IRALERT

March 3, 2008

TO: IRA Group Distribution

From: Richard K. Matta rkm@groom.com
David W. Powell dwp@groom.com
Louis T. Mazawey ltm@groom.com
Roberta J. Ufford rju@groom.com
Elizabeth T. Dold etd@groom.com
David N. Levine dnl@groom.com
Lars C. Golumbic lcg@groom.com

RE: H.R. 5160: The Small Businesses Add Value for Employees Act of 2008

On February 13, Reps. Ron Kind (D-WI) and Kenny Hulshof (R-MO) introduced H.R. 5160, the Small Businesses Add Value for Employees (SAVE) Act of 2008. The bill contains a number of provisions aimed at encouraging small businesses to offer SIMPLE IRAs to their employees (and SIMPLE 401(k) retirement plans as well) by increasing the amounts that can be contributed to them and by increasing the tax credit given to employers who establish a SIMPLE IRA.

A. SIMPLE IRA and 401(k) Plans -- Background

SIMPLE IRAs and 401(k) plans are intended to provide an administratively easy and low cost way for small businesses (those with no more than 100 employees) to provide their employees with an opportunity to have salary reduction contributions made to an employer-sponsored savings plan. While the SIMPLE plan is like a traditional 401(k) plan in some regards, under current law participants are only permitted to defer up to the annual contribution limit of $10,500 (for 2008), as opposed to participants in a traditional 401(k) arrangement who are permitted to defer up to $15,500. The employer sponsoring a SIMPLE IRA or 401(k) plan must make a matching contribution equal to the amount the participant contributed to the plan (up to a maximum of 3 percent of the participant's compensation) or a non-elective contribution of 2 percent of compensation for each eligible employee who has $5,000 or more in compensation. For traditional 401(k) plans that want to avoid the nondiscrimination tests, the employer must make a matching contribution of 50% of any employee's contribution above 3 percent of compensation in addition to a match equal to the participant's contribution that is below 3 percent of compensation, or the employer must make a non-elective contribution of 3 percent of compensation. No additional employer contributions are permitted under a SIMPLE IRA or 401(k) plan. Although contributions to a SIMPLE plan are more limited than those to traditional 401(k) arrangements, SIMPLE IRAs are generally not subject to many of the complex administrative requirements such as nondiscrimination and top-heavy testing applicable to traditional 401(k) arrangements.

B. Increase in Annual Contribution Limitation and Additional Employer Contributions

The proposed legislation would increase the annual contribution limit for SIMPLE plans to the limit applicable to traditional 401(k) arrangements. Additionally, the proposed legislation would allow participating employers to choose to make additional uniform nonelective contributions of up to 10 percent of each eligible employee's compensation. Consequently, under the proposed legislation, an employer with no more than 100 employees can adopt a SIMPLE 401(k) plan and make less costly matching contributions or non-elective contributions than a larger employer who cannot adopt a SIMPLE 401(k) plan.

C. Elimination of the Restriction on Simple IRA Rollovers and Stepped-Up Early Withdrawal Penalty

The legislation would eliminate the rollover restrictions applicable to distributions from a SIMPLE IRA during the first two years of participation in the plan. SIMPLE IRA plan participants could roll-over distributions tax-free to certain other retirement plans like traditional plan participants. Additionally, the proposed legislation would eliminate the stepped-up 25 percent early withdrawal penalty applicable to distributions before age 59½ that are within the employee's first two years of employment. Instead, all early withdrawals would be subject to the same 10 percent early withdrawal penalty.

D. Voluntary Automatic Deferral IRAs

Similar to several pending automatic IRA bills and proposals, the SAVE Act would create voluntary automatic IRAs for employers. The automatic arrangement would start at 3 percent of compensation, up to a maximum contribution percentage of 10 percent. Participating employers would be required to enroll eligible employees in the automatic arrangement (unless the employee opted out), and automatically defer amounts that would otherwise have been paid out in cash.

E. Tax Credit for Start Up Costs

Currently, an employer with no more than 100 employees that establishes a new retirement plan is eligible for a non-refundable tax credit equal to 50% of the start-up costs of the plan in the first 3 years of the plan (limited to $500 in each year). The SAVE Act will add to the credit in the first year an amount equal to $25 for each employee that participates in the plan that first year.

F. Outlook for Action on the Legislation

Although Rep. Kind and Hulshof are members of the House Ways and Means Committee and the National Federation of Independent Businesses (NFIB) and the Securities Industry and Financial Markets Association support this bill, Democratic leadership of the Committee may not be interested in moving legislation which allows small business owners to contribute more to their SIMPLE accounts without having to make increased matching or non-elective contributions to the rank and file employees like they would have to under a traditional 401(k) arrangement. However, automatic rollover proposals and proposals that provide incentives for small businesses to establish plans (like the increased tax credit proposal) seem to have support in the Congress as a means of addressing the decline in the personal savings rate and the low percentage of small businesses that provide retirement savings plans for their employees, so we may see some action to similar proposals.

Please feel free to direct questions to any of the Groom principals listed above or to IRA@groom.com.