SIMPLE 401(k): A Retirement Plan for Your Businesses

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Introduction to the SIMPLE 401(k)

The Savings Incentive Match Plan for Employees (SIMPLE) 401(k) is an employer-sponsored, defined-contribution investment account designed for self-employed individuals and small business owners. SIMPLE 401(k)s are relatively easy to operate, with fewer annual requirements than other retirement plans, and allow employees to contribute alongside their employer to fund their future retirement. The tax-deferred nature of investments in this account type makes it an effective investment vehicle for retirement.

Why Should I Consider a SIMPLE 401(k) for My Business?

There are many reasons you should consider a SIMPLE 401(k) retirement plan for your business. Depending on the profile of your business, the SIMPLE 401(k) rules may be the most beneficial to you and your employees.

Tax-Deferred Growth for Employee Portfolios
Like other retirement account types, the SIMPLE 401(k) allows assets invested in the account to grow on a **tax-deferred** basis. This means account owners won't incur any tax liability until withdrawing the assets in retirement, at which point the withdrawals are taxed as ordinary income. The impact of **tax-deferred** growth is massive in the long-term.

Tax Deductibility of Contributions for Your Business and Employees
Contributions to SIMPLE 401(k)s are **tax deductible** for both the business and the employee. Employer contributions are tax deductible for the business, while employee contributions are tax deductible to the employee.

Reduced Administrative Burden on the Business
Retirement plans that utilize SIMPLE 401(k)s are simple to set up and avoid mandatory annual compliance testing required by other retirement plan types, like a regular 401(k) plan. While businesses are required to provide certain notifications to employees regarding a SIMPLE 401(k) plan, the administrative burden is typically less than with some other plans.

Who Can Own a SIMPLE 401(k)?

Only employees of private employers that offer SIMPLE 401(k) plans can contribute to a SIMPLE 401(k) plan. Employees of companies without SIMPLE 401(k) plans cannot create and contribute to their own SIMPLE 401(k)s (although other retirement account options, such as IRAs, do exist).

To be eligible, the employee must also meet all of the requirements of the employer, which can include minimum age, tenure, and number of hours worked throughout the year (applicable to part-time employees). Employer requirements must be applied uniformly across all employees.

There are no age limits for contributing to a SIMPLE 401(k)—people of all ages can contribute—and no income restrictions either.

What are the Rules for SIMPLE 401(k) Contributions?

Employers and employees, alike, can contribute to a SIMPLE 401(k).

Employees have the option to contribute as much of their earnings as they would like to their SIMPLE 401(k), up to the annual limit. Contributions are typically made through payroll deductions every pay period, but if the plan allows it, employees can make a lump sum contribution.

Employers can choose to make either matching, dollar-for-dollar contributions up to 3% of employee compensation or a non-elective flat contribution of 2% of compensation. If the former is chosen, the employer will only contribute if the employee contributes. Employer contributions must be deposited by the federal income tax return due date for your business, including any extensions. While all employees need to be provided with the same terms, the employer can switch between matching and non-elective contributions from one year to the next.

All contributions to a SIMPLE 401(k) are immediately vested to the employee, meaning that once the money is deposited into a SIMPLE 401(k) account, it belongs to the employee. This includes employer contributions.

How Much Can Be Contributed to a SIMPLE 401(k)?

In 2025, the maximum contribution an employee can make to a SIMPLE IRA is $16,500. Those who are at least 50 years old are eligible for a bonus contribution amount of $3,500, and those who are between 60 and 63 years old can contribute a bonus amount of $5,250. These "catch-up" contribution amounts increase the total contribution limit. These dollar limit amounts are occasionally revised to adjust for cost of living and inflation.

Employer contributions are added on top of employee contributions, and usually equate to 2-3% of that employee's total compensation (not contribution amount) for the year.

How Can My Business Deduct Contributions to SIMPLE 401(k) Accounts?

The deadline for taking a tax deduction on SIMPLE 401(k) contributions is the federal income tax return due date for your business, including any extensions. The tax document on which contributions can be deducted depends on how your business is legally organized.

What are the Employer Requirements for SIMPLE 401(k) Plans?

Businesses that offer a SIMPLE 401(k) plan to employees must adhere to strict rules in order to remain in good standing with the IRS. For starters, SIMPLE 401(k) plans are covered by the

Employee Retirement Income Security Act (ERISA), meaning specific fiduciary responsibilities, protection for participants, and plan management practices need to be followed.

Unlike regular 401(k) plans, SIMPLE 401(k) plans are exempt from **annual nondiscrimination testing**. However, SIMPLE 401(k)s are required to file an annual **Form 5500** with the Department of Labor (DOL) and IRS to report plan activities and financial condition. Plans with fewer than 100 participants may be eligible to file a shorter version, Form 5500-SF.

<u>What are the Withdrawal Rules of a SIMPLE 401(k)?</u>

SIMPLE 401(k) plans are subject to specific withdrawal rules that, when not followed, could result in a substantial penalty. Starting at age 59½, you may take distributions from your SIMPLE 401(k) at any time and in any amount without incurring a penalty. These distributions are included in your taxable income for the year in which you take them.

Those who withdraw funds before age 59½ are subject to penalty in an amount of 10% of the distribution, unless the distribution qualifies for an exception. The most common exceptions include distributions related to birth or adoption expenses (up to $5,000 per child), emergency personal expenses (up to $1,000 per year), federally declared disasters (up to $22,000), certain unreimbursed medical expenses, death or disability of the SIMPLE 401(k) account owner and separation from service for those aged 55 and older.

Separately, SIMPLE 401(k) account owners must abide by **required minimum distribution (RMD)** rules. Starting at age 73, account owners are required to withdraw a certain amount from their account each year to avoid a penalty (up to 25% of the value) on the missed RMD. The amount of the RMD is calculated based on life expectancy and account balance.

<u>Can Account Owners Borrow Against the Balance of Their SIMPLE 401(k)?</u>

Yes, if the plan allows loans. If loans are permitted, participants can typically borrow up to 50% of their vested account balance, with a maximum limit of $50,000. Loans must generally be repaid within five years, unless the loan is used to purchase a primary residence, in which case the repayment period may be longer.

<u>What Types of Assets Can Be Invested in with a SIMPLE 401(k)?</u>

A SIMPLE 401(k) allows its account owner to invest in a fairly broad spectrum of assets. Stocks, exchange-traded funds (ETFs), mutual funds, bonds, money market funds, and certificates of deposit (CDs) are all permitted assets in a SIMPLE 401(k). Examples of investments that are prohibited in a SIMPLE 401(k) include life insurance, artwork and collectibles, S corporation stock, and real estate for personal use, among others.

However, the actual investment options any SIMPLE 401(k) plan offers is dependent on the choices of the SIMPLE 401(k) plan administrator. It is not uncommon for SIMPLE 401(k) plans to have a limited set of preselected stock and bond funds that participants can invest in.

What Other Forms of Retirement Plans Exist for Businesses Like Mine?

There are many other forms of retirement plans that may be a fit for your business, including:

- 401(k) / Roth 401(k) – A tax-deferred retirement plan commonly offered to the employees of large, private employers.
- Solo 401(k) / Roth Solo 401(k) – A 401(k) for self-employed individuals that allows for higher contribution limits.
- Safe Harbor 401(k) – A 401(k) that avoids the regulation requirements and expenses of Traditional 401(k)s and specifies that all employer contributions are immediately vested.
- SEP IRA – An IRA with special perks for self-employed individuals or small business owners.
- SIMPLE IRA – Another IRA with special perks for self-employed individuals or small business owners.
- Payroll Deduction IRA – The easiest retirement plan to establish with the least financial and legal requirements for the sponsoring business.

How Can I Start a SIMPLE 401(k) Retirement Plan for my Business?

To get started with a SIMPLE 401(k) retirement plan for your business, reach out to us at **FreeMind Financial Advisory** and we would be happy to provide a **free strategy session** personalized for your business. We can help determine if a SIMPLE 401(k) is the best retirement plan for your business, and if it is, we can assist in setting up accounts and onboarding employees.

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