WELLS FARGO Advisors

Any Questions?

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Simplified Employee Pension Plans

A flexible way to plan for retirement

If you decide to offer a retirement plan, the next step is to determine the type. Whether the business is a sole proprietorship, partnership, or corporation, the retirement plan should be structured to reflect the business's goals.

The Simplified Employee Pension (SEP) plan is easy to establish, inexpensive to administer, and may be ideal for a business that:

- Has fluctuating profits
- Requires a low-cost plan that's easy to administer
- Would like to provide a benefit for long-term employees only
- Employs few or no part-time individuals
- Employs family members only

SEP benefits

A SEP plan can offer you and your employees the following benefits:

- **Simplicity.** A SEP requires no complex paperwork or annual IRS filings. You just complete a simplified adoption agreement and make contributions.
- **Flexibility.** You can modify contributions annually based on the business's situation. The SEP can be terminated at any time with no permanency issues.
- **Tax savings.** Contributions are tax-deductible for the business and tax deferred for both you and your employees.
- **Avoiding investment related fiduciary responsibility.** Each eligible employee establishes his or her own IRA and manages the investments, which lets you avoid investment related fiduciary responsibility.

How a SEP works

Consider the following key points regarding establishing and administering a SEP and discuss them with your Financial Advisor.

The adoption agreement

A SEP is the only retirement plan that can be established retroactively for the previous business year if an adoption agreement is completed by the deadline for the business's tax return (including extensions). Each eligible employee should receive a copy of the completed adoption agreement.

Employee eligibility

You may exclude only employees who are younger than age 21 and those not employed during any part of three of the previous five years. Three years is the maximum service requirement permitted; however, you may choose to use a lower service requirement. You can generally exclude:

- Employees covered under a collective bargaining agreement
- Nonresident aliens receiving no U.S. earned income
- Employees receiving total annual compensation of less than $650* in the year the contribution is made

Keep in mind, any eligibility requirements will also apply to you. As an example, if the business has only been in place for two years, you cannot establish a three-year eligibility requirement and expect to make contributions.

About SEP contributions

A SEP provides for discretionary, tax-deductible contributions on behalf of eligible employees, including owners. Contributions are flexible and can vary from year to year; contributions can be skipped in any year, without penalty. However, you must use the same contribution calculation method for all eligible employees, including owner-employees.

Ways to determine SEP contributions

Depending on the available options in the plan document, contributions can be calculated using a:

- Prorata formula based on a percentage of compensation
- Social Security integrated formula
- Flat dollar benefit to all eligible employees

All contributions are immediately 100% vested. This means employees are entitled to all of their SEP assets, regardless of how long they have been employed by the business.

The maximum contribution for an employee in one year is the lesser of 25% of the employee's annual compensation or $58,000 for 2021 and $57,000 for 2020.* Keep in mind that compensation in excess of $290,000 for 2021 and $285,000 for 2020* cannot be included when calculating contributions. Also note that SEP contributions are fully funded by you as the employer. There are no salary deferral contributions into a SEP; therefore, catch-up contributions are not available.

IRS rules require that contributions be made either by cash, check or money order on or before the due date (including extensions) for filing the business's tax return. You can deduct the total contributions, thereby reducing your business's tax liability. Keep in mind that contributions are not included in the employee's taxable income.

Providing statements to employees

Each year, you should provide all employees with a statement indicating the amount contributed to his or her SEP. In addition, employees may make their Traditional IRA contributions to the same account. However, the individual contributions may not be deductible because the IRS considers a SEP an employer-sponsored retirement plan. Employees should consult their tax and/or legal advisors to help determine their Traditional IRA contributions' deductibility. For additional information on IRAs, see IRS Publication 590-A at irs.gov.

Considerations for self-employed individuals

If you are self-employed, be careful when calculating the maximum amount of your contribution based on your "compensation." For self-employed individuals, the IRS defines compensation as net earnings from self-employment reduced by the deduction:

- Allowed for one-half of the self-employment tax for a contribution made on behalf of the self-employed person

You should consult your business's tax advisor when calculating your SEP contribution. For additional information on the contribution calculation for self-employed individuals, see IRS Publication 560 at irs.gov.

Investment alternatives

Employees are responsible for investing their contributions according to their financial goals. The plan sponsor is not subject to the same fiduciary standards of other qualified plans.

Employee withdrawal alternatives and tax consequences

SEPs and Traditional IRAs follow the same distribution rules. SEP participants have access to their funds at any time. They can make withdrawals before age 59½; however, they may be subject to both a 10% IRS early withdrawal additional tax and ordinary income tax. (Certain distributions prior to age 59½ maybe exempt from the 10% additional tax.) If participants do not need current income, they may let the IRA assets continue to potentially accumulate tax-deferred. Remember, all individuals must begin taking mandatory distributions from a Traditional or SEP no later than April 1 following the calendar year in which they reach age 72. Your Financial Advisor can help you and your employees understand mandatory distribution requirements as well as plan for retirement.

Is a SEP right for you and your employees?

For many business owners and their employees, a SEP offers a simple and cost-effective step toward preparing for a more comfortable retirement. Although the SEP may provide one of the easiest retirement-plan solutions, another type of plan may be more appropriate for your situation or business profile.

You can count on us

Although SEP plans offer many benefits, they may not be right for every business. Wells Fargo Advisors offers a range of plans and can help you match the right plan with your needs and objectives.

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