

SEP IRAs

Simplified Employee Plan (SEP) IRAs are tax-advantaged accounts and one way for business owners to set aside funds for retirement for themselves as well as for their employees. Contributions are made with pre-tax dollars by the owner/company, earnings grow tax-deferred, and distributions are taxable.

SEP IRAs have much lower administrative costs than a traditional qualified plan, but they also require employer contributions be made in employees' accounts under certain circumstances. Employees do not contribute to these plans.

FEATURES

CONTRIBUTION LIMITS

For 2015, contributions to a SEP IRA cannot exceed the lesser of 25% of the employee's compensation (up to \$265,000) or \$53,000. Compensation generally does not include contributions. The SEP IRA plan document will specify how the employer contribution is determined and then how it will be allocated to each participant.

When determining the contribution amount for any given year, contributions to all defined contribution plans must be added together and must not exceed the above limits.

ELIGIBLE EMPLOYEES

If the self-employed person does have employees, all employees must receive the same benefits under the SEP IRA plan.

The employer is able to choose the conditions for employee eligibility but they cannot be more restrictive than the following:

- 1) be at least 21 years of age
- 2) has worked for the employer for at least three of the previous five years, and
- 3) received at least \$550 in compensation for the tax year

Employers must set up SEP IRAs for all eligible employees. Contributions do not have to be made every year, however, for years in which they are, they must be made in accordance with a written allocation formula and cannot discriminate in favor of highly compensated employees.

CONTRIBUTION DEADLINE

Contributions to a SEP IRA can be made any time during the year or up to the tax filing deadline for that year, including extensions. Contributions that exceed the contribution limit and are not withdrawn by the tax return due date for that year are considered excess contributions. Excess contributions are

included in the employee's income for the year and are treated as an employee contribution to his or her SEP IRA. These are subject to a 6% "excess contribution" tax for the employee.

CONTRIBUTION DEDUCTIBILITY

When deducting contributions to eligible employees' SEP IRAs, these are tax deductible up to a maximum of 25% of the compensation (limited to \$265,000 per participant) paid to the participants, but not to exceed \$53,000 per participant.

When calculating the deduction for contributions made to an employer's own SEP IRA, compensation is the net earnings from self employment. This takes into account both of the following deductions:

- The deduction for one-half the self-employment tax.
- The deduction for contributions to an employer's own SEP IRA.

DISTRIBUTIONS

SEP IRA distributions are the same as normal IRA distribution rules, which are subject to income taxes for any pre-tax contributions and earnings. Individuals can withdraw funds from an IRA at any time, but those under age 59 ½ will incur a 10% penalty in addition to income taxes in the year the distribution is made. There are exceptions to the 10% early withdrawal penalty and these include death, total disability, SEPP (discussed below), or a distribution that meets certain requirements in purchasing a first home.

REQUIRED MINIMUM DISTRIBUTIONS (RMD)

To ensure that IRAs are used for retirement income and not for estate planning purposes, IRA holders must begin making withdrawals by April 1st of the year after reaching age 70½ (the required beginning date). The minimum amount that must be withdrawn (RMD) is calculated by dividing the account balance on December 31st of the year preceding the distribution by the IRA owner's life expectancy as found in IRS Publication 590. Failure to withdraw the RMD before December 31st results in 50% excise tax on the amount not distributed as required.

SUBSTANTIALLY EQUAL PERIODIC PAYMENTS (SEPP)

Substantially equal periodic payments (SEPP) are one of the exceptions in the United States IRS Code that allows individuals under age 59 ½ to start receiving payments without incurring a 10% early distribution penalty. The individual must be at least 55 to take SEPP and the rules for SEPPs are set out in IRS code section 72(t). It allows for three specific methods of calculating the allowed withdrawal amounts and SEPP payments must continue for the longer of five years or until the account owner reaches age 59 ½.

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