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Upgrading a SIMPLE IRA to a 401(k) Plan

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Every year we receive 401(k) proposal requests from small employers that have SIMPLE IRA plans. There are very specific timing requirements when upgrading from a SIMPLE IRA to a 401(k) plan and proper planning is required. September is the perfect time to begin these discussions for the upcoming year.

Reasons for Upgrading to a 401(k) Plan

A SIMPLE IRA is an easy and inexpensive option for small employers. However, there are downsides:

- Inflexible employer contributions – 3% match or 2% non-elective is required.
- No vesting schedules – all employer contributions are immediately 100% vested.
- Participant loans are not permitted.
- Lower employee contribution limits than a 401(k) plan.

Which leads us to the benefits of adopting a 401(k) Plan:

- Employer contributions are significantly more flexible and can lead to larger tax deductions.
- Vesting schedules may be applied to employer contributions.
- Participant loans can be permitted.
- Higher employee contribution limits than a SIMPLE IRA.
- A 401(k) plan is perceived by many employees and recruits as a superior employee benefit.

How and When to Upgrade to a 401(k) Plan

The transition from a SIMPLE IRA to a 401(k) plan must occur on January 1st. The employer must notify the employees that they are going to cease contributions to the SIMPLE IRA no later than the November 2nd preceding the change. We receive requests for mid-year changes but the IRS strictly forbids the transition in the middle of the year.

Unlike converting a profit sharing plan to a 401(k) plan, there is no way to directly convert a SIMPLIE IRA to a 401(k) Plan. The assets of a SIMPLE IRA can be rolled-over to a 401(k) plan but a participant cannot be forced to transfer the assets. Although most participants will elect to rollover their SIMPLE IRA assets after a 401(k) plan education meeting, it is each participant's option to leave the money in an IRA account or roll it over to the new 401(k) plan account.

There are two timing issues that must be addressed regarding SIMPLE IRA rollovers:

- The 2-year rule – a participant's SIMPLE IRA account must be in place for at least 2 years before rolling-over.
- Surrender charges – many funds have surrender charges that must be reviewed. Charges may be avoided with proper liquidation planning.

Preparation is the key to a successful upgrade from a SIMPLE IRA to a 401(k) Plan. Proper plan design, employee education, and rollover planning will make the transition seamless for the employer and employees. Now is the time to act so please don't hesitate to contact us for more information on upgrading a SIMPLE IRA to a 401(k) plan.