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What Could be Simpler?
SIMPLEs Make it Easier for Small Employers to Offer a Retirement Plan

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Providing an employee retirement plan can be challenging, especially for smaller companies. But SIMPLEs — Savings Incentive Match Plans for Employees — are, as their name suggests, simpler to set up, contribute to and maintain than many other plans. Establishing a SIMPLE requires just a few steps and a nominal financial investment. And once it's up and running, a financial institution can handle much of the administrative work. Just as important, SIMPLEs allow employees to save for their retirement on a tax-deferred basis through payroll deductions.

The criteria

To offer a SIMPLE, your business must meet certain conditions. For example, you generally must have no more than 100 employees who earned $5,000 (or more) in compensation during the preceding calendar year. (All employees should be included in this tally, even if some don't meet the plan's eligibility requirements.) If your company starts a SIMPLE and then later grows to top the 100-employee mark, you may be able to keep the plan in effect for up to two more years.

Generally, you can't offer a SIMPLE in addition to another retirement plan. However, there are exceptions for employees covered under collective bargaining agreements and for companies that participated in an acquisition or disposition during the year.

Major decisions

You must decide whether your business will choose the financial institution to act as trustee for the plan, or whether employees will be able to choose their own financial institution for receiving their contributions. Only certain types of financial institutions, such as banks and some insurance companies, can be SIMPLE trustees.

The trustees agree to invest the plan contributions, typically in mutual funds. They also agree to provide employers with information on the plan each year.

Another decision involves choosing and executing the plan document. This step establishes the plan terms, such as eligibility criteria and employer contributions. Either IRS Form 5304-SIMPLE or IRS Form 5305-SIMPLE can be used for this purpose. The Form 5304-SIMPLE is used if each participant selects the financial institution receiving his or her plan contributions.

The latter is used if the business deposits all contributions at a financial institution it designates. Alternatively, some financial institutions have their own forms for employers to use.

You must also provide employees with information on the plan. The summary plan description uses plain language to explain, for instance, eligibility requirements, benefits provided, and the name and address of the trustee. Providing employees with copies of 5304-SIMPLE or 5305-SIMPLE can satisfy this requirement. Or, again, the financial institution may provide the summary plan description.

In addition, employees must receive an annual election notice outlining their ability to make contributions through salary reductions, as well as the employer's contributions. Again, Forms 5304-SIMPLE or 5305-SIMPLE may be used.

Employer contributions

Once your company establishes a SIMPLE, it must contribute to its employees' accounts. These contributions can take one of two forms:

1. The employer matches each employee's contributions up to 3% of their compensation, or
2. The employer contributes 2% of each eligible employee's compensation (up to a maximum compensation level of $260,000 in 2014). This contribution occurs whether or not the employee makes a contribution.

Each year, you decide which method you'll use, and then you must let employees know what you're doing.

Employee options

Employees don't have to contribute to their SIMPLEs, even if they're eligible. Those who decide to contribute can set aside up to $12,000 in 2014, although employees age 50 or older by the end of the tax year can add "catch-up" contributions of up to $2,500. The limits might go up for 2015; check with your tax and benefits advisors for the latest information.

Both employer and employee contributions immediately vest completely with the employee. That is, once the money is in the account, it belongs to the employee.

It's so simple

Given the relatively low cost and time required to administer a SIMPLE, it can be a great benefit to offer to your employees. Your tax and benefits advisors can help determine whether a SIMPLE is right for you and, if so, walk you through the steps for setting one up. •

The right plan?

While SIMPLEs have many benefits (see main article), they also have some drawbacks. One is that the contribution limits are lower than those of some other retirement plans. For instance, in contrast to the SIMPLE’s 2014 limits, employees participating in a 401(k) plan can defer up to $17,500 (with a $5,500 limit for catch-up contributions).

Another drawback is that SIMPLEs are less flexible than some other options. Employers must make annual contributions once they establish the plans, and the contributions have to fall within certain ranges.

Last, as with many retirement plans, early withdrawals can be expensive. Employees who take money from a SIMPLE before reaching age 59½ typically have to pay a 10% penalty on top of income tax on the amount withdrawn. (In limited circumstances, the penalty won’t apply.) What’s more, if the withdrawal occurs within the first two years of the employee’s participation, the penalty jumps to 25%.