

Understanding What Forms Are Needed To Establish a SEP-IRA

Jane Smith wishes to make a SEP-IRA contribution for herself. Jane is a self-employed horse rider/exerciser. She had a good year and so she wants to establish a SEP and then make a \$26,000 contribution to her SEP-IRA for tax year 2015.

What forms will she need to prepare?

First, as an employer (a one person business), she must establish her Simplified Employee Pension Plan (SEP). She will do so by completing and signing the IRS model form 5035-SEP. Note that she signs the form as the "employer." The financial institution does not sign this form. Jane will either obtain this form from her accountant, attorney, financial institution or she will find it on-line at the IRS website, www.irs.gov.

Second, as the employer, she will write a business check for the amount of \$26,000 and she will contribute it to her SEP-IRA. A SEP-IRA is established by a person establishing a standard traditional IRA (IRS model form 5305) and then making a SEP-IRA contribution to it. For 2015 she is permitted to make a SEP-IRA contribution equal to the lesser of 25% of her adjusted business earnings or \$53,000.

We recently had a call from an IRA representative where the IRA software system her bank was using did not make this clear. The system gave the idea that the only form needed was the Form 5305-SEP. The system did not make it clear that the individual either needed to have an existing IRA into which the SEP-IRA contribution would be contributed or a new SEP-IRA must be established. Both forms are needed and so hopefully the vendor will change its system once it is advised that a clarification is needed.

IRS statistics show that annual SEP-IRA contributions exceed those of annual traditional IRA contributions. A financial institution will benefit by communicating with its business customers about the benefits of SEP-IRAs. The tax laws do not require a person who has an existing traditional IRA to set up a new SEP-IRA. Some financial institutions choose for administrative reasons to require a separate IRA, but the tax laws do not require it. If any employee would fail to have a SEP-IRA so the business did not make a SEP contribution for such employee, there would be no SEP and the expected tax benefits would not apply for the sponsoring business and other employees.

In summary, establishing a SEP is easy as long as the two steps above are completed for a one person business and the three steps are completed for a business with employees.