

The background of the page is a light beige color with a faint, repeating pattern of a spiral notebook and a pen. The notebook is open, showing a grid pattern on the pages, and the pen is resting on it. The overall aesthetic is clean and professional.

SEPs

Simplified Employee Pension Plan

Questions & Answers

What is a Simplified Employee Pension (SEP) plan?

A SEP is a retirement plan established by an employer. A one-person business is considered an employer for these purposes and may establish a SEP. An employer can use this SEP plan to make contributions to the IRAs of eligible employees, including himself or herself. A (SEP) is a written arrangement (a plan) that allows an employer to make deductible contributions for the benefit of participating employees. The contributions are made to traditional individual retirement arrangements (IRAs) set up for participants in the plan. Under a SEP, traditional IRAs must be set up for each qualifying employee. IRAs may have to be set up for leased employees, but they do not have to be set up for excludable employees. Traditional IRAs set up under a SEP plan are referred to as SEP-IRAs.

Who is eligible to establish a SEP?

Any employer, including a sole proprietor, partnership, or corporation, can establish a SEP. The corporation may either be a for-profit corporation or a nonprofit corporation. A governmental entity may also establish a SEP. When a self-employed individual sponsors a SEP, he or she is considered to be both the employer and an employee.

Why would an employer, including a one-person business, want to have a SEP?

There are five excellent reasons for establishing a SEP:

- ◆ The SEP contribution is deductible by the employer, and it is not included in the employee's income for the year.
- ◆ The SEP contributions are not subject to Federal withholding or Federal payroll taxes unless an individual is self-employed.
- ◆ Interest earned on the SEP deposit is sheltered from federal and most state income taxes until withdrawals are made at retirement.
- ◆ Due to the effects of compounding, the SEP funds can grow into a sizable nest egg for retirement.
- ◆ Administrative and legal costs are generally substantially less than would be incurred under a qualified retirement plan.

What employees must an employer cover under the SEP?

The employer must cover any individual who is a qualifying employee. Such an employee is one who:

- ◆ Has attained the age of 21 years;
- ◆ Has worked for the employer in at least three of the immediately preceding five years, and
- ◆ Received at least \$550 during the calendar year.

An employer may establish less strict eligibility requirements.

If an employer fails to cover a person who is eligible, then there is no SEP plan, and the favorable tax benefits will be lost.

The following employees need not be covered by a SEP:

- ◆ Employees covered by a union agreement and whose retirement benefits were bargained for in good faith by their union and the employer, and
- ◆ Nonresident alien employees who have no U.S. source of earned income from the employer.

If an employer “leases” employees, it should consult with its tax advisor, as special rules may apply.

Can a person who is age 70½ or older establish or contribute to a SEP-IRA after attaining age 70½?

Yes. A self-employed person who is over age 70½, but who still has net earnings from his or her business, is eligible to establish a SEP and make a SEP-IRA contribution. A business that sponsors a SEP-IRA plan is required to make a SEP-IRA contribution for each employee who has met the age and service requirement. This includes employees who are age 70½ or older. It would be unlawful discrimination for a business to fail to make a SEP-IRA contribution just because an employee had attained age 70½ or older.

What technical requirements must a plan meet to be a SEP?

A SEP requires a written plan document that meets the requirements of Internal Revenue Code section 408(k). This plan document requirement is normally met by using IRS Form 5305-SEP or an approved SEP prototype document. A SEP requires each participant to establish an approved IRA. Employer contributions to a SEP must be made under a definite written formula specifying the method for allocating contributions to each participant (a percent of compensation).

What is the cost to the employer?

The cost depends on the degree to which the employer makes contributions. SEPs have relatively few governmental reporting requirements, which makes a SEP less costly to administer.

Must the employer make a contribution each year?

The employer has total discretion whether or not to make a contribution each year under a SEP. The employer need not make any contribution.

How much will an employer save on its federal income taxes by making a SEP contribution?

Savings depends upon the employer's marginal income tax bracket. A corporation would list its deduction for SEP contributions on its corporate tax return. A self-employed person deducts contributions for himself or herself on Form 1040, and for employees on Schedule C or F.

May an employer be able to claim a credit for the creation of a SEP?

Yes. A tax credit for start-up costs will be allowed for small employers who are establishing a SEP. For this purpose, a small employer is defined as an employer who has no more than 100 employees who were paid compensation in excess of \$5,000 for the previous plan year. The amount of the credit will be 50% of the qualified cost paid or incurred in connection with the adoption and establishment of the SEP. The expense must be viewed as ordinary and necessary. The credit cannot exceed \$500 and may be taken at any time during the first three years that the plan is in existence. The credit is not available to one-person plans.

What amount can the employer deduct each year?

The maximum amount is 25% of the eligible employees' compensation paid to them during the year. Compensation for common-law employees is their income as shown on Form W-2. Compensation for a self-employed individual is defined to be his or her net earnings from self-employment as reduced by the deduction one is allowed for one-half of his or her self-employment tax and the deduction of contributions on his or her behalf to the plan. See IRS Publication 560 for a more detailed discussion.

How much can be contributed and deducted on my behalf for 2009?

For 2009, the SEP rules permit an employer to contribute up to 25% of each participating employee's compensation, or \$49,000, whichever is less, to the employee's SEP-IRA. These contributions are funded by the employer.

How much can be contributed and deducted on my behalf for 2010?

For 2010, the SEP rules permit an employer to contribute up to 25% of each participating employee's compensation, or \$49,000, whichever is less, to the employee's SEP-IRA. These contributions are funded by the employer.

What is meant by the term "Self-Employed Person's Rate Table"?

Because a self-employed person's deduction amount and his or her compensation are each dependent on the other, the adjustment to net earnings can be made indirectly by using an adjusted contribution rate as determined from the following chart:

Note: The rates in the table below apply only if the contribution rate is a whole number, and if the employer only has this one plan.

Self-Employed Person's Rate Table	
<u>Column A</u> If the Plan Contri- bution Rate is: (shown as a %)	<u>Column B</u> The Self-Employed Person's Rate is: (shown as a decimal)
1 .....	.009901
2 .....	.019606
3 .....	.029126
4 .....	.038482
5 .....	.047619
6 .....	.056604
7 .....	.065421
8 .....	.074074
9 .....	.082569
10 .....	.090909
11 .....	.099099
12 .....	.107143
13 .....	.115044
14 .....	.122807
15 .....	.130435
16 .....	.137931
17 .....	.145299
18 .....	.152542
19 .....	.159664
20 .....	.166667
21 .....	.173554
22 .....	.180328
23 .....	.186992
24 .....	.193548
25 .....	.200000

What are net earnings from self-employment?

For SEP purposes, your net earnings are your gross income from your business minus allowable deductions for that business. Allowable deductions include contributions to your employees' SEP-IRAs. You also take into account the deduction allowed for one-half of your self-employment tax, and the deduction for contributions to your own SEP-IRA.

Include the following items in your net earnings.

1. Foreign earned income and housing cost amounts.
2. If you are a partner, your distributive share of partnership income or loss (other than separately stated items such as capital gains and losses).

If you are a limited partner, guaranteed payments for services to or for the partnership.

4. Elective contributions or deferrals under any of the following plans.
 - a. 401(k) plans.
 - b. 403(b) plans (tax-sheltered annuities).
 - c. SEP plans (salary-reduction arrangements).
 - d. Savings incentive match plans for employees (SIMPLE plans).
 - e. Cafeteria plans.
 - f. 457 plans (plans of state and local governments and certain tax-exempt organizations).

Do not include the following items in your net earnings.

- ◆ Tax-free items (or deductions related to them).
- ◆ If you are a limited partner, distributions of income or loss.
- ◆ Income passed through a S corporation.

In addition to the tax-deduction limits, are there any limits on the amount an employer can contribute to one or more retirement plans on behalf of any one participant?

Yes. In general, an employer cannot contribute, on behalf of any participant, more than the lesser of 100% of compensation, or \$40,000, as indexed for cost-of-living changes. For 2009, the increased amount is \$49,000, and for 2010, the increased amount is also \$49,000.

Special tax rules will apply if the employer sponsors plans in addition to a SEP, such as a profit sharing, money purchase, or defined benefit plan.

What is the contribution deadline?

The employer's contribution deadline is the due date of that year's tax return, including any extensions. For many corpo-

rations, this is March 15. For most individuals, this is April 15. If there is an extension, it is permissible to make the contribution by September 15 or October 15, as applicable.

Can an employer prohibit distributions from an employee's SEP-IRA?

No. Also, an employer cannot condition its SEP contributions on the keeping of any part of them in the IRA.

When must a person start to withdraw the money from the SEP-IRA?

With certain exceptions, a person must begin distributions by the first day of April following the calendar year in which he or she attains age 70½, and December 31 of each year thereafter.

Can an employee make regular IRA contributions into a SEP-IRA?

The answer is generally "yes." However, the extent to which a deduction will be allowed for the contribution may be limited by participation in the SEP or any other qualified retirement plan. The employee should consult with his or her tax advisor to determine the amount of deductible and nondeductible contribution(s) available.

How will distributions be taxed?

Distributions will be taxed as ordinary income. If the participant is under age 59½, penalties may apply.

How do my employer's contributions affect my taxes?

Your employer's contributions to your SEP-IRA are excluded from your income rather than deducted from it. Your employer's contributions to your SEP-IRA should not be included in your wages on your Form W-2 unless there are contributions under a salary-reduction arrangement.

Unless there are excess contributions, you do not include any contributions in your gross income; nor do you deduct any of them.

What are excess contributions?

If your employer contributes more than is allowed, you must include the excess in your gross income, without any offsetting deduction.

How do I correct an excess contribution?

You should follow the instructions set forth in IRS Publication 590.

What happens to a SEP-IRA when the participant dies?

The funds in a SEP will be paid to a participant's beneficiaries. Depending on their relationship to the participant, they may have the potential to partially continue to shelter the funds from current taxation. The standard IRA distribution rules for beneficiaries will apply.

May a SEP be integrated with social security?

Yes. An integrated SEP will permit a somewhat higher contribution percentage to be given to the more highly compensated employees. Integration may be permissible with a SEP prototype, but it is not permissible under the IRS Model Form 5305-SEP.

Who is responsible to administer the SEP?

The sponsoring employer is responsible for the SEP's administration. The employer may well need to consult with its tax and legal advisor. A financial institution's general role is to serve as the depository and not as the plan administrator.

What is a Salary-Reduction SEP (SAR-SEP), and what advantages does it offer?

An employer is not permitted to establish a salary-reduction SEP after December 31, 1996. SAR-SEPs established before January 1, 1997, can continue to receive contributions under present rules, and new employees of the employer, hired after December 31, 1996, can participate in the SAR-SEP in accordance with the rules. You should review IRS Publications 560 and 590 for additional information.

How does an employer establish a SEP?

Just talk with any of our retirement account specialists. They will discuss the benefits of SEPs with you and explain our investment vehicles.

The information provided in this brochure is not intended to be legal or tax advice. You should consult your attorney or tax advisor for information that relates to your specific circumstances.