



Simplified Employee Pension Plans
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We consider simplified employee pension plans as an option for taxpayers. A unique quirk of SEPs vs. traditional qualified plans is that they can be established after the end of the year in question. A traditional plan must be adopted by year end, even though it does not need to be funded until the extended due date of the sponsor's tax return.

So for clients who come in now and decide they'd like to establish a plan, a SEP represents the one option available.

As well, for some clients a SEP, while not terribly flexible, may still be a perfect fit—and one that is less expensive to implement and run on an ongoing basis. However, it's still important that the plan be properly operated and implemented, and the very fact that these plans are sold as being "simple" and "cheap" means that many operational problems exist, and tax professionals who aren't normally plan specialists may be exposed as the person the client will claim he/she "relied upon" to warn him/her about problems if the IRS or Department of Labor comes calling—so all tax professionals need to be aware of how SEPs operate.

Section 408(k) and (l)

IRC, 2005-CODE-VOL, **SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.**

SEC. 408. INDIVIDUAL RETIREMENT ACCOUNTS.

408(k) SIMPLIFIED EMPLOYEE PENSION DEFINED. —

408(k)(1) IN GENERAL. —For purposes of this title, the term “simplified employee pension” means an individual retirement account or individual retirement annuity —

408(k)(1)(A) with respect to which the requirements of paragraphs (2), (3), (4), and (5) of this subsection are met, and

408(k)(1)(B) if such account or annuity is part of a top-heavy plan (as defined in [section 416](#)), with respect to which the requirements of [section 416\(c\)\(2\)](#) are met.

408(k)(2) PARTICIPATION REQUIREMENTS. —This paragraph is satisfied with respect to a simplified employee pension for a year only if for such year the employer contributes to the simplified employee pension of each employee who —

408(k)(2)(A) has attained age 21,

408(k)(2)(B) has performed service for the employer during at least 3 of the immediately preceding 5 years, and

408(k)(2)(C) received at least \$450 in compensation (within the meaning of [section 414\(q\)\(4\)](#)) from the employer for the year.

For purposes of this paragraph, there shall be excluded from consideration employees described in subparagraph (A) or (C) of [section 410\(b\)\(3\)](#). For purposes of any arrangement described in subsection (k)(6), any employee who is eligible to have employer contributions made on the employee's behalf under such arrangement shall be treated as if such a contribution was made.

408(k)(3) CONTRIBUTIONS MAY NOT DISCRIMINATE IN FAVOR OF THE HIGHLY COMPENSATED, ETC.
—

408(k)(3)(A) IN GENERAL. —The requirements of this paragraph are met with respect to a simplified employee pension for a year if for such year the contributions made by the employer to simplified employee pensions for his employees do not discriminate in favor of any highly compensated employee (within the meaning of [section 414\(q\)](#)).

408(k)(3)(B) SPECIAL RULES. —For purposes of subparagraph (A), there shall be excluded from consideration employees described in subparagraph (A) or (C) of [section 410\(b\)\(3\)](#).

408(k)(3)(C) CONTRIBUTIONS MUST BEAR UNIFORM RELATIONSHIP TO TOTAL COMPENSATION. —For purposes of subparagraph (A), and except as provided in subparagraph (D), employer contributions, to simplified employee pensions (other than contributions under an arrangement described in paragraph (6)) shall be considered discriminatory unless contributions thereto bear a uniform relationship to the compensation (not in excess of the first \$200,000) of each employee maintaining a simplified employee pension.

408(k)(3)(D) PERMITTED DISPARITY. —For purposes of subparagraph (C), the rules of [section 401\(l\)\(2\)](#) shall apply to contributions to simplified employee pensions (other than contributions under an arrangement described in paragraph (6)).

408(k)(4) WITHDRAWALS MUST BE PERMITTED. —A simplified employee pension meets the requirements of this paragraph only if —

408(k)(4)(A) employer contributions thereto are not conditioned on the retention in such pension of any portion of the amount contributed, and

408(k)(4)(B) there is no prohibition imposed by the employer on withdrawals from the simplified employee pension.

408(k)(5) CONTRIBUTIONS MUST BE MADE UNDER WRITTEN ALLOCATION FORMULA. —The requirements of this paragraph are met with respect to a simplified employee pension only if employer contributions to such pension are determined under a definite written allocation formula which specifies —

408(k)(5)(A) the requirements which an employee must satisfy to share in an allocation, and

408(k)(5)(B) the manner in which the amount allocated is computed.

408(k)(6) EMPLOYEE MAY ELECT SALARY REDUCTION ARRANGEMENT. —

408(k)(6)(A) ARRANGEMENTS WHICH QUALIFY. —

408(k)(6)(A)(i) IN GENERAL. —A simplified employee pension shall not fail to meet the requirements of this subsection for a year merely because, under the terms of the pension, an employee may elect to have the employer make

payments —

408(k)(6)(A)(i)(I) as elective employer contributions to the simplified employee pension on behalf of the employee, or

408(k)(6)(A)(i)(II) to the employee directly in cash.

408(k)(6)(A)(ii) 50 PERCENT OF ELIGIBLE EMPLOYEES MUST ELECT. —Clause (i) shall not apply to a simplified employee pension unless an election described in clause (i)(I) is made or is in effect with respect to not less than 50 percent of the employees of the employer eligible to participate.

408(k)(6)(A)(iii) REQUIREMENTS RELATING TO DEFERRAL PERCENTAGE. —Clause (i) shall not apply to a simplified employee pension for any year unless the deferral percentage for such year of each highly compensated employee eligible to participate is not more than the product of —

408(k)(6)(A)(iii)(I) the average of the deferral percentages for such year of all employees (other than highly compensated employees) eligible to participate, multiplied by

408(k)(6)(A)(iii)(II) 1.25.

408(k)(6)(A)(iv) LIMITATIONS ON ELECTIVE DEFERRALS. —Clause (i) shall not apply to a simplified employee pension unless the requirements of [section 401\(a\)\(30\)](#) are met.

408(k)(6)(B) EXCEPTION WHERE MORE THAN 25 EMPLOYEES. —This paragraph shall not apply with respect to any year in the case of a simplified employee pension maintained by an employer with more than 25 employees who were eligible to participate (or would have been required to be eligible to participate if a pension was maintained) at any time during the preceding year.

408(k)(6)(C) DISTRIBUTIONS OF EXCESS CONTRIBUTIONS. —

408(k)(6)(C)(i) IN GENERAL. —Rules similar to the rules of [section 401\(k\)\(8\)](#) shall apply to any excess contribution under this paragraph. Any excess contribution under a simplified employee pension shall be treated as an excess contribution for purposes of [section 4979](#).

408(k)(6)(C)(ii) EXCESS CONTRIBUTION. —For purposes of clause (i), the term “excess contributions” means, with respect to a highly compensated employee, the excess of elective employer contributions under this paragraph over the

maximum amount of such contributions allowable under subparagraph (A)(iii).

408(k)(6)(D) DEFERRAL PERCENTAGE. —For purposes of this paragraph, the deferral percentage for an employee for a year shall be the ratio of —

408(k)(6)(D)(i) the amount of elective employer contributions actually paid over to the simplified employee pension on behalf of the employee for the year, to

408(k)(6)(D)(ii) the employee's compensation (not in excess of the first \$200,000) for the year.

408(k)(6)(E) EXCEPTION FOR STATE AND LOCAL AND TAX-EXEMPT PENSIONS. —This paragraph shall not apply to a simplified employee pension maintained by —

408(k)(6)(E)(i) a State or local government or political subdivision thereof, or any agency or instrumentality thereof, or

408(k)(6)(E)(ii) an organization exempt from tax under this title.

408(k)(6)(F) EXCEPTION WHERE PENSION DOES NOT MEET REQUIREMENTS NECESSARY TO INSURE DISTRIBUTION OF EXCESS CONTRIBUTIONS. —This paragraph shall not apply with respect to any year for which the simplified employee pension does not meet such requirements as the Secretary may prescribe as are necessary to insure that excess contributions are distributed in accordance with subparagraph (C), including —

408(k)(6)(F)(i) reporting requirements, and

408(k)(6)(F)(ii) requirements which, notwithstanding paragraph (4), provide that contributions (and any income allocable thereto) may not be withdrawn from a simplified employee pension until a determination has been made that the requirements of subparagraph (A)(iii) have been met with respect to such contributions.

408(k)(6)(G) HIGHLY COMPENSATED EMPLOYEE. —For purposes of this paragraph, the term “highly compensated employee” has the meaning given such term by [section 414\(q\)](#).

408(k)(6)(H) TERMINATION. —This paragraph shall not apply to years beginning after December 31, 1996. The preceding sentence shall not apply to a simplified employee pension of an employer if the terms of simplified employee pensions of such employer, as in effect on December 31, 1996, provide that an employee may make the election described in subparagraph (A).

408(k)(7) DEFINITIONS. —For purposes of this subsection and subsection (l) —

408(k)(7)(A) EMPLOYEE, EMPLOYER, OR OWNER-EMPLOYEE. —The terms “employee”, “employer”, and “owner-employee” shall have the respective meanings given such terms by [section 401\(c\)](#).

408(k)(7)(B) COMPENSATION. —Except as provided in paragraph (2)(C), the term “compensation” has the meaning given such term by [section 414\(s\)](#).

408(k)(7)(C) YEAR. —The term “year” means —

408(k)(7)(C)(i) the calendar year, or

408(k)(7)(C)(ii) if the employer elects, subject to such terms and conditions as the Secretary may prescribe, to maintain the simplified employee pension on the basis of the employer's taxable year.

408(k)(8) COST-OF-LIVING ADJUSTMENT. —The Secretary shall adjust the \$450 amount in paragraph (2)(C) at the same time and in the same manner as under [section 415\(d\)](#) and shall adjust the \$200,000 amount in paragraphs (3)(C) and (6)(D)(ii) at the same time, and by the same amount, as any adjustment under [section 401\(a\)\(17\)\(B\)](#); except that any increase in the \$450 amount which is not a multiple of \$50 shall be rounded to the next lowest multiple of \$50.

408(k)(9) CROSS REFERENCE. —

For excise tax on certain excess contributions, see [section 4979](#).

408(l) SIMPLIFIED EMPLOYER REPORTS. —

408(l)(1) IN GENERAL. —An employer who makes a contribution on behalf of an employee to a simplified employee pension shall provide such simplified reports with respect to such contributions as the Secretary may require by regulations. The reports required by this subsection shall be filed at such time and in such manner, and information with respect to such contributions shall be furnished to the employee at such time and in such manner, as may be required by regulations.

408(l)(2) SIMPLE RETIREMENT ACCOUNTS. —

408(l)(2)(A) NO EMPLOYER REPORTS. —Except as provided in this paragraph, no report shall be required under this section by an employer maintaining a qualified salary reduction arrangement under subsection (p).

408(l)(2)(B) SUMMARY DESCRIPTION. —The trustee of any simple retirement account established pursuant to a qualified salary reduction arrangement under subsection (p) and the issuer of an annuity established under such an arrangement shall provide to the employer maintaining the arrangement, each year a description containing the following information:

408(l)(2)(B)(i) The name and address of the employer and the trustee or issuer.

408(l)(2)(B)(ii) The requirements for eligibility for participation.

408(l)(2)(B)(iii) The benefits provided with respect to the arrangement.

408(l)(2)(B)(iv) The time and method of making elections with respect to the arrangement.

408(l)(2)(B)(v) The procedures for, and effects of, withdrawals (including rollovers) from the arrangement.

408(l)(2)(C) EMPLOYEE NOTIFICATION. —The employer shall notify each employee immediately before the period for which an election described in subsection (p)(5)(C) may be made of the employee's opportunity to make such election. Such notice shall include a copy of the description described in subparagraph (B).

Section 402(h)

IRC, 2005-CODE-VOL, SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

SEC. 402. TAXABILITY OF BENEFICIARY OF EMPLOYEES' TRUST.

402(h) SPECIAL RULES FOR SIMPLIFIED EMPLOYEE PENSIONS. —For purposes of this chapter —

402(h)(1) IN GENERAL. —Except as provided in paragraph (2), contributions made by an employer on behalf of an employee to an individual retirement plan pursuant to a simplified employee pension (as defined in [section 408\(k\)](#)) —

402(h)(1)(A) shall not be treated as distributed or made available to the employee or as contributions made by the employee, and

402(h)(1)(B) if such contributions are made pursuant to an arrangement under [section 408\(k\)\(6\)](#) under which an employee may elect to have the employer make contributions to the simplified employer pension on behalf of the employee, shall not be treated as distributed or made available or as contributions made by the employee merely because the simplified employee pension includes provisions for such election.

402(h)(2) LIMITATIONS ON EMPLOYER CONTRIBUTIONS. —Contributions made by an employer to a simplified employee pension with respect to an employee for any year shall be treated as distributed or made available to such employee and as contributions made by the employee to the extent such contributions exceed the lesser of —

402(h)(2)(A) 25 percent of the compensation (within the meaning of [section 414\(s\)](#)) from such employer includible in the employee's gross income for the year (determined without regard to the employer contributions to the simplified employee pension), or

402(h)(2)(B) the limitation in effect under [section 415\(c\)\(1\)\(A\)](#), reduced in the case of any highly compensated employee (within the meaning of [section 414\(q\)](#)) by the amount taken into account with respect to such employee under [section 408\(k\)\(3\)\(D\)](#).

402(h)(3) DISTRIBUTIONS. —Any amount paid or distributed out of an individual retirement plan pursuant to a simplified employee pension shall be included in gross income by the payee or distributee, as the case may be, in accordance with the provisions of [section 408\(d\)](#).

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Section 404(h)

SEC. 404. DEDUCTION FOR CONTRIBUTIONS OF AN EMPLOYER TO AN EMPLOYEES' TRUST OR ANNUITY PLAN AND COMPENSATION UNDER A DEFERRED-PAYMENT PLAN.

404(h) SPECIAL RULES FOR SIMPLIFIED EMPLOYEE PENSIONS. —

404(h)(1) IN GENERAL. —Employer contributions to a simplified employee pension shall be treated as if they are made to a plan subject to the requirements of this section. Employer contributions to a simplified employee pension are subject to the following limitations:

404(h)(1)(A) Contributions made for a year are deductible —

404(h)(1)(A)(i) in the case of a simplified employee pension maintained on a calendar year basis, for the taxable year with or within which the calendar year ends, or

404(h)(1)(A)(ii) in the case of a simplified employee pension which is maintained on the basis of the taxable year of the employer, for such taxable year.

404(h)(1)(B) Contributions shall be treated for purposes of this subsection as if they were made for a taxable year if such contributions are made on account of such taxable year and are made not later than the time prescribed by law for filing the return for such taxable year (including extensions thereof).

404(h)(1)(C) The amount deductible in a taxable year for a simplified employee pension shall not exceed 25 percent of the compensation paid to the employees during the calendar year ending with or within the taxable year (or during the taxable year in the case of a taxable year described in subparagraph (A)(ii)). The excess of the amount contributed over the amount deductible for a taxable year shall be deductible in the succeeding taxable years in order of time, subject to the 25 percent limit of the preceding sentence.

404(h)(2) EFFECT ON CERTAIN TRUSTS. —For any taxable year for which the employer has a deduction under paragraph (1), the otherwise applicable limitations in subsection (a)(3)(A) shall be reduced by the amount of the allowable deductions under paragraph (1) with respect to participants in the trust subject to subsection (a)(3)(A).

404(h)(3) COORDINATION WITH SUBSECTION (a)(7). —For purposes of subsection (a)(7), a simplified employee pension shall be treated as if it were a separate stock bonus or profit-sharing trust.

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