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Simplified Employer Pension (SEP) IRA

This newsletter provides you with information about SEP IRAs including several tax payer-friendly incentives for both individuals and businesses. SEP IRAs (Simplified Employer Pension Plan) are retirement plans that provide small business owners and self-employed individuals with a variety of benefits. This reference newsletter outlines some of the benefits and guidelines pertaining to this popular form of retirement plan.

What are SEP IRAs?

SEP IRAs (Simplified Employer Pension Plans) are retirement plans that provide small business owners and self-employed individuals with a variety of benefits. In addition to generally being 100% tax deductible, a SEP IRA allows a business to:

- Contribute up to 25% of compensation or $52,000 for 2014 ($53,000 for 2015), per employee.
- Contribution flexibility, as the percentage of contributions can vary each year from 0% to 25% of each employee's pay.
- Consolidate with other retirement plans, such as traditional IRAs, 401k, 403b, and rollover IRAs. (however, SEP IRAs cannot be combined with a Roth IRA or retirement accounts that have after-tax contributions).
- Grow interest tax-deferred. Similarly to other IRAs, you can withdraw from a SEP after age 59½ and must begin distributions at age 70½. Any withdrawals before age 59½. will result in a 10% IRS penalty, in addition to being taxed as ordinary income. Exceptions do apply, however, for some expenses, such as the purchase of home or medical bills.

Benefits to Businesses.

There are several benefits of establishing a SEP IRA for the small business owner:

- Marginal administrative costs.
- The business does not pay taxes on investment earnings.
- Tax credit of up to $500 per year for each of the first three years for the cost of starting a plan.
- Flexibility of contributions from year to year.
- Create positive employee relations.

Eligibility Requirements.

Many businesses qualify for establishing a SEP IRA: sole proprietors, partnerships, sub S corporations.

Additionally, all employees who are age 21 or older who earned $550 ($600 in 2015) or more income in the current year and have worked for the business in at least three of the past five years must be included in the SEP IRA plan.

A SEP IRA also allows the small business owner to cover the following employees, who may not be eligible for other plans:

- Employees covered by union contracts
- Employees who received less that $550 of income that year

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Establishing a SEP IRA.

There are three steps required to set up a SEP:

1. A written agreement. Approved SEP agreements include Form 5305-SEP, Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement, which can be accessed from the IRS website. Additional approved prototype SEPs are offered by financial institutions such as banks and insurance companies.

2. Eligible employees must be given information about the SEP. Information given includes the written agreement and its instructions. Information about the SEP IRA should include the following:

- The SEP administrator will give a copy of any amendments to the plan within 30 days of the date that it goes into effect.
- All employees who participate in the SEP plan will be given a report of employer contributions made by January 31st of the next year.

3. All eligible employees must be set up with a SEP-IRA account. As previously mentioned, this includes all employees who are age 21 or older who earned $550 or more income in the current year and have worked for the business in at least three of the past five years. The SEP IRA can be set up with a qualified institution, and is owned by the employee with contributions made on the employee's behalf by the employer.

Making SEP Contributions.

The employer can decide to contribute 0% to 25% of an employee's income into a plan fund. Additionally, the percentage level of contribution must be the same for the employer as for the employee. The SEP IRA allows the employee to receive a tax -free fringe benefit, which is a tax deductible contribution for the employer.

Tax Deductibility of SEP Contributions.

The most that can be deducted on the business' tax return for contributions to its employees' SEP-IRAs is the lesser of its contributions or 25% of compensation. Compensation for each employee of the business is limited to $260,000 for 2014 ($265,000 in 2015). However, a separate calculation must be made if the employee is self-employed. When calculating the maximum deduction for contributions to a self-employed individual's SEP-IRA, the compensation is net earnings from self-employment. This takes into account, the deduction of one-half of the individual's self-employment tax and the deduction for contributions to one's own SEP-IRA.

Deadlines to Establish and Fund a SEP IRA.

The employer must make deposited contributions for a year by the Federal income tax return deadline. If, however, the employer has extended its tax return, then it has until the end of that extension period to deposit the contribution, regardless of when it filed the tax return.

Sole proprietorship, partnership, LLC taxed as sole proprietorship: By the individual's personal tax filing deadline of April 15th.

C or S Corporation, or LLC taxed as a corporation: By the corporate tax filing deadline of March 15th.

Which Plan is Right for My Business?

For many employers the question is not "should I implement a retirement plan?" Rather, "Which plan is right for our business?"

Before deciding whether a SEP is right for you, consider all of the options available to business owners and the advantages of each type of plan. Please don't hesitate to call us if you would like to discuss your options further and determine what might best fit your needs.

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