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Is Your Client's SIMPLE IRA Plan Ready for an IRS Audit?

By **J. Timothy Corle, CPC, CFP®**
President, CEO

If you, or one of your clients, sponsor a Savings Incentive Match Plan for Employees (SIMPLE) and have not had the misfortune of undergoing an IRS audit, consider this a wake-up call!

Recently, I was involved in assisting a client who sponsored a SIMPLE IRA plan for his small manufacturing company of about 30 employees. He is a great guy to work for; he genuinely cares for his employees, encourages participation in the plan, makes employer contributions to the maximum allowed, provides solid investment vehicles for the participants to choose from, and genuinely thought he was doing everything right.



When he received the letter from the IRS indicating that his plan had been selected for an IRS audit, he was not afraid. He was doing everything right to the best of his knowledge, and was prepared to provide all the material they requested.....or so he thought!

Fast forward to the end result six months after the audit started.....

- **Over \$16,000 had to be deposited to the plan by the employer** for “missed deferral opportunity” plus investment earnings
- **Over \$3,000 had to be deposited to the plan** as “missed matching contribution on the missed deferral opportunity” also plus investment earnings
- **A \$4,000 sanction**, payable to the IRS.

If you know someone who sponsors a plan like this, it is very likely I could be using them as the above example, with only one simple exception....they haven't been selected for an audit....YET.

So what went wrong here? How is it that a nice, intelligent, well-meaning employer got it so wrong? Well, if you are an attorney reading this, you likely already figured out the key phrase I used in an earlier paragraph,he did everything right to the best of his knowledge. It's 'law school 101' – ignorance of the law does not excuse you from complying.

These are “self-administered” plans by design, to keep employer administration costs to a minimum. The problem is, many don't fully understand what their administrative requirements are.

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Tycor Benefit Administrators, Inc.®
850 Cassatt Road, Suite 310
Berwyn, PA 19312
Phone: 610.251.0670
www.tycorbenefit.com

Here are some key questions to ask — from IRS Publication 4284, SIMPLE IRA Checklist:

- **Has your SIMPLE IRA plan been amended for current law?** The answer to this one is usually No. Don't panic though, as this is usually a simple fix with little or no financial consequence.
- **Are all eligible employees allowed to participate in the plan?** Here is what is missing from the question....and can you PROVE it? If Human Resources gives an employee a kit and explains the plan to them, and they choose to not enroll by doing nothing, that's enough right? Wrong! IRS wants to see the paperwork the participant signed that indicates they DO NOT WISH TO PARTICIPATE. This was the largest simple item that cost my client close to \$23,000 in contributions and penalties.
- **Are you determining each eligible employee's compensation using the definition in your SIMPLE IRA plan document?** This one also cost my client. He paid quarterly production bonuses that all employees shared in. At a staff meeting one year, they took a vote: Do you want us to withhold salary deferral contribution on your bonuses? The answer was a unanimous NO. So the employer did not withhold deferrals on those amounts, in accordance with the wishes of his employees. The problem is, he never got them to modify their deferral election form to say such a thing. End result: He had to contribute on behalf of each employee the amount that *would have been* deferred on the bonuses, and the match that *would have been* paid on those amounts. Another significant chunk of the \$23,000 burden.
- **Are the correct employer contributions being made to each participant's SIMPLE IRA?** If they blew it on the previous two questions, they are likely not doing this one right either.
- **Are employee deferrals being deposited timely?** These must be deposited as soon as possible, but no later than 30 days following the month in which they were withheld from pay. With today's technology and ease of moving money around, there is no excuse for this one, and the IRS knows it.
- **Have all SIMPLE IRA notification requirements been satisfied?** If they ask...What Notices? They should go back and read up on their plan. Notices are required to be distributed annually to ALL eligible participants, not just the ones that signed up originally.
- **Do you have 100 or fewer employees who earned at least \$5,000 or more in the prior year?** Not much to trip them up here. If you are over the 100-employee mark, you aren't eligible to sponsor the plan to begin with.
- **Does your business only sponsor a SIMPLE IRA plan?** Also pretty simple (no pun intended). If they have a SIMPLE IRA plan, no other qualified plan is allowed.

One of the reasons many employers sponsored a SIMPLE IRA plan was to save on the administrative costs of a formal 401(k) plan. That is why my client choose that option as well, however, when it was all said and done, he would have spent less in administrative costs to run a 401(k) plan administered by professionals who make it their core business, than it cost him to correct his very honest mistakes in the end.

The take away from all of this: If you or your clients sponsor a SIMPLE IRA plan, you should encourage them to take a hard look at the requirements, before the IRS comes knocking. There is likely no such thing as a perfectly clean SIMPLE plan. It is better to discover the errors now and correct them before you are forced to do so by the IRS. Go to the IRS website and use the search term "SIMPLE IRA" and you will find plenty of resources to help you. Don't want to do that? **Call us at 610-251-0670. We will provide a complimentary review of the plan to get you back on track.**