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The SIMPLE IRA

Understanding the requirements and features of the SIMPLE IRA

A SIMPLE IRA can provide a low-cost, easy to administer retirement plan solution for a variety of types of businesses with 100 or fewer employees.

What is a SIMPLE IRA?

As a means of encouraging employee savings, a SIMPLE IRA (Savings Incentive Match Plan for Employees) allows employees and employers to jointly contribute to an IRA-based plan that is designated for the employees' benefit. A SIMPLE IRA is considered a low-cost retirement plan suited for employers with 100 or fewer employees. The SIMPLE IRA offers flexible benefits with less administration when compared to other plan types.

> In general, a SIMPLE IRA may be easier for an employer to administer but less flexible than other qualified retirement plans.

Can you establish a SIMPLE IRA?

The following types of employers may establish a SIMPLE IRA:

- Sole proprietorships
- Partnerships
- Corporations
- S Corporations
- Limited liability companies (LLCs)
- Government entities
- Nonprofit or tax-exempt organizations

To establish a SIMPLE IRA, you must:

- Have 100 or fewer employees (determined by Forms W-2 issued for the calendar year) earning at least $5,000 in compensation in the preceding year.
- Not maintain any other employer sponsored retirement plan to which contributions are made or accrued during the calendar year in which the SIMPLE IRA is effective. This does not apply to plans that cover only union employees who are excluded from SIMPLE IRA participation.

How does the SIMPLE IRA work?

To establish a plan, you need to complete an adoption agreement. To make tax-deductible contributions for the current year, you must establish the plan by October 1.

To participate, each eligible employee must establish a SIMPLE IRA. Both employee and employer contributions are deposited into these accounts. However, the employer and employees must both understand that only SIMPLE IRA contributions, transfers, and rollovers from other SIMPLE IRA plans can be deposited into these accounts for two years from the first deposit. After that time, other types of IRAs (excluding Roth IRAs) and qualified plans can roll into the SIMPLE IRA. No additional employee or employer contributions are allowed.

Employees are immediately 100% vested and have full ownership of all investments and earnings in their accounts, even if they terminate their employment.

Eligible employees

Employees must be allowed to contribute if they:

- Received at least $5,000 in salary during each of any two preceding years (not necessarily consecutive)
- Are reasonably expected to receive at least $5,000 in the current year

If the employer chooses, these requirements can be less restrictive (see “Frequently Asked Questions” on page 2 for details). In addition, employees covered by a collective bargaining agreement and nonresident aliens with no U.S. income can be excluded from the plan.

How are employee contributions determined?

The amount an employee can defer into the plan depends on his or her age. Individuals younger than age 50 can defer amounts up to the contribution limits shown below.

Participants aged 50 and older can also make catch-up contributions up to the limits shown. Contributions up to the annual limits are excluded from each employee’s taxable income and can potentially accumulate tax-deferred until withdrawn.

Year	Salary deferral limit	Catch-up contribution limit
2021	$13,500	$3,000*

*Subject to cost-of-living adjustments.

How are employer contributions determined?

You must make a tax-deductible contribution using one of the following formulas:

- A dollar-for-dollar matching contribution up to 3% of an employee’s compensation or a lower matching contribution (not less than 1%). The lower matching percentage cannot occur more than two out of any five years. In addition, matching contributions are limited to either 3% of the employee’s compensation or his or her elective deferral amount, whichever is less. (There is no compensation limit for this type of contribution.)
- A nonmatching contribution of 2% of compensation for each eligible employee. (Compensation is limited to $290,000 for 2021 for this type of contribution.)

You must notify employees about the elected contribution alternative 60 days in advance of the plan year. If you fail to notify the employees and continue to operate the SIMPLE IRA, you must use the 3% match and may be subject to IRS penalties.

How are SIMPLE IRA distributions taxed?

Overall, tax treatment of SIMPLE IRA distributions is similar to that of Traditional IRAs. As with a Traditional IRA, SIMPLE IRA withdrawals are categorized as ordinary income. However, if a participant younger than age 59½ takes a withdrawal from a SIMPLE IRA within the first two years of plan participation, he or she may owe a 25% IRS penalty and ordinary income taxes on the amount withdrawn (certain exceptions apply). Whereas, with a Traditional IRA, the early withdrawal penalty would be only 10%.

Participants may roll over or transfer one SIMPLE IRA to another SIMPLE IRA at any time. In addition, after the two year period, participants may roll assets from a SIMPLE IRA into a Traditional IRA without tax consequences. If a SIMPLE IRA participant ceases his or her participation, the SIMPLE IRA is treated as a Traditional IRA after two years. Termination of service does not waive the two-year holding period.

Frequently asked questions

May I impose less restrictive eligibility requirements?

Yes, you may impose less restrictive eligibility requirements by eliminating or reducing the prior-year compensation requirements, the current-year compensation requirements or both. For example, you could let employees who received $3,000 in compensation during any preceding calendar year participate instead of the $5,000 maximum. Keep in mind that the eligibility requirements must be consistent for all qualified employees.

Is there a required participation percentage?

No, because there is no discrimination testing with a SIMPLE IRA plan, there is no required participation percentage. For example, you may have 10 eligible employees with only the owner and one other employee making salary deferrals.

Is the business obligated to make a contribution?

Yes, the business must contribute to the plan, and all contributions must be immediately vested. You must also choose a contribution formula; see “How are employer contributions determined?” on the previous page for the available alternatives.

The following tables show hypothetical examples of the differences between the alternatives. If you choose the 3% match and the plan participants choose the following salary-deferral amounts, your contributions would be:

Employee	Salary deferral	Salary	Your contribution*
Sam	3%	$50,000	$1,500
John	3%	$35,000	$1,050
Sally	0%	$20,000	$0

*The contribution would be reduced if the employee contribution were less than the amount shown. For example, if Sam’s contribution were only $1,000, the company’s contribution would also be $1,000.

On the other hand, you would have to contribute the following if you chose to make 2% nonelective contributions:

Employee	Salary deferral	Salary	Your contribution
Sam	3%	$50,000	$1,000
John	3%	$35,000	$700
Sally	0%	$20,000	$400

If you elect to use the matching contribution formula and the employees elect not to participate, the result would be no funding of employer contributions.

If an employee makes a catch-up contribution, is the business required to make a matching contribution?

Yes, if you use the 3% matching contribution formula, the business must match the catch-up contribution. For example, an employee has a $550,000 salary and defers $16,500, which includes a $3,000 catch-up contribution. In this instance, your match would be $16,500 (dollar-for-dollar up to 3% of compensation).

When must I deposit employees’ salary-deferral contributions?

You must deposit the salary-deferral contributions into the financial institutions maintaining the SIMPLE IRA accounts as soon as administratively feasible, however, no later than the end of the 30-day period following the last day of the month in which the amounts would otherwise have been payable to the employee in cash. These rules also apply to self-employed individuals. Therefore, the last day for the deposit of salary-deferred contributions made on behalf of a self-employed individual for a calendar year is 30 days after the end of the year, or January 30. If it is possible to make contributions sooner than 30 days, this should always be done. Ultimately, deposits are one of the most common mistakes the IRS has identified in business-sponsored retirement plans.

Are salary deferrals exempt from all payroll taxes?

No, the amount an employee defers into the SIMPLE IRA plan is not exempt from FICA (Social Security) withholding. However, deferrals are exempt from current federal income-tax withholding as well as most state income-tax withholding. Check with your tax advisor to determine whether salary deferrals are exempt from your state’s income tax withholding.

When must the business’s contributions be deposited?

You may make employer SIMPLE IRA contributions up to the due date of your business’s tax returns, including extensions. Contributions are tax-deductible for the tax year in which the calendar year ends.

Are there any administration or IRS reporting requirements?

There are no IRS reports required (such as Form 5500). However, you are required to give each eligible employee a “notification to eligible employees,” which includes a Summary Plan Description and SIMPLE IRA Deferral Form each year by November 2. Failure to provide this notification can result in IRS penalties.

Can I contribute to a SIMPLE IRA if I maintain another qualified plan during the same calendar year?

No, you cannot make contributions under a SIMPLE IRA for a calendar year if you, or a former employer, maintain another qualified plan under which any of your employees receives a contribution (in the case of defined contribution plans, this also means salary deferrals).

In addition, you or a former employer cannot make contributions to a SIMPLE IRA for a calendar year if you maintain another qualified plan under which any of your employees has an increase in a benefit accrued (as in a defined benefit or money purchase pension plan). An exception may apply if the employer that maintained a qualified plan was acquired during the calendar year by an employer that maintained a SIMPLE IRA.

For this purpose, “qualified plans” also include SEP, SAR-SEP, and 403(b) plans, as well as retirement plans established for employees of a state or political subdivision or by an agency of any state or political subdivision [other than an eligible deferred-compensation plan described in Section 457(b)]. In applying these rules, transfers, rollovers, or forfeitures are disregarded, except to the extent forfeitures replace otherwise-required contributions.

May I terminate a SIMPLE IRA plan at any time during the year?

No, once the annual notice requirement has been met, you are required to operate the plan accordingly for that calendar year. You must also provide notification 60 days in advance, in the year prior to, termination of the plan.

Additional considerations

When evaluating whether a SIMPLE IRA is appropriate for your business, consider a variety of questions, including:

- How does the SIMPLE IRA compare with your existing retirement plan?
- How do the advantages and limitations of the SIMPLE IRA relate to your business needs if you do not currently maintain a retirement plan?
- How does the SIMPLE IRA compare with other retirement-plan alternatives available?

The keys to your assessment will be to review the full range of available retirement plan alternatives and then select the most appropriate plan and services to meet your business's needs today and in the future.

You can count on us

Although a SIMPLE IRA plan offers potential benefits, it may not be right for every business. Wells Fargo Advisors offers a range of plans and can help you match the right plan with your needs and objectives.

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Please keep in mind that rolling over or transferring your SIMPLE IRA to another SIMPLE IRA is just one option. Each option has advantages and disadvantages, and the one that is best depends on your individual circumstances. You should consider features such as investment options, fees and expenses and services offered. We recommend you consult with your current plan administrator before making any decisions regarding your retirement assets.

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