PacificCPE

COURSE
30904C

Financial Planning: Employer-Sponsored Retirement Plans

Retirement plan options can be a significant tax planning lever for business-owning clients and their employees. This course provides a focused look at employer-sponsored plans, covering SEP plans, SIMPLE plans, and qualified plans. You'll gain a clear understanding of contribution limits, eligibility rules, and structural differences between plan types. Whether you're helping a sole proprietor set up their first retirement plan or advising a small business on plan selection and compliance, this course gives you the foundational knowledge needed to guide those conversations confidently.

CREDIT HOURS 2 | FIELD OF STUDY TAXES | EXAM QUESTIONS 10

Start Course ↓ | Final Exam Copy ↓

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

Course 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.

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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. ASEP-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. Eligible Employee

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 $800 in compensation for 2026.

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

2. Excludable Employees

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 financial institution where the SEP-IRA is maintained. Employers can set up a SEP for a year as late as the due date (including extensions) of their income tax return for that year.

C. CONTRIBUTION RULES

The SEP rules permit employers to contribute a limited amount of money each year to each employee's SEP-IRA. If they are self-employed, they can contribute to their own SEP-IRA. Contributions must be in the form of money (cash, check, or money order); property cannot be contributed. However, participants may be able to transfer or roll over certain property from one retirement plan to another.

Employers do not have to make contributions every year. But if they make contributions, they must be based on a written allocation formula and must not discriminate in favor of highly compensated employees. When contributions are made, the employer must contribute to the SEP-IRAs of all participants who actually performed personal services during the year for which the contributions are made, even employees who die or terminate employment before the contributions are made.

Contributions are deductible within limits, and generally are not taxable to the plan participants. A SEP- IRA cannot be designated as a Roth IRA. Employer contributions to a SEP-IRA will not affect the amount an individual can contribute to a Roth or traditional IRA. To deduct contributions for a year, employers must make the contributions by the due date (including extensions) of their tax return for the year.

1. Contribution Limits

Contributions limits are established for each year. For example, contributions made for 2026 to a common-law employee's SEP-IRA could not exceed the lesser of 25% of the

employee's compensation or $72,000. Compensation generally does not include the employer's contributions to the SEP.

2. Self-Contributions

The annual limits on contributions to a common-law employee's SEP-IRA also apply to contributions employers make to their own SEP-IRA. However, special rules apply when figuring the maximum deductible contribution.

3. Annual Compensation Limit

Employers cannot consider the part of an employee's compensation over $360,000 for 2026 when figuring the contribution limit for that employee. However, $72,000 for 2026 is the maximum contribution for an eligible employee.

If an employer contributes to a defined contribution plan, annual additions to an account are limited to the lesser of $72,000 or 100% of the participant's compensation in 2026. When figuring this limit, employers must add their contributions to all defined contribution plans. Because a SEP is considered a defined contribution plan for this limit, contributions to a SEP must be added to contributions to other defined contribution plans.

4. Tax Treatment of Excess Contributions

Excess contributions are contributions to an employee's SEP-IRA (or to the employer's own SEP-IRA) that exceed the amount allowed for that particular year.

Excess contributions are included in the employee's income for the year and are treated as contributions by the employee to his or her SEP-IRA.

D. DEDUCTING CONTRIBUTIONS

Generally, a business can deduct the contributions made each year to each employee's SEP-IRA. If the employer is self-employed, he or she can deduct the contributions made each year to his or her own SEP-IRA.

1. Deduction Limit for Contributions for Participants

Federal law annually establishes a cap on how much an employer can deduct for his or her contributions (other than elective deferrals) for participants.

In 2026, for example, it is the lesser of the following amounts:

- The employer's contributions (including any excess contributions carryover); and

- 25% of the compensation (limited to $360,000 per participant) paid to the participants during 2026 from the business that has the plan, not to exceed $72,000 per participant.

In 2025, the amounts are $350,000 and $70,000.

2. Deduction Limit for Self-Employed Individuals

If an employer contributes to his or her own SEP-IRA, the employer must make a special computation to figure his or her maximum deduction for these contributions.

When figuring the deduction for contributions made to one's own SEP-IRA, compensation is the individual's net earnings from self-employment, which takes into account both the following deductions:

- The deduction for one-half of the individual's self-employment tax; and
- The deduction for contributions to his or her own SEP-IRA.

The deduction for contributions to one's own SEP-IRAand his or her net earnings depend on each other. For this reason, an individual determines the deduction for contributions to his or her own SEP-IRA indirectly by reducing the contribution rate called for in his or her plan.

3. Carryover of Excess SEP Contributions

If an employer made SEP contributions that are more than the deduction limit (nondeductible contributions), it can carry over and deduct the difference in later years.

However, the carryover, when combined with the contribution for the later year, is subject to the deduction limit for that year. If an employer made nondeductible (excess) contributions to a SEP, it may be subject to a 10% excise tax.

4. When To Deduct Contributions

When an employer can deduct contributions made for a year depends on the tax year on which the SEP is maintained. If the SEP is maintained on a calendar year basis, the employer can deduct contributions made for a year on its tax return for the year with or within which the calendar year ends. If the employer files its tax return and maintains the SEP using a fiscal year or short tax year, it may deduct contributions made for a year on its tax return for that year.

Example

Will Co is a fiscal year tax payer whose tax year ends June 30. Will Comaintains a SEP on a calendar year basis. WillCo deducts SEP contributions made for calendar year 2026 on their tax return for the tax year ending June 30, 2027.

E. SALARY REDUCTION SIMPLIFIED EMPLOYEE PENSION (SARSEP)

A SARSEP is a SEP set up before 1997 that includes a salary reduction arrangement. Under a SARSEP, employees can choose to have the employer contribute part of their pay to their SEP-IRAs rather than receive it in cash. This contribution is called an "elective deferral" because employees choose (elect) to set aside the money, and they defer the tax on the money until it is distributed to them. Employers are not allowed to set up a SARSEP after 1996. However, participants (including employees hired after 1996) in a SARSEP set up before 1997 can continue to have employers contribute part of their pay to the plan.

1. Who Can Have a SARSEP

A SARSEP set up before 1997 is available to an employer and its eligible employees only if all the following requirements are met.

- At least 50% of employees eligible to participate choose to make elective deferrals;
- The employer has 25 or fewer employees who were eligible to participate in the SEP at any time during the preceding year; and
- The elective deferrals of highly compensated employees meet the SARSEP ADP test.

2. SARSEP ADP Test

Under the SARSEP ADP test, the amount deferred each year by each eligible highly compensated employee as a percentage of pay (the deferral percentage) cannot be more than 125% of the average deferral percentage (ADP) of all non-highly compensated employees eligible to participate.

For figuring the deferral percentage, compensation is generally the amount the employer pays to the employee for the year. Compensation includes the elective deferral and other amounts deferred in certain employee benefit plans. Elective deferrals under the SARSEP are included in figuring an employees' deferral