

SIMPLE Retirement Plans

What are SIMPLE Retirement Plans?

Effective January 1, 1997, a new type of employer-sponsored retirement plan became available—the Savings Incentive Match Plan for Employees (SIMPLE). SIMPLE plans can be established by employers with 100 or fewer employees who received at least \$5,000 each in compensation from the employer in the preceding year, provided the employer does not maintain another qualified retirement plan, 403(b) annuity plan, 501(c)(18) trust, SEP, or governmental plan. An employer who contributes to a collectively bargained plan for some employees may set up a SIMPLE 401(k) plan or SIMPLE IRA for other employees; however, those employees who participate in the collectively bargained plan still count towards the 100-employee limit.

If an employer goes over the 100-employee limit as its business expands, the employer may continue to maintain the SIMPLE plan for another two years.

SIMPLE plans may be set up by self-employed persons as well as corporations.

Self-employed persons receiving earned income from an employer count as "employees" for determining the 100-employee limit.

SIMPLE plans are intended to replace salary reduction SEPs (SARSEPs), which may no longer be established after December 31, 1996.

SIMPLE plans are not subject to the anti-discrimination or top-heavy rules usually applicable to tax qualified retirement plans.

SIMPLE retirement plans can be established in two ways:

- as a SIMPLE IRA for each employee, or
- as a SIMPLE 401(k) plan.

SIMPLE IRAs

In a SIMPLE IRA plan, contributions allowed are:

- employee elective salary deferrals, and
- required employer matching contributions, or employer "nonelective" contributions.

Employee Elective Salary Deferrals

Employees' elective salary deferrals must be expressed as a percentage, or dollar amount, of compensation. Employees may defer up to 100% of their compensation after FICA withholding, subject to the SIMPLE dollar deferral limit.

The annual elective deferral limit for SIMPLE IRAs, and additional "catch-up" contributions permitted for participants age 50 and over, phase-in in accordance with the following table:

<u>Year</u>	<u>Deferral Limit Under Age 50</u>	<u>Deferral Limit Age 50 and Over</u>
2002	\$7,000	\$7,500
2003	\$8,000	\$9,000
2004	\$9,000	\$10,500
2005	\$10,000	\$12,000
2006	\$10,000*	\$12,500

*After 2005, the basic elective deferral limit (\$10,000) for SIMPLE IRAs will be indexed to inflation in \$500 increments, rounded down to the next lowest multiple of \$500. The age-50+ catch-up amount (\$2,500) will be indexed after 2006.

Technically, a plan may not permit additional catch-up contributions (elective deferrals) by persons age 50 and over for a particular year that are greater than the lesser of—

- the maximum incremental dollar amount allowable (i.e., \$1,500 for 2004), or
- the excess of the individual's compensation for the year over other elective deferrals made for the year, ignoring the additional catch-up amount.

A plan is not required to allow additional "catch-up" contributions by participants age 50 and over; it is merely permitted to do so. A participant is deemed to be age 50 for a particular year if he or she turns 50 during that year.

Employees must be allowed to discontinue their voluntary salary deferrals at any time during the year. They can elect to

participate, and to alter their previous elections, within at least 60 days before the start of the plan year (or in the case of a new participant, at least 60 days before or after the date of eligibility).

An employee may participate in a SIMPLE IRA plan even if he or she also participates in another employer's qualified retirement plan in the same year. However, his or her aggregate salary deferrals for the year are subject to the Sec. 402(g) limitation on elective deferrals.

Employer Contributions

The employer must either—

- match employee contributions dollar-for-dollar up to 3% of actual employee compensation for the year, or match a percentage as low as 1% in no more than two out of the five years ending with the year of the contribution), **or**
- make a nonelective contribution for each eligible employee of 2% of annual compensation (up to a maximum compensation of \$205,000 for 2004), regardless of whether the employee contributes.

The employer must notify the employees of the type and percentage of employer contribution within a reasonable period before the annual 60-day election period for the year.

Matching contributions to SIMPLE IRAs made on behalf of self-employed individuals are not treated as elective deferrals. Thus, they are not subject to the annual dollar limit on elective deferrals into SIMPLE IRAs, nor (for employees who participate in plans of non-affiliated employers) the Sec. 402(g) limitation on elective deferrals.

Participation

Employees who received at least \$5,000 in compensation from the employer during any two preceding years, and who are reasonably expected to receive at least \$5,000 in compensation during the current year, are eligible to participate. The employer may elect to exclude employees who are nonresident aliens and those covered under a collectively bargained arrangement. An employer may adopt less restrictive rules than these minimum standards set by the tax code, thereby allowing more employees to participate.

Vesting

All contributions to a SIMPLE IRA vest fully and immediately to the employee, including those made by the employer.

Taxation of SIMPLE IRA Contributions

Employee salary deferrals and employer contributions are excludable from employee gross income and deductible to the employer in the year made.

Employee deferrals are not considered wages for purposes of income tax withholding, but they are counted as wages for FICA, FUTA, and Medicare tax purposes. Employer matching contributions are not counted as wages for income tax withholding, FICA, FUTA, and Medicare tax purposes.

Distributions from SIMPLE IRAs

Contributions to SIMPLE IRAs and the earnings thereon are not taxed until withdrawn. The usual 10% penalty tax applies to early withdrawals (generally before age 59-1/2, with the usual exceptions for IRAs). However, if the withdrawal occurs within the first two years of plan participation, the penalty tax is 25% if the participant is under age 59½. Otherwise, SIMPLE IRA distributions are taxed the same as IRA withdrawals.

Rollovers

Distributions from SIMPLE IRAs during the first two years of plan participation are not eligible for tax-free rollover unless rolled to another SIMPLE IRA. After the two-year period expires, tax-deferred rollovers may be made to traditional IRAs or qualified retirement plans, as well as to other SIMPLE IRAs.

SIMPLE 401(k) Plans

An employer (other than a governmental employer) that does not employ more than 100 employees who received at least \$5,000 of compensation from the employer in the preceding year, nor maintain another qualified retirement plan in which the same employees (who received at least \$5,000 of compensation from the employer in the preceding year) are covered, may adopt a SIMPLE plan as part of a 401(k) cash-or-deferred arrangement. With a few exceptions discussed following, the rules for SIMPLE 401(k) plans follow those for regular 401(k) plans (e.g., eligibility rules, coverage rules, and the Section 415 contribution limits).

SIMPLE 401(k) plans do not have to meet the usual 401(k) nondiscrimination tests with respect to elective deferrals (the average deferral percentage test) or employer matches (the actual contribution percentage test), provided?

- no employee's elective salary deferrals exceed the lesser of **(a)** the maximum deferral limit or **(b)** 100% of compensation less FICA withholding;
- the employer either makes contributions that match the employee's elective salary deferrals for the year, up to 3% of the employee's compensation (up to \$205,000 for 2004), or makes a nonelective contribution of 2% of compensation (up to \$205,000 for 2004) for each eligible employee who earned at least \$5,000 in compensation for the year, and notifies employees of the election within a reasonable period before the 60-day election period;
- no other contributions are made under the arrangement; **and**
- all contributions to the SIMPLE 401(k) plan are 100% vested.

The annual elective deferral limit for SIMPLE 401(k) plans, and additional "catch-up" contributions permitted for participants age 50 and over, phase-in in accordance with the following table:

Year	Deferral Limit Under Age 50	Deferral Limit Age 50 and Over
2002	\$7,000	\$7,500
2003	\$8,000	\$9,000
2004	\$9,000	\$10,500
2005	\$10,000	\$12,000
2006	\$10,000*	\$12,500

*After 2005, the basic elective deferral limit (\$10,000) for SIMPLE 401(k) plans will be indexed to inflation in \$500 increments, rounded down to the next lowest multiple of \$500. The age-50+ catch-up amount will be indexed after 2006.

Technically, a plan may not permit additional catch-up contributions (elective deferrals) by persons age 50 and over for a particular year that are greater than the lesser of—

- the maximum incremental dollar amount allowable (i.e., \$1,500 for 2004), or
- the excess of the individual's compensation for the year over other elective deferrals made for the year, ignoring the additional catch-up amount.

In a SIMPLE 401(k) plan, the employer cannot use the option to reduce the contribution to less than 3% in up to two out of five years as is possible with a SIMPLE IRA plan.

If these requirements for SIMPLE 401(k) plans are met, the plan will avoid having to meet the top-heavy rules as well as the regular 401(k) and (m) nondiscrimination rules.

The employer's deduction for SIMPLE 401(k) plan contributions is the greater of (1) 15% of the compensation paid to plan participants for the year, and (2) the amount the employer is required to contribute to the plan for the year.

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