# SIMPLE IRA MID-YEAR CONVERSIONS

*The details on converting SIMPLE IRAs mid-year to safe harbor 401(k) plans*

## Background

SIMPLE IRA plans are a popular retirement plan type for small businesses. These plans are generally cheaper to implement with little administration for the employer, but they also lack flexibility and limit contributions that can be made to the plan. As a result, employers often move from a SIMPLE IRA plan to a 401(k) plan. However, SIMPLE IRA plans have an "exclusive plan rule." This states that an employer with a SIMPLE IRA plan cannot have another retirement plan in the same year. These plans operate on a calendar year basis, and previously, an employer couldn't terminate a SIMPLE IRA mid-year to start a 401(k) without violating the exclusive plan rule.

## Mid-year conversion option details

Beginning in 2024, due to the SECURE 2.0 legislation, a SIMPLE IRA plan can be "converted" mid-year to a 401(k) plan, as long as the plan is an ADP safe harbor plan. The 401(k) plan can be either a traditional safe harbor plan or a QACA safe harbor plan with automatic enrollment. The safe harbor plan must be effective as of the date the SIMPLE IRA is terminated. This ensures employee deferrals continue for the full year, without any gap.

## Calculating contribution limits

Because SIMPLE IRAs are more limited for employee deferrals than 401(k) plans, a mid-year switch means that the contribution limit will be a weighted average of the two separate limits, determined by how long each plan was in effect. This only applies during the year of transition.

To determine the limit, multiply the ratio of the days the SIMPLE plan was in effect by the SIMPLE plan limit for the year. Then, do the same for the 401(k) (including any eligible catch-up contributions), and then add them together. For example, if the conversion occurs on June 1, 2025, the SIMPLE plan was in effect for 150 days out of 365. Multiply the ratio 150/365 by the 2025 SIMPLE limit of $16,500, to get $6,780.82. The limit to use is $20,000 for those age 50 or older to include the catch-up contribution. Then, multiply 215/365 by the 402(g) limit of $23,500 to get $13,842.47 for the remaining portion of the year. Again, increase to $31,000 if catch-up eligible. Add the two limits together to find a new adjusted deferral limit of $20,623.29, or $26,479.46 for those 50 and older, for the 2025 year.

## Calculating contribution limits (continued)

Note, for 2024 and thereafter, SECURE 2.0 provided for an increase in SIMPLE contribution limits for those with 25 or fewer employees, and employers who elect to apply the increased limits if over 25 employees, if the SIMPLE notice included the increased limits, which was unlikely for 2024. In addition, beginning in 2025, catch-up contribution limits are increasing for those between the ages of 60 and 63. As a result of these changes, the contribution limits for the full year may vary from the general limits for both SIMPLE IRA plans and 401k plans.

## Plan conversion steps

Below are the steps to follow to complete the transition under SECURE 2.0:

1. Terminate the SIMPLE IRA plan by formal written action specifying a termination date. All SIMPLE contributions, including any match or nonelective allocations that accrued in the SIMPLE plan, must be contributed to the SIMPLE IRA accounts. Deferrals should continue as elected in the SIMPLE plan until the termination date.

2. The employees must receive notice at least 30 days in advance that the SIMPLE plan is terminating and deferrals to this plan will not be continued. The employer should also notify the payroll provider and financial institution(s) receiving SIMPLE contributions.

3. The employees must receive a notice for the safe harbor 401(k) plan for the first year that includes the weighted average contribution limit for the transition year. This must be provided by the first day the safe harbor 401(k) plan is in effect.

## Rollover rules

Typically, a SIMPLE IRA account cannot be rolled to any other type of retirement plan until the participant satisfies a two year period that begins with the first contribution to that SIMPLE plan. If the employer does a conversion to a safe harbor plan mid-year, the participants of the SIMPLE may roll over their accounts to the 401(k) plan, even if the two year period has not been met yet. However, if they do, these contributions must be treated like deferrals in the 401(k) plan. Therefore, they cannot be distributed until a distributable event occurs. Rollover contributions are often available at any time, so this is a new restriction that would apply in this situation. Thus, it may be preferable for employees to retain their SIMPLE IRA accounts until the two year period passes. Then, they can freely roll their funds to the new 401(k) plan or to another IRA.

If an employer chooses to allow rollover contributions prior to the end of the two year period, it is strongly recommended that they consult with their service providers to avoid potential compliance issues.