IIS FINANCIAL SERVICES

Insurance - Investments - Retirement Planning

SIMPLE IRA or Simply a 401(k)?

Take the Guesswork Out of Deciding

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

On the surface, SIMPLE IRAs may be more attractive because they are fairly easy to establish and maintain. However, 401(k) plans may offer considerably more flexibility in design, contribution range and access to accumulated balances. In addition, they may offer better tax diversification options, provide robust asset protection and often help to better manage costs of employee benefits. The table below summarizes key characteristics and distinctions between these two plans:

	SIMPLE	401(k)
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 the prior 2 years, regardless of hours or age.	Employees must first meet eligibility Requirements: age 21, one year of service (12 months with at least 1,000 hours). Employer may be less restrictive.
Maximum Contribution in 2020	Deferral: $13,500 ($16,500 if 50 or older) Required Employer Contribution: a dollar-for-dollar match up to 3 percent of compensation to participants who defer or a 2 percent fixed contribution to all.	Deferral: $19,500 ($26,000 if 50 or older) Discretionary Employer Contribution: match or profit-sharing up to the maximum of $57,000. The maximum may not exceed individual's compensation and includes salary deferrals.
Flexibility in Employee Contribution	Employer contributions are mandatory in each year. The match may be reduced to 1 percent no more than two out of every five years. May not be terminated midyear.	An employer may choose whether or not and how much to contribute annually. Safe harbor contributions may be stopped prospectively. The 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 or after-tax employee contributions.

(continued on page 2)

	SIMPLE	401(k)
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 percent per year over a six-year period.
Access to Tax-Free Distributions	None.	A qualified distribution from Roth 401(k) balances or in-plan Roth conversions is 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 and regulations.
Ability to Pair Up with Another 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 profit-sharing, defined benefit or 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 that cover both owner-employees and non-owner employees. Plans covering only owner-employees are protected under BAPCPA 2005.

SIMPLE IRA v. 401(k) Plan Case Study

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

Facts:

- S-corporation
- Single owner with a W-2 of $110,000 per year; remainder of profit is treated as pass-through incomeon K-1
- Two eligible employees earning $32,500 and $40,000
- Objectives: Maximize tax benefits for the owner

(continued on page 3)

Options Analysis:

	SEP	SIMPLE IRA	401(k)
Owner contribution	$27,500	$19,800	$63,500
Contribution for Employees	($18,125)	($2,175)	($5,710)
Annual plan maintenance fee	$0	$0	($2,100)
Tax savings, net of employee contribution and fees*	$4,437	$4,417	$12,953
Lost tax-savings opportunity	($17,390)	($8,535)	$0

**Assumes that top dollar is taxed at a combined 40 percent federal and state income tax rate. Individual results may vary.*

Bottom Line:

While SIMPLEs and SEPs offer a streamlined setup, low maintenance and minimum annual fees, the lost tax savings opportunity may be very costly: $17,390 (SEP) and $8,535 (SIMPLE) in the above examples, even after the administration costs associated with a 401(k) plan are taken into consideration. In addition, the 401(k) plan option offered additional flexibility, tax-diversification options (ability to accumulate and later access assets on a tax-free and tax-deferred basis), better-managed employee benefit costs, and robust asset protection under Title I of ERISA.

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 relevantfacts.
2. **Retirement Accumulation:** Find the savings vehicle that efficiently and effectively meets yourobjectives.
3. **Tax Savings:** Work to reduce the unnecessary tax exposure through tax benefits inherent inqualified plans.
4. **Investment Platform:** Review current platform for fees and services or help identify best options fora new plan.

Learn More About Employer Sponsored Retirement Plans

707 Sable Oaks Drive South Portland, ME 04106 T: (207) 761 – 4733
45 Memorial Circle Augusta, ME 04330 T: (207) 623 – 8421
retire@iisfinancial.com | www.iisfinancial.com