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### SEP - SIMPLIFIED EMPLOYEE PENSION PLANS

By Victor Sy, CPA, MBA

Simplified Employee Pension Plans are easy to establish and easy to maintain. Unlike other plans that have to be set up by the end of the year or IRAs that have to be funded by **April 17**, SEPs can be set up and funded **after April 17**. It's an excellent planning tool. You can determine the level of funding **after** the end of the year. This can be as **late as September 17** for corporations or **October 15** for sole proprietorships.

1. SEPs are available to **small businesses**, courtesy of Internal Revenue Code Section 408(k).
2. Contributions are **deducted by employer** (good) but are **not reported by employee** (very good).
3. A SEP is actually an IRA or **group of IRAs** for eligible participants. Employer contributes directly to IRAs on behalf of employees.
4. SEPs are written plans that are **100% funded by an employer**.
5. SEPs are **simple to establish**. Just fill out Form 5305 SEP and keep it for your files. You don't even have to send this form or any other annual report to the IRS.
6. You can set up and fund a SEP **after April 15**. You can wait until next year to decide on funding level.
7. Contributions are **voluntary** and can vary from zero to maximum depending on annual profitability.
8. You may **contribute** a flat amount for all or choose a percentage of compensation:
  - A. 25% of wages for employees (maximum of **\$49,000 for 2011**),
  - B. 20% of self-employment income for employers (used to be 13.0435%).
9. The following are **eligible**: 21 or older, **\$550** earnings during the year, worked during at least three of the last five years. All eligible employees must be covered, including part-timers who earn **\$500** during the year. Independent contractors are not eligible. They have to set up their own plans.
10. There is **immediate vesting @ 100%** (without the usual one to three-year wait). An employee can immediately resign without losing a dime because there are no vesting period requirements. Bad.
11. Employer is **not** under obligation to continue and may terminate the plan any time.
12. **Deduct** contributions for employees in Schedule C for Sole proprietors in page one of your personal income tax 1040. Spouse with self-employment income from Schedule C or wages is eligible.
13. **Distributions** are taxed the same way as IRAs.
14. Corporate **shareholder-employee** is considered an employee.
15. You may **continue to contribute** to your personal IRA if you are under phase-out limits.
16. You may contribute **even after 70 ½** (personal IRA must stop by 70 ½).
17. There's a tax credit of \$500 for each of the first three years for establishing/administering a plan.
18. There is no need to open a business bank account because benefits **immediately vest to participant**.
19. Merely open a **SEP-IRA bank account for each participant**.
20. SARSEPs (Salary Reduction SEPs) can no longer be established.

**Bottom Line:** This is a **first option** for a small business. Evaluate the wisdom of establishing a SEP before considering more sophisticated, expensive, and cumbersome retirement plans.