

Why a 401(k) over a SEP or SIMPLE IRA?

Understanding the Benefits of a 401(k) Plan

A 401(k) plan not only offers higher contribution limits but provides more options to your business for managing costs and deductions, maximizing contributions and accessing funds penalty-free.

Manage Costs and Tax Deductions Better with a 401(k) Plan (vs. a SEP or SIMPLE IRA)

- While SEP and SIMPLE IRAs may be easier initially for plan sponsors to establish over 401(k) plans, there are clear gaps in the benefit of these plan types for both employers and employees.
- Compared to a SIMPLE IRA, a 401(k) plan provides higher contribution levels for all employees, especially owners and highly compensated employees.
- Compared to a SEP, a 401(k) plan provides for lower contribution costs for eligible employees, and owners can vary their contributions between themselves rather than having to put in the same contribution percentage.

Disadvantages of SEPs and SIMPLE IRAs

- SIMPLE IRAs restrict employee contribution limits and minimize the amount they can invest for retirement. They also require immediate vesting by you as the plan sponsor—this may run counter to your business goals and hinder your plan design flexibility.
- SEPs can only be funded by the employer, limit allocation flexibility, require immediate vesting and can be prohibitive from an investment and administrative standpoint for employees.
- Both plan types have significant early withdrawal penalties.
- Both SEPs and SIMPLE IRAs do not have any withdrawal restrictions for employees, which unfortunately, can cause these plans to be used as savings accounts for employees versus retirement accounts.
- Neither SEPs nor SIMPLE IRAs offer a loan provision, which causes employees to take taxable distributions with pre-retirement penalties.

401(k) Advantages Over SEP and SIMPLE IRAs

	401(k)	SIMPLE IRA	SEP IRA
Who can contribute?	Employee Employer (optional)	Employee & Employer	Employer only; must contribute for all eligible employees
Max employee contribution	\$19,500 with \$6,500 catch-up if 50 or older	\$13,500 with \$3,000 catch-up if 50 or older	Not Applicable
Employer contributions	Optional up to 25% of eligible compensation with a \$57,000 cap (\$63,500 if 50 or older, \$6,500 is deferrals, not ER)	Required match of 100% first 3% of participating employee contributions or 2% of all eligible employee compensation	Optional only way to fund; up to 25% of eligible compensation with a \$57,000 cap
Vesting timing for employer contributions	Multi-year options or immediate	Immediate	Immediate
Access to funds before age 59 1/2	Penalty-free loans or 10% penalty for early withdrawal	25% penalty for withdrawing within first 2 years of participating; 10% thereafter	10% penalty for withdrawal
Loans	Yes	No	No

As of January 2021, Source: irs.gov

SIMPLE Illustration

Participant	Age	Compensation	Deferrals	SIMPLE Contribution	Profit Sharing Contribution	Total Contribution for Each Person	Percent of Compensation
Owner 1	53	\$285,000	\$16,500	\$8,550	N/A	\$25,050	3%
Owner 2	48	\$285,000	\$13,500	\$8,550	N/A	\$22,050	3%
Office Manager	33	\$50,000	\$1,500	\$1,500	N/A	\$3,000	3%
All Others (5)	-	\$200,000	\$6,000	\$6,000	N/A	\$12,000	3%
Totals	-	\$820,000	\$37,500	\$24,600	-	\$62,100	-

Owner's Total Contribution	Owner Deferrals & Employee Contributions	Net Tax Savings to Owner (37% Bracket)
\$47,100.00	86.26%	\$12,702.00

SEP Illustration

Participant	Age	Compensation	Deferrals	Match Contribution	SEP Contribution	Total Contribution for Each Person	Percent of Compensation
Owner 1	53	\$285,000	N/A	N/A	\$57,000	\$57,000	20%
Owner 2	48	\$285,000	N/A	N/A	\$57,000	\$57,000	20%
Office Manager	33	\$50,000	N/A	N/A	\$10,000	\$10,000	20%
All Others (5)	-	\$200,000	N/A	N/A	\$40,000	\$40,000	20%
Totals	-	\$820,000	-	-	\$164,000	\$164,000	-

Owner's Total Contribution	Owner Deferrals & Employee Contributions	Net Tax Savings to Owner (37% Bracket)
\$114,000.00	69.51%	\$10,680.00

401(k) with Safe Harbor 3% NE & Cross-Tested Illustration

Participant	Age	Compensation	Deferrals	Safe Harbor Contribution	Profit Sharing Contribution	Total Contribution for Each Person	Percent of Compensation
Owner 1	53	\$285,000	\$26,000	\$8,550	\$28,950	\$63,500	22.18%
Owner 2	48	\$285,000	\$19,500	\$8,550	\$28,950	\$57,000	20.00%
Office Manager	33	\$50,000	N/A	\$1,500	\$710	\$2,210	4.42%
All Others (5)	-	\$200,000	N/A	\$6,000	\$2,840	\$8,740	4.42%
Totals	-	\$820,000	\$45,500	\$24,600	\$61,450	\$131,550	-

Owner's Total Contribution	Owner Deferrals & Employee Contributions	Net Tax Savings to Owner (37% Bracket)
\$120,500.00	91.60%	\$37,623.50

For more information visit: marinerwealthadvisors.com

Source: ERISA Services Midwest

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