THE SIMPLIFIED EMPLOYEE PENSION (SEP)

Updated for 2020

SEP stands for Simplified Employee Pension.
Any employer may adopt a SEP, including self-employed individuals --- and the plan can be adopted as late as the employer's due date for filing its tax return (including extensions), and made retroactive to the beginning of its tax year.

- **Eligibility** – The plan *must* cover employees who meet all the following requirements:

  1) The employee performed service for you in at least 3 of the immediately preceding 5 years;
  2) The employee is 21 or older by the last day of the contribution year (employer may choose a lower age); and
  3) The employee made at least $600 (indexed for the contribution year).

  More *liberal* eligibility requirements *may* be adopted. Union employees and non-resident aliens may be excluded. The plan MUST cover employees of all related employers and leased employees.

- **Plan Year** --- can be either a calendar year or the employer's tax year.

- **Vesting** --- All contributions are 100% vested at all times.

- **Investment Vehicle** --- All deposits must go into an IRA.

- **Investment Responsibility** --- Once the money goes into the IRA, the employee must decide how it is to be invested.

- **In-Service Withdrawals** --- the employee has total control over his IRA account. If he is willing to pay the taxes (and 10% penalty for using retirement funds prior to age 59 ½) he can withdraw money from the IRA at any time, even if he is still an employee of the company making the contributions.

- **Testing** --- Contributions must not discriminate in favor of HCEs.

- **Compensation Cap** --- For all plan purposes, annual pay in excess of $285,000 for 2020 ($280,000 for 2019) must be ignored.

- **Employer contributions** --- Discretionary, but must be a uniform percentage of pay for all participants, or can be integrated with Social Security. Contributions are deductible for the fiscal taxable year that includes the last day of the calendar plan year.

- **Allocation method** --- Often allocated pro rata pay. However, the allocation can use "permitted disparity" (also called integration with Social Security) resulting in an allocation that gives a little higher percent to the highest paid participants than to all others. Contributions must be allocated to any participants who are eligible during the year.

- **Maximum Annual Contributions** --- The lesser of

  1) \$57,000 for 2020 (\$56,000 for 2019) or
  2) 25% of the participant's pay, ignoring pay in excess of the Compensation Cap (as indexed).

  The \$57,000 limit in (1) is adjusted if the formula is integrated.

- **Top-heavy minimum contribution** --- If over 60% of the plan assets are attributed to key employees, then any annual contribution to the non-key employees must be at least equal to the lesser of:
  1) 3% of pay, or
  2) the highest percent of pay allocated to any key employee for the year.

- **Employee Contributions** --- None permitted, for SEPs established after 1996.

- **Control Group Rules** --- When determining who is eligible for the SEP, must include all employees of all related employers.

- **Form 5500 Filing** --- Not applicable.

- **Advantages**
  a) Very basic documents (IRS provides a model Form 5305-SEP that can be used).
  b) No annual government filings.
  c) Can require more eligibility service than in some qualified plans.
  d) Minimal cost.
  e) No testing.
  f) Funds can be rolled over to any other IRA.
  g) You may maintain both a SEP and another plan.
  h) Self-employed individuals may set up a SEP even if they also participate in another employer's retirement plan at a second job.
  i) Plan can be established after fiscal year-end.

- **Disadvantages**
  a) Less flexibility than with some plans.
  b) Must fully vest all contributions.
  c) Employee can withdraw funds even before he terminates employment.
  d) Employee contributions are not allowed.
  e) No loan features.
  f) Must cover all employees of all related employers.