THE Pension Digest

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ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc., *"The Pension Specialists"*

SEPs Are So SIMPLE

41% of IRA contributions in 2000 came from SEP and SIMPLE IRA contributions. If your financial institution wants additional deposits, your financial institution should seriously consider offering SEP services. There is not that much work to offering SEPS and the liability, if any, of the financial institution can be greatly limited.

The maximum SEP-IRA contribution for 2004 is the lesser of $41,000 or 25% of compensation. Many farmers are now making SEP-IRA contributions in the range of $10,000- $41,000 for 2004. Your institution can be the recipient of these dollars, and at the same time, help your customers to save for retirement.

The maximum SEP-IRA contribution for 2005 is the lesser of $42,000 or 25% of compensation.

Some farmers and other small businesses had higher income years in 2004 versus some prior years. Many will want to establish and fund a SEP-IRA for 2004. A very attractive feature of SEP-IRAs is that such plans may be established (and funded) up until April 15, 2005, for tax year 2004. However, the April 15, 2005 deadline can be extended until a later date if the taxpayer has a valid extension. Such SEP-IRA contribution could just as well be made into your financial institution versus a brokerage or investment firm. Just let people know you offer SEP-IRA Services.

The Use of a Service Agreement

CWF strongly recommends a financial institution use a service agreement. The purpose of the service agreement is to have a written understanding with your SEP customer that the financial institution wishes to limit its role to being the depository of the SEP deposits and that the business customer agrees to look to its tax advisor for assistance with the tax and administrative tasks, if needed. It is the duty of the business customer to make the determination to cover those employees required to be covered.

Establishing a SEP-IRA Plan Versus Establishing a SEP-IRA to Accept the SEP-IRA Contribution

Step one is for an employer, including a one-person business, to execute a SEP-IRA plan document. This is normally done by completing and signing the IRS Form 5305-SEP. This form is set forth on page 7. In some cases, a financial institution will make a SEP prototype available to its customers. The prototype allows an employer with employees to use an allocation formula which is integrated with social security.

Establishing a SEP-IRA to Accept the SEP-IRA Contribution

Each eligible employee must establish a SEP-IRA. This is easy to do. Each and every traditional IRA plan agreement is authorized to accept a permissible SEP contribution in addition to accepting annual contributions, rollover contributions, transfer contributions and recharacterization contributions.

Contributions and IRA Contributions for the Same Year

A person may make both a traditional IRA contribution and a SEP contribution

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for the same tax year, or a person may make a traditional IRA contribution even though his or her employer has made a SEP contribution for the same tax year. The general rule, however, is that the SEP contribution will make a person an active participant for IRA deduction purposes. Whether or not the person will be able to claim a tax deduction will depend upon the result of applying the appropriate modified adjusted gross income limits.

A person may also make a Roth IRA contribution and a SEP contribution for the same tax year. A person is eligible to make a Roth IRA contribution even though a SEP contribution is also made.

Summary. The purpose of this article has been to suggest that it is very simple for a business customer to establish and fund a SEP-IRA. It is not too late to seek SEP-IRA deposits for 2004. Of course, the IRA custodian is not to be the tax advisor. However, if you want to receive SEP and IRA deposits, the likelihood of receiving such deposits increases the more you understand the tax benefits your customers receive when they fund such plans.

Revised IRS Form 5305-SEP Issued in December 2004

March 2002 was the latest previous revision to Form 5305-SEP. The IRS has now issued a December 2004 revision. No changes were made either in the eligibility requirements or the instructions to the employer. The only changes are detailed below:

1. The updating of the compensation amount on which contributions are based — raised from $200,000 (3/02 form) to $205,000* (12/04 form)
2. The updating of the allowed contribution amount — raised from $40,000 (3/02 form) to $41,000* (12/04 form)
3. *In the caveat at the asterisk, the "For 2002 and later years......" was changed to "For 2005 and later years......"
4. The address to which to write to make comments on the form has changed to:

   Internal Revenue Service
   Tax Products Coordinating Committee
   SE:W:CAR:MP:T:T:SP
   1111 Constitution Ave. NW
   Washington, DC 20224

There is no requirement to use the new form immediately (existing inventory of the 3/02 form may still be used until the IRS issues a statement that it cannot). However, for customer service purposes, CWF recommends that an institution use the latest revision of the form.

There is also no requirement to update those customers using the 3/02 form to the 12/04 form. As CWF's SEP customers are well aware, all SEPs had to updated in 2003. At some point in the future, the IRS will again require such updating. CWF will keep you informed concerning the IRS SEP requirements.

The New Automatic IRA Rollover Rules from the Perspective of the QP Administrator

The new automatic IRA rollover rules were adopted by the Department of Labor (DOL) on September 28, 2004. These new rules apply to any rollover of a mandatory distribution made on or after March 28, 2005. These new rules do NOT apply to mandatory distributions made before March 28, 2005. The final regulation of the DOL provided that the new rules would be effective 6 months after the final DOL regulation was adopted.

On January 18, 2005, the IRS issued additional guidance in Notice 2005-5. The IRS has chosen to give sponsoring employers another 9 months to comply with these new rules for plan qualification purposes. Some employers will need the additional time and others will not. A plan will now have until December 31, 2005, to comply with the new automatic rollover rules.

Background. Prior to 2001, a tax-qualified plan was permitted, under the existing tax laws, to incorporate provisions into the qualified plan document requiring

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an immediate distribution (i.e. cash-out) to a separating participant without his or her consent, if the vested account balance was $5,000 or less. A mandatory distribution is one that is made without the participant's consent and that is made to a participant before he or she attains the later of age 62 or the normal retirement age.

Under the same tax laws, a plan administrator was required to furnish a separating participant with a special written notice (many times called a section 402(f) notice) explaining that the participant may elect to directly roll over his or her vested account balance to an IRA or other eligible retirement plan as chosen by the separating participant, he or she may elect to receive cash, but then as a general rule 20% must be withheld, or he or she may elect to do a combination of a direct rollover and a cash payout. If the separated participant failed to elect to have a direct rollover, the plan administrator had to distribute the account balance to the participant and, in most cases, had to withhold 20% of the amount distributed.

The EGTRRA tax law enacted in 2001 made four related changes. EGTRRA is the acronym for the Economic Growth and Tax Relief Act of 2001.

The first change is that a mandatory distribution in the amount of $1,000.01 to $4,999.99 from a tax-qualified retirement plan must be directly rolled over to an IRA established with a designated IRA custodian unless the separating participant affirmatively elects one of the three previously-discussed options. Note, if the separating participant fails to complete and return the special notice to the plan administrator (generally within 30 days), then the plan administrator, by law, must roll over the participants funds to an IRA established with a specific financial institution as chosen by the plan administrator. The obvious intent of the law was to make it easier for plan administrators to make these mandatory distributions by allowing all of the new IRA to be set up with just one IRA custodian rather than having multiple IRA custodians. Consequently, the administrative costs associated with such distributions may decrease. Many plan administrators will not be disappointed if an employee fails to return his or her affirmative election/instruction within the standard 30-day time period. These plan administrators will have found an IRA custodian willing to establish the special rollover IRAs and will simply establish such IRAs.

The second change is that the tax-qualified retirement plan must be re-written to provide for an automatic IRA rollover for any mandatory distribution in the amount of $1,000.01 to $4,999.99 unless the separating participant affirmatively elects one of the three previously-discussed options.

The third change is that the plan administrator must advise plan participants of this new rule and that a separating participant still has the right to have the funds directly rolled over to an IRA of his or her choice.

The fourth change is that the new law directed the DOL to create one or more safe harbors for a plan administrator with respect to its selection of a financial institution to serve as the IRA custodian for the rollover IRA and its selection of how the rolled over funds would be invested. Such decisions by the plan administrator must comply with the fiduciary responsibility provisions of section 404(a) of ERISA.

The DOL issued their safe harbor final regulation on September 28, 2004. These regulations created a safe harbor under which a fiduciary of a tax-qualified plan will be deemed to have satisfied his or her fiduciary duties under section 404(a) of ERISA in connection with an automatic rollover of a mandatory distribution. This safe harbor also applies to an automatic rollover of $1,000 or less, even though such an amount is not in the statutory range of $1,000.01 to $4,999.99. In order to qualify for the safe harbor, a fiduciary must meet the following six conditions.

Condition #1. The present value of the vested account balance cannot exceed the maximum amount of $5,000.

Condition #2. The mandatory distribution is rolled over to an IRA. The IRA may be an IRA established under section 408(a) or an IRA annuity established under section 408(b).

The fiduciary is permitted to select just one IRA provider if it wishes. However, it may select additional IRA providers. Similarly, if the same employer has multiple plans, these plans could designate the same IRA provider for all of the automatic rollovers. The IRA

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which receives the automatic rollover may be an IRA established under Code section 408(c) (i.e. an employer-sponsored IRA program). The IRA which receives the automatic rollover may be a deemed IRA established under Code section 408(p).

Condition #3. The fiduciary must enter into a written agreement with the IRA custodian or other IRA provider that provides for the following. The investment product must be designed to preserve principal and earn a reasonable rate of return, but be liquid. There is no requirement that the earnings be guaranteed. There is to be a goal of retaining principal and income versus growth. The investment product must be offered by a bank or savings association as insured by the FDIC, a credit union as insured by the Federal Credit Union Act or an investment company registered under the Investment Act of 1940. The IRA provider will be able to charge for the services it provides to the automatic rollover IRA. However, all fees and charges for establishing, maintaining, investing, distribution, termination, transfers and surrender charges shall not exceed the fees the same IRA provider has for "comparable" IRAs. The DOL reminds the IRA providers in a footnote that a prohibited transaction will be found under Code section 4975 if its fees and expenses exceed reasonable compensation within the meaning of Code section 4975(d)(2). The participant who becomes the IRA accountholder must have the right to enforce the terms of the IRA provider.

Condition #4. The SPD for each qualified plan must be revised (or there must be a summary of material modifications) to explain the new automatic rollover rules. The SPD must identify who will be the IRA providers. The SPD must identify a plan contact who can be contacted if there are questions. There must be an explanation of the fees to be charged, those to be borne by the IRA accountholder by himself or herself and those to be shared with the plan or plan sponsor.

Condition #5. The selection of an IRA, the IRA Provider and the investment product(s) cannot result in a prohibited transaction under section 406 of ERISA, unless there is an applicable exemption.

The DOL furnished the following example in the overview. A prohibited transaction would occur if a plan fiduciary received consideration from a financial institution in exchange for selecting that institution as the IRA provider. This situation would not be covered by either the statutory service provider exemption or an administrative exemption. There is an indication that the DOL would have considered modifying this result, but no one asked them to consider such a change.

The DOL, however, did adopt a final class exemption to cover the prohibited transactions resulting from a financial institution selection of itself as the IRA provider to receive the automatic rollovers with respect to the financial institution's own retirement plans and selection of the investment products. Specifically, the exemption permits a bank or other financial institution to (1) select itself or an affiliate as the IRA provider to receive automatic rollovers from its own plan, (2) select its own funds or investment products for automatic rollover from its own plan and (3) receive fees therefore.

The Additional IRS Guidance of Notice 2005-5. A plan that is not ready to comply with the automatic rollover rules because its procedures have not yet been finalized, but which chooses to not make a distribution to a separated participant, will not be treated as failing to operate in accordance with the terms of the plan as long as such automatic rollovers are completed on or before December 31, 2005.

The plan administrator may select the IRA provider. The plan administrator has the authority to establish an IRA on behalf of a separating participant who fails to affirmatively elect to have a direct rollover to a specific IRA custodian or other eligible plan or who fails to elect an actual distribution. The plan administrator is authorized to use the participant's most recent mailing address as shown on the records of the plan administrator and the employer. The IRA custodian will be required to mail a disclosure statement to the former participant. The standard 7-day IRA revocation rules will apply. The IRA custodian/trustee will be in compliance with the disclosure statement regulation even if its mailing of the disclosure statement to the most recent address as furnished by the plan administrator is returned to the financial institution as undeliverable.

The automatic rollover requirements apply to any mandatory distribution that is more than $1,000 and is

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an eligible rollover distribution. This is so even if the amount exceeds $5,000 because some of the amount is attributable to rollover contributions which may be excluded for purposes of determining if the present value of the vested accrued benefit exceeds $5,000. However, an eligible rollover distribution in the form of a plan loan offset amount is not subject to the automatic rollover rules.

A sponsoring employer could decide to amend its plan and eliminate the mandatory distributions. Such an amendment would not violate the anti-cutback rules

The spousal consent rules do not apply if the vested account balance is not more than $5,000.

A qualified plan which provides for mandatory distributions and which does not already include the automatic rollover provisions must adopt a good faith plan amendment reflecting such rules by the end of the first plan year ending on or after March 28, 2005. The IRS has furnished a sample plan amendment. It can be adopted by individual plan sponsors and sponsors of preapproved plans. The adoption of this sample amendment by a sponsor of a pre-approved plan will not cause such a plan to be treated as an individually designed plan. If a plan is amended by a timely good faith amendment reflecting the automatic rollover requirements, a plan amendment correcting a disqualifying provision can be made within the plan's EGTRRA remedial amendment period. The amendment may be adopted on a retroactive basis effective as of March 28, 2005.

Summary—Employer Tasks Arising From the New Automatic Rollover Rules

An employer will want to make the determination if its plan or plans contain provision for mandatory distributions. Most plans do. The CWF prototypes contain these provisions.

An employer will want to start the process of adopting the model amendment. CWF will soon be furnishing this amendment to the users of CWF prototypes.

An employer will want to have available a revised SPD or summary of material modification explaining these new automatic rollover rules. CWF will soon be furnishing such revisions.

An employer will want to select a financial institution willing to serve as the IRA provider which will accept the automatic rollover. Keep in mind that an automatic rollover does not apply if the separating participant directs the employer to pay the participant or to directly roll over the account balance to the IRA he or she has set up with a specific financial institution.

Whomever is serving as a fiduciary of the employer's plan will want to make the determination that the six conditions required for the safe harbor have been met. The employer also wants to make this determination.

The employer will want to review the written agreement as discussed above. The employer will want to review the terms of the IRA and the various fees to be charged by the IRA provider.

The New Automatic IRA Rollover Rules from the Perspective of the IRA Provider

Financial institutions serving as IRA custodians will want to understand the new rules for automatic direct rollovers. Your institution may choose to serve as the IRA custodian for such IRAs or you may choose to not serve as the custodian. You may or may not decide that the deposits arising from such rollovers are worth the tasks you will be required to perform as the IRA custodian.

There are some unknowns about these accounts, but the DOL chose to be so reasonable about fees that an IRA custodian should be able to make money with respect to these IRAs. The IRS is aware of the following fees: those for establishing, maintaining, investing, distribution, termination, transfers and surrenders. The IRS only requires that the fees be "comparable." We don't believe the unknowns are so huge that a financial should conclude they don't want this business. If you can find a number of large 401(k) plans to choose your financial institution as the IRA provider, you should be able to realize some sizeable deposits.

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Many small deposits may still be worthwhile for your institution.

Task List - IRA Provider Tasks Arising From the New Automatic Rollover Rules

What will be required of the IRA custodian?

1. The written agreement. A financial institution will want to prepare a written agreement so that you are ready to furnish it to 401(k) plan administrators and other plan administrators. You may want to prepare some special fee schedules and some special investment accounts so that you are ready to furnish them to the plan administrators for review.

2. Plan establishment. The IRA custodian and the plan administrator will need to establish an IRA for each individual who fails to make an affirmative election that they don't want the mandatory rollover. The plan administrator is authorized to use the participant's most recent mailing address as shown on the records of the plan administrator and the employer. The IRA custodian will be required to mail a disclosure statement to the former participant. We would suggest that you also furnish a copy of the IRA plan agreement and inform them they should designate a beneficiary(ies) for their IRA, if the IRA plan agreement provides the estate is the default beneficiary if the IRA owner does not designate a beneficiary. The DOL and IRS did not require the plan administrator to require the IRA Provider to handle the beneficiary topic in any set way. The standard 7-day IRA revocation rules will apply. The IRA custodian/trustee will be in compliance with the disclosure statement regulation even if its mailing of the disclosure statement to the most recent address as furnished by the plan administrator is returned to the financial institution as undeliverable.

The DOL reminds the IRA providers in a footnote that a prohibited transaction will be found under Code section 4975 if its fees and expenses exceed reasonable compensation within the meaning of Code section 4975(d)(2). The participant who becomes the IRA accountholder must have the right to enforce the terms of the IRA provider.

3. On-going maintenance. You will want to expend some effort to stay in contact with these IRA account holders. In come cases, you may need to use the IRS procedures for trying to locate a person or persons.

4. Governmental reporting. You will prepare the various governmental reporting forms for these IRA accountholders in the same way you do for your other IRA accountholders.

5. The IRA custodian wants to have some procedure in place to make the determination that the acceptance of automatic rollovers from a certain employer will not result in a prohibited transaction under section 406.

If the institution has its own plan, and this plan has a mandatory distribution provision, then the institution will need to decide if it wants to act as the IRA Provider with respect to its own plans.

IRS Issues 2005 Form W-4P

The IRS issued the 2005 Form W-4P late in the fall of 2004. There are few changes to this form for 2005. The changes are mostly editorial and are not substantive. The section titled "Payments Outside the United States" is now titled "Payments to Foreign Persons and Payments Outside the United States." The language in this section has changed considerably, and, CWF believes, has been changed for the better. One of the changes states that, in the absence of a treaty, payments to foreign persons must have 30% withheld. If there is a treaty between the US and the individual's country of citizenship, then there would be no withholding. However, it is clearly up to the individual to prove they are covered by such a treaty. Before any payments are made to such individual, the payer will want them to submit Form W-8BEN, "Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding."

For your information, the term "foreign persons" would imply a nonresident alien (not a US citizen and <u>not residing</u> in the US), as opposed to a resident alien (not a US citizen, but <u>is residing</u> in the US and is subject to all US tax laws).

Because the W-4P is incorporated on many CWF forms, we will be revising the RMD, distribution and beneficiary forms to include the language changes of the 2005 W-4P.

Form **5305-SEP**
(Rev. December 2004)
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 Internal Revenue Code and the instructions to this form.
(Name of employer)

Article I—Eligibility Requirements (check applicable boxes—see instructions)

The employer agrees to provide 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 $450*.

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 $205,000* of compensation.
B. The same percentage of compensation for every employee.
C. Limited annually to the smaller of $41,000* or 25% 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

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 simplified employee pension (SEP) described in section 408(k).

Do not file Form 5305-SEP with the IRS. Instead, keep it with your records.

For more information on SEPs and IRAs, see Pub. 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans), 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 an easy way to make contributions toward your employees' retirement income. Under a SEP, you can contribute to an employee's traditional individual retirement account or annuity (traditional 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 traditional IRA established on an IRS form or a master or prototype traditional IRA for which the IRS has issued a favorable opinion letter. You may not make SEP contributions to a Roth IRA or a SIMPLE IRA. 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. Have any eligible employees for whom IRAs have not been established.

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

4. 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.

5. 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.

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. 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 $450* in compensation during the year.

Contribution limits. You may make an annual contribution of up to 25% of the employee's compensation or $41,000*, whichever is less. Compensation, for this purpose, does not include employer contributions to the SEP or the employee's compensation in excess of $205,000*. If you also maintain a salary reduction SEP, contributions to the two SEPs together may not exceed the smaller of $41,000* or 25% of compensation for any employee.

You are not required to make contributions every year, but when you do, you must contribute to the SEP-IRAs of all 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.

Contributions cannot discriminate in favor of highly compensated employees. Also, you may 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 salary reduction 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

* *For 2005 and later years, this amount is subject to annual cost-of-living adjustments. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS website at www.irs.gov.*

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 traditional IRAs other than the traditional 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 or 5500-EZ for the SEP. However, under Title I of the Employee Retirement Income Security Act of 1974 (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 a traditional individual retirement account/annuity (traditional IRA). Contributions must be made to either a Model traditional IRA executed on an IRS form or a master or prototype traditional 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, however, it must be allocated to all 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 greater than $205,000*) 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 $41,000* or 25% 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 make regular IRA contributions 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. This does not prevent your employer from adopting this IRS Model SEP and also maintaining an IRS Model Salary Reduction 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 the same or another 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 are includible in your gross income. Excess contributions left in your SEP-IRA 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.

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 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 Internal Revenue Service, Tax Products Coordinating Committee, SE:W:CAR:MP:T:T:SP, 1111 Constitution Ave. NW, Washington, DC 20224. Do not send this form to this address. Instead, keep it with your records.