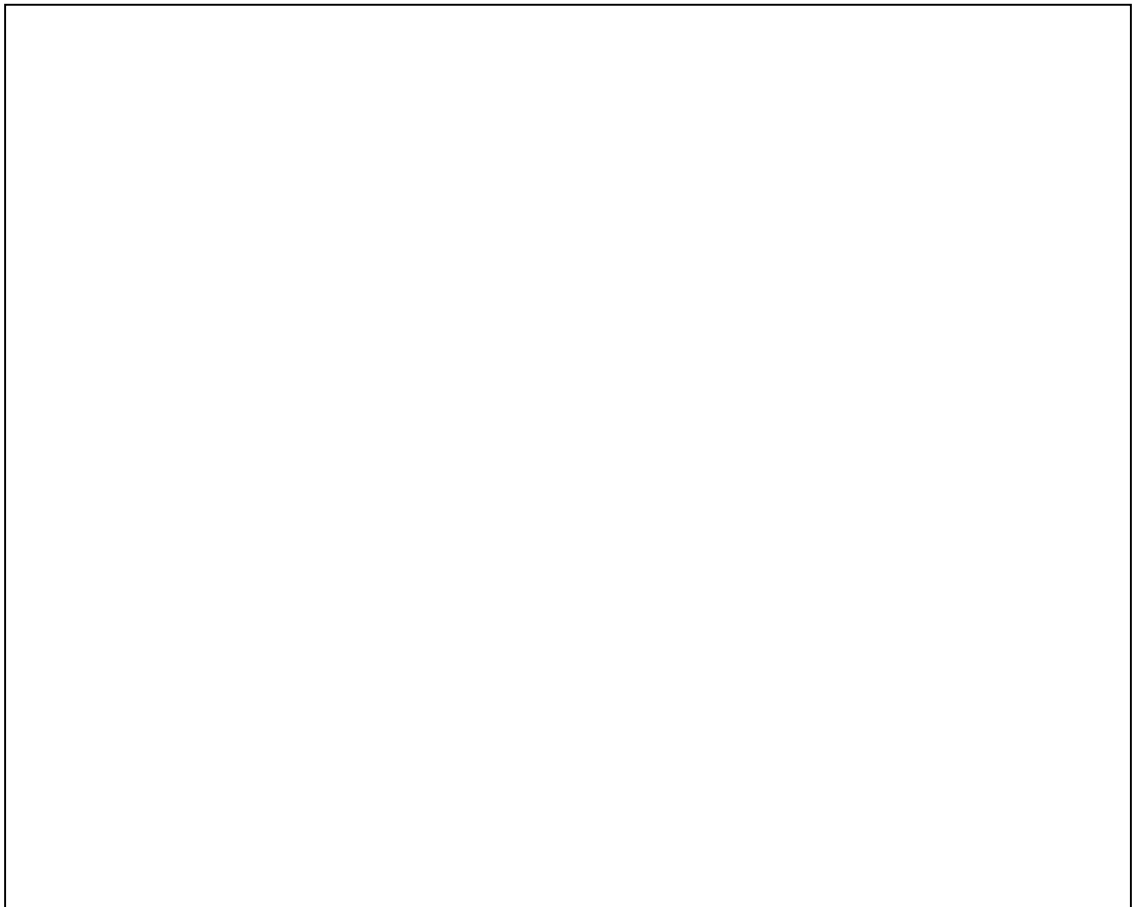




“No Fuss” Retirement Plans

Tax Exempt and Government Entities
Employee Plans
2003 IRS Nationwide Tax Forum

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“No Fuss” Retirement Plans

- 2002 IRS Nationwide Tax Forum
 - Choosing A Retirement Solution for Your Small Business
- 2003 IRS Nationwide Tax Forum
 - Establishing and Operating a “No Fuss” Retirement Plan
 - SEP (Simplified Employee Pension)
 - SIMPLE IRA (Savings Incentive Match Plan for Employees of Small Employers)

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Introduce yourself and provide your qualifications for speaking.

Last year at the 2002 IRS Nationwide Tax Forum, Employee Plans’ presentation was on “Choosing A Retirement Solution for Your Small Business”. During that session, we provided a brief overview of the different types of small business retirement plans available, from the simplest to the most complex.

This year, as promised, we will be providing you with a more in-depth look at what is involved in Establishing and Operating the simpler “no fuss” retirement plans that were discussed at last year’s Tax Forum.

Today’s presentation will be focusing on 2 IRA based plans: **SEPs** - Simplified Employee Pension plans and **SIMPLEs** - Savings Incentive Match Plans for Employees of Small Employers.

Many of your clients may ask, “Why bother with setting up a retirement plan?”

A good reason, there are tax advantages for both the employer and the employee.

A relatively new incentive for the employer is the “**Credit for Start Up Costs**”. This credit is available for plans that become effective after December 31, 2001. The employer may be able to receive a **tax credit of 50% of the first \$1,000 of qualified startup costs involved in setting up a SEP or SIMPLE.**

Qualified startup costs:

- The cost to set up the plan
- The cost to administer the plan
- The cost to educate employees about the plan.

This credit is only available to employers with 100 or fewer employees receiving at least \$5,000 of compensation from the employer for the preceding year and at least one participant who is non-highly compensated. Employers use *Form 8881, Credit for Small Employer Pension Plan Startup Costs* to claim this credit.

Another tax advantage is that an employer can deduct its contributions to a SEP or a SIMPLE - within certain limits that we will further discuss later in the presentation.

The Employee also has tax advantages for participating in a retirement plan. Beginning in 2002, retirement plan participants, *including self-employed individuals*, who make contributions to their retirement plan may qualify for the “**Saver’s Tax Credit**”. The maximum contribution eligible for the credit is \$2,000. The amount of the credit is based on the contribution amount and the participant’s “credit rate”. The credit rate ranges from 10% to 50%, depending on the participant’s adjusted gross income and filing status. An employee whose filing status is married filing jointly is eligible for the tax credit if the adjusted gross income shown on the return is not more than \$50,000, \$37,500 if head of household and \$25,000 if single or married filing separately. Employees use *Form 8880, Credit for Qualified Retirement Savings Contributions* with their individual income tax return to claim this credit.

Also, employee contributions - and earnings on those contributions - to a SEP or SIMPLE are tax deferred until withdrawn.



SEP

- What is a SEP?
- Who can have a SEP?
- Where do the contributions go?

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SEP stands for “Simplified Employee Pension”.

A SEP is a written plan that allows an employer to make contributions towards their retirement and their employees’ retirement without getting involved in a more complex plan.

*Under a SEP, the employer makes contributions to a traditional IRA (SEP-IRA) set up by or **for each eligible employee**. Just who is an eligible employee will be discussed later in the presentation.*

A SEP-IRA is owned and controlled by the employee and the employer makes contributions to the financial institution where the SEP-IRA is maintained.

Sole proprietors, partnerships and corporations – including S corporations and LLCs - can set up a SEP.

Salary reduction SEPs, known as SARSEPs, have been replaced by SIMPLEs. No new SARSEPs can be established after December 31, 1996.

There are three basic steps in setting up a SEP:

- 1) You must execute a formal written agreement to provide benefits for all eligible employees.
- 2) You must give each eligible employee certain information about the SEP.
- 3) A SEP-IRA must be set up by or for each eligible employee.

Executing a formal written agreement to provide benefits to all eligible employees can be done in one of two ways:

One way is to adopt an IRS model SEP using *Form 5305-SEP, Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement*. **This form is not filed with the IRS** – the employer keeps the form in its records. The model SEP is considered to be adopted when IRAs have been established for all eligible employees, the form has been completed and specified information has been given to all eligible employees. By using the *Form 5305-SEP*, the employer is usually relieved from filing an annual retirement plan information return with the IRS and Department of Labor.

Model *Form 5305-SEP* may not be used by an employer who:

- Has another qualified retirement plan,
- Uses the services of leased employees,
- Wants a SEP maintained on a fiscal year rather than a calendar year, or
- Wants a contribution formula that takes into account Social Security withholdings

Another way that an employer can establish a SEP **is with a prototype plan**. This can be done through a mutual fund, bank or insurance company. These plans have been reviewed and approved by the Internal Revenue Service.

By using a prototype document, rather than a model, the employer can customize a SEP.

The SEP can be set up for a year as late as the due date (including extensions) of the employer's income tax return for that year.



Establishing a SEP cont...

- Eligible Employee
 - Age 21
 - Worked for employer in 3 of 5 years
 - Received at least \$450 in compensation

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For a SEP, an eligible employee is someone who meets all of the following requirements:

- Has reached age 21.
- Has worked for the employer in at least 3 of the last 5 years. There is no minimum service requirement per year, so part-time and seasonal employees must be included.
- Has received at least \$450 in compensation from the employer for the year. This number will change based on cost-of-living increases.

Employers are allowed to use less restrictive eligibility requirements, but not more restrictive. For example, a SEP could cover all employees without restriction. Certain collectively bargained and nonresident alien employees can be excluded from participation in a SEP.

The SEP rules allow the employer – including self-employed individuals - to contribute a limited amount of money each year to each eligible employee's SEP-IRA.

The employer is not required to make a contribution every year, but when contributions are made, they must be based on a written allocation formula and must not discriminate in favor of highly compensated employees.

Contributions must be:

- In the form of cash, not property,
- Made for all participants who performed services during the year, even terminated employees.
- Made by the due date of the employer's tax return for the year.

The contributions can not be invested in collectibles such as artwork, stamps, rugs and antiques.

Contributions to an employee's SEP-IRA can not exceed the lesser of 25% of their compensation or \$40,000. The maximum amount of compensation that can be considered for 2002 and 2003 is \$200,000.

If the employer sponsors more than one plan, the contributions to both plans when combined are generally limited to the lesser of \$40,000 or 25% of compensation.

Self-employed individuals must use a special formula to determine their maximum contribution because their maximum contribution is based on net earnings from self-employment. Net earnings from self-employment take into account both the deduction for one-half of the self-employment tax and the deduction for contributions to the SEP-IRA. *Publication 560, Retirement Plans for Small Business* provides a Rate Table and Rate Worksheet to assist in this calculation.

If you have an existing SARSEP that has more than 60% of contributions going to key employees (generally, owners, officers and highly paid individuals) (section 416(i)), then non-key employees are entitled to a minimum contribution (generally 3%).

Employer contributions under a SEP are used to determine if the 60% threshold has been crossed. Keep in mind that if an employer who adopts the IRS Model plan (Form 5305A-SEP) in any year has a key employee make an elective deferral, the plan is deemed to be top-heavy regardless of the 60% threshold.

Contributions to a SEP-IRA are always 100% owned – (often referred to as “100% vested”) - by the employee.

IRAs are the investment vehicles for both SEP and SIMPLE IRA plans. Therefore, the required minimum distribution rules apply for each year after the employee turns age 70 ½. The required minimum distribution for each year is calculated by dividing the IRA account balance as of

SIMPLE stands for “Savings Incentive Match Plan for Employees of Small Employers”. A SIMPLE IRA plan is a retirement plan in which a SIMPLE IRA is established **for each eligible employee**. Who is an eligible employee will be discussed later in the presentation.

Only employers with 100 or fewer employees who received \$5,000 or more in compensation in the preceding calendar year can set up a SIMPLE IRA plan. All employees employed at any time during the calendar year – not just eligible employees - must be taken into account.

Once an employer sets up a SIMPLE IRA plan, the 100 employee limit must be met each year the plan is maintained.

Once the SIMPLE IRA plan is effective, it generally must be the only retirement plan maintained by the employer.

Most types of employers, including C-corporations, S-corporations, LLCs, partnerships and sole proprietorships, can sponsor a SIMPLE IRA plan.

With a SIMPLE IRA plan, a SIMPLE IRA is established for each eligible employee with a bank, insurance company or other qualified financial institution.

Form 5304-SIMPLE and *Form 5305-SIMPLE* are model forms for use by employers to establish SIMPLE IRA plans. Which form is used depends on whether the employer or the employees select the financial institution which receives the contributions.

Form 5304-SIMPLE is used if the employer allows plan participants to select the financial institution to receive contributions made under the SIMPLE IRA plan. *Form 5305-SIMPLE* is used if the employer requires that all contributions be initially deposited in a designated financial institution.

As was the case with the SEP plan, the SIMPLE IRA plan is adopted when the form is completed and signed by the employer. **The form is not filed with the IRS** – the employer keeps the form in its records.

Instead of using either of the model forms, an employer can use a prototype document to establish a SIMPLE IRA plan.

A SIMPLE IRA plan must be maintained on a calendar year basis, regardless of the employer's tax year.

A SIMPLE IRA must be set up for an employee before the first date by which a contribution is required to be deposited into the employee's IRA.

Eligible employees must be given a summary description of the SIMPLE IRA plan and a notice of their right to make elective contributions prior to the beginning of the 60 day election period. The notice requirement can be satisfied using the "Model Notification to Eligible Employees" contained in the model forms.

You can establish a SIMPLE IRA plan effective on any date between January 1 and October 1 of the year for which you make your first contributions. However, if you previously maintained a SIMPLE IRA plan, you can set up a SIMPLE IRA plan effective only on January 1 of the year for which you make your first contributions.



Establishing a SIMPLE IRA cont...

- Eligible Employee
 - SIMPLE IRA
 - Any employee who received at least \$5,000 in compensation during any 2 preceding years and is reasonably expected to receive at least \$5,000 for the current year.

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The definition of an eligible employee for a SIMPLE IRA plan is different from that for a SEP.

For a SIMPLE IRA, an eligible employee is someone who:

- Received at least \$5,000 in compensation during any 2 years preceding the current calendar year, and
- Is reasonably expected to receive at least \$5,000 during the current calendar year.

Again, the employer is allowed to use less restrictive eligibility requirements, but not more restrictive. For example, a SIMPLE IRA plan could cover all employees without restriction. Certain collectively bargained and nonresident alien employees can be excluded from participation in a SIMPLE IRA plan.

contributions. The employer must make either matching contributions or nonelective contributions.

The employer must provide an election period each year of at least 60 days during which the employee may enter into or modify a contribution election. This 60-day period generally begins November 2nd of the year prior to the beginning of a calendar year for an established plan or 60 days prior to the effective date of a newly established plan. Employees who become eligible after the last regular election period must be given at least a 60-day enrollment period which includes the employee's initial eligibility date.

Every eligible employee must be given the opportunity to make elective contributions under the SIMPLE IRA plan. Elective contributions under a SIMPLE IRA plan are limited to \$7,000 for 2002 and \$8,000 for 2003.

Participants who are age 50 or over can make a "catch-up" contribution of up to \$500 in 2002 and \$1,000 in 2003. The employer can not place restrictions on the contribution amount, except to comply with the dollar limit amounts just discussed.

Elective contributions are subject to FICA and FUTA.

The employer matching contribution for each employee's salary reduction contribution is generally on a dollar-for-dollar basis up to a limit of 3% of the employee's compensation. The employer may choose to limit matching contributions to less than 3% of employee compensation for a year. However, the employer cannot choose a percentage of less than 3% for more than 2 years during the 5-year period that ends with and includes the year for which the choice is effective. The employees must be notified if the employer chooses to match at less than 3%.

Instead of making matching contributions, the employer can choose to make nonelective contributions of 2% of compensation on behalf of each eligible employee who has at least \$5,000 of compensation from the employer for the year. These nonelective contributions must be for all participants, even those who did not make salary reduction contributions. The employees must be notified if the 2% contribution formula is selected.

An employer may not make both matching contributions and nonelective contribution in the same year.

The employer must deliver the salary reduction contributions to each employee's SIMPLE IRA as soon as possible but no later than 30 days after the end of the month in which the amounts would otherwise have been payable to the employee in cash. For example, if your employees would have otherwise received compensation (instead of the elective deferrals) in March, you would have until April 30th to deposit the deferral amounts.

The matching or nonelective contributions must be deposited by the due date (including extensions) for filing the employer's federal income tax return for the year. SIMPLEs are not subject to the top-heavy rules.



Operating a SEP or SIMPLE IRA

- Reporting Requirements
 - Employees
 - IRS
- Amending Your Plan
 - New IRS Guidance
 - Law Changes

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A SIMPLE IRA plan offers features similar to a 401(k) plan (e.g., flexibility...)

After a SEP or SIMPLE is adopted and, later, after a new employee becomes employed, the employer must furnish the following information to each eligible employee:

- Notice that the SEP or SIMPLE has been adopted.
- Requirements an employee must meet to receive an allocation and
- The basis upon which the employer's contributions will be allocated.

All three of these are met if the employer provides a copy of the model or prototype document.

Each year the employer must furnish a statement to each SEP or SIMPLE participant, showing the amount contributed to the employee's SEP-IRA or SIMPLE IRA for the year.

Generally, the statement needs to be furnished to the employee before the following January 31 for calendar year plans.

The *Form 5500* series forms that are required to be filed by most qualified plans are not filed for SEPs or SIMPLEs. Most SEPs and SIMPLEs are also exempt from the



Compliance

- Common Problems
 - Incorrect Employer Contributions
 - Excess Employee Deferrals
 - Not Covering Eligible Employees
 - Fiduciary Problems

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There are several types of errors that occur commonly:

EP field offices conducted SEP/SARSEP examinations during fiscal year 2002. The goal of the project was to research, select and study a statistically reliable sample of plans from the SEP plan universe identified for the 2000 year. Code F in box 13 on the W-2 indicates that an employee has made a salary reduction contribution to a SARSEP. The EP personnel encountered various issues in their examination of these project cases.

The most important issues are:

- 1) top-heavy failure;
- 2) lack of documentation for the plans due to no filing requirements;
- 3) in SARSEPs, failure to satisfy the 50% participation rule for eligible employees; and
- 4) in SARSEPs, failure of the 25 employee rule.

One error which seems simple, but occurs frequently is simply a failure to complete the eligibility requirements on the SEP or SIMPLE documents. Meaning this is

The IRS has a comprehensive system of correction programs for sponsors of retirement plans that are intended to satisfy the requirements - but have failed - of the Internal Revenue Code.

The system – called the **Employee Plans Compliance Resolution System** or “EPCRS” - permits plan sponsors to correct retirement plan failures and thereby continue to enjoy tax-favored status for their retirement plans. EPCRS also allows employees to continue accruing retirement benefits on a tax-favored basis. In early June the IRS came out with a new Rev. Proc. (2003-44) that details the corrections allowable to maintain your deduction for contributions to a SEP or SIMPLE IRA.

Under EPCRS, employers can:

1. Self-correct insignificant SEP failures, or
2. Apply to the IRS for corrections of certain other failures under the “Voluntary Correction of SEP Failures”. This application involves a payment of a fee and the IRS will provide a written approval of the correction method.

Applications to the Service can also be made for correction of SIMPLE IRA plan failures.

The Department of Labor’s Employee Benefits Security Administration, EBSA, (formerly known as Pension Welfare Benefits Administration, or PWBA) has a correction program, the Voluntary Fiduciary Correction Program. You can visit their website for additional information on this program.



Time is Running Out!

- September 30, 2003 Deadline!
 - M&P or Volume Submitter
 - Changed your M&P Document?
 - Modified a Pre-approved Document?

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If you are an employer who maintains a qualified master and prototype (M&P) or volume submitter retirement plan, you generally have to amend your plan by **September 30, 2003** for extensive changes in the tax rules which govern qualified plans.

If you're an employer who made changes to the pre-approved M&P plan document other than choosing options or making changes allowed by the adoption agreement, you must file an application for a determination letter by September 30, 2003 to preserve the tax benefits of your M&P plan

If you maintain a volume submitter plan and you have modified the pre-approved document other than choosing options permitted under the document, you also must file an application for a determination letter by September 30, 2003 to preserve the tax benefits of your plan.

Consult the sponsor of your M&P or volume submitter document and your pension plan advisor or attorney now! Take prompt action – Prevent the loss of valuable tax benefits.

Call the Employee Plans toll-free customer service telephone number, **1-877-829-5500 for more details. Also see our web page at www.irs.gov/ep for more information.**



Need Help?

- IRS
 - www.irs.gov/ep
 - 1-877-829-5500: Customer Account Services
 - Retirement Plan Correction Programs
 - CD-ROM
- DOL
 - www.dol.gov/ebsa

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This presentation provided you with a more in-depth analysis of the requirements for establishing and operating SEPs and SIMPLEs.

If you have any additional questions, please visit our website at www.irs.gov/ep.

In addition, we have a booth in the exhibit hall with trained and experienced IRS agents who are available to answer your questions. We have forms, publications and CD-ROMs available for you.

Please stop by and see us.