

Retirement Reimagined® | 2020

WHICH TYPE OF IRA IS RIGHT FOR YOUR BUSINESS?

IRA plans offer special retirement arrangements for small businesses and self-employed individuals. They combine the tax advantages of conventional profit-sharing retirement plans and 401(k) savings plans with the administrative ease of Individual Retirement Accounts (IRAs).

You can choose between two types of IRA plans for your business: a [Simplified Employee Pension \(SEP\) IRA plan](#) or a [Savings Incentive Match Plan for Employees \(SIMPLE\) IRA plan](#).

SEP IRA VS. SIMPLE IRA

Both a SEP IRA plan and a SIMPLE IRA plan can offer you and your other eligible employees the opportunity to save for retirement on a tax-deferred basis. Under both types of plans, each covered employee owns and controls his or her own IRA. But depending on the type of IRA plan you select, the contributions made to each IRA will differ significantly. The checklist below can help you determine which IRA plan might meet your business and retirement needs. Then, discuss your findings with your financial professional.

SEP IRA

You may want to consider a SEP IRA plan for profit-sharing and similar contributions if...

- You are a sole proprietor or own a business.** Each eligible employee under a SEP IRA plan must receive the same percentage of compensation as a contribution. If your business has no employees other than you or your family members, you can make a contribution to your respective SEP IRAs without worrying about mandatory contributions for other individuals.
- You would like to decide the contribution percentage for each year.** A SEP IRA plan lets you decide the amount of any contribution, subject to a maximum annual limit (see chart on next page). You may wish to increase the percentage of compensation contributed to each participant's IRA for an especially profitable year, and decrease the percentage contributed in other years.
- You would like the flexibility to skip or suspend contributions under the IRA plan for any reason.** You are permitted to make contributions to a SEP IRA plan annually, but you are not required to make contributions each year or for any particular year. You have the ability to suspend annual contributions if you want to conserve cash or for any other reason.
- You would like to make annual contributions to your IRA in excess of \$13,000 for 2019 and \$13,500 for 2020.** Contributions to a SEP IRA can be as big as 25% of your earned income¹ subject to a maximum of \$56,000 for 2019 and \$57,000 for 2020. If your own earned income is more than \$70,000, the contribution limit for your own SEP IRA will be significantly higher than the SIMPLE IRA limit of \$13,500 for 2020.



SIMPLE IRA

You may want to consider a SIMPLE IRA plan for payroll contributions and a match if...

- Your business employs multiple individuals (other than you or your spouse).** Unlike a SEP IRA plan, a SIMPLE IRA plan does not require each eligible employee to receive the same contribution. Participants make payroll contributions to their own SIMPLE IRAs. The employer is required to provide a match on these contributions, unless non-elective contributions are made instead (see chart on next page).
- You would like your employees to take primary responsibility for their IRA plan retirement savings.** As an employer, you have discretion over the mix between current compensation and retirement benefits for your employees. By adopting a SIMPLE IRA plan, you will empower your employees so that they can personally decide the best combination of current compensation and retirement savings for themselves.
- You would like to give your employees the ability to make contributions each and every year.** Eligible employees are able to make payroll contributions under a SIMPLE IRA plan each year. Employer contributions are mandatory and must be made each year in the form of a match or a non-elective contribution.
- Your employees would like the flexibility to determine the amount of their own IRA plan contributions.** A SIMPLE IRA plan allows each eligible employee to make voluntary pre-tax payroll contributions of up to \$13,500 for 2020, and an additional catch-up contribution if age 50 or older of \$3,000 for 2020. Employer contributions are mandatory, but the employer may elect to make them in the form of a dollar-for-dollar match, subject to certain limits (see chart on next page), to encourage participation.

SEP & SIMPLE IRA PLANS: A COMPARISON²

Feature	SEP IRA plan	SIMPLE IRA plan
Employer eligibility	Any self-employed individual or business that does not maintain another plan.	Any self-employed individual or business that does not maintain another plan and which employs no more than 100 individuals who earned more than \$5,000 from the business in the preceding year.
Model IRS form for adopting employer	Form 5305-SEP, SEP IRA Contribution Agreement	Form 5305-SIMPLE. Alternatively, Form 5304-SIMPLE may be used if you'd like participants to choose their own IRA custodian.
When to set up IRA plan	Any time up to due date of employer's tax return (including extensions).	Any time between January 1st and October 1st of the calendar year. ³
Minimum coverage	Must cover individuals who were employed for three of the immediately preceding five calendar years, earning at least \$600 in 2019 and 2020, and who are at least age 21.	Must cover individuals who are reasonably expected to earn at least \$5,000 in current calendar year and also earned this amount in any two prior years.
Employee contribution	Not applicable	Voluntary pre-tax payroll contribution of up to \$13,500 for 2020. If at least age 50, pre-tax catch-up contribution of up to \$3,000 for 2020 is also permitted.
Employer contribution	Employer contribution of up to 25% of earned income or compensation, ⁴ subject to a maximum of \$56,000 for 2019 and \$57,000 for 2020.	Dollar-for-dollar match on payroll contributions up to 3% of compensation. ⁵ Alternatively, employer may choose to make non-elective contributions of 2% of compensation. ⁶
Vesting	All contributions fully and immediately vested.	
Tax on distributions	All contributions taxable as ordinary income when distributed from IRA.	
Early withdrawal additional federal tax	10% additional federal tax for withdrawals prior to age 59½. Exceptions may apply in limited circumstances.	10% additional federal tax for withdrawals prior to age 59½. Additional federal tax increased to 25% if withdrawal is within two years of commencement date of payroll contributions. Exceptions may apply in limited circumstances.
Minimum distributions	Required from age 70½	Required from age 70½
Impact on contributions to Roth and Traditional IRAs	No impact on ability to make same-year contribution to Roth IRA. Traditional IRA contribution can be made instead, but deduction will be subject to phase-out based on income limits.	

¹ For self-employed individuals, earned income is equal to net earnings reduced by 50% of the individual's self-employment tax and contributions to the individual's own SEP IRA.

² Sources: Internal Revenue Service Publication 560 (January 24, 2019); IRS Forms 5305-SEP, 5305-SIMPLE and 5304-SIMPLE; IR-2018-211 (November 6, 2019).

³ New business formed after October 1st may adopt a SIMPLE IRA plan as soon as administratively feasible.

⁴ For self-employed individuals, earned income is equal to net earnings reduced by 50% of the individual's self-employment tax and contributions to the individual's own SEP IRA. Earned income and compensation taken into account must be limited to \$280,000 for 2019 and \$285,000 for 2020.

⁵ Employer may elect to reduce match to as low as 1% in any two years during the five-year period that ends with and includes the year in which a reduced match is made.

⁶ Compensation taken into account must be limited to \$280,000 for 2019 and \$285,000 for 2020. See IRS Forms 5305-SIMPLE and 5304-SIMPLE for the definition of "compensation" applicable to a self-employed individual.

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All investments involve risk, including loss of principal.

This document is intended to provide a general overview of SEP and SIMPLE IRA plans but does not address all applicable federal tax rules applicable to such plans.

This document does not address state or local tax rules concerning IRAs or other accounts.

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