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PAYROLL

Starting a Retirement Plan? Keep It SIMPLE

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Ken Berry • Aug. 04, 2022



As the name implies, a SIMPLE—short for Savings Incentive Match Plan for Employees—is a simplified type of qualified retirement plan available to self-employed individuals and other small business owners. This type of plan has proven to be popular along with its close cousin, the Simplified Employee Pension (SEP), due to ease of administration.

Icing on the cake: The Setting Every Community Up for Retirement Enhancement

The (SECURE) Act provides extra tax incentives for using qualified plans like SIMPLEs. Notably, the SECURE Act increases the maximum available credit for starting a plan to \$5,000 and creates a new credit of up to \$500 per year for automatic enrollment plans.

Before we go any further, be aware that you can set up either one of two variations of a SIMPLE, the IRA version or the 401(k) version, but the IRA version is far more prevalent. For these purposes, we'll refer to a SIMPLE as being synonymous with the SIMPLE-IRA version.

Basic premise: To qualify to use a SIMPLE, the business can't employ more than 100 workers. This includes any employees who earned at least \$5,000 in the previous year. An employee who has been paid at least \$5,000 in compensation for any two previous years—and who expects to receive at least that amount in the current year—is also eligible to participate in the plan. If you choose, your business can implement less restrictive eligibility requirements.

The contribution limits for SIMPLEs are adjusted annually. For 2022, eligible employees may elect to contribute up to \$14,000. Plus, an employee who is age 50 or older can add a “catch-up contribution” of \$3,000, for a grand total of \$17,000.

Generally, the employer must provide matching elective contributions of up to 3% of compensation (but not less than 1% in no more than two out of five years) or non-elective contributions of 2% of each eligible employee's compensation (based on a maximum compensation of \$305,000 in 2022). These contributions are deductible by the employer.

Like SEPs, contributions to a SIMPLE vest immediately. Thus, employees have the ability to withdraw funds from the plan anytime, but withdrawals made prior to age 59½ are hit with a tax penalty, in addition to regular income tax, unless a special tax law exception applies.

Tax alert: Usually, the penalty for early withdrawals from a qualified plan is 10%, but this penalty is multiplied to 25% during the first two years of participation in a SIMPLE. After two years have elapsed, early withdrawals will result in the standard 10% penalty.

Furthermore, the regular rules for required minimum distributions (RMDs) apply after a SIMPLE participant turns age 72 (increased from age 70½ by the SECURE Act), as with other qualified plans. To continue tax deferral, funds may be rolled over into a traditional IRA.

Be aware that time is on your side because a SIMPLE set up before October 1, 2022 is effective for the 2022 plan year. This gives a self-employed individual or other small business owner added flexibility. Finally, you don't have to file an annual return for the plan. SIMPLE, right?

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