

2010

IRS Nationwide  
**TaxFORUM**

# SIMPLE Solutions for SIMPLE IRA Plan Mistakes

Tax Exempt and Government Entities  
Employee Plans

2010 IRS Nationwide Tax Forum

Slide 1:

Good morning/afternoon.

Many of you have clients who are setting money aside in a SIMPLE IRA retirement plan. How can they avoid mistakes in operating their SIMPLE IRA plans? Today, we will provide detailed information on how to find and fix SIMPLE IRA plan mistakes. At the end of today's session, you will be able to locate the IRS SIMPLE IRA Plan Fix-It Guide - Common Problems, Real Solutions, at [www.irs.gov/ep](http://www.irs.gov/ep) and use the Guide to help your clients find, fix and avoid common SIMPLE IRA plan mistakes. This presentation-style workshop's tips will help your clients stay a step ahead of the IRS.

After the final Tax Forum in September, we will post this presentation, along with the speakers' notes, to our website, [www.irs.gov/ep](http://www.irs.gov/ep). So if you miss anything during our discussion, please visit our website to view the presentation.

# Retirement Plan Assistance

- [www.irs.gov/ep](http://www.irs.gov/ep)
  - Fix-It Guides
  - Information on Correcting Plan Errors
- (877) 829-5500
- [RetirementPlanQuestions@irs.gov](mailto:RetirementPlanQuestions@irs.gov)
- Newsletters

## Slide 2:

We have developed many tools to assist you and your clients with retirement plans. Our website is designed to provide information for the “Benefits Practitioner,” “Plan Participant/Employee” and “Plan Sponsor/Employer.” You will find the IRS Fix-It Guides – we have four of them so far - that will provide real solutions to common problems in retirement plans and information on Correcting Plan Errors. It also has other resources that will help you keep your clients out of trouble with the IRS.

There are two different ways that you may discuss your questions with a retirement plan specialist. You may call our Customer Account Services toll-free at (877) 829-5500. Or, if you prefer, you may e-mail your questions to [RetirementPlanComments@irs.gov](mailto:RetirementPlanComments@irs.gov). Our specialists must respond to all e-mail questions by telephone, so please remember to include your phone number.

Finally, we have two free, quarterly electronic newsletters you may subscribe to. The first is the *Employee Plans News*. This newsletter is geared toward the practitioner community. It provides current and technical retirement plan information. Our second newsletter is *Retirement News for Employers*. This newsletter is geared toward plan sponsors and provides them with information that will help them manage their plans. Being a web-based product, the newsletters make an excellent reference guide.

Subscribing to these newsletters is easy and it will keep you and your clients current with all the latest news regarding retirement plans. Just go to our Website, [www.irs.gov/ep](http://www.irs.gov/ep), click on “Newsletters” in the left pane, click on “Employee Plans News” or “Retirement News for Employers,” click on “Subscribe,” then provide us with your e-mail address.

# SIMPLE IRA Fix-It Guide

## Common Problems, Real Solutions

- Found @ [www.irs.gov/ep](http://www.irs.gov/ep)
- Common mistakes
- Tips on how to:
  - Find mistakes
  - Fix mistakes (Applicable IRS correction programs)
  - Avoid mistakes
- Click “More” to find examples

Slide 3:

The SIMPLE IRA Plan Fix-It Guide – Common Problems, Real Solutions discusses the steps to find, fix and avoid common mistakes we find in audits and voluntary compliance submissions of SIMPLE IRA Plans. You can view the Guide from the Employee Plans Web page at [www.irs.gov/ep](http://www.irs.gov/ep). Look for the link “Fix-It Guides – Common Problems, Real Solutions.” Each of the potential mistakes found in the Fix-It Guide includes tips on how to find the mistake, what corrective action and IRS correction programs you can use to fix the mistake and common-sense tips on how to avoid making the mistake in the future. If you click on the hyperlinked “More” in the table, found on the first page of the Guide, you will be directed to additional information, including examples on each of the potential mistakes.

Before we dive into the details of some of the mistakes, let’s take a few minutes to discuss the basics of SIMPLE IRA plans.

# SIMPLE IRA Plan Overview

- What is a SIMPLE IRA plan?
- How is a SIMPLE IRA plan set up?
- Which employees may participate?
- Required contributions?
- Basic distribution rules?
- Filing requirements?

Slide 4:

SIMPLE stands for **S**avings **I**ncentive **M**atch **P**lan for **E**mployees.

A business can set up a SIMPLE IRA plan if it meets both of the following requirements:

First, it must have 100 or fewer employees who received \$5,000 or more in compensation from the employer for the preceding year. There is a grace period, which I will discuss in a later slide, if the employer stops meeting the 100-employee limit in a later year. Second, the business does not maintain another retirement plan to which it makes contributions, other than a collectively bargained plan that covers only union employees.

There are three basic steps in setting up a SIMPLE IRA plan:

- First, the employer must execute a formal, written agreement.
- Second, the employer must give each eligible employee certain information about the SIMPLE IRA plan, and
- Third, a selected financial institution must set up a SIMPLE IRA for each eligible employee.

There are several ways an employer can adopt a formal, written agreement. The simplest method is for an employer to adopt an IRS Model SIMPLE IRA plan using Form 5304-SIMPLE, if the employer allows each participant to select the financial institution for receiving his or SIMPLE IRA plan contributions. If the employer requires that all contributions under the SIMPLE IRA plan be deposited initially at a designated financial institution, then it should use Form 5305-SIMPLE. You can fill out and print this form from the IRS website.

The SIMPLE IRA plan is adopted when the employer has completed all appropriate boxes and blanks on the form and he or she (and the designated financial institution, if any) have signed it. The employer should keep the original form. Do not file it with the IRS.

If your clients set up their SIMPLE IRA plans using either Form 5304-SIMPLE or Form 5305-SIMPLE, they can use the model notification included with the form to satisfy the notification requirements by giving each employee a copy of page 3 of either of the signed forms.

Another type of document an employer can adopt is a prototype SIMPLE IRA plan. Financial institutions and other approved organizations can sponsor a prototype and the IRS issues opinion letters approving them. Prototype plans are sold to and adopted by individual businesses. Adopting an individually designed document is a third method for setting up a SIMPLE IRA plan. Individually designed documents are rare and the IRS does not have an approval process for them.



The employer must notify each employee of the following information before the beginning of the time period when the employee has an opportunity to make or change a salary reduction choice under the SIMPLE IRA plan:

- The employer's choice to make either matching contributions or non-elective contributions;
- If applicable, the requirement to select the financial institution that will serve as the trustee of the participant's SIMPLE IRA;
- A summary description of the plan. The financial institution will provide this to you; and
- Written notice that the employee's balance can be transferred without cost or penalty if you use a designated financial institution.

Finally, a SIMPLE IRA must be set up for each employee who is eligible to be in the plan. SIMPLE IRAs can be set up with banks, insurance companies or other qualified financial institutions and the employer sends its SIMPLE contributions to where the SIMPLE IRAs are maintained.

As a general rule, an employer can set up a SIMPLE IRA plan for a year as late as October 1 of that year.

Generally, any employee who earned \$5,000 or more during any two preceding calendar years and is reasonably expected to earn at least \$5,000 during the current year must be included in the SIMPLE IRA plan. There are some exceptions. The employer may exclude those employees who are:

- Covered by a union agreement and whose retirement benefits were bargained for in good faith by the employer and the employees' union.
- Nonresident alien employees who have no U.S. wages from the employer.

Under a SIMPLE IRA plan, contributions are subject to certain limits and are always 100% vested. They are made up of salary reduction contributions – the amount of money that an employee asks to have withheld from their pay and paid into the plan - and employer contributions. Employee elective contributions are limited to \$11,500 for 2010 unless the participant is age 50 or over. In this case, the employee may increase his or her elective deferrals by \$2,500. The employer is required to make either matching contributions of up to 3% of employee's compensation or non-elective contributions of 2% of an employee's compensation.

Note that the employer may reduce this 3% to a lower percentage, but not lower than 1%. And, the 3% may not be lowered for more than 2 calendar years out of the 5-year period ending with the calendar year the reduction is effective.

I want to talk briefly about taking money out of a SIMPLE IRA. Because the SIMPLE investment vehicle is an IRA, the IRA rules apply.

- Employees can withdraw SIMPLE IRA contributions and earnings at any time.
- Money withdrawn is taxable in the year it is received.
- If an employee makes a withdrawal before he or she is age 59½, a 10% additional tax generally applies. However, this tax is increased to 25% if the withdrawal is made in the first two years of participation in the plan.
- Employees may roll over SIMPLE IRA contributions and earnings tax-free to other IRAs and retirement plans. However, during the first two years of plan participation, rollovers can be made only to other SIMPLE IRAs.
- SIMPLE IRA contributions and earnings must eventually be distributed. The law requires specific minimum amounts to be distributed each year beginning no later than April 1 of the year following the year the employee turns age 70½.

An employer has no filing requirements of the Form 5500-series return for a SIMPLE IRA plan. The financial institution that holds the SIMPLE IRAs handles most of any other paperwork.

# EPCRS Overview

- Self-Correction Program
  - Insignificant failures only
  - No IRS contact or fee
- Voluntary Correction Program
  - IRS approval of correction, \$250 fee
- Audit Closing Agreement Program
  - Sanction imposed
  - Higher than VCP fee - Ouch!



Slide 5:

If an employer makes **insignificant** mistakes in its SIMPLE IRA plan, it may use the IRS's Employee Plans Compliance Resolution System, or EPCRS, to remedy the mistakes and avoid the consequences of plan disqualification. A correction for a mistake should be reasonable and appropriate. The correction method should resemble one already provided for in the Code and the employer should consider all applicable facts and circumstances. There are three components to EPCRS, found in Revenue Procedure 2008-50. Micky, why don't you tell our audience about the first component, self-correction?

In order to be eligible for the Self-Correction Program, the plan sponsor or administrator must have established formal or informal practices and procedures in place. They must be reasonably designed to promote overall compliance with the Code. For example, the plan sponsor of a SIMPLE IRA plan may include in its plan operating manual specific steps to determine when new employees are eligible to enter the plan so that the eligibility rules of the Code are satisfied. We have been asked if a plan document alone is evidence of established procedures. It is not.

SCP is available for correcting operational problems only – that is, the failure to follow the terms of the plan. SCP is not available for other types of problems, such as failing to keep the plan document up to date to reflect law changes. We will talk about this issue in more detail later in the presentation.

Under SCP, the plan sponsor corrects the mistakes using the General Correction Principles described in the EPCRS Revenue Procedure. If a plan sponsor corrects a mistake in accordance with the correction methods included in Appendix A or Appendix B of Revenue Procedure 2008-50, it may be certain that the correction is reasonable and appropriate for the mistake.

The plan sponsor may need to make changes to its administrative procedures to ensure the mistakes don't happen again.

Self-Correction may be used **only** if, considering all of the facts and circumstances, the mistakes, in the aggregate, are insignificant operational failures. How do you decide if a mistake is significant or insignificant? Revenue Procedure 2008-50 lists some facts and circumstances to consider. Examples include the percentage of plan assets involved in the failure, the number of years the failure occurred and whether correction was made within a reasonable time after the discovery of the failure. If you and your client determine the failure is insignificant, then document how you came to that decision.

When using SCP, the plan sponsor should maintain adequate records to demonstrate that they have corrected a mistake in the event of an audit of the plan.

And the best part is there is no fee for self-correction.

Think of this program as similar to changing a tire on your car when you get a flat.

Voluntary Correction is more like taking your car into the shop to get your brakes fixed.

Under VCP, the plan sponsor identifies the mistakes and proposes correction using the General Correction Principles described in the EPCRS Revenue Procedure.

The plan sponsor proposes changes to its administrative procedures to ensure the mistakes do not recur and, for SIMPLE IRA plans, pays a compliance fee to the IRS of \$250.

The IRS issues a Compliance Statement that details the qualification mistakes identified by the plan sponsor and the correction approved by the IRS.

The plan sponsor corrects the identified mistakes within 150 days of the Compliance Statement.

While the submission is pending, Employee Plans will not examine the plan, except under unusual circumstances.

Under Audit CAP, the plan is under examination, the plan sponsor corrects the mistakes and enters into a Closing Agreement with the IRS.

The plan sponsor pays a sanction which has been negotiated with the IRS and is based on the sum for all open taxable years of the Maximum Payment Amount which is basically the total amount of tax due if the plan were disqualified and is determined by adding the:

- 1) Additional income tax and interest and penalties that the employees would have to pay if contributions to their SIMPLE IRAs were included in their income and
- 2) Additional tax resulting from the 6% tax on excess contributions to IRAs.

The sanction paid under Audit CAP is greater than the fee paid under VCP.

Envision your car breaking down on the freeway and being towed to the shop....

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# Streamlined VCP Submission Available!

- Appendix F Streamlined application
  - Fillable .pdf document
- Common errors in SIMPLE IRA plans
- Easy to fill in and submit
- Visit “Correcting Plan Errors” @  
[www.irs.gov/ep](http://www.irs.gov/ep)

Slide 6:

In order to make it easier for employers to get their plans back into compliance, the IRS has included a “streamlined application process” for some errors in retirement plans being submitted under the Voluntary Correction Program. Appendix F of the EPCRS Revenue Procedure 2008-50 has been substantially expanded to add additional failures that commonly occur in plans maintained by small employers, and significantly reduces the burden and cost to an employer of submitting under the VCP.

There are several schedules that can be submitted with the Appendix F application. For example, Schedule 2 deals with nonamendment failures. Schedule 4 is specifically for SIMPLE IRA plans and includes errors commonly found in this type of plan.

Part I of Schedule 4 asks the applicant to identify the failure and correction methods. Four potential failures can be submitted with this Schedule:

- Employer eligibility failure
- Failure to make required employer contributions
- Failure to provide eligible employees with the opportunity to make elective deferrals
- Excess amounts contributed

Part II of the schedule requires a description of changes in administrative procedures to ensure the errors do not occur in the future.

Part III is a request for excise tax relief

Part IV lists required enclosures.

Correcting errors in a plan does not have to be intimidating. We want employees to enjoy their retirement savings. Mistakes happen and they can almost always be corrected under one of our correction programs.

So let’s look at some of the mistakes that we see most often in retirement plans and discuss how you and your clients can find, fix and avoid these mistakes.

# Common Mistake: Ineligible Employer

- More than 100 employees with comp  $\geq$  \$5,000
- Sponsors other retirement plan





Slide 7:

A couple of questions must be answered prior to establishing a SIMPLE IRA plan:

- Did the employer have more than 100 employees making \$5,000 or more in the previous year?
- Does the employer sponsor another retirement plan?

If your client answered yes to either of these two questions, then he or she should not establish a SIMPLE IRA plan. A SIMPLE IRA plan can only be established by employers who do not sponsor another retirement plan and who only have 100 or fewer employees making \$5,000 or more. There is an exception if the employer sponsors a collectively bargained plan, then it can provide a SIMPLE IRA plan for other employees.

Generally, no contributions can be made to a SIMPLE IRA during any calendar year in which an employee receives contributions or accrues a benefit from another retirement plan beginning or ending in that calendar year.

Let me give you an example of the one plan rule. An employer maintains a calendar-year profit-sharing plan. For the current calendar year, the employer adopts a SIMPLE IRA plan. Although the employer does not formerly terminate the profit-sharing plan, it does not make any contributions to that plan for the calendar year. Since there were no profit-sharing contributions made, there was no exclusive plan violation and the maintenance of the SIMPLE IRA plan is permissible for the current calendar year.

Now, let me give you an example of the 100-employee rule. Remember an employee includes full-time, part-time and seasonal employees. In addition, if your client's business is a member of a control group or an affiliated service group, all of the employees of all of the groups are considered employees. So in my example, Paul owns a computer rental agency. I'll call it Business A. Business A has 80 employees who received at least \$5,000 in 2009. Paul also owns Business B that repairs computers. It has 60 employees who received at least \$5,000 in compensation in 2009. Paul is the sole proprietor of both businesses. Code section 414(c) provides that employees of partnerships and sole proprietorships that are under common control are treated as employees of a single employer. Thus, all 140 employees would be treated as employed by Paul and neither Business A nor Business B would be eligible to establish a SIMPLE IRA plan.

So, how do you find this mistake?

Review compensation data such as payroll records, W-2s and quarterly filings with the state to determine if there were more than 100 employees who earned \$5,000 or more in compensation during the previous year. Generally, compensation means the sum of wages, tips and other compensation subject to federal income tax withholding. Determine whether any employee received an allocation or accrued a benefit in another qualified plan that was sponsored by your client, or a control group or affiliated service group of which your client was a member for any part of the calendar year.

How do you to fix this mistake?

If this is the first year of the plan, your client should stop making any new contributions to the plan. If relief is not requested, or granted, under VCP, your client should return salary deferral contributions and the related earnings to the employees and report the returned amounts on Form 1099-R as a taxable distribution that is not eligible for rollover.

Employer contributions and related earnings should be returned to your client and reported on a Form 1099-R issued to the participant indicating the taxable amount is zero. Remember that no contributions should have been made to the SIMPLE IRA plan. Therefore, the contributions are considered excess contributions and subject to excise tax. A Form 5330 excise tax return should be filed. In addition, for each year that excess contributions are made to a participant's SIMPLE IRA, the affected participant is liable for excise tax.

So if your client has this mistake, which Correction Programs are available?

Your client may not correct this type of mistake under the Self-Correction Program. In order to retain plan qualification, your client must correct this mistake under VCP.

Your client can make a VCP submission to the IRS identifying the mistake. The fee for correcting this mistake is \$250.

If the IRS discovers this mistake on audit, your client may correct it under Audit CAP. The method of correcting this mistake would be the same as under VCP or Audit CAP, but the sanction under Audit CAP is a percentage of the Maximum Payment Amount and would be greater than \$250.

How do you avoid this mistake?

Prior to establishing a SIMPLE IRA plan, ask your client to make sure that he or she takes all employees into account for purposes of the "100-employee count." All part-time, seasonal and leased employees who earned at least \$5,000 in compensation in the prior year must be included, as well as employees of any control or affiliated service group. Make sure that no employer member maintains any other qualified retirement plan.

If there is another plan and your client wants to establish a SIMPLE IRA plan, then ask him or her to take the steps to terminate the qualified plan before the calendar year for which he or she contributes to the SIMPLE IRA Plan. In addition, if your client had less than 100 employees and the business grew to the point where it exceeded the 100-employee count then there is a grace period. Generally, the grace period is two calendar years following the year in which the 100-employee limitation was satisfied. During the grace period, the employer may still contribute on behalf of the affected employees. In addition, the employer would have the opportunity to set up another type of retirement

plan that it could sponsor for the benefit of its employees but only after the year of the last contribution to the SIMPLE IRA plan.

# Common Mistake: SIMPLE IRA Plan Not Current

- IRS model plans
- Prototype plans
- Individually designed plans



Slide 8:

Laws related to retirement plans change quite frequently. There are statutory deadlines for which many provisions must become effective. The IRS generally establishes a firm deadline for adopting these changes. In addition, these law changes might mean your client can simplify some areas of plan administration or improve benefits. Your client will need to change plan language and operation to keep the plan within the law and to take advantage of increased benefit limits.

How do you find this mistake?

If your client is using an IRS Model plan (Form 5304-SIMPLE or 5305-SIMPLE), please make sure that your client is using the current revision date, which is currently September 2008. As noted in the instructions, those employers who used the Form 5304-SIMPLE and Form 5305-SIMPLE with a revision date of March 2002 or August 2005 are not required to use the September 2008 version.

If your client is using a financial institution's SIMPLE IRA prototype document, check with the financial institution to see if it has received an IRS opinion letter that ruled that the SIMPLE IRA prototype document complies with current law.

Individually designed SIMPLE IRA plans must also be updated for law changes. If this is your client's situation, he or she may want to consult a benefits professional.

What corrective action should your client take to fix this mistake?

Your client should adopt a current IRS SIMPLE IRA Model plan or IRS approved SIMPLE IRA prototype plan.

For years in which your client did not update the plan by a valid plan document, the SIMPLE IRA could lose the tax benefits associated with contributions made to the SIMPLE IRAs and the earnings accumulated in the SIMPLE IRAs, unless your client uses the Voluntary Correction Program.

[Revenue Procedure 2002-10](#) states that all SIMPLE IRA plans need to be updated for the law changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001, also known as EGTRRA. One example is for increased contribution limits. In addition, employers should give notice to employees of the new contribution limits for EGTRRA. This failure deserves special attention as we are finding in our audits that over 50% of all plans reviewed have not been timely updated for EGTRRA.

Let's look at an example - Employer Y established a SIMPLE IRA plan in 2000 using a Model plan Form 5304-SIMPLE. Starting in 2002, EGTRRA contribution limits were used by the employer.

Employer Y in this example was required to adopt the IRS SIMPLE IRA Model plan that was issued on March 2002 or later. If Employer Y did not adopt the IRS SIMPLE IRA Model plan and provide notice to employees of the new contribution limits for EGTRRA, then Employer Y would have to use EPCRS to correct the mistake.

So if your client has this mistake, which Correction Programs are available?

Your client may not correct this type of mistake under the Self-Correction Program. As we stated earlier, SCP is limited to operational problems, and this mistake is the result of not keeping the plan language up to date. In order to retain plan qualification, your client must correct this mistake under VCP.

Your client can make a VCP submission to the IRS identifying the mistake. The fee for correcting this mistake is \$250.

If the IRS discovers this mistake on audit, your client may correct it under Audit CAP. The method of correcting this mistake would be the same as under VCP or Audit CAP, but the sanction under Audit CAP is a percentage of the Maximum Payment Amount and would be greater than \$250.

How does your client avoid this mistake?

If your client is using the IRS SIMPLE IRA Model plan (Form 5304-SIMPLE or 5305-SIMPLE), visit the IRS Website before the end of each calendar year and find out whether the IRS has updated the applicable model plan. If there is a newer version of the form on the Website, then you should check the instructions to determine whether adopting the newer form is necessary. If you are using a financial institution's SIMPLE IRA prototype, then check with the financial institution to ensure that there are proper procedures in place that will ensure that they send any required updates that your client needs to sign in a timely manner.

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# Common Mistake: Eligible Employees Not Participating

- \$5,000 compensation
  - Current year and
  - Any prior 2 years
- Less restrictive requirements?
  - OK!

Slide 9:

Under the general participation rule for SIMPLE IRA plans, employees who you reasonably expected to receive at least \$5,000 in compensation during a calendar year, and who did so in any prior 2 years, are eligible to participate in a SIMPLE IRA plan. Employers may increase the number of employees eligible to participate by lowering the \$5,000 amount or by allowing all employees to participate regardless of how much they earn.

How do you find this mistake?

Review the SIMPLE IRA plan document to determine who your client must allow to participate. Compare past payroll information with employees who participated in the SIMPLE IRA plan. For example:

1. Review payroll data, for example, W-2s, quarterly returns filed with the state and internal payroll records for prior years.
2. List all employees who earned at least \$5,000 from your client during any two preceding years and are expected to receive at least \$5,000 in compensation in the current year.
3. Determine whether any of those employees did not either make salary deferral contributions or receive an allocation of employer contributions in either the prior years or the current year.
4. If any of them did not make salary deferral contributions or receive employer contributions, make sure that your client excluded them due to the terms of the plan.
5. If the employer improperly excluded any of them from the plan, then this could be an indicator of a larger problem, and you could expand the search to include other employees. This might require a review of payroll data that is more than two years old.

What corrective action should your client take to fix this mistake?

During the period an eligible employee was improperly excluded, the employer must make up for his or her “missed deferral opportunity” that is equal to 1.5% of the eligible employee’s compensation plus earnings. In addition, the employer is required to make a matching or non-elective contribution plus earnings. Calculate earnings from the date that the employer should have made the contribution up to the date of correction.

Let’s look at an example - Nancy met the eligibility requirements under her employer’s SIMPLE IRA plan. However, the employer excluded her from making a salary reduction contribution. During the year that her employer excluded her, she earned \$10,000. The terms of the plan also required an employer contribution of 3% of compensation.

1. Missed deferral opportunity. Since the plan matches deferrals up to 3% of compensation, it is assumed a typical employee would defer 3%. Nancy’s “missed



deferral opportunity” is 3% times \$10,000 or \$300. The required corrective employer contribution to replace Nancy’s missed deferral opportunity is 50% of \$300, or \$150 (1.5% of eligible employee’s compensation) plus earnings.

2. Employer contributions. Under the terms of the plan, the employer’s matching contribution was 3% of eligible employee’s compensation. Nancy was also entitled to an employer matching contribution of \$300 (3% of compensation) plus earnings.

If, under the plan, the employer was required to make a non-elective contribution (instead of a matching contribution) of 2% of eligible employee’s compensation, then the missed deferral opportunity will still be \$150 (as calculated earlier) and the non-elective contribution will equal 2% of compensation, or \$200.

Which Correction Programs are available for this mistake?

The example illustrates an operational problem, in that the employer failed to follow the terms of the plan by not allowing an eligible employee to participate in the plan. If you determine that this mistake is insignificant and if the other eligibility requirements of SCP are satisfied, the employer may use SCP to correct the mistake. There are no fees for self-correction, but the employer must make the correction and have practices and procedures in place.

Under VCP, correction would be the same and the employer would make a VCP submission to the IRS and pay a fee of \$250.

Under Audit CAP, correction would be the same. The employer and the IRS would enter into a Closing Agreement outlining the corrective action and negotiate a sanction based on the Maximum Payment Amount.

How can you advise your client to avoid this mistake? Your client should review the participation status of all employees at least once a year. The person assigned the task should have a good understanding of the eligibility requirements and have access to the employment and payroll records necessary to make eligibility decisions for all employees.

# Common Mistake: Required Employer Contributions Not Made

- All eligible employees
- Terminated employees
  - 2% of employee's compensation or
  - Up to 3% employee deferral match



Slide 10:

There are two potential mistakes included in the SIMPLE IRA plan Fix-It Guide that involve the employer contribution:

**Mistake #5 - Were correct employer contributions made on behalf of the eligible employees?**

and

**Mistake #10 - Did you make employer contributions to all eligible employees whether or not they terminated during the plan year?**

An employer must make matching or nonelective contributions to all eligible employees. This means all of the employees who have satisfied the eligibility requirements that we discussed earlier in the presentation. A SIMPLE IRA plan cannot require employment on a particular day, such as the last day of the year, in order to receive matching or nonelective contributions.

The required employer contributions must be either:

- 2% of an employee's compensation regardless of whether they made a salary deferral contribution; or
- A matching contribution equal to an employee's salary deferral contribution (up to 3% of such employee's compensation).

How to Find the Mistake:

Review employee payroll information to determine if all employees who have satisfied the eligibility requirements of the plan have received an employer contribution. This must include any employee who terminated employment during the year.

Review plan document provisions relating to employer contributions. Based on those provisions, and compensation data for all employees, calculate the employer contribution that the employer should have made on behalf of those participants. Compare the calculation with the amounts the employer actually contributed on behalf of the participants. If the amounts contributed differ, then there is a possibility that your client is not following the plan's terms.

How to Fix the Mistake:

If additional amounts are required, contribute make-up amounts, adjusted for earnings from the date of the mistake to the date of correction. If your client contributed amounts in excess of an employee's benefit, distribute the excess amount, adjusted for earnings through the date of correction. Report the distribution on Form 1099-R issued to the participant indicating the taxable amount as zero.

Let's look at an example – Your client, JoCo, asks you to look at its SIMPLE IRA plan to make sure everything is o.k. with its operation. You review the plan operations and find that one of JoCo's employees, Ann, met the plan's eligibility requirements and should have received an employer contribution, but did not. All of the other plan participant's received a non-elective employer contribution in the amount of 2% of compensation. Ann's compensation for the year was \$30,000. How would you fix this error?

JoCo must contribute additional amounts to the plan for Ann. The corrective contribution is determined by calculating the contribution Ann would have been entitled to receive under the terms of the plan and subtracting any contributions already made for Ann for the plan year. So in our example, Ann should receive a corrective contribution in the amount of \$600, her compensation, \$30,000 multiplied by 2% - the employer contribution percentage. The corrective contribution made for Ann must be adjusted for earnings. Earnings are calculated from the day the contribution should have been made through the date of the corrective contribution. The corrective contribution (adjusted for earnings) will be made to each affected employee's SIMPLE IRA account. If an affected employee does not have a SIMPLE IRA account, an account must be established for that employee. If the plan did not provide eligible employees with the opportunity to make elective deferrals and the plan provides for matching contributions, the corrective matching contribution must be based on the assumption that the eligible employee would have made an elective deferral equal to 3% of compensation.

The earnings calculation for an affected employee may be based on one of the following methods:

- Actual investment results of the affected employee's SIMPLE IRA account.
- The interest rate incorporated in the Department of Labor's Voluntary Fiduciary Correction Program Online Calculator ("VFCP Online Calculator") (<http://www.dol.gov/ebsa/calculator/main.html>), since the actual earnings of the affected employee's IRA account cannot be ascertained.
- Actual investment results for years in which data is available, or the rate incorporated in the VFCP Online Calculator for years in which the actual earnings of the affected employee's IRA account cannot be ascertained.

Let's assume for our example that Ann had a SIMPLE IRA account and it earned 5% during the time that the contribution was missed. In our example, earnings on the contribution in the amount of \$30 would also need to be deposited by JoCo to Ann's SIMPLE IRA account.

Which Correction Programs are available for this mistake?

The mistake may be corrected under SCP if your client determines the mistake is insignificant.

You may make a VCP submission to the IRS identifying the mistake on your client's behalf. The fee for the VCP submission is \$250.

If this mistake is discovered on audit, it may be corrected under Audit CAP. Correction of the plan under Audit CAP should be very similar to correction under SCP. The sanction under Audit CAP is a percentage of the MPA.

#### How to Avoid the Mistake:

The individuals administering the SIMPLE IRA plan should be familiar with the terms of the plan document. After gaining familiarity with the key provisions of the plan document, the person administering the plan can make sure that the plan procedures (for example, checklists, software, manuals, method for calculating compensation, calculations of the required employer contributions and methods for deposit and allocation) ensure compliance with plan terms.

# Common Mistake: Salary Deferrals Not Deposited Timely

Should be made:

- Earliest administratively feasible date
- No later than 30 days following the month in which the deferrals were withheld



Slide 11:

If a SIMPLE IRA is subject to Title I of ERISA, and most with common-law employees are, then DOL requires that salary deferral contributions be made to the employees' SIMPLE IRA accounts at the earliest administratively feasible date after the deferrals are withheld from the employees' salary. They recently published a final rule to protect employee contributions deposited to small retirement and welfare benefit plans with fewer than 100 participants by providing a safe harbor period of seven business days following receipt or withholding by employers.

The IRS requires that plan sponsors make the salary deferral contributions no later than 30 days following the month in which they withheld the deferrals from the employees' salary.

Example:

Contributions withheld from an employee's paycheck in January must be deposited by March 2 (30 days following January 31st, assuming that February has only 28 days in the particular calendar year).

How to Find the Mistake:

Compare the date that the salary deferral contributions were withheld with the date the salary deferrals were contributed to the employees' SIMPLE IRA account. If the deposits don't meet the 30-day rule, the plan has a qualification defect.

How to Fix the Mistake:

In addition to making elective deferral amounts to the employee's SIMPLE IRAs, you should make a contribution of earnings that the deferrals would have earned from the date that you should have deposited the amounts through the date of the actual deposit.

Which correction programs are available?

The mistake may be corrected under SCP if your client determines that the mistake is insignificant.

You may make a VCP submission to the IRS identifying the failure on behalf of your client. The fee for the VCP submission is \$250.

If this mistake is discovered on audit, it may be corrected under Audit CAP. Correction of the plan under Audit CAP should be very similar to correction under SCP. The sanction under Audit CAP is a percentage of the MPA.

Your client should also correct this mistake under the DOL's Voluntary Fiduciary Correction Program, if applicable.

How to Avoid the Mistake:

Your client should establish administrative procedures to ensure that he or she makes the employees' salary deferral contributions to the employees' SIMPLE IRAs shortly after being held from their paychecks.



# Fix-It Guides - Common Problems, Real Solutions

- 401(k)
- SEP
- SARSEP
- “Correcting Plan Errors” Web page
- [www.irs.gov/ep](http://www.irs.gov/ep)
- Questions?



Slide 12:

We have focused on the most frequent problems that we see in SIMPLE IRA plans and how to find, fix and avoid these problems in today's session. We also have Fix-It Guides for 401(k), SEP and SARSEP plans to help you and your clients find, fix and avoid mistakes in these types of plans. You can easily view or download these guides on our website, [www.irs.gov/ep](http://www.irs.gov/ep). They are a great resource to help you explain mistakes to your clients and to emphasize their need to fix these mistakes sooner rather than later and how to avoid them in the first place. Additionally, you can find more in-depth information on correcting plan errors on our "Correcting Plan Errors" Web page.

Maybe after reviewing the SIMPLE IRA Fix-It Guide, you or your client may find that a SIMPLE IRA plan is not the right plan for them. We have a publication, *Choosing a Retirement Solution for Your Small Business*, which may help your client choose a plan that better fits their needs. Our online Retirement Plans Navigator found at [www.retirementplans.irs.gov](http://www.retirementplans.irs.gov) is a great tool to help your client choose the plan that best suits their needs.