Financial Planning Tax Considerations: Retirement Part 1

Course #30904B

Taxes

2 Credit Hours

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FINANCIAL PLANNING TAX CONSIDERATIONS: RETIREMENT PART 1

This course explains the types of retirement plans small business owners can set up for themselves and their employees, along with the tax impacts of each. It also outlines the key rules and benefits of the Social Security system, helping business owners understand how these programs fit into overall retirement planning.

LEARNING ASSIGNMENTS AND OBJECTIVES

As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.

SUBJECTS

Employer-Sponsored Retirement Plans
Taxation of Social Security Benefits

Study the course materials

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

Objectives:

- Identify the various types of retirement plans that small business owners can establish for themselves and their employees and the tax implications of each.
- Recognize the rules governing the benefits provided through the social security system.

NOTICE

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EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.

- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.

- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.

- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.

- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

TABLE OF CONTENTS

CHAPTER 1: EMPLOYER-SPONSORED RETIREMENT PLANS

Chapter Objective

After completing this chapter, you should be able to:

- Identify the various types of retirement plans that small business owners can establish for themselves and their employees and the tax implications of each.

I. INTRODUCTION AND OVERVIEW

Virtually every detailed financial plan includes provisions for retirement. One important way in which people can save for retirement is through the savings of pre-tax dollars. This has the double benefit of providing an important source of retirement funding and of limiting income tax liability in the present time. This chapter discusses retirement plans small business owners can set up and maintain for themselves and their employees. The following types of retirement plans are covered:

- SEP (simplified employee pension) plans;
- SIMPLE (savings incentive match plan for employees) plans; and
- Qualified plans (also called H.R. 10 plans or Keogh plans when covering self-employed individuals).

SEP, SIMPLE, and qualified plans offer small business owners and their employees a tax-favored way to save for retirement. Employers can deduct contributions made to the plan for their employees. A sole proprietor can deduct contributions he or she makes to the plan for himself or herself.

Trustees' fees can also be deducted if contributions to the plan do not cover them. Earnings on the contributions are generally tax-free until an employer or his or her employees receive distributions from the plan.

Under certain plans, employees can have their employer contribute limited amounts of their before-tax pay to a plan. These amounts (and earnings on them) are generally tax free until the employees receive distributions from the plan. The following is a summary of each type of plan.

A. SEP PLANS

SEPs provide a simplified method for an employer to make contributions to a retirement plan for employees. Instead of setting up a profit-sharing or money purchase plan with a trust, an employer can adopt a SEP agreement and make contributions directly to a traditional individual retirement account or a traditional individual retirement annuity (SEP-IRA) set up for each eligible employee.

B. SIMPLE PLANS

A SIMPLE plan can be set up by an employer who had 100 or fewer employees who received at least $5,000 in compensation from the employer for the preceding calendar year and who meets certain other requirements. Under a SIMPLE plan, employees can choose to make salary reduction contributions rather than receiving these amounts as part of their regular pay. In addition, the employer will contribute matching or nonelective contributions. The two types of SIMPLE plans are the SIMPLE IRA plan and the SIMPLE 401(k) plan.

C. QUALIFIED PLANS

The qualified plan rules are more complex than the SEP plan and SIMPLE plan rules. However, there are advantages to qualified plans, such as increased flexibility in designing plans and increased contribution and deduction limits in some cases.

II. SIMPLIFIED EMPLOYEE PENSION (SEP) PLANS

A simplified employee pension (SEP) is a written plan that allows employers to make contributions toward their own retirement (if they are self-employed) and their employees' retirement without getting involved in a more complex qualified plan. Under a SEP, employers make the contributions to a traditional individual retirement arrangement (called a SEP-IRA) set up by or for each eligible employee. A SEP-IRA is owned and controlled by the employee, and employers make contributions to the financial institution where the SEP-IRA is maintained.

A. ELIGIBILITY REQUIREMENTS

SEP-IRAs are set up for, at a minimum, each eligible employee. A SEP-IRA may have to be set up for a leased employee, but does not need to be set up for excludable employees, discussed later.

1. <u>Eligible Employee</u>

An eligible employee is an individual who meets all the following requirements:

- Has reached age 21;
- Has worked for the employer in at least three of the last five years; and
- Has received at least $750 in compensation for 2025.

Employers can use less restrictive participation requirements than those listed, but not more restrictive ones.

2. <u>Excludable Employees</u>

The following employees can be excluded from coverage under a SEP:

- Employees covered by a union agreement and whose retirement benefits were bargained for in good faith by the employees' union and the employer; and
- Nonresident alien employees who have received no U.S. source wages, salaries, or other personal services compensation from the employer.

B. SETTING UP A SEP

There are three basic steps in setting up a SEP:

- Execution of a formal written agreement to provide benefits to all eligible employees;
- Providing each eligible employee with certain information about the SEP; and
- Establishing a SEP-IRA by or for each eligible employee.

1. Formal Written Agreement

Employers must execute a formal written agreement to provide benefits to all eligible employees under a SEP. This requirement can be satisfied by adopting an IRS model SEP using Form 5305-SEP.

If an employer adopts an IRS model SEP using Form 5305-SEP, no prior IRS approval or determination letter is required. However, employers cannot use Form 5305-SEP if any of the following apply:

- They currently maintain any other qualified retirement plan. This does not prevent them from maintaining another SEP;
- They have any eligible employees for whom IRAs have not been set up;
- They use the services of leased employees;
- They are a member of any of the following unless all eligible employees of all the members of these groups, trades, or businesses participate under the SEP:
    - An affiliated service group described in § 414(m);
    - A controlled group of corporations described in § 414(b); and
    - Trades or businesses under common control described in § 414(c); or
- They do not pay the cost of the SEP contributions.

2. Information Provided to Employees

Employers must give each eligible employee a copy of Form 5305-SEP, its instructions, and the other information listed in the Form 5305-SEP instructions. An IRS model SEP is not considered adopted until each employee has been given this information.

3. Establishing Plan for Each Employee

A SEP-IRA must be set up by or for each eligible employee. SEP-IRAs can be set up with banks, insurance companies, or other qualified financial institutions. Employers send SEP contributions to the