Understanding SIMPLE Retirement Plans

Options for Small Businesses

SIMPLE retirement plans are designed for small businesses with 100 or fewer employees. Learn the details regarding their setup, eligibility, key features, differences between IRA and 401(k) versions, and the advantages and disadvantages for employers and employees.

The Savings Incentive Match Plan for Employees (SIMPLE) was created under the Small Business Job Protection Act of 1996. This plan offers a simplified way for small businesses to help their employees save for retirement. Here's a comprehensive look at how SIMPLE retirement plans work, based on the provided documents.

What is a SIMPLE Retirement Plan?

A SIMPLE retirement plan is designed for small businesses with 100 or fewer employees. It provides an easy-to-establish, low-cost retirement option with lower administrative burdens compared to traditional 401(k) or 403(b) plans. Employers can set up a SIMPLE plan as either a traditional IRA, a Roth IRA (starting in 2023), or a SIMPLE 401(k) plan.

Eligibility Criteria

A SIMPLE plan is available to businesses that:

- Have 100 or fewer employees.
- Do not maintain another tax-qualified retirement plan to which contributions are made.
- Are either incorporated or unincorporated entities.

Key Features

Employer Responsibilities:

- **Contributions:** Employers must either match employee contributions dollar-for-dollar up to 3% of compensation or make a non-elective contribution of 2% of compensation for all eligible employees, whether they contribute or not.

- **Tax Deductibility:** Employer contributions are tax-deductible.
- **Establishment Deadline:** Employers must set up the SIMPLE plan by October 1 of the year in which they want to start the plan.
- **Contribution Deadline:** Employer contributions must be deposited within 30 days after the end of the month in which the contributions were made.

Employee Responsibilities:

- **Deferrals:** Employees can elect to defer a portion of their salary into the SIMPLE plan.
- **Contribution Limits:** For 2024, the maximum elective contribution is $16,000, with an additional $3,500 catch-up contribution allowed for those aged 50 and older.
- **Plan Types:** Employees have the choice between a traditional SIMPLE IRA (pre-tax contributions), a Roth SIMPLE IRA (after-tax contributions), or a SIMPLE 401(k).
- **Self-Directed:** Employees typically control their investments, and the investment risk remains with them.

Plan Variants

SIMPLE plans can be set up as either IRA or 401(k) versions. Here are some differences:

Plan Type	Individual IRA for each participant	Cash or deferred profit-sharing plan
Participation	Employees who earned $5,000 or more in any 2 prior years and expect to earn $5,000 in the current year	Regular qualified plan rules (age 21, 1 year of service, 1,000 hours)
Do Cash or Deferred Nondiscrimination Rules Apply?	No	No, unless employer fails to contribute
Top-Heavy Rules	They do not apply	Do not apply unless employer fails to contribute
ERISA Reporting and Disclosure Rules	Simplified rules apply	Regular rules apply
Vesting	Always 100%	Always 100%
Employee Contributions	Up to $16,000 (100% of compensation), additional $3,500 for those aged 50+	Up to $16,000 (100% of compensation), additional $3,500 for those aged 50+

Plan Type	Individual IRA for each participant	Cash or deferred profit-sharing plan
Minimum Participation Requirements	No minimum number or percentage of eligible employees who must participate	No minimum number or percentage of eligible employees who must participate
Employer Contributions	Must satisfy one of two alternatives. Election must be made at least 60 days before the start of the plan year.	Must satisfy one of two alternatives. Election must be made at least 60 days before the start of the plan year.
Alternative #1 - Matching Contributions	Employer matches employee's elective deferral, dollar for dollar, up to 3.0% of compensation. For any two years out of five, employer may have a lower match, but not less than 1.0%. No conditions may be imposed on the right to the employer match.	Employer matches employee's elective deferral, dollar for dollar, up to 3.0% of compensation. The $345,000 compensation limit applies. No conditions may be imposed on the right to the employer match.
Alternative #2 - Nonelective Contribution	Employer contribution is 2% of compensation to all eligible employees, whether they defer or not. $345,000 compensation limit applies.	Employer contribution is 2% of compensation to all eligible employees, whether they defer or not. $345,000 compensation limit applies.
Employer Contributions Due By	Due date of employer's income tax return, plus filing extensions	Due date of employer's income tax return, plus filing extensions
Employee In-service Withdrawals	Allowed for any reason. Traditional SIMPLE IRA: taxed as ordinary income and may be subject to a 10% penalty if taken before age 59½. Roth SIMPLE IRA: "Qualified" distributions made after a five-year waiting period and because of (1) reaching age 59½; (2) death; (3) disability; or (4) for first-time homeowner expenses are received income-tax free.	Rules are the same as for 401(k) plans. If plan provides for loans or hardship withdrawals, they are allowed.
Taxation of Distributions	Traditional SIMPLE IRA: treated in the same fashion as withdrawals from a traditional IRA, i.e., ordinary income. Penalty taxes may apply. Roth SIMPLE IRA: "Qualified" distributions made after a five-year waiting period and because of (1) reaching age 59½; (2) death; (3) disability; or (4) for first-time homeowner expenses are received income-tax free.	Same as 401(k) plans. Distribution is ordinary income.

Plan Type	Individual IRA for each participant	Cash or deferred profit-sharing plan
May Employer Have Another Plan?	No	No
Rollovers	Traditional SIMPLE IRA: Allowed if to another traditional SIMPLE IRA or, after 2 years of SIMPLE participation, to a traditional IRA or qualified plan. Roth SIMPLE IRA: allowed if to another Roth SIMPLE IRA, a Roth IRA, or to a ROTH account that is part of a qualified plan.	These are allowed when made to a traditional IRA or qualified plan.
Taxation of Premature Distributions (within first two years)	Traditional SIMPLE IRA: taxed as ordinary income, plus a 25% penalty, unless an exception applies. Roth SIMPLE IRA: "Qualified" distributions made after a five-year waiting period and because of (1) reaching age 59½; (2) death; (3) disability; or (4) for first-time homeowner expenses are received income-tax free. Taxable distributions, if any, are subject to a 25% penalty, unless an exception applies.	Taxed as ordinary income, plus a 10% penalty, unless an exception applies.
Taxation of Premature Distributions (after first two years)	Traditional SIMPLE IRA: taxed as ordinary income, plus a 10% penalty, unless an exception applies. Roth SIMPLE IRA: "Qualified" distributions made after a five-year waiting period and because of (1) reaching age 59½; (2) death; (3) disability; or (4) for first-time homeowner expenses are received income-tax free. Taxable distributions, if any, are subject to a 10% penalty, unless an exception applies.	Taxed as ordinary income, plus a 10% penalty, unless an exception applies.
Reporting Requirements	The plan trustee must provide employer with information on basic plan details. Employer must notify employee of right to defer and provide above information. By January 30, employer must give each participant a statement setting forth account balances as of December 31, and all activity during the calendar year.	Regular reporting and disclosure requirements apply. 5500 filing, Summary Plan Description and Summary Annual Report. 401(k)-type of participant reports is required. Time limit is 9 months after the close of the plan year with Summary Annual Report.

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Early Withdrawals and Retirement

Early Withdrawals:

- **Penalty:** A 25% penalty applies to taxable withdrawals within the first two years, decreasing to 10% after two years.
- **Exceptions:** Certain exceptions to the penalty may apply.

Retirement:

- **Traditional SIMPLE IRA:** Required Minimum Distributions (RMDs) must begin by the required beginning date (RBD).
- **Roth SIMPLE IRA:** No RMDs are required during the owner's lifetime, and qualified distributions are income-tax free.

Advantages

For Employers:

- Predictable financial commitment.
- Tax-deductible contributions.
- Easy setup and understanding for employees.
- Minimal administrative costs.
- Flexibility to convert to Safe Harbor plans mid-year starting in 2024.
    - ❖ You can only convert to a 3% non-elective contribution Safe Harbor and must be calculated on full year compensation.

For Employees:

- Pre-tax contributions for traditional SIMPLE IRAs and SIMPLE 401(k)s.
- Roth contributions for tax-free withdrawals.
- Employer contributions are not currently taxable.
- Right to direct investments.
- Significant protection from creditors under ERISA and federal bankruptcy laws.

Disadvantages

For Employers:

- Mandatory contributions required.
- Cannot sponsor another plan simultaneously before 2024.

- Highly paid participants may pressure for additional retirement benefits.

For Employees:

- Investment risks are borne by the employee.
- No guarantee of future benefits.
- Contributions to Roth SIMPLE IRAs are included in current income.

Secure Act 2.0 Provisions

The Secure Act 2.0 of 2022 introduced several changes affecting SIMPLE plans, including:

- Increased contribution limits for businesses with 25 or fewer employees.
- Higher catch-up contributions for participants aged 60-63 starting in 2025.
- Mid-year conversion from SIMPLE IRAs to safe harbor plans without penalties.

Conclusion

SIMPLE retirement plans provide a flexible, cost-effective retirement savings option for small businesses. With both traditional and Roth options available, they offer tax advantages and simplicity in setup and maintenance. Understanding the rules and benefits can help both employers and employees make the most of these plans.

How a SIMPLE IRA Works

Employer

- SIMPLE plans are available only to firms with 100 employees or less and which do not maintain another qualified retirement plan.
- Employer generally must match employee contributions dollar for dollar up to 3% of compensation. Alternatively, employer may choose to contribute 2% of compensation to all eligible employees, whether they defer or not.

SIMPLE IRA

- A separate IRA, either a "traditional" (pre-tax contributions) or Roth (after-tax contributions) exists for each participant.
- Earnings accumulate tax-deferred.
- Most plans are self-directed (employee controls investment).
- Investment risk remains on employee.

Employee

- Employee may elect to defer a percentage of salary.
- Contributions to a traditional SIMPLE IRA are pre-tax. Contributions to a Roth SIMPLE IRA are after-tax.
- For 2024, elective contributions cannot exceed the lesser of $16,000 or 100% of compensation. For those age 50 and older, additional "catch-up" contributions of $3,500 may be made.

Early Withdrawal

- A 25% penalty generally applies to all taxable withdrawals within the first two years, decreasing to 10% after two years.
- Exceptions to the 25%/10% penalty are available.

Retirement

- Traditional SIMPLE IRA - Required Minimum Distributions (RMDs) must begin by a specified date, the required beginning date (RBD).[1]
- Roth SIMPLE IRA – No RMDs are required during the lifetime of the account owner. "Qualified" distributions are received income-tax free.[2]

Death

- Value of IRA is included in owner's gross estate.
- Proceeds can pass to beneficiaries with payments over varying time periods.
- Income and estate taxes can severely reduce IRA funds left to nonspousal beneficiaries.