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Ken Berry • Jun. 30, 2014

(This is the first in a series of articles on qualified retirement plans for small business owners.)

SIMPLE. The name says it all. It stands for Savings Incentive Match Plan for Employees, a contrived moniker, but you get the picture. This type of qualified retirement plan, created back in 1996, is designed to provide an easy and convenient retirement plan option for small business operations.

Here are the basics: There are actually two variations of the SIMPLE: (1) the SIMPLE-IRA and (2) the SIMPLE-401(k). As you might imagine, a SIMPLE-IRA resembles a traditional IRA and the SIMPLE-401(k) works more like a 401(k) plan. For ease of administration, most small business owners opt for the SIMPLE-IRA and it has become synonymous with the term "SIMPLE." We will limit this discussion to SIMPLE-IRAs.

To qualify to use a SIMPLE, the business can't employ more than 100 workers. For this purpose, you must count all employees who have earned at least $5,000 in the previous year. Any employee who has been paid at least $5,000 in compensation for any two previous years at the company — and who expects to receive at least that amount in the current year — is eligible to participate in the plan. If the employer chooses, it can establish less restrictive eligibility requirements. Note that this type of plan is also available to self-employed individuals.

As with other qualified plans, the contribution limits are adjusted annually. For

to withdraw funds from the plan at any time, subject to an early withdrawal penalty.

However, withdrawals made prior to age 59 ½ that don’t qualify under one of the tax law exceptions are hit with a penalty tax. Caution: The usual 10% penalty for an early withdrawal from a qualified plan is increased to 25% during the first two years of participation in the SIMPLE. After two years, it reverts to the normal 10% penalty.

The rules for mandatory distributions from qualified plans after an employee turns age 70 ½ also apply to SIMPLEs. To continue tax deferral, funds may be rolled over into a traditional IRA.

Finally, a SIMPLE taking effect in the current year may be set up anytime during the year before October 1. The employer doesn't have to file an annual return for the plan nor is nondiscrimination testing required.

Use Form 5304-SIMPLE or Form 5305-SIMPLE to set up a SIMPLE- IRA plan. Form 5304-SIMPLE is used if plan participants select the financial institution for receiving the contributions.? If all SIMPLE IRA plan contributions are going to a financial institution designated by the employer, use Form 5305-SIMPLE

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