Retirement Plan Correction Solution
The Not So SIMPLE Life:
What to Do When You Get Too Big for a SIMPLE

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Paris owns an air conditioner business, That's Not Hot, Inc. ("That's Not Hot"), which had 70 employees who made $5,000 or more in 2019. Overwhelmed by all of the retirement plan options, she engaged Richie Retirement Solutions, a third party administrator (TPA), to help her figure out what retirement plan is best for her new business. Nicole Richie, her contact at the TPA, suggested she sponsor a SIMPLE IRA for her employees because that type of plan does not require a lot of administrative management and has lower maintenance costs. Nicole explained to Paris that employers are only eligible to sponsor SIMPLEs if they have 100 or fewer employees who earn $5,000 or more. Paris agreed with Nicole that she should sponsor the SIMPLE IRA and set up the plan.

After a successful first year, Paris decided to hire 35 additional part-time employees in 2020, all of whom earned $5,000 or more during the year. Towards the end of 2021, Paris remembers what Nicole told her about the 100-participant limit and begins to panic. She calls Nicole to figure out what will happen now that she has more than 100 employees at the minimum earnings threshold. Nicole explains that the SIMPLE rules contain a grace period for when a company grows to more than 100 eligible participants, so Paris need not be concerned for the immediate future.

What is a SIMPLE?

Savings Incentive Match Plans for Employees ("SIMPLEs") are for small business owners with 100 or fewer eligible employees. An "eligible employee" is an employee who received at least $5,000 in compensation during any prior two calendar years, and is reasonably expected to earn at least $5,000 in the current year. SIMPLEs are considered to be a good option for small business owners because they allow the owners and employees to save for retirement from their salary on a pre-tax basis, have fewer requirements to meet than 401(k) plans, and are generally less expensive to set up and operate. (For example, SIMPLEs are not subject to non-discrimination testing and SIMPLE IRAs do not require the filing of Form 5500 each year.) There are some trade-offs, however: the maximum savings in a SIMPLE is less than in a 401(k) plan, there is a required employer contribution each year, and employees are fully vested in all contributions.

The 100-participant limit is a strict limit; once you are over it, you no longer qualify to sponsor a SIMPLE. To determine if you have more than 100 eligible employees, you must count all employees who met the $5,000 earnings threshold. This includes full-time, part-time, seasonal, and leased employees. Furthermore, the employee count includes all employees of the plan sponsor, as well as any related employers that are in a controlled or affiliated service group with the sponsor. (Remember that, to be eligible for the plan, an employee needs to work two years at the $5,000 or higher income level. Therefore, a diligent employer should be able to see the inability to continue to use the SIMPLE well before it happens. However, as with Paris, some employers forget to look!)

Whoops! I have over 100 eligible employees this year! What do I do?

In comes the grace period to save the day! If you previously maintained a SIMPLE and just this year exceeded 100 eligible employees, not to worry! You are deemed to satisfy the 100-employee limitation in the two calendar years in which you first exceed 100 eligible employees. In the case of That's Not Hot, Inc., Paris can maintain the SIMPLE IRA for 2022 and 2023, because of the grace period.

The grace period is over. What do I do now?

Once the grace period is over, if you have more than 100 employees at the minimum earnings threshold, you must stop all employer and employee contributions to the SIMPLE.

If you didn't do that and continued the plan after the grace period expired, do not despair! You can file a Voluntary Correction Program (VCP) application, specifically Form 14568-D, with the IRS, requesting that contributions made for the previous years in which you had more than 100 eligible employees be permitted to remain in the employees' SIMPLE accounts.

How do I avoid getting into this situation in the first place?

Prior to establishing the SIMPLE, you should ensure you meet the requirements for it. Make sure that you include all employees who earned at least $5,000 in compensation in two prior years in your employee count.

Let's say you have a SIMPLE Plan with 80 participants at the beginning of a calendar year. You expect to grow significantly over the next year or two. What should you do to make sure you don't inadvertently violate the 100-employee rule?

At the end of each year, determine who you expect to be an eligible employee in the following year. Remember that you have a two-year grace period, so if you monitor the plan in this fashion, you should be able to take your first "over" year to plan how to change the retirement program in future years, when you expect that the SIMPLE will no longer suffice. (Be sure to terminate the SIMPLE when that happens.)

Special Rules for Mergers and Acquisitions: Code Section 410(b)(6)(C)

Suppose all the stock of That's Not Hot is purchased by a much larger air conditioner company, Hello, Is It A/C You're Looking For?, LLC ("Hello"). Surely the addition of the Hello employees to the count will cause the SIMPLE to exceed the limits. Further, as a SIMPLE must be the only plan of the controlled group, any plan sponsored by Hello will be problematic for the SIMPLE.

The SIMPLE rules provide some relief to both problems in the form of another transition period. A plan is eligible for the transition period if: 1) it satisfied the SIMPLE eligibility requirements immediately before the transaction; and 2) the SIMPLE's coverage is not significantly changed during the transition period (except by virtue of the acquisition). In other words, the SIMPLE is not amended to change who is eligible. The transition period runs from the date of the transaction through the earlier of either: 1) the date of a significant change in the SIMPLE's coverage; or 2) the last day of the second plan year that begins after the date of the transaction. During the transition period, the SIMPLE can continue to operate as it did prior to the transaction.

For example, suppose that That's Not Hot had fewer than 100 eligible employees in 2020, and its stock was sold to Hello on June 23, 2021. The transition period will run from June 23, 2021, until December 31, 2023. Paris will be able to maintain the SIMPLE IRA as it was prior to the transaction through 2023.

More can be said about mergers and acquisitions generally and their effect on retirement plans. For any further questions on those topics, Ilene Ferenczy's book, Employee Benefits in Mergers and Acquisitions, is a great resource.

Conclusion

If you find your SIMPLE Plan ends up far from SIMPLE, don't fret! Remember you have multiple options: the grace periods and the VCP. If you have questions about SIMPLE IRAs (or any other not so SIMPLE plan), let us know. Remember: we are your ERISA Solution!