



Employer's Guide

# **Simplified Employee Pension (SEP) Plans**

*SEP plans were created to allow self-employed persons, sole proprietorships, partnerships, small businesses, small employee groups, and corporations to provide retirement plans via an easily established and maintained retirement program. Qualified retirement programs have extensive record-keeping and reporting requirements. The administrative costs of these plans are often more than small businesses can afford. SEP plans meet the needs of small employers with few employees and limited resources because they are easy to administer and are relatively inexpensive to establish and maintain.*

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## What is a SEP plan?

A SEP plan gives employers an alternative to establishing a complex retirement plan. Through a SEP plan, an employer makes SEP contributions to the traditional individual retirement accounts (IRAs) of each eligible employee, subject to certain limits set by law. The SEP contributions can be bigger than regular IRA contributions. Once a SEP contribution has been made, the employer has no further responsibility for managing the funds. Each employee directs the investment of the funds within his or her own IRA, and management of the funds is the responsibility of the financial institution that maintains the IRA.

## What are the advantages of a SEP plan for you as an employer?

- A SEP plan can help you and your employees save for retirement. Up to 25% of the first \$210,000\* of the compensation you pay each employee (including yourself) can be contributed to a SEP plan each year, up to a maximum of \$42,000.\*
- Your SEP plan contributions are tax-deductible, and contributions you make for employees are a business expense that reduces your net profits. The deadline for establishing and making contributions to a SEP plan is the employer's tax return deadline for the year for which the contributions are being made. This lets you determine the profits for the year before you decide the amount you are going to contribute.

\* *This is the limit for a plan year beginning in 2005. This limit is adjusted annually for inflation.*

- SEP plans give you the flexibility to change the contribution rate; you can increase contributions in some years and decrease contributions in other years. You can even choose not to make a SEP plan contribution for a particular year.
- Unlike most retirement plans, SEP plans do not require you to file any additional reports with the government.
- Even if you are employed and covered by a retirement plan at work, you can establish a SEP plan and make SEP plan contributions based on any self-employment income that you have.
- SEP plans have lower administrative costs when compared to other retirement plans, since an outside administrator is not required.
- SEP plans help you attract and retain a quality work force.

## What are the advantages of a SEP plan for your employees?

- SEP plans offer your employees immediate vesting. The SEP contributions you make to your employees' IRAs belong to them, even if they leave your employment.
- The IRAs that are funded by SEP contributions are portable. An employee can move his or her IRA to any other financial institutions that offer IRAs.
- SEP plan contributions are invested in accordance with the employees' instructions. Employees can choose from the investments offered by the financial institutions that administer their IRAs.

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- SEP plan contributions can be made until the employee retires, regardless of age.
  - SEP plan contributions made by an employer are not included in the employee's income for tax purposes, and employees pay no taxes on the amounts in their SEP accounts until the funds are withdrawn.

## How can you establish a SEP plan?

Your credit union has made it easy for you to establish a SEP plan using the Credit Union SEP Contribution Agreement. This is an IRS-approved prototype SEP plan agreement that allows an employer with any number of employees to sponsor a SEP plan. However, if you have ever maintained a defined benefit retirement plan that has been terminated, you cannot sponsor a SEP plan under this agreement.

Unlike other agreements, the Credit Union SEP Contribution Agreement offers an employer greater flexibility when establishing a SEP plan.

## What are the steps to establishing a SEP plan?

**1** *Determine the SEP plan option that best meets your needs.*

You can choose either the Pro Rata or the Social Security Integration option. Under the Pro Rata option, each eligible employee receives SEP contributions that equal the same percentage of the employee's compensation.

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The Social Security Integration option enables higher-paid employees to receive a greater share of the SEP contributions. Integrated plans use two contribution rates: one contribution rate for compensation at or below the integration level, and a higher contribution rate for compensation above the integration level. You set the integration level as a percentage of the Social Security taxable wage base.

## 2 *Set eligibility requirements for the plan.*

Generally, any employee who receives compensation from an employer must be included in the SEP plan. However, as an employer, you have flexibility and can exclude from the SEP plan employees who:

- Have not worked for the employer during three out of the preceding five years.
- Earn less than \$450.\*
- Have not reached age 21 during the calendar year for which contributions are made.

The following employees must be excluded from a SEP plan maintained under the Credit Union SEP Contribution Agreement: (a) nonresident aliens who receive no earned income from the employer that constitutes income from sources within the United States, and (b) employees included in a unit of employees covered by a collective bargaining agreement, if retirement benefits were the subject of good faith bargaining. Either or both of these groups can be included if the IRS 5305-SEP Contribution Agreement is used.

\* *This is the limit for a plan year beginning in 2005. This limit is adjusted annually for inflation.*

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For example, you can choose to include employees who are under age 21 or employees who have earned less than \$450.\* Likewise, you can include employees who have worked for the company in only one or two of the last five years, or waive this requirement altogether. However you cannot be more restrictive. For example, you cannot exclude employees who earn more than \$450,\* provided the employees meet all of the other eligibility requirements.

### **3** *Determine the plan year.*

You can establish a SEP plan on the basis of a calendar year or your company's fiscal year.

### **4** *Determine the contribution rate.*

SEP plans allow you, as an employer, flexibility in setting the contribution rate, changing the rate, and determining whether to make a contribution for a particular plan year.

### **5** *Ask employees to set up a traditional IRA at your credit union to receive your SEP contributions.*

If you have eligible employees, ask your eligible employees to set up traditional IRAs to receive the SEP contributions you make on their behalf. Please note that SEP contributions cannot be made directly to a Roth IRA.

### **6** *Calculate each eligible employee's SEP contributions for the year.*

Deliver or mail the SEP contributions to the credit union where the employee maintains his or her traditional IRA. Remember that you can change the contribution rate from year to year, or not make a contribution in a particular year, if you so choose.

## 7 *Provide required disclosures.*

The IRS requires that each eligible employee receive a copy of the SEP contribution agreement and disclosure statement, along with information on available investment options. You must also notify each eligible employee of the amount of his or her SEP contribution each year.

## 8 *Once established, you can make changes to your SEP plan as your business needs change.*

You only need to change the contribution agreement for a Pro Rata SEP plan if you want to change the eligibility requirements. You need to adopt a new contribution agreement each year if you use a Social Security Integration SEP plan.

*Not intended as tax advice. Please consult a tax professional.*

### **Need more information?**

Your credit union has all of the forms, agreements, and disclosures necessary to establish a SEP plan. However, whether or not a SEP plan is appropriate for your business will depend on a number of factors. You may want to discuss the appropriateness of a SEP plan and the best plan option for your business with your tax advisor prior to establishing a plan.



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