

Retirement Planning Opportunities

Is a SIMPLE IRA a Good Option for Your Client?

What Is a SIMPLE IRA?

A SIMPLE IRA is like a Safe Harbor 401(k) Plan that has been miniaturized. Like the Safe Harbor 401(k) Plan, the participants can make deferrals, but the maximum deferrals are lower.

And, like the Safe Harbor 401(k) Plan, the employer can choose between making a contribution to all the participants or a matching contribution which goes just to those participants who made deferrals, but both of these contributions are smaller than in a Safe Harbor 401(k) Plan.

SIMPLE IRA - Employee Salary Deferrals

The maximum any participant age 49 or younger can defer is \$10,500. If the participant is age 50 or older then the maximum deferral can be increased by a catch-up contribution of \$2,500 so the total maximum deferral allowed for participants age 50 and older is \$13,000

SIMPLE IRA - Employer Contributions

Employers can choose between making a contribution to all the eligible employees of 2% of their salaries or making a matching contribution just to those employees who have made deferrals. The matching contribution is 100% of the their deferral up to 3% of their salaries.

SIMPLE IRA – Advantages

The main advantage of the SIMPLE IRA is that very little in the way of administration is required.

Employers can also keep employees out of the plan until they have completed almost three years of service. (The employee must have earned \$5,000 pay for the current year and any previous two years.)

SIMPLE IRA vs. Safe Harbor 401(k) Plan

	Age	Salary	SIMPLE IRA*		Profit Sharing*	
			Contrib.	%Contrib.	Contrib.	%Contrib.
Owner Bob	56	100,000	16,000	100%	24,500	100%
Employee A	36	35,000	0		0	
Employee B	31	30,000	0		0	
Employee C	26	25,000	0		0	
Employee D	21	20,000	0		0	
			\$16,000		\$24,500	

*Figures assume the maximum contributions allowed in 2008 under the applicable provisions of the Internal Revenue Code. These figures are indexed for inflation & may change in the future. We are assuming the business owner is the only one deferring anything.

Additionally, the cost for including the non highly compensated employees can be very low - just 2% of their salaries. No employer contributions are required for any employees who do not make deferrals in a SIMPLE plan using the matching contributions.

SIMPLE IRA – Disadvantages

Business owners are not able to contribute much for themselves in a SIMPLE IRA. The maximum contribution including the salary deferral is \$19,900 in the SIMPLE IRA. In a safe harbor 401(k) plan, the maximum contribution would be much higher --\$29,700.

Additionally loans and life insurance are not allowed in a SIMPLE IRA. And business owners with SIMPLE IRAs can not have any other qualified plans so when a business owner is ready to graduate to higher deduction plan, he may end up having to wait for a year or more if he has already contributed to a SIMPLE IRA.

Finally, a business owner may have to cover more employees in a SIMPLE IRA because employees earning at least \$5,000 must be included if they earned at least \$5,000 in the current year and any two preceding years.

SIMPLE IRA vs. Safe Harbor 401(k) Plan with Matching Contributions

In the example above we see a comparison between a SIMPLE IRA and a Safe Harbor 401(k) Plan using matching contributions. In both plans we are assuming the business owner is the only one deferring anything.

If any of the other employees had made deferrals, then they would be entitled to matching contributions. Since Bob, the business owner, is the only one making a deferral, he is the only one receiving a contribution in either plan in this example.

There is a substantial difference in the amount Bob can contribute for himself in these plans. In the safe harbor 401(k) plan, Bob, can defer \$20,500 and give himself a matching contribution of \$4,000 for a total contribution of \$24,500.

In the SIMPLE IRA the contribution Bob can make for himself is limited to a total of \$16,000 (\$13,000 in deferral and \$3,000 in matching contributions). Bob can, therefore, raise his own contribution substantially by setting up a safe harbor 401(k) plan instead of a SIMPLE IRA.