SIMPLE IRAs

I remember when I first realized a SIMPLE IRA was not just a simple (meaning regular old traditional) IRA. Once I began to learn more about them, I still had trouble understanding why anyone would ever want one. The truth is if you are like most doctors you are either an employee, an independent contractor, or a partner in a partnership. But if you own a practice and have several employees, then a SIMPLE IRA might be worth considering.

The Downsides

There are lots of downsides with a SIMPLE IRA. Let’s take a look at them one by one.

Lower contribution limits- Instead of being able to put in $17.5K (like a 401K), a SIMPLE IRA only allows an employee to contribute $12K. The catch-up contribution for those over 50 is only $2500, instead of $5500 with the other types of retirement accounts.

Low matching limits- You can only match up to 3% of the employee’s first $250K in compensation. So the maximum you could get into the account each year would be $12K + $7.5K= $19.5K. That’s much less than the $51K total you can get into a 401K, profit-sharing plan, SEP-IRA, or solo 401K.

Inflexible, Required Match- If you have employees, you have to give them that same 3% match. There are a few ways you can make it less than that, like a 2% set contribution instead of a match, or you can actually decrease the match as low as 1%, but only for 2 out of 5 years.

The Upsides

There are a few upsides to a SIMPLE IRA, although I feel they
rarely outweigh the significant downsides.

No Discrimination Testing- A 401K has to be discrimination tested each year. That means that the average “highly compensated employee” (HCE- anyone making $115K or more or who owns 5% or more of the company cannot contribute more than 2% more than the average “non-HCEs.” Sometimes this keeps the HCEs from being able to max out the account. For example, consider a dentist with a 401K who employs two hygienists, an assistant and a clerk. If he doesn’t get the employees to make big contributions, he might not be able to contribute more in the 401K than to a SIMPLE IRA.

Easier and Cheaper to Administer- Most employers will need to hire a company to run their 401K. A SIMPLE IRA, on the other hand, can easily be done yourself for nearly nothing. At Vanguard the employer pays nothing, but the employees pay $25 per fund per year.

So Who Should Use A SIMPLE IRA?

The ideal person to use is a relatively low paid business owner with just a few employees who WANTS to offer his employees a retirement plan. If you’re highly paid (and want to save more than say $15K a year in a pre-tax manner), a SIMPLE IRA is less than ideal, but perhaps better than other options for you. If you would prefer NOT to pay any extra toward your employee’s retirement, you might consider a non-qualified plan (no up-front tax deduction) or a cash balance/defined benefit plan.