What Is a SIMPLE?

There are many types of employer-sponsored retirement plans. One that may appeal to small businesses and to self-employed individuals is the savings incentive match plan for employees of small employers (SIMPLE) because, as the name implies, it is easy to set up and administer, and employers are allowed to take a tax deduction for the contributions that are made.

SIMPLEs can be established by small businesses that have 100 or fewer employees (who were paid at least $5,000 or more in compensation during the previous year) and do not maintain other retirement plans. They can be structured as an IRA for each eligible individual or as part of a qualified cash or deferred arrangement such as a 401(k) plan. Typically, they are structured as SIMPLE IRAs.

Eligible employees (those who earned at least $5,000 in the preceding year) can make pre-tax contributions to their plans each year. Participants may contribute 100% of their salaries up to $12,500 in 2015. Those who are 50 or older during the year can elect to make $3,000 catch-up contributions. These amounts are indexed annually for inflation.

Administrators of SIMPLE IRAs are required to make either matching contributions equal to employee contributions (up to 3% of employee salaries) or nonelective contributions, which set a flat 2% contribution rate for all eligible employees. Employees are immediately 100% vested in contributions made by the employer, and they direct their own investments.

Distribution rules are similar to most IRA plans. Withdrawals are taxed as ordinary income and are also subject to a 10% federal income tax penalty if withdrawn prior age 59½, unless there are extenuating circumstances as outlined by the IRS. Required minimum distributions also must begin after the participant reaches age 70½.

An additional rule for SIMPLE plans is that there is a two-year waiting period after the date when an employee enrolls in the plan to transfer contributions to another IRA on a tax-deferred basis. Any withdrawals taken during the first two years of an employee’s participation in the plan are subject to a 25% tax penalty in addition to ordinary income taxes. After the first two years, early withdrawals are generally subject to the 10% early-withdrawal penalty prior to age 59½. Of course, the IRS sometimes allows exceptions under special circumstances.

SIMPLE IRAs may be a good choice for small-business owners because the responsibility for funding the plan is shared between the employer and the employee. The start-up and maintenance costs also may be lower than for other qualified plans. If you are considering whether to establish a retirement plan for your business, you may want to make it SIMPLE.