LEGG MASON
GLOBAL ASSET MANAGEMENT

Retirement Reimagined®

# ADVANTAGES OF A SIMPLE IRA PLAN

**Key benefits:**

Effective way to reduce current taxes while saving for retirement

Full and immediate vesting of all contributions

**Who can participate in a SIMPLE IRA plan?:**

A SIMPLE IRA plan is designed for self-employed individuals and employees of small businesses with no more than 100 employees.

**How do SIMPLE IRA plans work?:**

Each eligible employee or self-employed individual owns and controls his or her own IRA, and they enter into salary reduction agreements with the employer to make payroll contributions to them. The employer either provides a dollar-for-dollar match (see "Contributions") or elects to make non-elective contributions instead.

A special retirement plan designed for small businesses can combine the power of payroll contributions with the simplicity of IRAs. Have you considered participating in your employer's "Savings Incentive Match Plan for Employees" (SIMPLE) IRA plan?

## Highlights

### Eligibility requirements

If your employer has established a SIMPLE IRA plan, you are eligible to participate if:

- You reasonably expect to earn at least $5,000 in the current year; and
- You earned at least $5,000 during any two prior calendar years.

### Contributions

- Both the employer and employee make contributions under a SIMPLE IRA plan.
- Eligible employees can make payroll contributions up to $13,000 for 2018 and 2019.
- If age 50 or older, an employee can make additional catch-up contributions of up to $3,000 for 2018 and 2019.
- The employer generally makes a dollar-for-dollar match on payroll contributions up to 3% of compensation.[1] Or the employer may elect to make a non-elective contribution equal to 2% of compensation.[2] Other rules and exceptions may apply.

[1] 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.

[2] Compensation taken into account must be limited to $275,000 for 2018 ($280,000 for 2019). See IRS Forms 5305-SIMPLE and 5304-SIMPLE for the definition of "compensation" applicable to a self-employed individual.

Sources: IRS Publication 560 (11/15/2018); IRS Forms 5304-SIMPLE and 5305-SIMPLE; IR-2018-222 (11/15/2018); IR-Notice 2018-83.

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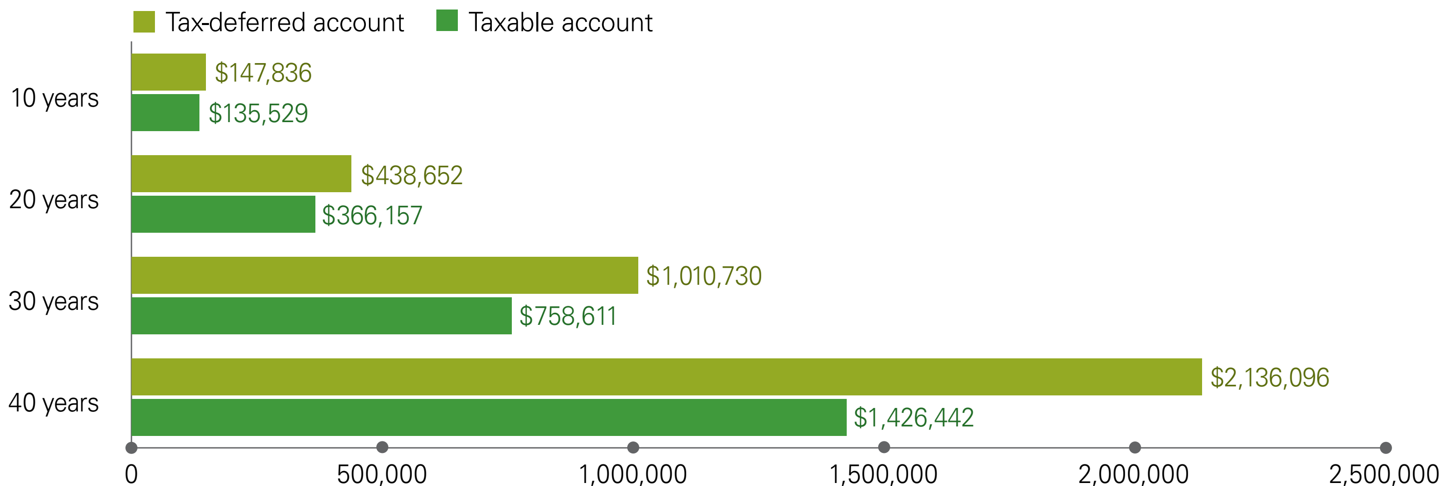
# The power of tax-deferred compounding

In a tax-deferred account, you will not pay taxes on your contributions or account earnings until you take a withdrawal — which can make a significant difference over time. To understand how much of a difference, consider the following hypothetical illustration:

**Growth of annual contributions of $10,000 at a hypothetical annual return rate of 7%**




Source: Legg Mason, 2019. The above illustration assumes a $10,000 annual investment, and a hypothetical annual return rate of 7%, compounded annually over 10-, 20-, 30- and 40-year periods, and does not represent an actual investment. For purposes of the illustration, it has been assumed that the taxable account will generate a combination of long-term capital gains and qualified dividends taxable at a rate of 15% under current federal income tax law,[3] and short-term capital gains and interest taxable as ordinary income (taxable at a rate of 24%), resulting in an annual blended federal tax rate of 22%. This illustration assumes that no distributions are made from the tax-deferred account during or at the end of such period, and that taxes applicable to the taxable account are paid out of such accounts each year. Actual investments may include fees, charges and other expenses that would affect an investment's return. Changes in tax rates and tax treatment of investment earnings may impact the comparative results. This illustration is not representative of any investment product. Actual returns will vary. Withdrawals from a tax-deferred account are taxable as ordinary income in the year made, and early withdrawals prior to age 59½ are generally subject to a 10% additional federal tax. The impact of taxes on tax-deferred withdrawals is not reflected in the above illustration. If reflected, such impact would make the accumulation of assets in the tax-deferred account relative to the accumulation of assets in the taxable account look less favorable.

## Consider the following hypothetical example

- Annual $10,000 payroll contributions are made to a tax-deferred account. Assuming 40 years of contributions, and a 7% hypothetical return, the tax-deferred account will have a pre-tax value of approximately $2.1 million at retirement, representing approximately $1.7 million in growth ($2,136,096 pre-tax value minus $400,000 investment amount[4]).
- If the $10,000 is received as current taxable compensation and invested into a taxable account subject each year to a blended 22% federal tax rate, the account would accumulate only about $1.4 million over the same period, with growth that just exceeds $1,000,000 ($1,426,442 taxable account value rate minus $400,000 investment amount[4]).
- The growth of the tax-deferred account beats the taxable account by over $700,000 due to the power of tax-deferred compounding. Please note that distributions from a tax-deferred account are taxed as ordinary income in the year made, and early withdrawals prior to age 59½ generally are also subject to a 10% additional federal tax. The impact of such taxes is not reflected in the above illustration.
- Your actual experience will vary depending on your actual investment returns and your specific tax rate (which may be more or less than the figures shown). Capital gains and qualified dividends may receive more favorable tax treatment within a taxable account relative to a tax-deferred account due to the lower rates currently applicable to long-term capital gains and qualified dividends and the fact that all distributions from a tax-deferred account are taxed as ordinary income. You should consider your investment time horizon and tax brackets, both current and anticipated. **All investments involve risk, including possible loss of principal.**

[3] The tax rate on long-term capital gains and qualified dividend income is 20% for high-income taxpayers. Capital gains and dividend income is subject to an additional 3.8% tax on "net investment income" for taxpayers with modified adjusted gross income over $200,000 (single persons)/$250,000 (married persons filing jointly).

[4] The $400,000 investment account was calculated by multiplying the annual $10,000 investment by 40 years. Please note that for the taxable account, in order to be able to invest $400,000 you will have had to earn a higher amount because your investment is made on an after-tax basis.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