Notice 98–4

PURPOSE

This notice modifies and supersedes Notice 97–6, 1997–2 I.R.B. 26, relating to SIMPLE IRA Plans described in § 408(p)

of the Internal Revenue Code. The questions and answers contained in this notice reflect technical corrections made by the Taxpayer Relief Act of 1997, Pub. L. 105–34 ("TRA 97"). This notice also amends the answers to certain questions in Notice 97–6 in order to reflect the issuance of Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules) and provides a transition period for the use of Form 5305-SIMPLE (for Use With a Designated Financial Institution) for a SIMPLE IRA Plan that does not use a designated financial institution.

BACKGROUND

Section 1421 of the Small Business Job Protection Act of 1996, Pub. L. 104–188 ("SBJPA") established a simplified tax-favored retirement plan for small employers (a "SIMPLE IRA Plan") under § 408(p) of the Code. Contributions under a SIMPLE IRA Plan are made to individual retirement accounts or annuities ("SIMPLE IRAs") that are established pursuant to the SIMPLE IRA Plan adopted by the employer.

Section 1601(d)(1) of TRA 97 amended § 1421 of SBJPA, making technical changes to the statutory requirements for SIMPLE IRA Plans.

Notice 97–6 was issued on December 23, 1996, and provided guidance, in the form of questions and answers, on SIMPLE IRA Plans.

On October 31, 1996, the Internal Revenue Service issued Form 5305-SIMPLE, a model form that may be used by an employer to establish a SIMPLE IRA Plan with a designated financial institution, and on December 30, 1996, the Service issued 5304-SIMPLE, a model form that may be used by an employer to establish a SIMPLE IRA Plan without using a designated financial institution. Notice 97–6 contained instructions for modifying Form 5305-SIMPLE for an employer that did not want to use a designated financial institution but that wanted to use a Service-approved model form to establish a SIMPLE IRA Plan. Form 5304-SIMPLE is now available for this purpose.

On November 25, 1997, the Department of Labor ("DOL") issued a final rule, consistent with the statements in Q&A G–5 of Notice 97–6, amending 29 CFR 2510.3–102, relating to the definition of "plan assets" under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA"), to harmonize those Title I rules with the rules for salary reduction contributions to SIMPLE IRA Plans under § 408(p) of the Code.

CHANGES TO NOTICE 97–6

This notice modifies Q&As B–3, C–1 and H–2 to reflect technical corrections made by TRA 97; Q&A G–5 to reflect the amendment to the DOL plan asset regulations; and Q&As E–4, G–1, H–1 and K–3 to reflect the issuance of Form 5304-SIMPLE. A new Q&A, K–4, is added to provide a transition period for employers using Form 5305-SIMPLE as modified in accordance with Notice 97–6 for a SIMPLE IRA Plan that does not use a designated financial institution. In addition, this notice makes certain stylistic changes to the Q&As as published in Notice 97–6, including substituting the term "SIMPLE IRA Plan" for "SIMPLE plan."

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QUESTIONS AND ANSWERS

A. SIMPLE IRA PLANS IN GENERAL

Q. A–1: What is a SIMPLE IRA Plan?

A. A–1: A SIMPLE IRA Plan is a written arrangement established under § 408(p) of the Code that provides a simplified tax-favored retirement plan for small employers. If an employer establishes a SIMPLE IRA Plan, each employee may choose whether to have the employer make payments as contributions under the SIMPLE IRA Plan or to receive these payments directly in cash. An employer that chooses to establish a SIMPLE IRA Plan must make either matching contributions or nonelective contributions. All contributions under a SIMPLE IRA Plan are made to SIMPLE IRAs.

Q. A–2: Can contributions made under a SIMPLE IRA Plan be made to any type of IRA?

A. A–2: Contributions under a SIMPLE IRA Plan may only be made to a SIMPLE IRA, not to any other type of IRA. A SIMPLE IRA is an individual retirement account described in § 408(a), or an individual retirement annuity described in § 408(b), to which the only contributions that can be made are contributions under a SIMPLE IRA Plan and rollovers or transfers from another SIMPLE IRA.

Q. A–3: Can a SIMPLE IRA Plan be maintained on a fiscal year basis?

A. A–3: A SIMPLE IRA Plan may only be maintained on a calendar year basis. Thus, for example, employer eligibility to establish a SIMPLE IRA Plan (see Q&As B–1 through B–5) and SIMPLE IRA Plan contributions (see Q&As D–1 through D–6) are determined on a calendar-year basis.

B. EMPLOYERS THAT CAN ESTABLISH SIMPLE IRA PLANS

Q. B–1: Can any employer establish a SIMPLE IRA Plan?

A. B–1: SIMPLE IRA Plans may be established only by employers that had no more than 100 employees who earned $5,000 or more in compensation during the preceding calendar year (the "100-employee limitation"). See Q&As C–4 and C–5 for the definition of compensation. For purposes of the 100-employee limitation, all employees employed at any time during the calendar year are taken into account, regardless of whether they are eligible to participate in the SIMPLE IRA Plan. Thus, employees who are excludable under the rules of § 410(b)(3) or who have not met the plan's minimum eligibility requirements must be taken into account. Employees also include self-employed individuals described in § 401(c)(1) who received earned income from the employer during the year.

Q. B–2: Is there a grace period that can be used by an employer that ceases to satisfy the 100-employee limitation?

A. B–2: An employer that previously maintained a SIMPLE IRA Plan is treated as satisfying the 100-employee limitation for the 2 calendar years immediately following the calendar year for which it last satisfied the 100-employee limitation. However, if the failure to satisfy the 100-employee limitation is due to an acquisition, disposition or similar transaction involving the employer, then the 2-year grace period will apply only in accordance with rules similar to the rules of § 410(b)(6)(C)(i).

Q. B–3: Can an employer make contributions under a SIMPLE IRA Plan for a calendar year if it maintains another qualified plan?

A. B–3: Generally, an employer cannot make contributions under a SIMPLE IRA Plan for a calendar year if the employer, or a predecessor employer, maintains a qualified plan (other than the SIMPLE IRA Plan) under which any of its employees receives an allocation of contributions (in the case of a defined contribution plan) or has an increase in a benefit accrued or treated as an accrued benefit under § 411(d)(6) (in the case of a defined benefit plan) for any plan year beginning or ending in that calendar year. In applying these rules, transfers, rollovers or forfeitures are disregarded, except to the extent forfeitures replace otherwise required contributions. For purposes of this Q&A B–3, "qualified plan" means a plan, contract, pension or trust described in § 219(g)(5) and includes a plan qualified under § 401(a), a qualified annuity plan described in § 403(a), an annuity contract described in § 403(b), a plan established for employees of a State, a political subdivision or by an agency or instrumentality of any State or political subdivision (other than an eligible deferred compensation plan described in § 457(b)), a simplified employee pension ("SEP") described in § 408(k), a trust described in § 501(c)(18) and a SIMPLE IRA Plan described in § 408(p).

However, an employer can make contributions under a SIMPLE IRA Plan for a calendar year even though it maintains another qualified plan if either:

(1) The other qualified plan maintained by the employer covers only employees described in paragraph (1) of Q&A C–1 (i.e., employees covered under a collective bargaining agreement for which retirement benefits were the subject of good faith bargaining) and the SIMPLE IRA Plan excludes these employees.

(2) The other qualified plan is maintained by the employer during the calendar year in which an acquisition, disposition or similar transaction occurs (or the following calendar year); the requirements of this Q&A B–3 would have been satisfied if the transaction had not occurred (and thus the employer maintaining the SIMPLE IRA Plan had remained a separate employer); and only individuals who would have been employees of that "separate" employer are eligible to participate in the SIMPLE IRA Plan.

Q. B–4: Are tax-exempt employers and governmental entities permitted to maintain SIMPLE IRA Plans?

A. B–4: Yes. Excludable contributions may be made to the SIMPLE IRA of employees of tax-exempt employers and governmental entities on the same basis as contributions may be made to employees of other eligible employers.

Q. B–5: Do the employer aggregation and leased employee rules apply for purposes of the SIMPLE IRA Plan rules under § 408(p)?

A. B–5: For purposes of applying the SIMPLE IRA Plan rules under § 408(p), certain related employers (trades or businesses under common control) are treated as a single employer. These related employers include controlled groups of corporations under § 414(b), partnerships or sole proprietorships under common control under § 414(c), and affiliated service groups under § 414(m). In addition, leased employees described in § 414(n) are treated as employed by the employer.

Example: Individual P owns Business A, a computer rental agency, that has 80 employees who received more than $5,000 in compensation in 1996. Individual P also owns Business B, which repairs computers and has 60 employees who received more than $5,000 in compensation in 1996. Individual P is the sole proprietor of both businesses. Section 414(c) provides that the employees of partnerships and sole proprietorships that are under common control are treated as employees of a single employer. Thus, for purposes of the SIMPLE IRA Plan rules, all 140 employees are treated as employed by Individual P. Therefore, neither Business A nor Business B is eligible to establish a SIMPLE IRA Plan for 1997.

C. EMPLOYEE ELIGIBILITY TO PARTICIPATE IN A SIMPLE IRA PLAN

Q. C–1: Which employees of an employer must be eligible to participate under the SIMPLE IRA Plan?

A. C–1: If an employer establishes a SIMPLE IRA Plan, all employees of the employer who received at least $5,000 in compensation from the employer during any 2 preceding calendar years (whether or not consecutive) and who are reasonably expected to receive at least $5,000 in compensation during the calendar year, must be eligible to participate in the SIMPLE IRA Plan for the calendar year.

An employer, at its option, may exclude from eligibility employees described in § 410(b)(3). These employees are:

(1) Employees who are included in a unit of employees covered by an agreement that the Secretary of Labor finds to be a collective bargaining agreement between employee representatives and one or more employers, if there is evidence that retirement benefits were the subject of good faith bargaining between such employee representatives and such employer or employers;

(2) In the case of a trust established or maintained pursuant to an agreement that the Secretary of Labor finds to be a collective bargaining agreement between air pilots represented in accordance with Title II of the Railway Labor Act and one or more employees, all employees not covered by that agreement; and

(3) Employees who are nonresident aliens and who received no earned income (within the meaning of § 911(d)(2)) from the employer that constitutes income from sources within the United States (within the meaning of § 861(a)(3)).

Moreover, during the calendar year in which an acquisition, disposition or similar transaction occurs (or the following calendar year), an employer may exclude from eligibility all of the employees who would not have been eligible if the transaction had not occurred (and thus the employer maintaining the SIMPLE IRA Plan had remained a separate employer). See paragraph (2) of Q&A B–3 for circumstances in which exclusion of these employees would be required.

As noted in Q&A B–5, the employer aggregation and leased employee rules

apply for purposes of § 408(p). Thus, for example, if two related employers must be aggregated under the rules of § 414(b), all employees of either employer who satisfy the eligibility criteria must be allowed to participate in the SIMPLE IRA Plan.

Q. C–2: May an employer impose less restrictive eligibility requirements?

A. C–2: An employer may impose less restrictive eligibility requirements by eliminating or reducing the prior year compensation requirements, the current year compensation requirements, or both, under its SIMPLE IRA Plan. For example, the employer could allow participation for employees who received $3,000 in compensation during any preceding calendar year. However, the employer cannot impose any other conditions on participating in a SIMPLE IRA Plan.

Q. C–3: May an employee participate in a SIMPLE IRA Plan if he or she also participates in a plan of a different employer for the same year?

A. C–3: An employee may participate in a SIMPLE IRA Plan even if he or she also participates in a plan of a different employer for the same year. However, the employee's salary reduction contributions are subject to the limitations of § 402(g), which provides an aggregate limit on the exclusion for elective deferrals for any individual. Similarly, an employee who participates in a SIMPLE IRA Plan and an eligible deferred compensation plan described in § 457(b) is subject to the limitations described in § 457(c). An employer that establishes a SIMPLE IRA Plan is not responsible for monitoring compliance with either of these limitations.

Q. C–4: What definition of compensation applies for purposes of the SIMPLE IRA Plan rules in the case of an individual who is not a self-employed individual?

A. C–4: For purposes of the SIMPLE IRA Plan rules, in the case of an individual who is not a self-employed individual, compensation means the amount described in § 6051(a)(3) (wages, tips, and other compensation from the employer subject to income tax withholding under § 3401(a)), and amounts described in § 6051(a)(8), including elective contributions made under a SIMPLE IRA Plan, and compensation deferred under a § 457 plan. For purposes of applying the 100-employee limitation, and in determining whether an employee is eligible to participate in a SIMPLE IRA Plan (i.e., whether the employee had $5,000 in compensation for any 2 preceding years), an employee's compensation also includes the employee's elective deferrals under a § 401(k) plan, a salary reduction SEP and a § 403(b) annuity contract.

Q. C–5: What definition of compensation applies for purposes of the SIMPLE IRA Plan rules in the case of a self-employed individual?

A. C–5: For purposes of the SIMPLE IRA Plan rules, in the case of a self-employed individual, compensation means net earnings from self-employment determined under § 1402(a), prior to subtracting any contributions made under the SIMPLE IRA Plan on behalf of the individual.

D. SIMPLE IRA PLAN CONTRIBUTIONS

Q. D–1: What contributions must an employer make under a SIMPLE IRA Plan?

A. D–1: If an employer establishes a SIMPLE IRA Plan, it must make salary reduction contributions, as described in Q&A D–2, to the extent elected by employees. In addition, the employer must make employer matching contributions, as described in Q&As D–4 and D–5, or employer nonelective contributions, as described in Q&A D–6. These are the only contributions that may be made under a SIMPLE IRA Plan.

Q. D–2: What is a salary reduction contribution?

A. D–2: A salary reduction contribution is a contribution made pursuant to an employee's election to have an amount contributed to his or her SIMPLE IRA, rather than have the amount paid directly to the employee in cash. An employee must be permitted to elect to have salary reduction contributions made at the level specified by the employee, expressed as a percentage of compensation for the year. Additionally, an employer may permit an employee to express the level of salary reduction contributions as a specific dollar amount. An employer may not place any restrictions on the amount of an employee's salary reduction contributions (e.g., by limiting the contribution percentage), except to the extent needed to comply with the annual limit on the amount of salary reduction contributions described in Q&A D–3.

Q. D–3: What is the annual limit on the amount of salary reduction contributions under a SIMPLE IRA Plan?

A. D–3: For 1997 (and for 1998), the maximum annual amount of salary reduction contributions that can be made on behalf of any employee under a SIMPLE IRA Plan is $6,000. This amount will be adjusted by the Service to reflect any changes in the cost of living.

Q. D–4: What employer matching contribution is generally required under a SIMPLE IRA Plan?

A. D–4: Under a SIMPLE IRA Plan, an employer is generally required to make a contribution on behalf of each eligible employee in an amount equal to the employee's salary reduction contributions, up to a limit of 3 percent of the employee's compensation for the entire calendar year.

Q. D–5: Can the 3-percent limit on matching contributions be reduced?

A. D–5: The 3-percent limit on matching contributions is permitted to be reduced for a calendar year at the election of the employer, but only if:

(1) The limit is not reduced below 1 percent;

(2) The limit is not reduced for more than 2 years out of the 5-year period that ends with (and includes) the year for which the election is effective; and

(3) Employees are notified of the reduced limit within a reasonable period of time before the 60-day election period during which employees can enter into salary reduction agreements. See Q&A E–1.

For purposes of applying the rule described in paragraph (2) of this Q&A D–5, in determining whether the limit was reduced below 3 percent for a year, any year before the first year in which an employer (or a predecessor employer) maintains a SIMPLE IRA Plan will be treated as a year for which the limit was 3 percent. If an employer chooses to make nonelective contributions for a year (see Q&A D–6), that year also will be treated as a year for which the limit was 3 percent.

Q. D–6: May an employer make nonelective contributions instead of matching contributions?

A. D–6: As an alternative to making matching contributions under a SIMPLE IRA Plan (as described in Q&A D–4 and D–5), an employer may make nonelective contributions equal to 2 percent of each eligible employee's compensation for the entire calendar year. The employer's nonelective contributions must be made for each eligible employee regardless of whether the employee elects to make salary reduction contributions for the calendar year. The employer may, but is not required to, limit nonelective contributions to eligible employees who have at least $5,000 (or some lower amount selected by the employer) of compensation for the year.

For purposes of the 2-percent nonelective contribution, the compensation taken into account must be limited to the amount of compensation that may be taken into account under § 401(a)(17) for the year. The § 401(a)(17) limit for 1997 (and for 1998) is $160,000. This amount will be adjusted by the Service for subsequent years to reflect changes in the cost of living.

An employer may substitute the 2-percent nonelective contribution for the matching contribution for a year, only if:

(1) Eligible employees are notified that a 2-percent nonelective contribution will be made instead of a matching contribution; and

(2) This notice is provided within a reasonable period of time before the 60-day election period during which employees can enter into salary reduction agreements. See Q&A E–1.

E. EMPLOYEE ELECTIONS

Q. E–1: When must an employee be given the right to enter into a salary reduction agreement?

A. E–1: During the 60-day period immediately preceding January 1 of a calendar year (i.e., November 2 to December 31 of the preceding calendar year), an eligible employee must be given the right to enter into a salary reduction agreement for the calendar year, or to modify a prior agreement (including reducing the amount subject to this agreement to $0). However, for the year in which the employee becomes eligible to make salary reduction contributions, the period during which the employee may enter into a salary reduction agreement or modify a prior agreement is a 60-day period that includes either the date the employee becomes eligible or the day before that date. For example, if an employer establishes a SIMPLE IRA Plan effective as of July 1, 1997, each eligible employee becomes eligible to make salary reduction contributions on that date and the 60-day period must begin no later than July 1 and cannot end before June 30, 1997.

During these 60-day periods, employees have the right to modify their salary reduction agreements without restrictions. In addition, for the year in which an employee becomes eligible to make salary reduction contributions, the employee must be able to commence these contributions as soon as the employee becomes eligible, regardless of whether the 60-day period has ended.

Q. E–2: Can a SIMPLE IRA Plan provide additional or longer election periods?

A. E–2: Nothing precludes a SIMPLE IRA Plan from providing additional or longer periods for permitting employees to enter into salary reduction agreements or to modify prior agreements. For example, a SIMPLE IRA Plan can provide a 90-day election period instead of the 60-day period described in Q&A E–1. Similarly, in addition to the 60-day period described in Q&A E–1, a SIMPLE IRA Plan can provide quarterly election periods during the 30 days before each calendar quarter.

Q. E–3: Does an employee have the right to terminate a salary reduction agreement outside a SIMPLE IRA Plan's normal election period?

A. E–3: An employee must be given the right to terminate a salary reduction agreement for a calendar year at any time during the year. A SIMPLE IRA Plan may provide that an employee who terminates a salary reduction agreement at any time other than the periods described in Q&A E–1 or E–2 is not eligible to resume participation until the beginning of the next calendar year.

Q. E–4: Must an employer allow an employee to select the financial institution to which the employer will make all SIMPLE IRA Plan contributions on behalf of the employee?

A. E–4: Generally, under § 408(p), an employer must permit an employee to select the financial institution for the SIMPLE IRA to which the employer will make all contributions on behalf of the employee. The employee must communicate to the employer the name of the financial institution selected and any additional information necessary to facilitate transmittal of the contribution to that institution. The Model Salary Reduction Agreement on page 3 of Form 5304-SIMPLE can be used for this purpose. Alternatively, under the exception described in Q&A J–1, an employer may require that all contributions on behalf of employees be made to a specified designated financial institution.

F. VESTING REQUIREMENTS

Q. F–1: Must contributions under a SIMPLE IRA Plan be nonforfeitable?

A. F–1: Yes. All contributions under a SIMPLE IRA Plan must be fully vested and nonforfeitable when made.

Q. F–2: May amounts held in a SIMPLE IRA be withdrawn at any time?

A. F–2: Yes. An employer may not require an employee to retain any portion of the contributions in his or her SIMPLE IRA or otherwise impose any withdrawal restrictions.

G. EMPLOYER ADMINISTRATIVE AND NOTIFICATION REQUIREMENTS

Q. G–1: What notification requirements apply to employers?

A. G–1: An employer must notify each employee, immediately before the employee's 60-day election period described in Q&A E–1, of the employee's opportunity to enter into a salary reduction agreement or to modify a prior agreement. If applicable, this notification must disclose an employee's ability to select the financial institution that will serve as the trustee of the employee's SIMPLE IRA as described in Q&A E–4. In the case of a SIMPLE IRA Plan established using Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules), the employer may use the Model Notification to Eligible Employees on page 3 of the form to disclose to each employee the employee's right to select the financial institution that will serve as the trustee of the employee's SIMPLE IRA as described in Q&A E–4. The notification must also include the summary description described in Q&A H–1. In the case of a

SIMPLE IRA Plan established using Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules) or Form 5305-SIMPLE (for Use With a Designated Financial Institution), the summary description requirement may be satisfied by providing a completed copy of pages 1 and 2 of the form that reflects the terms of the employer's plan (including the materials provided by the trustee for completion of Article VI).

Q. G–2: May the notifications regarding a reduced matching contribution (described in Q&A D–5) and a nonelective contribution in lieu of a matching contribution (described in Q&A D–6) be provided at the same time as the notification of an employee's opportunity to enter into a salary reduction agreement and the summary description?

A. G–2: Yes. An employer is deemed to provide the notification regarding a reduced matching contribution or a nonelective contribution in lieu of a matching contribution within a reasonable period of time before the 60-day election period if, immediately before the 60-day election period, this notification is included with the notification of an employee's opportunity to enter into a salary reduction agreement.

Q. G–3: What reporting penalties under the Code apply if an employer fails to provide one or more of the required notices?

A. G–3: If the employer fails to provide one or more of the required notices described in Q&A G–1, the employer will be liable, under the Code, for a penalty of $50 per day until the notices are provided. If the employer shows that the failure was due to reasonable cause, the penalty will not be imposed. To the extent that each employee is permitted to select the trustee for his or her SIMPLE IRA pursuant to Q&A E–4, and is so notified in accordance with Q&A G–1, and the information with respect to the trustee (the name and address of the trustee and its withdrawal procedures) is not available at the time the employer is required to provide the summary description, the employer is deemed to have shown reasonable cause for failure to provide this information to eligible employees, but only if the employer sees to it that this information is provided to the employee as soon as administratively feasible once the trustee has been selected.

Q. G–4: What if an eligible employee is unwilling or unable to establish a SIMPLE IRA?

A. G–4: If an eligible employee who is entitled to a contribution under a SIMPLE IRA Plan is unwilling or unable to establish a SIMPLE IRA with any financial institution prior to the date on which the contribution is required to be made to the SIMPLE IRA of the employee under Q&A G–5 or G–6, an employer may execute the necessary documents to establish a SIMPLE IRA on the employee's behalf with a financial institution selected by the employer.

Q. G–5: When must an employer make salary reduction contributions under a SIMPLE IRA Plan?

A. G–5: The employer must make salary reduction contributions to the financial institution maintaining the SIMPLE IRA no later than the close of the 30-day period following the last day of the month in which amounts would otherwise have been payable to the employee in cash. The Department of Labor has indicated that most SIMPLE IRA Plans are also subject to Title I of ERISA, and under Department of Labor regulations, at 29 CFR 2510.3–102, salary reduction contributions to these plans must be made to the SIMPLE IRA as of the earliest date on which the contributions can reasonably be segregated from the employer's general assets, but in no event later than the 30-day deadline described above.

Q. G–6: When must an employer make matching and nonelective contributions under a SIMPLE IRA Plan?

A. G–6: Matching and nonelective employer contributions must be made to the financial institution maintaining the SIMPLE IRA no later than the due date for filing the employer's income tax return, including extensions, for the taxable year that includes the last day of the calendar year for which the contributions are made.

H. TRUSTEE ADMINISTRATIVE REQUIREMENTS

Q. H–1: What information must a SIMPLE IRA trustee provide to an employer?

A. H–1: (1) *Summary description.* Each year, a SIMPLE IRA trustee must provide the employer sponsoring the SIMPLE IRA Plan with a summary description containing the following information:

(a) The name and address of the employer and the trustee.

(b) The requirements for eligibility for participation.

(c) The benefits provided with respect to the arrangement.

(d) The time and method of making employee elections with respect to the arrangement.

(e) The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.

(2) *Timing.* Each trustee must provide the summary description to the employer early enough to allow the employer to meet its notification obligation described in Q&A G–1. However, a trustee is not required to provide the summary description prior to agreeing to be a trustee of a SIMPLE IRA under the SIMPLE IRA Plan.

(3) *Penalties.* Each trustee that fails to provide the employer with one or more summary descriptions incurs a $50 penalty, under § 6693(c) of the Code, for each day the failures continue, unless the trustee shows that the failures are due to reasonable cause. To the extent that the employer or a trustee provides the information described in paragraphs (1)(a) through (e) of this Q&A H–1 within the time period prescribed in Q&A G–1 to the employee for whom the SIMPLE IRA is established, the trustee of that SIMPLE IRA is deemed to have shown reasonable cause for failure to provide that information to the employer. For example, if, in accordance with Q&A G–1, an employer who uses a designated financial institution provides, to all eligible employees in a SIMPLE IRA Plan, its name and address, the information described in paragraphs (1)(a) through (d) of this Q&A H–1, and the effects of withdrawal, and the trustee provides its name and address and its procedures for withdrawal to each eligible employee for whom a SIMPLE IRA is established with the trustee under the SIMPLE IRA Plan, the trustee will be deemed to have shown reasonable cause for failing to provide the employer the information described in paragraphs (1)(a) through (e) of this Q&A H–1.

(4) *Use of model forms as the summary description.* In the case of a SIMPLE IRA Plan established using Form 5304-

SIMPLE (Not Subject to the Designated Financial Institution Rules) or Form 5305-SIMPLE (for Use With a Designated Financial Institution), a trustee may satisfy this obligation by providing an employer (and/or the employee in the case of Form 5304-SIMPLE) with a current copy of Form 5304-SIMPLE or Form 5305-SIMPLE, the instructions, the information required for completion of Article VI, and the name and address of the financial institution. The trustee should provide guidance to the employer (and the employee, if Form 5304-SIMPLE is provided directly to the employee) concerning the need for the employer to complete the first two pages of Form 5304-SIMPLE or Form 5305-SIMPLE in accordance with its plan's terms and to distribute completed copies to eligible employees.

(5) *Transfer SIMPLE IRAs.* The trustee of a transfer SIMPLE IRA is not required to provide the summary description described in the preceding paragraph. A SIMPLE IRA is a transfer SIMPLE IRA if it is not a SIMPLE IRA to which the employer has made contributions under the SIMPLE IRA Plan.

Q. H–2: What information must a SIMPLE IRA trustee provide to participants in the SIMPLE IRA Plan?

A. H–2: Within 31 days after the close of each calendar year, a SIMPLE IRA trustee must provide each individual on whose behalf an account is maintained with a statement of the individual's account balance as of the close of that calendar year and the account activity during that calendar year. A trustee who fails to provide individuals with this statement incurs a $50 penalty, under the Code, for each day the failure continues, unless the trustee shows that the failure is due to reasonable cause. The trustee must also provide any other information required to be furnished to IRA holders (e.g., disclosure statements for individual retirement plans as referred to in § 1.408–6 of the regulations).

Q. H–3: What information must a SIMPLE IRA trustee provide to the Service?

A. H–3: Section 408(i) requires the trustee of an individual retirement account to make reports regarding these accounts to the Service. Form 5498, Individual Retirement Arrangement Information, has been modified to require that the amount of contributions to a SIMPLE IRA, rollover contributions, and the fair market value of the account be reported, and that contributions to a SIMPLE IRA be identified as such. A trustee who fails to file these reports incurs a $50 penalty under the Code for each failure, unless it is shown that the failure is due to reasonable cause.

Q. H–4: Are distributions from a SIMPLE IRA required to be reported on Form 1099–R?

A. H–4: Pursuant to § 6047 of the Code and § 35.3405–1 of the regulations, the payor of a designated distribution from an IRA must report the distribution on Form 1099–R. A distribution from a SIMPLE IRA is a designated distribution from an IRA and thus must be reported on Form 1099–R. The Service has revised Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-sharing Plans, IRAs, Insurance Contracts, Etc., to reflect the requirements that apply to SIMPLE IRAs. The penalty, under the Code, for failure to report a designated distribution from an IRA (including a SIMPLE IRA) is determined under sections 6721–6724.

Q. H–5: Is a SIMPLE IRA trustee responsible for reporting whether a distribution to a participant occurred during the 2-year period described in Q&A I–2?

A. H–5: Yes. A SIMPLE IRA trustee is required to report on Form 1099–R whether a distribution to a participant occurred during the 2-year period described in Q&A I–2. A trustee is permitted to prepare this report on the basis of its own records with respect to the SIMPLE IRA account. A trustee may, but is not required to, take into account other adequately substantiated information regarding the date on which an individual first participated in any SIMPLE IRA Plan maintained by the individual's employer. See Q&A I–2 on the effect of distributions within this 2-year period.

I. TAX TREATMENT OF SIMPLE IRA PLANS

Q. I–1: What are the tax consequences of SIMPLE IRA Plan contributions?

A. I–1: Contributions to a SIMPLE IRA are excludable from federal income tax and not subject to federal income tax withholding. Salary reduction contributions to a SIMPLE IRA are subject to tax under the Federal Insurance Contributions Act ("FICA"), the Federal Unemployment Tax Act ("FUTA"), and the Railroad Retirement Act ("RRTA"), and must be reported on Form W–2, Wage and Tax Statement. Matching and nonelective contributions to a SIMPLE IRA are not subject to FICA, FUTA, or RRTA taxes, and are not required to be reported on Form W–2.

Q. I–2: What are the tax consequences when amounts are distributed from a SIMPLE IRA?

A. I–2: Generally, the same tax results apply to distributions from a SIMPLE IRA as to distributions from a regular IRA (i.e., an IRA described in § 408(a) or (b)). However, a special rule applies to a payment or distribution received from a SIMPLE IRA during the 2-year period beginning on the date on which the individual first participated in any SIMPLE IRA Plan maintained by the individual's employer (the "2-year period").

Under this special rule, if the additional income tax on early distributions under § 72(t) applies to a distribution within this 2-year period, § 72(t)(6) provides that the rate of additional tax under this special rule is increased from 10 percent to 25 percent. If one of the exceptions to application of the tax under § 72(t) applies (e.g., for amounts paid after age 59½, after death, or as part of a series of substantially equal payments), the exception also applies to distributions within the 2-year period and the 25-percent additional tax does not apply.

Q. I–3: Are there any special rollover rules that apply to a distribution from a SIMPLE IRA?

A. I–3: Section 408(d)(3)(G) provides that the rollover provisions of § 408(d)(3) apply to a distribution from a SIMPLE IRA during the 2-year period described in Q&A I–2 only if the distribution is paid into another SIMPLE IRA. Thus, a distribution from a SIMPLE IRA during that 2-year period qualifies as a rollover contribution (and thus is not includable in gross income) only if the distribution is paid into another SIMPLE IRA and satisfies the other requirements of § 408(d)(3) for treatment as a rollover contribution.

Q. I–4: Can an amount be transferred from a SIMPLE IRA to another IRA in a tax-free trustee-to-trustee transfer?

A. I–4: During the 2-year period described in Q&A I–2, an amount in a SIMPLE IRA can be transferred to another SIMPLE IRA in a tax-free trustee-to-trustee transfer. If, during this 2-year period, an amount is paid from a SIMPLE IRA directly to the trustee of an IRA that is not a SIMPLE IRA, the payment is neither a tax-free trustee-to-trustee transfer nor a rollover contribution; the payment is a distribution from the SIMPLE IRA and a contribution to the other IRA that does not qualify as a rollover contribution. After the expiration of the 2-year period, an amount in a SIMPLE IRA can be transferred in a tax-free trustee-to-trustee transfer to an IRA that is not a SIMPLE IRA.

Q. I–5: When does the 2-year period described in Q&A I–2 begin?

A. I–5: The 2-year period described in Q&A I–2 begins on the first day on which contributions made by the individual's employer are deposited in the individual's SIMPLE IRA.

Q. I–6: Do the qualification rules of § 401(a) apply to contributions under a SIMPLE IRA Plan?

A. I–6: None of the qualification rules of § 401(a) apply to SIMPLE IRA Plans. For example, the § 415 and 416 rules do not apply to contributions under a SIMPLE IRA Plan. Similarly, the § 401(a)(17) limit does not apply to salary reduction contributions and matching contributions. However, as noted in Q&A D–6, the amount of compensation that may be taken into account for purposes of the 2-percent nonelective contribution is limited to the amount that may be taken into account under § 401(a)(17) for the year.

Q. I–7: What rules apply to an employer's ability to deduct contributions under a SIMPLE IRA Plan?

A. I–7: Pursuant to § 404(m), contributions under a SIMPLE IRA Plan are deductible in the taxable year of the employer with or within which the calendar year for which contributions were made ends (without regard to the limitations of § 404(a)). For example, if an employer has a June 30 taxable year end, contributions under the SIMPLE IRA Plan for the calendar year 1997 (including contributions made in 1997 before June 30, 1997) are deductible in the taxable year ending June 30, 1998. Contributions will be treated as made for a particular taxable year if they are made on account of that taxable year and are made by the due date (including extensions) prescribed by law for filing the return for the taxable year.

J. EXCEPTION FOR USE OF DESIGNATED FINANCIAL INSTITUTION

Q. J–1: Can an employer designate a particular financial institution to which all contributions under the SIMPLE IRA Plan will be made?

A. J–1: Yes. In accordance with § 408(p)(7), instead of making SIMPLE IRA Plan contributions to the financial institution selected by each eligible employee (see Q&A E–4), an employer may require that all contributions on behalf of all eligible employees under the SIMPLE IRA Plan be made to SIMPLE IRAs at a particular financial institution if the following requirements are met: (1) the employer and the financial institution agree that the financial institution will be a designated financial institution under § 408(p)(7) ("DFI") for the SIMPLE IRA Plan; (2) the financial institution agrees that, if a participant so requests, the participant's balance will be transferred without cost or penalty to another SIMPLE IRA (or, after the 2-year period described in Q&A I–2, to any IRA) at a financial institution selected by the participant; and (3) each participant is given written notification describing the procedures under which, if a participant so requests, the participant's balance will be transferred without cost or penalty to another SIMPLE IRA (or, after the 2-year period described in Q&A I–2, to any IRA) at a financial institution selected by the participant.

This Q&A J–1 is illustrated by the following examples:

Example 1: A representative of Financial Institution L approaches Employer B concerning the establishment of a SIMPLE IRA Plan. Employer B agrees to establish a SIMPLE IRA Plan for its eligible employees. Employer B would prefer to avoid writing checks to more than one financial institution on behalf of employees, and is interested in making all contributions under the SIMPLE IRA Plan to a single financial institution. Employer B and Financial Institution L agree that Financial Institution L will be a DFI and Financial Institution L agrees that, if a participant so requests, it will transfer the participant's balance, without cost or penalty, to another SIMPLE IRA (or, after the 2-year period described in Q&A I–2, to any IRA) at a financial institution selected by the participant. A SIMPLE IRA is established for each participating employee of Employer B at Financial Institution L. Each participant is provided with a written description of how and when the participant may direct that the participant's balance attributable to contributions made to Financial Institution L be transferred without cost or penalty to a SIMPLE IRA (or, after the 2-year period described in Q&A I–2, to any IRA) at another financial institution selected by the participant. Financial Institution L is a DFI, and Employer B may require that all contributions on behalf of all eligible employees be made to SIMPLE IRAs at Financial Institution L.

Example 2: A representative of Financial Institution M approaches Employer C concerning the establishment of a SIMPLE IRA Plan. Employer C invites Financial Institution M to make a presentation on its investment options for SIMPLE IRAs to Employer C's employees. Each eligible employee receives notification that the employer must permit the employee to select which financial institution will serve as the trustee of the employee's SIMPLE IRA (see Q&A G–1). All eligible employees of Employer C voluntarily select Financial Institution M to serve as the trustee of the SIMPLE IRAs to which Employer C will make all contributions on behalf of the employees. Financial Institution M is not a DFI merely because all eligible employees of Employer C selected Financial Institution M to serve as the trustee of their SIMPLE IRAs and Employer C consequently makes all contributions to Financial Institution M. Therefore, Financial Institution M is not required to transfer SIMPLE IRA balances without cost or penalty.

Example 3: Assume the same facts as Example 2, except that Employee X and Employee Y, who made salary reduction elections, failed to establish SIMPLE IRAs to receive SIMPLE IRA Plan contributions on their behalf before the first date on which Employer C is required to make a contribution to their SIMPLE IRAs. Employer C establishes SIMPLE

IRAs at Financial Institution M for these employees and contributes the amount required to their accounts. Financial Institution M is not a DFI merely because Employer C establishes SIMPLE IRAs on behalf of Employee X and Employee Y while all other employees voluntarily select Financial Institution M to serve as the trustee of the SIMPLE IRAs to which Employer C will make contributions on their behalf.

Q. J–2: May the time and manner in which a participant may transfer his or her balance without cost or penalty be limited without violating the requirements of § 408(p)(7)?

A. J–2: Yes. Section 408(p)(7) will not be violated merely because a participant is given only a reasonable period of time each year in which to transfer his or her balance without cost or penalty. A participant will be deemed to have been given a reasonable period of time in which to transfer his or her balance without cost or penalty if, for each calendar year, the participant has until the end of the 60-day period described in Q&A E–1 to request to transfer, without cost or penalty, his or her balance attributable to SIMPLE IRA Plan contributions for the calendar year following that 60-day period (or, for the year in which an employee becomes eligible to make salary reduction contributions, for the balance of that year) and subsequent calendar years.

If the time or manner in which a participant may transfer his or her balance without cost or penalty is limited, any such limitation must be disclosed as part of the written notification described in Q&A J–1. In the case of a SIMPLE IRA Plan established using Form 5305-SIMPLE, if the summary description requirement is being satisfied by providing a completed copy of pages one and two of Form 5305-SIMPLE, Article VI (Procedures for Withdrawal) must contain a clear explanation of any such limitation.

This Q&A J–2 is illustrated by the following examples:

Example 1: Employer A first establishes a SIMPLE IRA Plan effective January 1, 1998, and intends to make all contributions to Financial Institution M, which has agreed to serve as a DFI. For the 1998 calendar year, Employer A provides the 60-day election period described in Q&A E–1 beginning November 2, 1997, and notifies each participant that he or she may request that his or her balance attributable to future contributions be transferred from Financial Institution M to a SIMPLE IRA at a financial institution that the participant selects. The notification states that the transfer will be made without cost or penalty if the participant contacts Financial Institution M prior to January 1, 1998. For the 1998 calendar year, the requirements of § 408(p)(7) will not be violated merely because participants are given only a 60-day period in which to request to transfer their balances without cost or penalty.

Example 2: Assume the same facts as Example 1. Participant X does not request a transfer of her balance by December 31, 1997, but requests a transfer of her current balance to another SIMPLE IRA on July 1, 1998. Participant X's current balance would not be required to be transferred without cost or penalty because Participant X did not request such a transfer prior to January 1, 1998. However, during the 60-day period preceding the 1999 calendar year, Participant X may request a transfer, without cost or penalty, of her balance attributable to contributions made for the 1999 calendar year and, if she so elects, for all future calendar years (but not her balance attributable to contributions for the 1998 calendar year).

Example 3: Assume the same facts as Example 1. Under the terms of the SIMPLE IRA Plan, Participant Y becomes an eligible employee on June 1, 1998, and, for Participant Y, the 60-day period described in Q&A E–1 begins on that date. For the 1998 calendar year, Participant Y will be deemed to have been given a reasonable amount of time in which to request to transfer, without cost or penalty, his balance attributable to contributions for the balance of the 1998 calendar year if Financial Institution M allows such a request to be made prior to July 31, 1998.

Q. J–3: Is there a limit on the frequency with which a participant's balance must be transferred without cost or penalty?

A. J–3: In order to satisfy § 408(p)(7), if a participant acts, within applicable reasonable time limits, if any, to request a transfer of his or her balance, the participant's balance must be transferred on a reasonably frequent basis. A participant's balance will be deemed to be transferred on a reasonably frequent basis if it is transferred on a monthly basis.

Q. J–4: How does a DFI transfer a participant's balance without cost or penalty?

A. J–4: In order to satisfy § 408(p)(7), a participant's balance must be transferred in a trustee-to-trustee transfer directly to a SIMPLE IRA (or, after the 2-year period described in Q&A I–2, to any IRA) at the financial institution specified by the participant.

A transfer is deemed to be made without cost or penalty if no liquidation, transaction, redemption or termination fee, or any commission, load (whether front-end or back-end) or surrender charge, or similar fee or charge is imposed with respect to the balance being transferred. A transfer will not fail to be made without cost or penalty merely because contributions that a participant has elected to have transferred without cost or penalty are required to be invested in one specified investment option until transferred, even though a variety of investment options are available with respect to contributions that participants have not elected to transfer.

This Q&A J–4 is illustrated by the following examples:

Example 1: Financial Institution Q agrees to be a DFI for the SIMPLE IRA Plan maintained by Employer D. Employer D provides the 60-day election period described in Q&A E–1 beginning on November 2 of each year and each participant is notified that he or she may request, before the end of the 60-day period, a transfer of his or her future contributions from Financial Institution Q without cost or penalty to a SIMPLE IRA (or, after the 2-year period described in Q&A I–2, to any IRA) at a financial institution selected by the participant. The notification states that a participant's contributions that are to be transferred without cost or penalty will be invested in a specified investment option and will be transferred to the financial institution selected by the participant on a monthly basis.

Financial Institution Q offers various investment options to account holders of SIMPLE IRA accounts, including investment options with a sales charge. Any participant who does not elect to have his or her balance transferred to another financial institution may invest the contributions made on his or her behalf in any investment option available to account

holders of SIMPLE IRA accounts at Financial Institution Q. However, contributions that a participant has elected to have transferred are automatically invested, prior to transfer, in a specified investment option that has no sales charge. The requirement that a participant's balance be transferred without cost or penalty will not be violated merely because contributions that have been designated to be transferred pursuant to a participant's election are automatically invested in one specified investment option and transferred on a monthly basis to the financial institution selected by the participant.

Example 2: Assume the same facts as in Example 1. Financial Institution Q generally charges its IRA accounts a reasonable annual administration fee. Financial Institution Q also charges this annual administration fee with respect to SIMPLE IRA accounts, including SIMPLE IRA accounts from which balances must be transferred in accordance with participants' transfer elections. The requirement that participants balances be transferred without cost or penalty will not be violated merely because a reasonable annual administration fee is charged to SIMPLE IRA accounts from which balances must be transferred in accordance with participants' transfer elections.

Q. J–5: Is the "without cost or penalty" requirement violated if a DFI charges an employer for a participant's transfer of his or her balance?

A. J–5: The "without cost or penalty" requirement of § 408(p)(7) is not violated merely because a DFI charges an employer an amount that takes into account the financial institution's responsibility to transfer balances upon a participant's request or otherwise charges an employer for a transfer requested by a participant, provided that the charge is not passed through to the participant who requests the transfer.

K. SIMPLE IRA PLAN ESTABLISHMENT

Q. K–1: Must an employer establish a SIMPLE IRA Plan on January 1?

A. K–1: An existing employer may establish a SIMPLE IRA Plan effective on any date between January 1 and October 1 of a year beginning after December 31, 1996, provided that the employer (or any predecessor employer) did not previously maintain a SIMPLE IRA Plan. This requirement does not apply to a new employer that comes into existence after October 1 of the year the SIMPLE IRA Plan is established if the employer establishes the SIMPLE IRA Plan as soon as administratively feasible after the employer comes into existence. If an employer (or predecessor employer) previously maintained a SIMPLE IRA Plan, the employer may establish a SIMPLE IRA Plan effective only on January 1 of a year.

Q. K–2: When must a SIMPLE IRA be established for an employee?

A. K–2: A SIMPLE IRA is required to be established for an employee prior to the first date by which a contribution is required to be deposited into the employee's SIMPLE IRA (see Q&As G–5 and G–6).

Q. K–3: Has the Service issued model forms that an employer can use to establish a SIMPLE IRA Plan?

A. K–3: Yes. On October 31, 1996, the Service issued Form 5305-SIMPLE (for Use With a Designated Financial Institution), which is a form that may be used by an employer establishing a SIMPLE IRA Plan with a financial institution that is a DFI. On December 30, 1996, the Service issued Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules), which is the model form that may be used by an employer to establish a SIMPLE IRA Plan that does not use a DFI.

Q. K–4: How long may an employer use the modified Form 5305-SIMPLE (for Use With a Designated Financial Institution)?

A. K–4: An employer that established or establishes a SIMPLE IRA Plan (that does not use a DFI) by using Form 5305-SIMPLE (for Use With a Designated Financial Institution) as modified in accordance with Q&A K–3 as it originally appeared in Notice 97–6 may continue to use that modified form through the end of 1998. The Service has not approved the use of the modified form beyond 1998. Consequently, such an employer that makes contributions for a calendar year after 1998 must adopt one of the two model forms (Form 5304-SIMPLE or Form 5305-SIMPLE) or an approved prototype SIMPLE IRA Plan in order to rely on Service-approved SIMPLE IRA Plans for 1999 and future years. For purposes of Q&As E–4, G–1 and H–1 of this notice, the modified Form 5305-SIMPLE is treated as a Form 5304-SIMPLE (Not Subject to the Designated Financial Institution Rules).

EFFECT ON OTHER DOCUMENTS

This notice modifies and supersedes Notice 97–6.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1502.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this notice is in the sections headed "EMPLOYEE ELECTIONS" and "EMPLOYER ADMINISTRATIVE AND NOTIFICATION REQUIREMENTS." This information is required to assure compliance with the new provisions of the Small Business Job Protection Act of 1996. The collection of information is required to obtain a benefit. The likely respondents are individuals, businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting burden is 75,000 hours. The estimated annual burden per recordkeeper is 15 minutes. The estimated number of respondents is 300,000. The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information regarding

this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.