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Insurance & Benefits – *By Paul Breslau*

Upgrading Simple IRA to 401k

Does your company have a Simple IRA retirement plan? Do you know why? Do you want to defer more money for retirement than your Simple IRA allows?

When owners ask their Financial Advisors about starting a retirement plan, many suggest starting a Simple IRA because in their mind it's quick and easy. But a more thorough review might suggest the small business would be better suited in a 401(k) & Profit Sharing plan.

The upgrade to a 401(k) plan needs to occur before any contributions have been submitted to the Simple IRA in a given calendar year. For this reason, January is the most popular time to make this change. And to be ready, most clients who make the change start to plan for it in November.

What makes a Simple, simple? Advisors will argue these three points: cost of the plan, no testing and two year eligibility for new employees

Let's respond to these three points:

Cost of the plan: On the surface, this seems like a strong argument, however, the funds for Simple IRA's are usually A Shares (or B, or C, or some other share class) that has some sort of "Load," either in upfront fees or higher ongoing expenses. Also, take note in reasons to consider a 401(k) plan below, and you'll find the tax saving offered through higher contributions in a 401(k) more than makes up for the costs of administration.

No Testing: There is no discrimination testing in a Simple IRA. What's the trade -off? The company is required to give its employees a contribution. The formula is either ALL employees receive a 2 percent contribution whether they participate or not. Or alternatively, employers may provide a dollar for dollar match up to 3 percent of pay. Most companies choose the match formula.

Two year eligibility for new employees: This is one area where the owner benefits. In a 401(k) plan, the longest employment period offered for eligibility is 12 months.

Fourteen reasons to choose a 401(k) instead of a Simple IRA:

1. Perception among employees: Everyone knows about 401(k) plans, and understands their value. When your company sponsors a Simple IRA, and employees ask what it is, the most common answer is, "it's like a 401(k) plan."

2. Higher Deferral Amounts: For 2007, you're able to defer $15,500 into a 401(k) plan. ($20,500 if you're over age 50.) Higher deferral amounts equal more tax savings.

3. Additional Profit Sharing: If you want to save more than $15,500, you can include a profit sharing plan, and boost your savings all the way to $45,000 in 2007. ($50,000 if you're over age 50.)

4. Match: In a Simple IRA, the company contribution is mandatory. In a 401(k), the company contribution is optional.

5. Setting up accounts: For Simple IRAs, each employee must open their own account and complete more paperwork. With a 401(k) plan, the company establishes the plan, and employees who want to participate simply complete the enrollment form.

6. Vesting: In a 401(k) plan, you can attach a vesting schedule to your company contributions. In the Simple IRA, employees are immediately 100 percent vested in any company contributions.

7. Auto Enrollment: This is a feature available for 401(k) plans. It helps drive participation, and also new for 2008, if you choose auto enrollment with a Safe Harbor 401(k) plan, you can include a two-year vesting schedule.

8. Share Class: Most 401(k) plans will offer funds with no loads and no surrender fees.

9. Loans: In a 401(k) plan, you can allow employees to take loans against their account.

10. Flexible Plan Design: In a 401(k) plan, you're able to amend your plan to accomplish the goals you're trying to achieve.

11. Employees are informed: With administration and regulation, employees are aware and informed about their rights to join the 401(k) plan. Many employees never hear about the Simple IRA that may be offered by their employee.

12. Additional Retirement Plans: With a Simple IRA, you are not allowed to have any other company sponsored retirement plans.

13. Adoption Period: Simple IRA's must be established by Oct. 1st. A 401(k) plan can be set up anytime before year end.

14. Early Withdrawal Penalty: If you're under age 59½, and take money from a 401(k) plan, you pay a hefty 10 percent IRS penalty. In a Simple IRA, during the 2 years, your IRS penalty is an astounding 25 percent.

Now is the time to prepare for January 2008! Review your retirement plan and talk to your benefits broker or financial advisor. If you're looking for more tax saving and a more flexible plan, upgrade your Simple IRA to a 401(k) plan. ■

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