WHY & HOW TO CONVERT SIMPLE MID-YEAR

Prior to the passage of SECURE 2.0 and Section [332], a plan sponsor could not have SIMPLE IRA and another plan in the same calendar year. In fact the SIMPLE had to run for the entire year and notice had to be given to plan participants by November 1st that the SIMPLE IRA was not going to be offered the following year.

Now, with SECURE 2.0 and effective for 401k plans starting after December 31, 2023, a plan sponsor can transition from a SIMPLE IRA to a 401(k) PS Plan mid-year provided that the SIMPLE IRA is replaced immediately with a 401(k) PS Plan that has required employer contributions (401k plans with a Safe Harbor Provision). In order to convert there is a special notice that would explain the salary deferrals applicable for the transition year, which would be a proportion of the SIMPLE and 401(k) deferral limits to the days that each plan operated.

Why convert to a 401(k) Plan from a SIMPLE

- 401(k) PS plans have much higher contribution limits than SIMPLE IRA's. In addition, 401(k) PS plans are much more flexible with plan design options, including the ability to have individual PS allocations rates (New Comparability) to target benefits for key employees.
- Since a 401(k) is a group plan and not individual IRA's for each participant they are easier to operate for the financial professional and many times the plan sponsor. Plan enrollments and educations meetings can be conducted in group settings rather than at the individual participant level saving time and money and allow advisors to focus on key relationships and have more retirement plan business. Most record keepers have robust financial tools and retirement calculators available on their platform.
- Plan assets stay longer and with the higher limits many times grow much faster in a 401(k) Plan. Since SIMPLE Plans are IRA's, a plan participant can take a distribution anytime they want, which could lead to asset leakage as well as penalties for early withdraw which can range from 10% - 25%. Whereas distributions from a 401(k) require a qualified event with in-service distributions generally being allowed at 59 1/2 , and with loans and hardships being optional provisions. In addition, some or all employer contributions may be on a vesting schedule and would stay in the plan if a participant terminates before being 100% vested.

Mid-year conversion example

Below is an example of a plan sponsor that converts June 1st from a SIMPLE IRA to a Safe Harbor Non-Elective 3% with a New Comparability PS Allocation. The SIMPLE has a 3% match and runs from January 1 to the start of the 401(k) June 1.

The overall deferral limits for the transition year are in proportion for the days each plan operated (including catch-up if 50+). So for this example with the transition happening on June 1, 2024, the overall deferral limit for the owner and spouse is $25,949 or ((151/365)*$19,500) + ((214/365)*$30,500), while the deferral limit for employees under 50 years of age is $20,078.

	Wages 1/1—6/1	**Wages 6/1—12/31**	**SIMPLE**	**401(k) SH NE 3%**	**Profit Share**	**Totals**
Owner (57)	$83,000	$180,000	$2,490 $2,490 Match	$23.459 $5,400 SH NE	 $36,000 PS	$25,949 $43,890
Spouse (57)	$25,000	$35,000	$750 $750 Match	$25,199 $1,050 SH NE	 $5,250 PS	$25,949 $7,050
Employee (30)	$20,800	$29,200	$624 $624 Match	$624—20,104 $876 SH NE	 $584 PS	$624—20,104 $2,078
Employee (35)	$20,800	$29,200	$624 $624 Match	$624—20,104 $876 SH NE	 $584 PS	$624— 20,104 $2,078
Employee (25)	$20,800	$29,200	$0 $0 Match	$0—20,104 $876 SH NE	 $584 PS	$0-20,104 $1,454

Other advantages of conversion

Another advantage of a conversion is that a participant can immediately roll over their SIMPLE account to the 401(k) without penalty and taxes, even if they had the SIMPLE account for less than 2 years.

In addition, the plan sponsor would be eligible for auto-enrollment credits from SECURE 2.0 if they include an auto-enrollment provision such as a QACA SH provision. They may also be eligible for four (out of five) years of the graded employer contribution credits after the transition year by moving to a 401(k).

Farmer & Betts has mid-year SIMPLE transition notices ready to go and experience in mid-year transitions and would be happy to assist in providing a better retirement plan to your plan sponsors and plan participants.