THE Pension Digest

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Rev. Proc. 97-9 — IRS Issues Model SIMPLE Amendment for 401(k) Plans

The IRS has recently issued a two-page model amendment to assist employers so they can adopt a 401(k) plan that contains SIMPLE-401(k) provisions. An employer who adopts the model amendment will not need to file with the IRS or pay any filing fee. The IRS will not issue a new letter. The sponsoring financial institution, however, will be required to file Form 8837, Notice of Adoption of Revenue Procedure Model Amendments to inform the IRS that it has chosen to amend its prototypes by adopting the model amendment.

If your financial institution sponsors a 401(k) prototype, by adopting this model amendment, you will be able to give certain business customers of yours, who currently sponsor a 401(k) plan, a way to convert their existing plan into a SIMPLE-401(k) plan or to sponsor a new SIMPLE-401(k) plan. CWF will be making this model amendment available to those banks which have adopted its 401(k) prototypes. CWF will be sending out an information letter within the next 20 days.

There will be some employers who will wish to have a SIMPLE-401(k) plan rather than a 401(k) plan or a SIMPLE-IRA plan. Other employers will wish to have a 401(k) plan or a SIMPLE-IRA plan. An employer will need to understand the attributes of each plan and then make its decision.

What Makes a 401(k) Plan Special?

A 401(k) plan that includes SIMPLE-401(k) provisions is not required to satisfy the ADP (actual deferral percentage) and ACP (actual contribution percentage) tests otherwise applicable to a 401(k) plan or a plan with matching contributions. In addition, a plan that contains SIMPLE-401(k) provisions is treated as not being top heavy.

The IRS makes it very clear that this model amendment does not apply to a SIMPLE-IRA plan.

This model amendment may only be adopted by employers that employed 200 or fewer employees earning at least $5,000 in compensation for the preceding year. And such employer cannot sponsor another plan which covers any employee which is eligible to participate in the SIMPLE-401(k) plan.

An employer maintaining a 401(k) plan on a fiscal-year basis must first convert or amend its plan to have a calendar-year plan year before it can adopt the model amendment. The plan year of a 401(k) plan containing the SIMPLE-401(k) provisions must be the calendar year.

The SIMPLE-401(k) model amendment will supersede any plan provisions that are inconsistent with the provisions of the model amendment. For example, if the 401(k) plan would contain a provision which would limit the salary-reduction contributions to a percentage that results in an amount less than $6,000, then this provision would be overridden by the model amendment which permits salary reduction contributions of $6,000.

Rule — If a New Plan

An employer who adopts a new 401(k) plan containing the SIMPLE-401(k) model amendment may make it effective as of any date on or after January 1, 1997, but in no event later than October 1 of the year in which adopted. Employees will have a 60-day election period to make or modify a salary-reduction election that includes either the date the employee becomes eligible or the day before.

Rule —If The Employer Currently Has a 401(k) Plan

The general rule is that an employer's adoption of the model amendment in 1997 will mean it must become effective as of January 1, 1998. An employer's adoption of the model amendment in 1998 or subsequent years will mean it must become effective as of January 1 of the following year.

The exception — the amendment may be effective for 1997 if the employer is eligible to and elects to use the following

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IRS Issues Further Guidance on SIMPLE-IRA Plans

The IRS has issued Notice 97-6 which provides additional guidance on SIMPLE-IRA plans. This article will discuss only those statements which appear to be new and different. As with any new law, the IRS must do its best to construe the new statute and adopt policy stances on those situations not directly covered by the statute.

The Subject of Fees and the Right to Have Transfers

An employer and a financial institution may agree that the financial institution will be the designated financial institution ("DFI"). This is normally done for the administrative convenience of the employer who then will be able to issue just one check to one financial institution. When a financial institution is a DFI, the employees must have the right to have his or her account transferred without cost of penalty to another SIMPLE-IRA at a financial institution selected by the employee. If the financial institution is not a DFI, then there is no rule which prohibits the imposition of any types of fees, including transfer fees.

The IRS, within this Notice, creates some "exceptions" or "clarifications" to the "without cost or penalty" rule.

The IRS has ruled that the time and manner in which a participant may transfer his or her balance from a DFI without cost or penalty may be limited.

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The IRS will allow a DFI to require that a participant be given only a reasonable period of time in which to transfer his or her balance without cost or penalty. The IRS defines this reasonable period of time to be the 60-day election period. The IRS has also ruled that a participant's instruction will only apply for the upcoming year's and future year's contributions. That is, the DFI will be able to impose transfer costs or fees on prior account balances (i.e. account balances which were eligible to be transferred in earlier years but which were not). Example – Sara Cragun's employer has designated ABC National Bank as the DFI. Sara did not instruct ABC National Bank to transfer her 1997 SIMPLE-IRA contributions to another financial institution. From November 2, 1997, to December 31, 1997, Sara will have the right to decide if she will exercise her right to transfer without cost or penalty her 1998 and subsequent year contributions. If Sara now wishes to transfer her 1997 contributions (and related earnings), ABC National Bank is free to impose a transfer fee or another fee.

The IRS has also stated that a DFI will be in compliance with the "transfer without cost or penalty rule" if, on a monthly basis it transfers the accounts of those participants requesting such transfers.

In order for a DFI to accomplish a transfer of a participant's SIMPLE-IRA balance without cost or penalty, the participant's balance must be transferred in a trustee-to-trustee transfer directly to a SIMPLE-IRA at another financial institution as specified by the participant. Comment: The statute requires a DFI to allow a rollover distribution without cost or penalty; the IRS has modified this to be a trustee-to-trustee transfer.

A transfer will qualify as being made without cost or penalty if no liquidation, transaction, redemption or termination fee, or any commission, load (whether front-end or back-end) or surrender charge, or similar fee or charge is imposed with respect to the balance being transferred.

The IRS then lists two exceptions to the "without cost or penalty rule." First, if the financial institution may negotiate it, the financial institution may assess fees to the employer for such transfers without violating the "without cost or penalty fee rule." Second, the IRS has concluded that a DFI will be able to impose a reasonable annual administrative fee to all of the SIMPLE-IRAs (even those being transferred) and this imposition of an annual administrative fee will not violate the "without cost or penalty rule."

A DFI will also be able to establish one specific investment option for those participants who have instructed to have their balances transferred, and then transfer them on a monthly basis. The DFI must explain this limitation in its explanation of transfer rights. The DFI may impose this limit even though it offers a variety of investment options to those participants who have not elected to have the transfers.

Plan Establishment Topics

In determining whether an employer had not more than 100 employees who earned $5,000 or more in compensation during the preceding calendar year, all employees employed at any time during the year are taken into account regardless of whether they are eligible to participate in the SIMPLE plan.

In some situations, an employer need not establish a plan on January 1. First, an employer may establish a SIMPLE-IRA plan to be effective on any date between January 1 and October 1 as long as the employer (or any predecessor) has NOT previously maintained a SIMPLE plan. If the employer has previously maintained a SIMPLE plan, then the employer may only establish a SIMPLE plan to be effective as of January 1 of a year. Second, a new employer that comes into existence after October 1 may establish a SIMPLE plan to be effective as soon as administratively feasible.

An employer cannot make contributions under a SIMPLE plan for a calendar year if the employer, or a predecessor-employer, maintains a qualified plan under which any of its employees receives an allocation of contributions or has an increase in his or her accrued benefit for any plan year beginning or ending in that calendar year. That is, a contribution made to a profit sharing plan in 1997 for 1996 would disqualify an employer from sponsoring a SIMPLE for 1997. For the purpose of this limiting rule, a qualified plan is defined to encompass those plans under Code sections 401(a) – qualified plans, 403(a) – qualified annuities, 403(b) – tax-sheltered annuities, 408(k) – SEP, 457 – certain governmental plans, and 219(g)(5). In applying these rules, transfers, rollovers or forfeitures are disregarded, except, if under the qualified plan, the forfeitures are required to replace otherwise required employer contributions.

Tax exempt employers and governmental entities may sponsor SIMPLE-IRA plans as long as the rules discussed above are satisfied (100 or fewer employees and no other plans).

The employer aggregation (controlled group) rules and leased employee rules do apply to SIMPLE-IRA plans. Leased employees are treated as employed by the employer. The employer aggregation rules can be very important. For example, if there are two related employers, one with 30 employees and one with 45 employees, and the one employer with 30 employees establishes a SIMPLE-IRA plan, the employees of the other business would be eligible, and mandatory contributions would have to be made.

In order to have a SIMPLE-IRA plan, all eligible employees must establish a SIMPLE-IRA. The IRS has set the deadline for the individual SIMPLE-IRA agreements as being any day prior to the first date by which a contribution is required to be deposited into the employee's SIMPLE-IRA. The IRS' position is that an employer must contribute the salary-reduction contributions to each employee's SIMPLE-IRA no later than the close of the 30-day period following the last day of the month in which amounts would otherwise have been payable to the employee in cash. As in the case of SEP plans, if there is an eligible employee who is entitled to a contribution under a SIMPLE-IRA plan (i.e. the employer wishes to make a nonelective contribution) who is unwilling or unable to establish his or her SIMPLE-IRA agreement prior to the deadline date, an employer may execute the necessary documents to establish the SIMPLE-IRA on the employee's behalf at an institution selected by the employer.

If an employer fails to furnish one or more of the required notifications to the eligible employees, the employer will be liable for a penalty of $50 per day until the notice(s) are furnished unless it can show that there was a reasonable cause for the failure.

A quite important change is that the IRS has expanded the law regarding the format of an employee's election or instruction to have an amount withheld from his or her salary and such amount contributed by the employer to the individual's SIMPLE-IRA. Code section 408(p)(2)(ii) reads as follows, "the amount which an employee may elect under clause (i) for any year is required to be expressed as a percentage of compensation and may not exceed a total of $6,000 for any year." The IRS has concluded this means an employee must be permitted to elect to have salary-reduction contributions made at the level specified by the employee, expressed as a percentage of compensation, or an employer may permit an employee to express the level of salary-reduction contributions as a specific dollar amount. Except for the $6,000 limit, the employer may not impose any limit or restrictions on an employee's deferral instruction.

Duties of the Trustees

The trustee who has agreed to be the designated financial institution (DFI) must provide the employer with the summary description sufficiently early so that the employer will meet its notification requirement. However, the trustee is not required to provide a summary description prior to agreeing to

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be the trustee of a SIMPLE-IRA for the SIMPLE plan.

The IRS indicates that the trustee "should" provide guidance to the employer concerning the need to complete the first two pages of the Form 5305-SIMPLE and to distribute copies to eligible employees.

A financial institution which does not serve as the DFI (e.g. the receiving trustee of a transfer SIMPLE-IRA) is not required to provide the summary description. A SIMPLE-IRA is a transfer SIMPLE-IRA if it is not a SIMPLE-IRA to which the employer has made contributions under the SIMPLE plan.

All SIMPLE-IRA custodians/trustees will be required to complete the Form 5498 and 1099-R for each SIMPLE-IRA. A trustee who fails to file the Form 5498 is liable to the extent of $50 per failure unless the reasonable cause exception would apply. A trustee who fails to file the Form 1099-R or report a designate distribution is determined under Code section 6721-6724.

A SIMPLE-IRA custodian/trustee does have the responsibility to determine if a distribution has occurred to a person within the two-year period so that the 25% excise tax may apply. This two-year period begins on the first day on which contributions made by the employer are deposited in the person's IRA. If your institution is the first SIMPLE-IRA custodian for this SIMPLE, having this information is no problem. However, if you are the recipient of a transfer or rollover SIMPLE-IRA, then you are going to have to request this information. The Notice states that you will be permitted to base this determination on your own records. A custodian/trustee may, but is not required to, take into account other adequately substantiated information regarding the date on which an individual first participated in the employer's SIMPLE-IRA plan.

Various Tax Issues

The general rule is that distributions from a SIMPLE-IRA will be treated the same way as would any distribution from a regular IRA except when the 25% excise tax applies. The IRS has made very clear that if one of the exceptions for the assessment of the 10% excise tax applies (e.g. for amounts paid after age 59 1/2, after death, or as part of a series of substantially equal payments), the exception will also apply so that the 25% excise tax will not be owed.

During the two-year period, transfers are permissible from one SIMPLE-IRA to another SIMPLE-IRA. After the two-year time period requirement has been met, an amount in a SIMPLE-IRA may be transferred to an IRA which is not a SIMPLE-IRA (i.e. a regular IRA).

If, during the two-year period, there is a purported transfer from a SIMPLE-IRA to a regular IRA, the tax consequences will be as follows: the payment from the SIMPLE-IRA is a taxable distribution, and the contribution to the regular IRA is a contribution.

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Miscellaneous IRS Releases

1. IRS issues a revised Form 5305-SEP. The old form expired as of February 28, 1997. The changes to the form are very minimal. The form, as revised, is for the 1997 tax year. The main change is that the permissible compensation limit has been increased from $150,000 for 1996 and prior years to $160,000 for 1997. A copy of the revised Form 5305-SEP is enclosed.

2. The IRS in Rev. Proc. 97-8 sets forth the revised user fee schedule for 1997. These fees are very similar to those which applied for 1996.

3. The IRS has issued guidance on the drafting of QDROs. IRS Notice 97-11. This was mandated by the Small Job Business Protection Act of 1996.

5. The IRS has announced a zip code change for the Information Reporting Program at the Martinsburg Computing Center. The new zip code will apply only to the Post Office Box 1359 address. You are to make this change on your mailing label. The zip code change will appear in the next revisions of all publications and forms related to information which returns include the PO Box 1359 address. IRS Announcement 96-126.

The change will affect the filing of Form 4804 (Transmittal of Information Returns Reported Magnetically/Electronically) and Form 8809 (Request for Extension of Time to File Information Returns).

The revised address (with new zip code) is:

IRS-Martinsburg Computing Center
Information Reporting Program
PO Box 1359, MS-360
Martinsburg, WV 25402-1359

6. The IRS has issued Announcement 96-124. The IRS explains that there will be three new reporting codes for Box 13 of the 1997 Form W-2. Code "R" will be used to report employer contributions to an MSA. Code "S" will be used to report salary-reduction contributions to a SIMPLE. Code "T" will be used to report employer payments under an adoption assistance plan for qualified adoption expenses.

Reminder on IRA Bonds

Under existing law there are IRA accounts and IRA annuities. IRA accounts are sponsored by banks, savings and loans, credit unions and brokerage firms who qualify to act as an IRA custodian or trustee.

At one time, individual retirement bonds as issued by the federal government were another type of permissible IRA investment. The sale of such government IRA bonds were suspended after April 30, 1982. This means such bonds were permissible investments from January 1, 1975, to April 30, 1982, and there are individuals who still own such IRA bonds.

IRA bonds have the following features: (1) interest is paid by the government to the bondholder only when he or she surrenders the bond for cash; (2) interest is no longer paid after the IRA bondholder reaches age 70 1/2; (3) interest is no longer paid at a certain point after the IRA bondholder died (the earlier of five years after the death or the date the IRA bondholder would have reached age 70 1/2); (4) the ownership of such IRA bonds cannot be transferred; and (5) such bonds may not be used by the IRA bondholder as collateral or security.

An IRA bondholder may roll over the redemption proceeds into an IRA.

IRA Issues 1996 Publication 590

This publication only increased in size by two pages, from 68 to 70. The changes from the 1995 version to the 1996 version are minimal, except as follows.

The 1996 version does a very good job of explaining the new rules which apply for 1997.

The 1996 version also highlights or emphasizes certain topics by use of a "caution" or "tip" graphic.

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1997 Transition Rule which requires the following conditions be satisfied:

1. The employer adopts the SIMPLE-401(k) provisions by July 1, 1997, effective as of January 1, 1997;

2. The salary-reduction contributions for the year made prior to the adoption of the model amendments do not total more than $6,000 for each employee;

3. The matching or nonelective contributions are of inherently equal or greater value than the contributions required under the plan prior to the amendment;

4. All eligible employees are provided with the election period described in the model amendment.

Status of Plan as a Qualified Plan

A 401(k) plan which has been amended by the SIMPLE-401(k) amendment is still a 401(k) plan subject to all of the other qualified plan rules and 401(k) rules except as discussed above. For example; all other qualification requirements of the code continue to apply to a plan that contains SIMPLE-401(k) provisions including the contribution limitations of Code section 415; the compensation limitations of 401(a)(17); and the requirement that the plan continue to be operated in accordance with its terms. The general 401(k) rules restricting distributions apply, as does the rule prohibiting governmental entities from sponsoring a 401(k) plan. The employer's ability to claim a tax deduction for the contributions is still determined by Code section 404(a).

Summary

If your institution sponsors a 401(k) prototype, you will wish to adopt the model SIMPLE-401(k) amendment which the IRS has made available. Presumably, the sponsor of your prototype will be in contact with you to allow you to adopt this model SIMPLE-401(k) amendment. PD

✔✔✔ Check It Out ✔✔✔

Question: What type of plan might an employer who presently does not sponsor a plan adopt in March of 1997 for tax year 1996?

✔ Answer. IRS rules require that an employer must establish a qualified plan on or before the last day of the tax year. Therefore, if the QP documents were not executed by December 31, 1996, it is too late to establish a QP plan for 1996. One could be established for tax year 1997, but not for 1996 purposes.

The SIMPLE plan is a new type of retirement plan. However, 1997 is the first year for which an employer may sponsor a SIMPLE plan. It is not available for 1996 tax year purposes. It certainly can be used for 1997 purposes if it looks to be the best plan for an employer.

Since neither the QP plan or the SIMPLE plan is available for 1996, this means the SEP is the only viable alternative for the employer for 1996.

The employer should establish the SEP plan for 1996 purposes and then decide if the SEP will be best for 1997 purposes or if the QP or SIMPLE plan would be better for 1997 and subsequent years.

Question: Is it true that an employer may no longer establish a SEP plan?

✔ Answer. No. There is quite a bit of confusion regarding the law changes which took place with respect to SEPs and SAR-SEPs. The law was changed for SAR-SEPs; the law was not changed for SEPs. Employers may still establish a SEP plan for tax year 1996 if established by the tax-filing deadline (plus extensions). The tax-filing deadline is normally April 15. Employers who did not maintain a SAR-SEP as of December 31, 1996 may not now establish one.

Question: We have a business customer who has an employee, Tony Garcia. Tony was born on July 5, 1922, and has worked for this employer for nine years. This employer has a SEP plan. Must the employer make a SEP contribution for Tony? How is the RMD calculation made?

✔ Answer. Yes, a contribution must be made for Tony. Both the SEP rules and the age discrimination rules require it. The fair market value of Tony's SEP-IRA was $25,600 as of December 31, 1996. On March 3, 1997, his employer allocated to his SEP-IRA the 1996 contribution amount of $3,400. Tony attained age 70 1/2 and 71 in 1993. Because he had designated his church as his primary beneficiary, he uses a single life-expectancy factor. He had elected the nonrecalculation method, so his factor for 1997 is 11.3 (15.3 - 4). His RMD for 1997 is $2,176.99. This is determined by dividing the account balance of $24,600 by 11.3.

Note, the account balance used is the actual balance of $24,600 and not $28,000 (the $24,600 plus the carryback contribution of $3,400). Some consultants argue that such an adjustment is required for qualified plans, and therefore, must also be made for SEP plans. We disagree. A SEP is a special type of IRA. The IRS wrote specific rules for IRAs. If the IRS had wanted to adjust the December 31 balance by IRA and SEP carryback contributions, they would have written the regulation to say that. A carryback contribution is normally one made between January 1 and April 15, but which is designated for the prior tax year.

Question: What FDIC insurance coverage will apply to Medical Savings Accounts?

✔ Answer. The FDIC has not formally adopted a policy on this issue yet. From discussing this issue with them, it appears the FDIC's position will be that MSAs are not retirement accounts. They will be a type of custodial account. FDIC regulation 330.6 provides that a custodial account shall be insured to the same extent as if deposited in the name of the principal. Or, it may be that they would be insured under the revocable trust account section. PD

The Pension Digest invites your questions and comments. Please address to "Check It Out," Collin W. Fritz & Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

Form **5305-SEP**

(Rev. January 1997)

Department of the Treasury
Internal Revenue Service

Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement

(Under section 408(k) of the Internal Revenue Code)

OMB No. 1545-0499

DO NOT File With the Internal Revenue Service

________________________________ makes the following agreement under section 408(k) of the
(Name of employer)

Internal Revenue Code and the instructions to this form.

Article I—Eligibility Requirements (Check appropriate boxes—see **Instructions.**)

The employer agrees to provide for discretionary contributions in each calendar year to the individual retirement account or individual retirement annuity (IRA) of all employees who are at least ________ years old (not to exceed 21 years old) and have performed services for the employer in at least ________ years (not to exceed 3 years) of the immediately preceding 5 years. This simplified employee pension (SEP) ☐ includes ☐ does not include employees covered under a collective bargaining agreement, ☐ includes ☐ does not include certain nonresident aliens, and ☐ includes ☐ does not include employees whose total compensation during the year is less than $400*.

Article II—SEP Requirements (See **Instructions.**)

The employer agrees that contributions made on behalf of each eligible employee will be:

A. Based only on the first $160,000* of compensation.

B. Made in an amount that is the same percentage of compensation for every employee.

C. Limited annually to the smaller of $30,000* **or** 15% of compensation.

D. Paid to the employee's IRA trustee, custodian, or insurance company (for an annuity contract).

________________________________ ________________________________
Employer's signature and date | Name and title

Paperwork Reduction Act Notice

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping	1 hr., 40 min.
Learning about the law or the form	1 hr., 35 min.
Preparing the form	1 hr., 41 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send this form to this address. Instead, keep it for your records.

Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Form

Form 5305-SEP (Model SEP) is used by an employer to make an agreement to provide benefits to all eligible employees under a SEP described in section 408(k). **Do not** file this form with the IRS. See **Pub. 560,** Retirement Plans for the Self-Employed, and **Pub. 590,** Individual Retirement Arrangements (IRAs).

Instructions to the Employer

Simplified Employee Pension.—A SEP is a written arrangement (a plan) that provides you with a simplified way to make contributions toward your employees' retirement income. Under a SEP, you can contribute to an employee's individual retirement account or annuity (IRA). You make contributions directly to an IRA set up by or for each employee with a bank, insurance company, or other qualified financial institution. When using Form 5305-SEP to establish a SEP, the IRA must be a Model IRA established on an IRS form or a master or prototype IRA for which the IRS has issued a favorable opinion letter. Making the agreement on Form 5305-SEP does not establish an employer IRA described in section 408(c).

When Not To Use Form 5305-SEP.—Do not use this form if you:

1. Currently maintain any other qualified retirement plan. This does not prevent you from maintaining another SEP.

2. Previously maintained a defined benefit plan that is now terminated.

3. Have any eligible employees for whom IRAs have not been established.

4. Use the services of leased employees (described in section 414(n)).

5. Are a member of an affiliated service group (described in section 414(m)), a controlled group of corporations (described in section 414(b)), or trades or businesses under common control (described in sections 414(c) and 414(o)), unless all eligible employees of all the members of such groups, trades, or businesses, participate in the SEP.

6. Will not pay the cost of the SEP contributions. Do not use Form 5305-SEP for a SEP that provides for elective employee contributions even if the contributions are made under a salary reduction agreement.

Use Form 5305A-SEP, or a nonmodel SEP if you permit elective deferrals to a SEP.

Note: *SEPs permitting elective deferrals cannot be established after 1996.*

Eligible Employees.—All eligible employees must be allowed to participate in the SEP. An eligible employee is any employee who: **(1)** is at least 21 years old, and **(2)** has performed "service" for you in at least 3 of the immediately preceding 5 years.

Note: *You can establish less restrictive eligibility requirements, but not more restrictive ones.*

Service is any work performed for you for any period of time, however short. If you are a member of an affiliated service group, a controlled group of corporations, or trades or businesses under common control, service includes any work performed for any period of time for any other member of such group, trades, or businesses.

Excludable Employees.—The following employees do not have to be covered by the SEP: **(1)** employees covered by a collective bargaining agreement whose retirement benefits were bargained for in good faith by you and their union, **(2)** nonresident alien employees who did not earn U.S. source income from you, and **(3)** employees who received less than $400* in compensation during the year.

Contribution Limits.—The SEP rules permit you to make an annual contribution of up to 15% of the employee's compensation or $30,000*, whichever is less. Compensation, for this purpose, does not include employer contributions to the SEP or the employee's compensation in excess of $160,000*. If you also maintain a Model Elective SEP or any

* *This amount reflects the cost-of-living increase effective January 1, 1997. The amount is adjusted annually. The IRS announces the increase, if any, in a news release and in the Internal Revenue Bulletin.*

other SEP that permits employees to make elective deferrals, contributions to the two SEPs together may not exceed the smaller of \$30,000* or 15% of compensation for any employee.

Contributions cannot discriminate in favor of highly compensated employees. You are not required to make contributions every year. But you must contribute to the SEP-IRAs of all of the eligible employees who actually performed services during the year of the contribution. This includes eligible employees who die or quit working before the contribution is made.

You may also not integrate your SEP contributions with, or offset them by, contributions made under the Federal Insurance Contributions Act (FICA).

If this SEP is intended to meet the top-heavy minimum contribution rules of section 416, but it does not cover all your employees who participate in your elective SEP, then you must make minimum contributions to IRAs established on behalf of those employees.

Deducting Contributions.—You may deduct contributions to a SEP subject to the limits of section 404(h). This SEP is maintained on a calendar year basis and contributions to the SEP are deductible for your tax year with or within which the calendar year ends. Contributions made for a particular tax year must be made by the due date of your income tax return (including extensions) for that tax year.

Completing the Agreement.—This agreement is considered adopted when:

- IRAs have been established for all your eligible employees;
- You have completed all blanks on the agreement form without modification; and
- You have given all your eligible employees the following information:

1. A copy of Form 5305-SEP.

2. A statement that IRAs other than the IRAs into which employer SEP contributions will be made may provide different rates of return and different terms concerning, among other things, transfers and withdrawals of funds from the IRAs.

3. A statement that, in addition to the information provided to an employee at the time the employee becomes eligible to participate, the administrator of the SEP must furnish each participant within 30 days of the effective date of any amendment to the SEP, a copy of the amendment and a written explanation of its effects.

4. A statement that the administrator will give written notification to each participant of any employer contributions made under the SEP to that participant's IRA by the later of January 31 of the year following the year for which a contribution is made or 30 days after the contribution is made.

Employers who have established a SEP using Form 5305-SEP and have furnished each eligible employee with a copy of the completed Form 5305-SEP and provided the other documents and disclosures described in **Instructions to the Employer** and **Information for the Employee,** are not required to file the annual information returns, Forms 5500, 5500-C/R, or 5500-EZ for the SEP. However, under Title I of ERISA, this relief from the annual reporting requirements may not be available to an employer who selects, recommends, or influences its employees to choose IRAs into which contributions will be made under the SEP, if those IRAs are subject to provisions that impose any limits on a participant's ability to withdraw funds (other than restrictions imposed by the Code that apply to all IRAs). For additional information on Title I requirements, see the Department of Labor regulation at 29 CFR 2520.104-48.

Information for the Employee

The information below explains what a SEP is, how contributions are made, and how to treat your employer's contributions for tax purposes. For more information, see Pub. 590.

Simplified Employee Pension.—A SEP is a written arrangement (a plan) that allows an employer to make contributions toward your retirement. Contributions are made to an individual retirement account/annuity (IRA). Contributions must be made to either a Model IRA executed on an IRS form or a master or prototype IRA for which the IRS has issued a favorable opinion letter.

An employer is not required to make SEP contributions. If a contribution is made, it must be allocated to all the eligible employees according to the SEP agreement. The Model SEP (Form 5305-SEP) specifies that the contribution for each eligible employee will be the same percentage of compensation (excluding compensation higher than \$160,000*) for all employees.

Your employer will provide you with a copy of the agreement containing participation rules and a description of how employer contributions may be made to your IRA. Your employer must also provide you with a copy of the completed Form 5305-SEP and a yearly statement showing any contributions to your IRA.

All amounts contributed to your IRA by your employer belong to you even after you stop working for that employer.

Contribution Limits.—Your employer will determine the amount to be contributed to your IRA each year. However, the amount for any year is limited to the smaller of \$30,000* or 15% of your compensation for that year. Compensation does not include any amount that is contributed by your employer to your IRA under the SEP. Your employer is not required to make contributions every year or to maintain a particular level of contributions.

Tax Treatment of Contributions.—Employer contributions to your SEP-IRA are excluded from your income unless there are contributions in excess of the applicable limit. Employer contributions within these limits will not be included on your Form W-2.

Employee Contributions.—You may contribute the smaller of \$2,000 or 100% of your compensation to an IRA. However, the amount you can deduct may be reduced or eliminated because, as a participant in a SEP, you are covered by an employer retirement plan.

SEP Participation.—If your employer does not require you to participate in a SEP as a condition of employment, and you elect not to participate, all other employees of your employer may be prohibited from participating. If one or more eligible employees do not participate and the employer tries to establish a SEP for the remaining employees, it could cause adverse tax consequences for the participating employees.

An employer may not adopt this IRS Model SEP if the employer maintains another qualified retirement plan or has ever maintained a qualified defined benefit plan. This does not prevent your employer from adopting this IRS Model SEP and also maintaining an IRS Model Elective SEP or other SEP. However, if you work for several employers, you may be covered by a SEP of one employer and a different SEP or pension or profit-sharing plan of another employer.

SEP-IRA Amounts—Rollover or Transfer to Another IRA.—You can withdraw or receive funds from your SEP-IRA if within 60 days of receipt, you place those funds in another IRA or SEP-IRA. This is called a "rollover" and can be done without penalty only once in any 1-year period. However, there are no restrictions on the number of times you may make "transfers" if you arrange to have these funds transferred between the trustees or the custodians so that you never have possession of the funds.

Withdrawals.—You may withdraw your employer's contribution at any time, but any amount withdrawn is includible in your income unless rolled over. Also, if withdrawals occur before you reach age 59½, you may be subject to a tax on early withdrawal.

Excess SEP Contributions.—Contributions exceeding the yearly limitations may be withdrawn without penalty by the due date (plus extensions) for filing your tax return (normally April 15), but is includible in your gross income. Excess contributions left in your SEP-IRA account after that time may have adverse tax consequences. Withdrawals of those contributions may be taxed as premature withdrawals.

Financial Institution Requirements.—The financial institution where your IRA is maintained must provide you with a disclosure statement that contains the following information in plain, nontechnical language:

1. The law that relates to your IRA.

2. The tax consequences of various options concerning your IRA.

3. Participation eligibility rules, and rules on the deductibility of retirement savings.

4. Situations and procedures for revoking your IRA, including the name, address, and telephone number of the person designated to receive notice of revocation. (This information must be clearly displayed at the beginning of the disclosure statement.)

5. A discussion of the penalties that may be assessed because of prohibited activities concerning your IRA.

6. Financial disclosure that provides the following information:

a. Projects value growth rates of your IRA under various contribution and retirement schedules, or describes the method of determining annual earnings and charges that may be assessed.

b. Describes whether, and for when, the growth projections are guaranteed, or a statement of the earnings rate and the terms on which the projections are based.

c. States the sales commission for each year expressed as a percentage of \$1,000.

In addition, the financial institution must provide you with a financial statement each year. You may want to keep these statements to evaluate your IRA's investment performance.

** This amount reflects the cost-of-living increase effective January 1, 1997. The amount is adjusted annually. The IRS announces the increase, if any, in a news release and in the Internal Revenue Bulletin.*