SECURE 2.0

Mid-Year Termination of SIMPLE IRA

Employers may now terminate a SIMPLE IRA and replace it with a safe harbor plan.

An employer that maintains a SIMPLE IRA plan is generally not permitted to maintain another retirement plan in which employees may accrue benefits—a principle known as the exclusive plan rule. In addition, the Internal Revenue Service (IRS) has taken the position that a SIMPLE IRA must be maintained on a calendar-year basis, even if the employer's tax year is not based on a calendar year. These rules have limited employers' flexibility in transitioning to a different type of qualified plan during a calendar year.

For plan years beginning after December 31, 2023, employers may terminate a SIMPLE IRA plan at any time during a calendar year and replace it with a safe harbor section 401(k) plan. Notice 2024-02 clarifies that the establishment of a safe harbor 401(k) plan is considered an exception to the SIMPLE IRA exclusive plan rule. The effective date of the safe harbor plan must be the day after the termination date of the SIMPLE IRA plan.

Terminating a SIMPLE IRA Plan

An employer must take formal written action that documents the termination date of the SIMPLE IRA plan. Employers must also notify employees of the intent to terminate the SIMPLE IRA plan. The notification to employees is required to

- Be provided 30 days before the SIMPLE IRA plan termination date.
- Specify that no salary reduction contributions will be permitted on compensation paid after the termination date.
- Include a statement that matching or nonelective contributions will be made based on compensation through the termination date.

The employer is not required to notify the IRS of the SIMPLE IRA plan termination, but should

- Notify the financial institution and payroll provider that contributions will cease.
- Keep records of the steps taken during the termination process.

Contributions Under a Terminated SIMPLE IRA Plan

When an employer terminates a SIMPLE IRA plan, salary reduction contributions should continue with respect to employee's compensation up to the plan's termination date. Matching contributions and nonelective contributions should also be calculated based on employees' compensation earned through the termination date of the SIMPLE IRA plan.

Distributions From a Terminated Simple IRA

The early distribution tax (25%) will not apply to distributions from a SIMPLE IRA within the first two years of participation if the distributed assets are rolled into a 401(k) or 403(b) plan. The rollover contributions are then subject to the distributable events permitted in the applicable safe harbor plan.

Calculating Aggregated Deferral Limits for the Transition Year of the Safe Harbor Plan

The aggregate contribution amount deposited into both the SIMPLE IRA plan (during its last plan year) and the safe harbor plan (during its transition year) may not exceed the applicable limits of each type of plan based on the date of the transition. The transition year begins the day after the termination date of the SIMPLE IRA and ends on the last day of the calendar year during which the transition to the safe harbor plan occurred.

The total amount that may be contributed as elective deferrals to the safe harbor plan is equal to:

$$\text{SIMPLE IRA deferral limit (plus catch-up limit if eligible)} \times \frac{\text{\# of days SIMPLE plan was effective}}{365}$$

Plus

$$\text{Safe harbor plan deferral limit (plus catch-up limit if eligible)} \times \frac{\text{\# of days 401(k) plan was effective}}{365}$$

Minus

SIMPLE IRA deferrals for the year

Equals

Total elective contributions to the safe harbor plan

Example

Susan, age 50, earned $95,000 in compensation in 2024. She has made salary reduction contributions to a SIMPLE IRA in the amount of $10,000. Her employer terminated the SIMPLE IRA plan on September 30, 2024, and replaced it with a 401(k) safe harbor plan effective October 1, 2024.

$$\$19{,}500 \times \frac{273}{365} = \$14{,}584.93$$ *Prorated SIMPLE IRA deferral limit*

Plus

$$\$30{,}500 \times \frac{92}{365} = \$7{,}687.67$$ *Prorated Safe Harbor 401(k) deferral limit*

Minus

$10,000 *SIMPLE IRA deferrals for 2024*

Equals

$12,272.60 *Total permissible elective contributions to the safe harbor 401(k) plan for 2024*