Payroll Deduction IRAs for Small Businesses

Payroll Deduction IRAs for Small Businesses is a joint project of the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) and the Internal Revenue Service.

It is available on the Internet at: www.dol.gov/ebsa. For a complete list of publications or to speak with a benefits advisor, call toll free:
1-866-444-EBSA (3272).
Or contact the agency electronically at www.askEBSA.dol.gov.

This material is available to sensory impaired individuals upon request:
Voice phone: (202) 693-8513
TDD: (202) 501-3911

This publication constitutes a small entity compliance guide for purposes of the Small Business Regulatory Enforcement Fairness Act of 1996.

Want to help your employees save for retirement but don't want the responsibility of an employee benefit plan? Think about a payroll deduction IRA program.

A payroll deduction individual retirement account (IRA) is an easy way for businesses to give employees an opportunity to save for retirement. The employer sets up the payroll deduction IRA program with a bank, insurance company or other financial institution, and then the employees choose whether and how much they want deducted from their paychecks and deposited into the IRA. Employees may also have a choice of investments depending on the IRA provider.

Many people not covered by an employer retirement plan could save through an IRA, but do not do so on their own. A payroll deduction IRA at work can simplify the process and encourage employees to get started.

Under federal law, individuals saving in a traditional IRA may be able to receive some tax advantages on the money they save, up to a certain amount, and the investments can grow tax-deferred. If the individual selects a Roth IRA, the employee's contributions are after-tax and the investments grow tax-free.

Advantages of a payroll deduction IRA:

- ❏ The payroll deduction IRA is a simple and direct way for employees to set up an IRA and save for their retirement.
- ❏ The employee makes all of the contributions. There are no employer contributions. By making regular payroll deductions, employees are able to contribute smaller amounts each pay period to their IRAs, rather than having to come up with a larger amount all at once.
- ❏ There is little administrative cost and no annual filings with the government.
- ❏ There is no requirement that an employer have a certain number of employees to set up a payroll deduction IRA.
- ❏ The program will not be considered an employer retirement plan subject to federal requirements for reporting and fiduciary responsibilities as long as the employer keeps its involvement to a minimum.
- ❏ Providing a payroll deduction IRA for employees may assist an employer to attract and retain quality employees.

This booklet provides a simplified overview of payroll deduction IRA programs and is not a legal interpretation.

ESTABLISHING

A payroll deduction IRA program is easy to set up and operate.

The employer sets up the payroll deduction IRA program with a financial institution, such as a bank, mutual fund or insurance company. The employee establishes either a traditional or a Roth IRA (based on the employee's eligibility and personal choice) with the financial institution and authorizes the payroll deductions. The employer withholds the payroll deduction amounts that the employee has authorized and promptly transmits the funds to the financial institution. After doing so, the employee and the financial institution are responsible for the amounts contributed.

As long as the employer keeps its involvement to a minimum, the program will not be treated as an employer retirement plan under federal law, and the employer will not be subject to the requirements for such plans, including annual filings with the government.

In setting up a program, the employer can limit the number of IRA providers to which it will remit contributions. The employer can designate as few as one IRA provider to receive contributions. However, it must disclose any limitations or costs associated with an employee's ability to transfer contributions to another IRA provider before the employee begins to participate in the program.

The employer needs to remain neutral with respect to the IRA provider. It cannot negotiate with an IRA provider to obtain special terms for its employees, exercise any influence over the investments made or permitted by the IRA provider, or receive any compensation in connection with the IRA program except reimbursement for the actual cost of forwarding the payroll deductions.

The employer can:

- ❏ Encourage its employees to save for retirement by providing general information on the payroll deduction IRA program and other educational materials that explain why it is important to save, including the advantages of contributing to an IRA.

- ❏ Answer employees' questions about the payroll deduction program and refer inquiries to the IRA provider; and

- ❏ Provide informational materials written by the IRA provider, as long as the materials do not suggest any endorsement by the employer.

However, the employer should make clear that its involvement in the program is limited to collecting employee contributions and sending them promptly to the IRA provider.

OPERATING

Generally, any employee who performs services for the business (or "employer") can be eligible to participate. The decision to participate is up to the employee and an IRA may not be appropriate for all individuals. The employees should understand that they have the same opportunity to contribute to an IRA outside the payroll deduction program and that the employer is not providing any additional benefit to employees who participate.

Each employee determines the amount they want deducted for contribution to their IRA. Participants are always 100% vested in (in other words, have ownership in) all of the funds in their IRAs.

Participant loans are not permitted. Withdrawals are permitted anytime, but they are subject to income taxes (except for certain distributions from nondeductible IRAs and Roth IRAs). If the employee is under age 59 ½, there may also be a 10% additional tax.

Employee's tax-deferred contributions are limited:

$4,000 in 2006 & 2007
$5,000 in 2008

Additional "catch-up" contributions are permitted for employees age 50 or over. This special catch-up amount is currently limited to $1,000 per year.

The employees control where their money is invested and they also bear the investment risk. The financial institution holding the IRA manages the funds. An employee may move the IRA assets from one IRA provider to another. The employee should be made aware that the employer does not guarantee or promise any rate of return. The employer is merely acting as a conduit.

The employer's costs for the program are low because the program is not subject to the government filings, administrative and fiduciary requirements imposed on employer retirement plans (such as 401(k) plans).

The employer may pay fees charged by the IRA provider for services in connection with establishing and operating the payroll deduction process. The employer may pay its own internal costs (such as bookkeeping and overhead) for setting up and operating the program. However, the employee must pay the fees related to setting up and maintaining the IRA itself.

TERMINATING

A payroll deduction IRA program can be terminated at any time. If the employer decides that a payroll deduction IRA program no longer suits its business needs, it simply notifies the payroll department. The employer also should notify its employees that the program is being terminated. The employer may need to notify the IRA provider(s) that it will no longer be making such deposits. No termination notice is required for the IRS. Although the employer's involvement will end, the employees can continue to save through their IRAs working directly with the IRA provider.

RESOURCES

The U.S. Department of Labor's (DOL's) Employee Benefits Security Administration and the IRS feature this booklet and other information on retirement plans on their web sites:

www.dol.gov/ebsa — Click on "Publications" or "Compliance Assistance for Small Employers" for information you and your employees can use.

www.irs.gov/ep — Click on "More Topics" in the "Retirement Plans Community Topics" section and then click on "Types of Plans."

Publications can be ordered by calling the appropriate agency's toll free number — for the IRS, **1-800-TAX-FORM (829-3676)** or for DOL, **1-866-444-EBSA (3272)**.

The following jointly developed publications are available on the IRS and DOL web sites and through the toll-free numbers:

- ❏ *Choosing a Retirement Solution for Your Small Business*, Publication 3998, provides an overview of retirement options available to small businesses.
- ❏ *Retirement Plan Correction Programs*, Publication 4224, provides a brief description of the IRS and DOL correction programs.
- ❏ *Retirement Plan Correction Programs CD-ROM*, Publication 4050, provides information on the IRS and DOL correction programs.
- ❏ *SEP Retirement Plans for Small Businesses*, Publication 4333, provides a brief description of this type of retirement plan.
- ❏ *SIMPLE IRA Plans for Small Businesses*, Publication 4334, provides a brief description of this type of retirement plan.
- ❏ *401(k) Plans for Small Businesses*, Publication 4222, provides information regarding the establishment and operation of a 401(k) plan.

Related materials available from the DOL

For employees:

- ❏ *Savings Fitness…A Guide to Your Money and Your Financial Future* (also in Spanish)
- ❏ *Taking the Mystery Out of Retirement Planning*
- ❏ *Top Ten Ways to Prepare for Retirement* (also in Spanish)
- ❏ *Women and Retirement Savings* (also in Spanish)

Related materials available from the IRS

- ❏ *Choosing a Retirement Plan for Employees of Tax Exempt and Government Entities*, Publication 4484.
- ❏ *Individual Retirement Arrangements (IRAs),* Publication 590
- ❏ *Lots of Benefits*, Publication 4118.
- ❏ *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, Publication 560.
- ❏ *The Retirement Plan Products Navigator,* Publication 4460.

Department of the Treasury
Internal Revenue Service

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