plans:

	SIMPLE IRA	401(k) Plan
Eligible employer	Employers with fewer than 100 participants who earned \$5,000 or more.	Any employer regardless of the number of employees.
Who should be included in the plan	Any employee who received at least \$5,000 in compensation during the calendar year and in prior 2 years, regardless of hours or age.	Employees must first meet eligibility requirements: age 21, 1 year of service (12 months with at least 1,000 hours). Employer may be less restrictive.
Maximum Contribution	Deferral: \$12,500 (\$15,500 if 50 or older) Required Employer Contribution: a dollar-for-dollar match up to 3% of compensation to participants who defer or a 2% fixed contribution to all.	Deferral: \$18,000 (\$24,000 if 50 or older) Discretionary Employer Contribution: match or profit sharing up to the maximum of \$53,000 (\$59,000 if 50 or older). Maximum may not exceed individual's compensation and includes salary deferrals.
Flexibility in Employer Contributions	Employer contributions are mandatory in each year. Match may be reduced to 1% no more than 2 out of every five years. May not be terminated midyear.	Employer may choose whether or not and how much to contribute annually. Safe Harbor contributions may be stopped prospectively. Plan may be terminated mid-year.
Contribution Types	Pre-tax only.	Pre-tax: traditional 401(k) deferrals and all employer contributions. After-tax: Roth 401(k) deferrals.
Ability to tailor contributions based on employee groups	None. All participants receive the same allocation match or fixed contribution.	Employer may base contributions - match or profit sharing - based on a variety of factors, including compensation, deferral levels, job classification, location, etc.
Vesting	All contributions are immediately vested.	Salary deferrals are fully vested. Employer contributions may be subject to a vesting schedule, e.g. incremental vesting of 20% per year over a six year period.
Access to tax-free distributions	None.	Qualified distribution from Roth 401(k) balances in the plan are distributed tax-free.
Penalty-free Access in Pre-retirement	None. In certain circumstances, participants may have access to funds tax-free for up to 60 days using indirect IRA Rollover approach. Otherwise, premature distribution penalty may apply: 25% if accessed in the first two years, 10% after two years.	Participants may access up to the lesser of 50% of their vested balance of \$50,000 through a plan loan. Plan loan is tax-free and penalty-free if repaid timely within terms specified by the plan.

Ability to pair-up with another re plan	None. Must operate as the only plan for full calendar year.	Yes, may be combined with another plan for testing purposes to improve outcomes or to increase tax-deductible contributions, e.g. addition of a Defined Benefit or a Cash Balance Plan.
Asset Protection	Under Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). BAPCPA applies only to assets in bankruptcy. No dollar limit. May be limited if rolled over to an IRA; depends on state law.	Unlimited protection under Title I of ERISA for plans which cover both owner-employees and non-owner employees. Plans covering only owner-employees are protected under the Bankruptcy Act.

SIMPLE IRA v. 401(k) Plan Case Study

A small business owner in New York asked for assistance in evaluation of plan options for her practice. We were asked to help determine whether a SEP, SIMPLE, or a 401(k) plan would help best meet client's objectives. The table below illustrates outcome of each funding scenarios net of employee and plan maintenance costs:

Facts:

- S-corporation
- Single owner with a W-2 of \$102,000 per year; remainder of profit is treated as pass-through income on K-1
- Two eligible employees earning \$32,500 and \$40,000
- Objectives: maximize tax benefits for the owner

Options Analysis:

	SEP IRA	SIMPLE IRA	401(k) Plan
Owner contribution	\$25,500	\$17,650	\$59,000
Contribution for employees	(\$18,125)	(\$2,175)	(\$5,710)
Annual plan maintenance fee	\$0	\$0	(\$2,100)
Tax savings, net of employee contributions and fees*	(\$675)	\$6,119	\$18,074
Lost tax-savings opportunity	(\$18,749)	(\$11,955)	\$0

* Assumes that top dollar is taxed at a combined 40% federal and state income tax rate

Bottom line: While SIMPLEs and SEPs offer a streamlined set-up, low maintenance, and minimum annual fees, the lost tax savings opportunity is very costly, \$18,749 (SEP) and \$11,955 (SIMPLE) in the above examples, even after the administration costs associated with a 401(K) plan are taken in consideration. In addition, 401(k) plan option offers greater flexibility, tax-diversification options (ability to accumulate and later access assets on a tax-free and tax deferred basis), better manage employee benefit costs, and offer more robust asset protection.

Here to Help

With the end of the year just around the corner, NOW is the time to start reviewing retirement plan options to identify optimal design, increase tax efficiency, and build retirement account balances. We are prepared to assist you with:

1. **Plan Design:** review all available options and identify an optimum solution in light of all relevant facts;
2. **Retirement Accumulation:** find the savings vehicle that efficiently and effectively meets your objectives;
3. **Tax Savings:** work to reduce the unnecessary tax exposure through tax benefits inherent in qualified plans;
4. **Investment Platform:** review current platform for fees and services or help identify best options for a new plan.

We are ready to help!