

SIMPLIFIED EMPLOYEE PENSION (SEP)

**Listing of Required Modifications and Information Package (LRMs)
(For use with prototype SEPs intending to satisfy the
requirements of Code § 408(k).)
(Changes from the 7-1994 package are underlined.)**

**This information package contains samples of plan provisions
that satisfy certain specific requirements of the Internal
Revenue Code, as amended through the Job Creation and Worker
Assistance Act of 2002 (P.L. 107-147). Such language may or may
not be acceptable in specific plans, depending on the context.**

**We have prepared this package to assist sponsors who are
drafting SEPs. To expedite the review process, sponsors are
encouraged to use the language in this package.**

**1. Statement of Requirement: Participation Requirements, Code
§§ 408(k)(2) and 408(k)(7).**

Sample Plan Language:

The SEP shall cover each employee (including all employees of controlled groups as described in Code § 414(b), groups under common control as described in Code § 414(c), and affiliated service groups as described in Code § 414(m), and all leased employees who are not employees of the employer but are required to be treated as employees of the employer under Code § 414(n), and all employees required to be aggregated under Code § 414(o)) who:

- (a) has attained the age of _____ (cannot exceed 21),
- (b) has performed service for the employer during at least _____ (cannot exceed 3) of the immediately preceding 5 calendar years, and
- (c) has received at least \$_____ (cannot exceed \$450, as adjusted for the cost of living in accordance with Code

§ 408(k)(8)) of compensation from the employer during the calendar year.

(Note to reviewer: These LRMs assume the SEP is maintained on a calendar-year basis; however a prototype SEP may provide for an election whereby an employer may elect to use either the calendar year or its taxable year for participation and contribution/allocation purposes. The same "year" must be used for both participation and contribution/allocation purposes. The SEP must provide that if the employer already maintains a SEP and desires to change the SEP's "year," an employee who has any service during the short year must be given credit for that service in determining whether he or she has performed service in 3 of the last 5 years. Such an employee must also receive a contribution for the short year if he or she would have been entitled to a contribution for the "year" in which the short year begins if there had been no change.)

For purposes of determining which employees are eligible to participate, the following employees are excluded from consideration:

- (a) nonresident aliens who receive no earned income from the employer which constitutes income from sources within the United States, and
- (b) employees included in a unit of employees covered by a collective bargaining agreement, if retirement benefits were the subject of good faith bargaining.

2. Statement of Requirement: Definite written allocation formula, Code § 408(k)(5)(A).

Sample Plan Language:

Each employee who satisfies the eligibility requirements of section _____ will share in an allocation as determined in section _____ .

(Note to reviewer: The first blank should contain the section of the plan that corresponds to LRM 1 and the second blank should contain the section of the plan that corresponds to LRM 3.)

3. Statement of Requirement: Nondiscrimination and definite written allocation formula, Code §§ 408(k) (3) and 408(k) (5) (B) .

Sample Plan Language:

(Use as alternatives)

(a) Definite contribution formula

The employer will contribute to each participant's IRA an amount equal to the lesser of _____% (not to exceed 25%) of the participant's compensation for the calendar year or \$40,000, as adjusted under Code § 415(d). For purposes of the 25% limitation described in the preceding sentence, a participant's compensation does not include any elective deferral described in Code § 402(g) (3) or any amount that is contributed by the employer at the election of the employee and that is not includible in the gross income of the employee under Code §§ 125, 132(f) (4) or 457.

(b) Definite integrated contribution formula

Subject to the overall permitted disparity limits, the employer will contribute to each participant's IRA an amount equal to _____% ("base contribution percentage," not less than 3%) of the participant's compensation for the calendar year, up to the integration level plus _____% ("excess contribution percentage," not less than 3% and not to exceed the base contribution percentage by more than the lesser of: (1) the base contribution percentage, or (2) the maximum disparity rate) of the participant's compensation in excess of the integration level. However, for any participant who has exceeded the cumulative permitted disparity limit, the employer will contribute an amount equal to the excess contribution percentage multiplied by the participant's total compensation.

Overall permitted disparity limits:

Annual overall permitted disparity limit: Notwithstanding the preceding paragraph, for any calendar year this SEP benefits any participant who benefits under another SEP or qualified plan described in Code § 401(a) maintained by the employer that provides for permitted disparity (or imputes disparity), the employer will contribute an amount equal to the excess contribution percentage multiplied by the participant's total compensation.

Cumulative permitted disparity limit: Effective for calendar years beginning on or after January 1, 1995, the cumulative permitted disparity limit for a participant is 35 total cumulative permitted disparity years. Total cumulative permitted disparity years means the number of years credited to the participant for allocation or accrual purposes under this SEP or any other SEP or any qualified plan described in Code § 401(a) (whether or not terminated) ever maintained by the employer. For purposes of determining the participant's cumulative permitted disparity limit, all years ending in the same calendar year are treated as the same year. If the participant has not benefited under a defined benefit or target benefit plan for any year beginning on or after January 1, 1994, the participant has no cumulative permitted disparity limit.

The integration level shall be equal to the taxable wage base or such lesser amount elected by the employer below. The taxable wage base is the contribution and benefit base in effect under § 230 of the Social Security Act at the beginning of the year.

The integration level is equal to:

[] the taxable wage base ("TWB")

[] _____% of the TWB (not to exceed 100%)

(Note to reviewer: A sponsor may not permit the employer to elect a stated dollar amount as the integration level.)

The maximum disparity rate is equal to the lesser of:

(i) 5.7%, or

(ii) the applicable percentage determined in accordance with the table below.

(d) Discretionary integrated contribution formula

Employer contributions for the calendar year will be allocated to participants' IRAs as follows:

STEP ONE: Contributions will be allocated to each participant's IRA in the ratio that the participant's total compensation bears to all participants' total compensation, but not in excess of 3% of the participant's compensation.

STEP TWO: Any contributions remaining after the allocation in Step One will be allocated to each participant's IRA in the ratio that the participant's compensation for the calendar year in excess of the integration level bears to the excess compensation of all participants, but not in excess of 3% of the participant's compensation. For purposes of this Step Two, in the case of any participant who has exceeded the cumulative permitted disparity limit described below, such participant's total compensation for the calendar year will be taken into account.

STEP THREE: Any contributions remaining after the allocation in Step Two will be allocated to each participant's IRA in the ratio that the sum of the participant's total compensation and compensation in excess of the integration level bears to the sum of all participants' total compensation and compensation in excess of the integration level, but not in excess of the maximum disparity rate. For purposes of this Step Three, in the case of any participant who has exceeded the cumulative permitted disparity limit described below, 2 times such participant's total compensation for the calendar year will be taken into account.

STEP FOUR: Any remaining employer contributions will be allocated to each participant's IRA in the ratio that each participant's total compensation for the calendar year bears to all participants' total compensation for that year.

Overall permitted disparity limits:

Annual overall permitted disparity limit: Notwithstanding the preceding paragraphs, for any calendar year this SEP benefits any participant who benefits under another SEP or qualified plan described in Code § 401(a) maintained by the employer that provides for permitted disparity (or imputes disparity), employer contributions will be allocated to each participant's

IRA in the ratio that the participant's total compensation for the calendar year bears to all participants' total compensation for that year.

Cumulative permitted disparity limit: Effective for calendar years beginning on or after January 1, 1995, the cumulative permitted disparity limit for a participant is 35 total cumulative permitted disparity years. Total cumulative permitted disparity years means the number of years credited to the participant for allocation or accrual purposes under this SEP or any other SEP or any qualified plan described in Code § 401(a) (whether or not terminated) ever maintained by the employer. For purposes of determining the participant's cumulative permitted disparity limit, all years ending in the same calendar year are treated as the same year. If the participant has not benefited under a defined benefit or target benefit plan for any year beginning on or after January 1, 1994, the participant has no cumulative permitted disparity limit.

The integration level shall be equal to the taxable wage base or such lesser amount elected by the employer below. The taxable wage base is the contribution and benefit base in effect under § 230 of the Social Security Act at the beginning of the year.

The integration level is equal to:

[] the taxable wage base ("TWB")

[] _____ % of the TWB (not to exceed 100%)

(Note to reviewer: A sponsor may not permit the employer to elect a stated dollar amount as the integration level.)

The maximum disparity rate is equal to the lesser of:

(i) 2.7%, or

(ii) the applicable percentage determined in accordance with the table below.

If the integration level:

is more than but not more than the
 applicable
 percentage is:

| | | |
|------------|------------|------|
| \$0 | X* | 2.7% |
| X* | 80% of TWB | 1.3% |
| 80% of TWB | Y** | 2.4% |

*X = the greater of \$10,000 or 20% of the TWB

**Y = any amount more than 80% of the TWB but less than 100% of the TWB.

If the integration level is equal to the taxable wage base, the applicable percentage is 2.7%.

In no event can the amount allocated to each participant's IRA exceed the lesser of 25% of the participant's compensation or \$40,000, as adjusted under Code § 415(d). For purposes of the 25% limitation described in the preceding sentence, a participant's compensation does not include any elective deferral described in Code § 402(g)(3) or any amount that is contributed by the employer at the election of the employee and that is not includible in the gross income of the employee under Code §§ 125, 132(f)(4) or 457.

4. Reserved

5. Statement of Requirement: Approved IRAs, Rev. Proc. 87-50, 1987-2 C.B. 647.

Sample Plan Language:

This agreement must be used with an Internal Revenue Service model traditional IRA or a Service-approved prototype traditional IRA.

6. Statement of Requirement: Withdrawals must be permitted, Code § 408(k)(4).

(Note to reviewer: The sponsor must delete any language that prohibits withdrawals by participants from their IRAs.)

7. Statement of Requirement: Definition of compensation, Code §§ 402(h)(2) and 408(k)(7)(B).

Sample Plan Language:

Compensation shall mean:

[] Information required to be reported under Code §§ 6041, 6051 and 6052 (wages, tips and other compensation as reported on Form W-2). Compensation is defined as wages within the meaning of Code § 3401(a) and all other payments of compensation to an employee by the employer (in the course of the employer's trade or business) for which the employer is required to furnish the employee a written statement under Code §§ 6041(d), 6051(a)(3) and 6052. Compensation must be determined without regard to any rules under Code § 3401(a) that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in Code § 3401(a)(2)).

[] Section 3401(a) wages. Compensation is defined as wages within the meaning of Code § 3401(a) for the purposes of income tax withholding at the source but determined without regard to any rules that limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in Code § 3401(a)(2)).

[] 415 safe-harbor compensation. Compensation is defined as wages, salaries, and fees for professional services and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the employer maintaining the SEP to the extent that the amounts are includible in gross income (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, bonuses, fringe benefits, and reimbursements or other expense allowances

under a nonaccountable plan (as described in Regulations § 1.61-2(c)), and excluding the following:

(a) Employer contributions to a plan of deferred compensation which are not includible in the employee's gross income for the taxable year in which contributed, or employer contributions under a SEP, or any distributions from a plan of deferred compensation;

(b) Amounts realized from the exercise of a non-qualified stock option, or when restricted stock (or property) held by the employee either becomes freely transferable or is no longer subject to a substantial risk of forfeiture;

(c) Amounts realized from the sale, exchange or other disposition of stock acquired under a qualified stock option; and

(d) Other amounts which received special tax benefits, such as premiums for group-term life insurance (but only to the extent the premiums are not includible in the gross income of the employee).

For any self-employed individual covered under the SEP, compensation will mean earned income.

Compensation shall include only that compensation which is actually paid or made available to the participant during the year.

(Note to reviewer: The same "year" must be used for calculating compensation as is used for participation. See the Note to reviewer at the end of LRM 1.)

Except where specifically stated otherwise in this plan, a participant's compensation shall include any elective deferral described in Code § 402(g)(3) or any amount that is contributed by the employer at the election of the employee and that is not includible in the gross income of the employee under Code §§ 125, 132(f)(4) or 457.

The annual compensation of each participant taken into account under the SEP for any year shall not exceed \$200,000, as adjusted for increases in the cost of living in accordance with Code § 401(a)(17)(B). If the SEP determines compensation for a period of time that contains fewer than 12 calendar months, then the annual compensation limit is an amount equal to the annual

compensation limit for the calendar year in which the compensation period begins multiplied by a fraction, the numerator of which is the number of full months in the short compensation period, and the denominator of which is 12.