
Folks:

Take-Away: With employers now being offered some tax credits to induce them to adopt a retirement plan for their employees, they may be faced with a choice of establishing either a SEP IRA plan or a SIMPLE IRA plan. There appears to be much more flexibility with a SEP IRA plan than a SIMPLE IRA plan.

Background: Both the SECURE Act and the SECURE 2.0 Act contain provisions that include tax credits which are intended to encourage small employers to sponsor retirement plans for their employees. Cost and complexity are often cited by small employers as reasons that they do not sponsor employee retirement plans. Fortunately, both Simplified Employee Pensions (SEP) IRA and Savings Incentive Match Plans for Employees (SIMPLE) IRA are intended to reduce these start-up costs and on-going administration complexity that are the excuses used by employers why they chose to not sponsor such a plan. Consequently, choosing between the two, a SEP IRA vs. a SIMPLE IRA is the primary decision that the sponsoring employer will have to make. The following is a short comparison of these two types of employee retirement plans.

Eligibility: Any business can adopt a **SEP IRA**, regardless of its size. There are no limits or restrictions associated with the adoption of a SEP IRA.

For a **SIMPLE IRA** plan, the employer can have **no more than 100 employees** who earned \$5,000 or more from the employer during the prior calendar year, unless a statutory exception applies. *All* employees must be counted for purposes of this maximum 100 employee restriction, including those employees who are not eligible to participate in the SIMPLE IRA plan. The other condition, and acknowledged complexity, is if the employer owns more than one business, since determining how many employees are covered by the SIMPLE IRA plan

might also include other businesses that are either controlled by the employer or which might fall within the technical definition of an affiliated service group. A SIMPLE IRA must be the **only plan** maintained by the employer unless a statutory exception applies, e.g., some employees may be ‘covered’ by a collectively bargained agreement who will not be ‘covered’ by the SIMPLE IRA plan.

Adoption Deadline: An employer can establish a retirement plan for a year only if the plan’s adoption is completed by the applicable deadline. For a **SEP IRA** the deadline is the employer’s tax filing due date, including extensions. This is favorable to the employer since the extended deadline gives the employer more time to decide whether to establish and fund the SEP IRA plan for the calendar year.

For a **SIMPLE IRA** plan, the adoption deadline is October 1, unless a statutory exception applies. If the business is formed after October 1, an exception allows that employer to establish the SIMPLE IRA plan ‘as soon as administratively feasible.’ If the employer previously maintained a SIMPLE IRA plan, the deadline is January 1. With a SIMPLE IRA plan the employer must commit to make contributions for a year at least **60 days before that year starts**; while that contribution percentage can be *de minimis*, e.g., 1% of compensation, this commitment can be a big hurdle to overcome if the business has losses instead of profits.

Covered Employees: For a **SEP IRA** any employee who worked for the sponsoring employer for **three of the five years** that precede the year for which the employer’s contribution is made **must share** in the contributions made for that year.

Example: Ajax Company funds a SEP IRA for 2024. Any employee who worked for any three years of the past 5 for Ajax, i.e., from 2019 to 2023, must be covered for 2024. For the Ajax SEP IRA plan, a year of service is **any period, however short**. Employees under the age of 21 can be excluded from the SEP IRA plan.

For a **SIMPLE IRA** plan, all employees who earned at least **\$5,000** in compensation from the employer during **any two years** that precede the year for which the SIMPLE plan is being maintained and who are reasonably expected to receive at least \$5,000 in the calendar year for which the plan is being maintained are eligible to participate in that employer's SIMPLE IRA plan. There is **no age** requirement for a SIMPLE IRA plan's eligibility.

Contribution Flexibility: For a **SEP IRA** plan, contributions are **discretionary**. This allows the SEP plan's sponsoring employer to choose to make contributions from 0% to **25% of compensation for the year** or make no contributions if the employer's financial situation is tight.

For a **SIMPLE IRA** plan, the employer's contributions can be **mandatory**. If the SIMPLE IRA plan sponsor chooses to make a matching contribution, employer contributions must be made for **all** eligible employees who choose to make salary deferral contributions. If the employer chooses to make a nonelective contribution, the SIMPLE IRA plan sponsor's contributions must be made for **all** eligible employees, regardless of whether they make a salary deferral.

Maximum Contributions: For a **SEP IRA** plan, the maximum contribution is **25% of W-2 wages. Only employer contributions are allowed.** The compensation limit for 2024 is **\$345,000**.

For a **SIMPLE IRA** plan, the maximum contribution is: (i) for salary deferrals, 100% of compensation up to **\$16,000** for 2024, and if the SIMPLE IRA participant is over the age 50 years, he/she may make an additional *catch-up* contribution of up to **\$3,500**; and (ii) the employer's matching contribution of up to **3%** of compensation for each employee who makes a salary deferral contribution. This compensation limit applies to a SIMPLE IRA only if the employer elects to make a nonelective contribution (limited to **2%**) instead of a matching contribution.

Example #1: Carl is age 57. Carl's compensation is \$400,000. Carl

wants to contribute the maximum amount to his retirement plan account. If Carl's employer sponsors a SEP IRA, Carl can contribute \$69,000 to his SEP IRA. If Carl's employer sponsors a SIMPLE IRA plan, Carl can contribute a maximum amount of \$31,500 to his SIMPLE IRA. Because the maximum compensation that is considered for the SEP IRA in 2024 is \$345,000, and SEP contributions are limited to the lesser of 25% of compensation, or \$69,000, the maximum amount that Carl can contribute to his SEP IRA is \$69,000 [not 25% of \$400,000, or \$82,500.] While the SEP IRA is funded only with Carl's employer's contributions, the SIMPLE IRA is funded with Carl's salary deferral of \$16,000 for 2024, with his *catch-up* contribution of another \$3,500 plus a \$1.00 for \$1.00 matching contribution of up to 3% of \$400,000 from Carl's employer.

Example #2: Carla is age 44. Carla's compensation is \$400,000. Carla wants to contribute the maximum amount to her retirement plan account. If Carla's employer sponsors a SEP IRA, she may contribute \$69,000 to her SEP IRA. If Carla's employer sponsors a SIMPLE IRA plan, Carla can contribute a maximum amount of \$28,000 to her SIMPLE IRA.

Conclusion: For employer that are encouraged to open retirement plans for their employees, induced now by some favorable new income tax credits that are available under the SECURE Acts, probably a SEP IRA plan is the best place to start since it is far more flexible than a SIMPLE IRA plan, particularly by the fact that the employer's contributions are always discretionary, and the maximum dollar amount contributed can be substantial.
