

# SEP IRAs

*Useful savings plans for the smallest businesses.*

Do you own a small business with a few employees? Are you self-employed? In either case, the SEP IRA may be the ideal low-cost, easily administered retirement savings plan for you.

This is a simple pension plan using a traditional IRA. (SEP stands for Simplified Employee Pension.) It lets you put aside money into individual IRAs for you and your employees, with lower administrative fees and less paperwork than other types of retirement plans.<sup>1</sup>

**Tax-deferred compounding of pre-tax dollars.** You contribute pre-tax dollars to a SEP IRA, and that has the effect of lowering your tax bill. The money in the IRA grows tax-deferred, and your business doesn't pay any taxes on the IRA earnings.<sup>1</sup> The assets can be invested in many ways.

The traditional IRA rules apply. When you take the money out of a SEP IRA for retirement, you pay ordinary income taxes on it. (Should you withdraw SEP IRA assets before age 59½, you'll likely be assessed a penalty, with some exceptions.)<sup>2</sup>

**Contributions are discretionary.** Each year, you can contribute or not contribute to the IRA(s) involved. The amount you put into the IRA(s) can also vary.<sup>1</sup>

In 2009, you can contribute up to 25% of an eligible employee's compensation, up to a limit of \$49,000. No catch-up contributions are permitted for older employees.<sup>3</sup>

**A three-point employee eligibility test.** Generally, employees of a small business are eligible for a SEP IRA if they 1) are older than 21, 2) have worked for the business in at least three of the five years preceding the year in which the IRA contribution is made, 3) have received \$550 or more in compensation from the business in 2009 (this can rise with COLA adjustments in future years). However, the IRS states that an employer "may use less restrictive requirements to determine an eligible employee."<sup>3</sup>

Employees covered by a union contract may be excluded from a SEP, as well as non-resident aliens who have not earned income from your business.<sup>3</sup>

All eligible employees must participate in the SEP - including part-time and seasonal workers and employees who die, quit, or get laid off or fired during the year.<sup>1</sup>

**Are you self-employed?** Assuming your business is unincorporated, you can contribute up to 20% of your net adjusted self-employment income to a SEP each year. If you have a bad year, you have the option of skipping your SEP contribution, and no penalty will come your way if you do.<sup>4</sup>

**Starting up a SEP IRA is easy.** You can open up one of these plans with the help of almost any financial advisor or financial institution. In fact, you can even have other retirement plans at your business in addition to SEP IRAs, and you can set up a SEP IRA for your small business even if you are already participate in another retirement plan at another company.<sup>3</sup>

Sole proprietors, partnerships, and corporations can all create SEPs. In fact, they may qualify for annual tax credits of up to \$500 during the plan's first three years, which can be applied toward the plan's start-up costs.<sup>1</sup> So if you have a small business or work on your own and you want a retirement plan that works for your future without a lot of hassles, talk to a financial advisor to see if a SEP IRA is right for you.

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#### **Citations.**

<sup>1</sup> [dol.gov/ebsa/publications/SEPPlans.html](http://dol.gov/ebsa/publications/SEPPlans.html) [2/20/09]

<sup>2</sup> [investopedia.com/university/retirementplans/sepira/sepira3.asp](http://investopedia.com/university/retirementplans/sepira/sepira3.asp) [2/20/09]

<sup>3</sup> [irs.gov/retirement/article/0,,id=111419,00.html](http://irs.gov/retirement/article/0,,id=111419,00.html) [10/23/08]

<sup>4</sup> [publicradio.org/columns/marketplace/gettingpersonal/2008/09/\\_question\\_i\\_understand\\_that\\_1.html](http://publicradio.org/columns/marketplace/gettingpersonal/2008/09/_question_i_understand_that_1.html) [9/29/08]