INSIDER

October 6, 2021

What to know about SIMPLE IRAs: Retirement accounts for small businesses and their employees

Just like with the traditional IRA, contributions to the SIMPLE IRA are tax-deferred. Maskot Bildbyrå/Getty Images

- **A SIMPLE IRA is a type of individual retirement account offered by small businesses.**
- **SIMPLE IRAs allow for employee contributions up to $13,500 annually ($16,500 for those 50 or older).**
- **Employers can make matching contributions of up to 3% of the participant's salary.**
- **Visit Insider's Investing Reference library for more stories.**

Savings Incentive Match Plans for Employees (SIMPLE) IRAs are a type of individual retirement account offered by small businesses with less than 100 employees. SIMPLE IRAs function similarly to 401(k)s, allowing both employer- and employee-side contributions.

SIMPLE IRAs are a great option for small business owners who want to help their employees save. "They are fairly inexpensive to set up and maintain when compared to a conventional retirement plan," says Karina Valido, vice president and private client advisor at First American Bank.

Understanding how SIMPLE IRAs work

SIMPLE IRAs are set up by employers — specifically, those with 100 workers or less. Employees can then contribute a portion of their earnings to the account, and their employer can then match those contributions up to 3% of their salary.

Employers can also choose "nonelective contributions," which essentially means they'll contribute up to 2% of the employer's salary — even if the employee never contributes to the account themselves.

"For employers, contributions are tax-deductible," Valido says. "For participants, contributions and earnings are not taxed until withdrawn."

Quick tip: As with other types of IRAs, these accounts are intended as retirement-saving tools. Employees face a 10% penalty for withdrawing funds before the age of 59 ½. This penalty goes up to 25% if made within the first two years of participation in the plan.

Eligibility requirements

With SIMPLE IRAs, there are requirements both for employers and employees.

- **Employer requirements:** Employers must be small businesses with 100 workers or less, and they cannot offer any additional retirement plans. They must agree to provide a matching contribution up to 3% of employees' salary or 2% in nonelective contributions annually.
- **Employee requirements:** To participate in a SIMPLE IRA, employees need to have earned at least $5,000 in the prior two years and expect to receive $5,000 in compensation in the current year.

"There are no income limits for these accounts, so even high-income earners qualify for SIMPLE IRAs," says John Hagensen, founder of Keystone Wealth Partners.

SIMPLE IRA contribution limits

SIMPLE IRAs do come with contribution limits, though, and these vary by tax year. Here are the limits for 2021:

Participant	Details	Annual contribution
Employee	Under age 50	Up to $13,500
	Age 50 or older	Up to $16,500
Employer	Nonelective contributions (does not require employee contributions)	2% of employees' salary
	Matching contributions (dollar-for-dollar match of employee contributions)	Up to 3% of employees' salary

Quick tip: If you're 50 or older, you can take advantage of what the IRS calls "catch-up contributions." On SIMPLE IRAs, this means you can contribute an additional $3,000 per year compared to other age brackets.

Pros and cons of a SIMPLE IRA

As with anything, there are both pros and cons to using a SIMPLE IRA. One major advantage is that employees have full control over what their SIMPLE IRA is invested in. For employers, these accounts are easy to set up, are tax-deductible, and come with few administrative costs.

On the downside, the contribution limits are lower on SIMPLE IRAs than they are on 401(k)s, and there's no Roth version of these IRAs either. As a result, participants may pay higher taxes on their withdrawals down the line (if they're in a higher tax bracket at that point).

Here's a breakdown of all the pros and cons a SIMPLE IRA comes with:

Pros	Cons
• Easy to set up and manage • Employees have full control over investments • Employees are immediately fully vested • Employer contributions are tax-deductible • Limited administrative costs	• Employers can't offer additional retirement plans • No Roth IRA versions • Contribution limits are lower than 401(k) and SEP IRA retirement plans • Taxes are paid on withdrawal, which could make them more expensive if you're in a higher tax bracket by then

Simple IRA vs. Traditional IRA

SIMPLE and traditional IRAs are both types of individual retirement accounts, but they're not one and the same.

"Traditional IRAs are set up by individuals and only that same individual can contribute to it, while SIMPLE IRAs are set up by small business owners," Hagensen says. "Both the employee and employer are able to contribute to that account."

There are also differences in contribution levels and income requirements, and traditional IRAs don't offer employer matching, as SIMPLE IRAs do. Here's a full look at the differences between these two types of accounts:

SIMPLE IRA	Traditional IRA
• Opened by the employer • $13,500 limit ($16,500 if you're 50 or older) • Up to 3% employer matching • Must have earned $5,000 in two previous years and be on track for $5,000 in earnings this year • Come with a 25% penalty if funds are withdrawn in the first two years	• Opened by the participant • $6,000 limit ($7,000 if 50 or older) • No matching contributions • Must have earned some taxable compensation for the year

The financial takeaway

If you work for or own a small business, a SIMPLE IRA may be an option for you. These retirement accounts are easy to set up and manage, and they offer low administrative costs, flexible investments, and immediate vesting, too.

Keep in mind, though, they are pre-tax accounts, so if you expect your tax bracket to be higher in retirement, they could result in higher costs. They also come with smaller contribution limits than 401(k)s and SEP IRAs.