SIMPLEs

SIMPLE-IRA

Savings Incentive Match Plans for Employees of Small Employers & for Self-Employed Individuals

Questions & Answers

What is a SIMPLE-IRA plan?

A SIMPLE-IRA plan is a type of employer-sponsored retirement plan. A SIMPLE has its own special features which will make it attractive to some employers and unattractive to others. The purpose of this brochure is to explain the basic features of a SIMPLE-IRA plan. If you are an employee and not an employer, you will still benefit from understanding how a SIMPLE plan works. An employee may enjoy substantial tax benefits by participating in a SIMPLE-IRA plan.

Why have a SIMPLE-IRA plan?

The main reason is – you are allowed to save for retirement and you receive substantial tax benefits as an incentive to do so.

What businesses or employers may establish a SIMPLE?

To be eligible to have a SIMPLE, an employer must meet two requirements. First, an employer will be eligible if it employed 100 or fewer employees on any day during the year who earned $5,000 or more in compensation from the employer during the year. Second, the employer (or any predecessor employer) cannot currently maintain, during any part of the calendar year, another Qualified Plan. For these purposes, a Qualified Plan includes a qualified retirement plan, a qualified annuity plan, a governmental plan, a tax-sheltered annuity, and a SEP to which contributions were made or benefits were accrued, for service in the calendar year.

May a sole proprietor establish a SIMPLE?

Yes. A sole proprietor may establish a SIMPLE as long as the rules discussed above are satisfied. When a self-employed individual sponsors a SIMPLE, he or she is considered to be both the employer and an employee.

If you are self-employed, you are allowed to make an elective deferral up to the maximum permitted without regard to any "percentage of compensation" as is common with profit sharing and SEP-IRA plans. You are, however, not allowed to defer more than the lesser of: your net earnings or the applicable annual limit.

Why do some small employers like SIMPLE-IRA plans rather than 401(k) plans?

The administrative costs of 401(k) plans can become expensive, since there is the requirement to file the annual Form 5500. In addition, there would not be as many fiduciary concerns with the SIMPLE-IRA as with the 401(k) plan since each employee chooses how to invest the SIMPLE-IRA contributions within his or her own SIMPLE-IRA.

Why would an employer and its employees want to have a SIMPLE-IRA?

There are six excellent reasons:

1. An employee, by making elective deferrals, can defer current income taxation.
2. An employer is allowed to deduct the cost of these elective deferrals.
3. Interest or the other income earned on the SIMPLE deferrals is sheltered from federal and most state income taxes while in the SIMPLE-IRA until withdrawn.
4. Due to the effects of compounding, the SIMPLE-IRA funds can grow into a sizable nest egg for retirement.
5. Administrative and legal costs are generally substantially less than would be incurred under a qualified plan.

Why do some small employers like SIMPLE-IRA plans rather than profit sharing or SEP-IRA plans?

In many cases, the cost of contributing for employees is less under a SIMPLE-IRA than it is if the employer sponsors a profit sharing or SEP-IRA plan. In general, the employer must put in the same percentage of compensation for the other employees as he or she contributes for himself or herself, whereas the maximum contribution for an employee is 3% of his or her compensation under a SIMPLE-IRA plan.

How does an employer establish a SIMPLE-IRA plan?

The employer must execute a written plan document that meets the requirements of Internal Revenue Code section 408(p). Normally an employer will do this by either signing the IRS Model Form 5305-SIMPLE or Form 5304-SIMPLE. The employer must also then have each eligible employee establish his or her own SIMPLE Individual Retirement Account (SIMPLE-IRA). A SIMPLE-IRA is similar to a traditional IRA but is different because a SIMPLE-IRA may only accept contributions made under a SIMPLE-IRA plan or certain qualifying rollover or transfer contributions.

What is the basic concept of the SIMPLE retirement plan?

A SIMPLE is a simplified version of a 401(k) plan or salary-reduction SEP plan. The basic concept is that an employee/participant will be eligible to contribute his/her own funds from his/her payroll or bonus, and that the employer will make matching contributions. Limits exist as to how much the employee may contribute (i.e. electively defer), and there are limits as to the matching contribution the employer must make. An employee may elect to defer an amount not to exceed the amount set forth in the following chart:

Tax Year	**Younger Than Age 50**	**Age 50 or Older**
2012	$11,500	$14,000
2013-2014	$12,000	$14,500
2015-2018	$12,500	$15,500

An employee is not eligible to defer more than this chart indicates or more than his or her compensation.

The amount which an employee defers must be expressed as a percentage of compensation. The employer must match on a dollar-for-dollar basis what the employee has chosen to electively defer, up to 3% of the employee's compensation. There is a special rule, as discussed later, which allows an employer to set its match at less than 3% (but not less than 1%) if certain rules are met.

<u>A SIMPLE does not permit an employer to make any other type of contributions.</u> An employer is not permitted to make a pro rata contribution (e.g. 8% of compensation) to the eligible employees, as permitted with a standard profit sharing plan or a SEP plan.

What employees must an employer cover in order to have a SIMPLE?

In essence, a SIMPLE has a maximum two-year participation requirement. Any employee who was paid at least $5,000 in compensation by the sponsoring employer during each of the preceding two years, and who is reasonably expected to receive at least $5,000 in compensation during the "upcoming" year, must be eligible to participate in the SIMPLE for the upcoming year. Note that under this plan it is the amount of compensation which will determine eligibility and not hours of service or age. Thus, under a SIMPLE, an employee must be eligible to make his or her elective deferrals and also to receive the mandatory employer matching contribution. An employer will be able to choose to exclude nonresident aliens and employees covered under a collective bargaining agreement. Compensation for an employee is defined to be the sum of his or her Form W-2 compensation plus any elective deferral amount. Self-employed individuals can participate in a SIMPLE. Compensation for a self-employed individual is defined to be his or her net earnings without regard to any contribution under the SIMPLE.

Must an employee make an elective deferral each year?

No. The employee has total discretion whether or not to make a contribution each year.

What is the cost to the employer?

The employer will be required to make its matching contributions. SIMPLEs have relatively few government reporting requirements, and therefore, lower administrative costs.

Who is responsible to administer the SIMPLE?

The sponsoring employer is responsible for the SIMPLE administration. The employer may well need to consult with its tax and legal advisor. A financial institution's general role is to serve as the depository and not as the plan administrator.

When must employer contributions be made?

Employer matching contributions must be made by the time its tax returns for the year are filed.

The Internal Revenue Code provides the rule that an employer must contribute an employee's elective contributions to his or her SIMPLE-IRA not later than 30 days after the month-end in which they are made. The Department of Labor (DOL) has a regulation which it believes applies to SIMPLE-IRA plans in addition to the rule set forth in the Internal Revenue Code. Such elective contributions must be segregated as of the earliest date the employer can reasonably segregate them from its general assets. The DOL has created an optional safe harbor – there is deemed compliance as along as such contributions are deposited no later than the 7th business day following the day on which such amount is received by the employer.

When may an employer make a matching contribution of less than 3%?

An employer may set its matching rate at as little as 1% of compensation, if two requirements are met. First, the employer must notify the employees of the lower percentage within a reasonable amount of time before the 60-day "decision" period commences. Second, the employer cannot set the percentage for the upcoming year at less than 3%, if the percentage had been set at less than 3% in two out of the four preceding years. If the SIMPLE was not in existence for all or any part of this four-year time period, then it is deemed that the employer's matching rate was 3% for such year.

May the employer avoid making a matching contribution by making a 2% nonelective contribution?

Yes. An employer is not required to make a 3% matching contribution if the employer elects to make a nonelective contribution of 2% of compensation for each employee who is eligible to participate in the SIMPLE and who has at least $5,000 of compensation for the current year. The employer must notify the employees within a reasonable amount of time before the 60-day period that it will be making this 2% contribution rather than the matching contribution. Compensation is limited to $200,000 for 2002 (as indexed) and subsequent years for purposes of this 2% nonelective contribution. For 2017, this limit is $270,000. For 2018, this limit is also $275,000.

What is the tax treatment of contributions?

Contributions to a SIMPLE are excludable from the gross income of the employee.

The employer will be able to deduct both its elective deferral contributions and its matching contributions. With respect to the employee elective contributions, a deduction is allowed only if the contributions are made by the due date (including extensions) of the employer's tax return.

The rules do allow the employer to make contributions after the end of the year if they are made on account of such taxable year and are made not later than the time prescribed by law for filing the return for such year (including extensions). The employee's elective contributions are to be treated as wages for employment tax purposes. That is, these elective deferrals will be subject to social security and medicare taxes. The employer's matching contribution will not be subject to such taxes.

The income earned by the contributions will not be taxed until a distribution occurs.

An employee is always 100% vested in any contribution to the SIMPLE account.

An employee who makes an elective contribution to a SIMPLE account will be an active participant for IRA deduction purposes.

What is the tax treatment of distributions?

Distributions will be taxed under the rules generally applicable to IRAs. Distributions prior to age 59½ will generally be subject to the 10% excise tax. However, a 25% tax will be imposed, rather than the 10% tax, if there is a withdrawal of contributions within the two-year period commencing on an employee's participation in the SIMPLE, unless the individual qualifies to use one of the exceptions (e.g. disability, death, etc.)

What administrative rules will apply to the elective deferrals?

An employee will use the 60-day period before the start of any year to decide to what extent he or she will make elective deferrals during the upcoming year, or change prior instructions. Prior to this 60-day period, the employer will inform the employees what its matching rate will be for the upcoming year.

A plan may be permitted to be written to allow a participant to increase or decrease his or her deferral instruction during the year, but the plan need not permit this. However, a participant must have the right to stop his or her elective deferrals at any time. Once a participant stops his or her elective deferrals, the plan may be written to not allow elective deferrals to start again until the next year.

What rollover rules apply to SIMPLE-IRAs?

If a person receives a distribution (i.e. the check is made payable to the SIMPLE-IRA accountholder) of all or a part of his or her SIMPLE-IRA, he or she can redeposit the funds into a SIMPLE-IRA without being taxed on the receipt of the funds. The standard IRA rollover rules apply. These are: the rollover must be completed within 60 days, only one IRA distribution, including a SIMPLE-IRA distribution, may be rolled over within a 12-month period and a required distribution is ineligible to be rolled over.

If a SIMPLE-IRA participant has met the 2-year requirement as set forth in Code section 72(t)(6), then he ,or she may roll funds into or out of a SIMPLE-IRA into or out of another qualifying plan such as a 401(k) plan or a traditional IRA.

May SIMPLE-IRA funds be transferred to another SIMPLE-IRA or a standard traditional IRA?

Yes, but a transfer to a traditional IRA is only permissible if the transfer occurs after the 2-year rule has been met.

What reports will the trustee (i.e. the financial institution) be required to prepare to comply with IRS and ERISA rules?

At least once a year the trustee must furnish a report to the IRS.

Within 31 days after the end of each calendar year (i.e. by January 31), the trustee must furnish each participant a statement showing the SIMPLE account balance as of December 31 of such year and the activity for such account during the calendar year.

The trustee must generally furnish the sponsoring employer a summary description in September of each year.

What reports must the employer prepare for the IRS and for ERISA purposes?

The employer must notify each employee of his or her eligibility to make elective deferrals immediately before the employee becomes eligible to make the election. That is, the employer must give notice to the employee before the 60-day election period commences. The employer's notice must contain a copy of the summary description furnished by the trustee.

How will ERISA apply to a SIMPLE retirement account?

Only simplified reporting will be required under ERISA. Thus, there is no Form 5500 or any similar form to be completed.

An employer who sponsors a SIMPLE will not be subject to any fiduciary liability when the employee or a beneficiary exercises control over the assets in his or her own SIMPLE account.