IRS NEWSLETTER HIGHLIGHTS TIMING RULES FOR SEPs AND SIMPLE-IRAs

For the most part, SEPs (Simplified Employee Pensions) and SIMPLE (Savings Incentive Match Plan for Employees) - IRAs live up to their billing as easy ways to set aside tax-favored retirement funds for employees and employers. However, as IRS's latest issue of Retirement News for Employers points out, contribution timing rules for these plans can pose a challenge.

- **SEP plans**.

IRS's Retirement News for Employers reminds business owners they still have time to set up a SEP plan for 2013. If they set up and fund their SEP by the due date of their 2013 business return (including extensions), they can still take a deduction for 2013. For businesses using the calendar year as their tax year, the deadline to set up and contribute to a SEP plan for 2013 is:

- March 15, 2014, (September 15, 2014, if an extension is filed) if the business is a corporation filing Form 1120 or 1120S.
- April 15, 2014, (September 15, 2014, if an extension is filed) if the business is a partnership filing Form 1065, or a sole proprietorship (reported on Form 1040, Schedule C.

SEPs may be an attractive alternative for smaller businesses because they can be set up (as a SEP-IRA for each participant) for little or no cost at a bank, investment firm or insurance company, and they offer relatively high contribution and deduction limits, minimal paperwork and no annual Form 5500 filing. The plan must cover employees who are at least age 21 and have performed service for the business in at least three of the last five years. All eligible employees must participate in the plan, including part-time employees, seasonal employees and employees who die or terminate employment during the year. A SEP may, but is not required to, also cover the following: employees covered by a union contract; certain nonresident alien employees; and employees who received less than $550 in compensation (for 2013 or 2014) during the year.

Observation: SEPs offer a key advantage to cyclical businesses in that the contribution rate may vary from year to year, as long as contributions are made at a uniform rate for all employees.

SEPs aren't so simple, however. Although a SEP promises streamlined requirements and flexibility, it does exhibit some unusual quirks which businesses should be aware of before adopting one. A key quirk is the differentiation between the maximum contribution rate for employees and a self-employed employer. Whether for the employer or employee, contributions may be based only on the first $255,000 of compensation for 2013 ($260,000 for 2014).

For employees, the maximum annual contribution is the lesser of (1) 25% of the employee's compensation, or (2) $51,000 for 2013 ($52,000 for 2014).

For the self-employed employer, because of the confluence of the rules, when figuring the contribution for his or her own SEP-IRA, compensation is net earnings from self-employment (i.e. earnings net of one-half of the employer's self-employment tax), less contributions to the employer's own SEP-IRA.

Thus the calculation of item (1) above for a self-employed person involves a circular calculation; a simpler way to express that calculation for a self-employed person is: his compensation multiplied by [contribution rate (expressed as a decimal) ÷ (contribution rate +1)].

Illustration: Sam, a self-employed individual who owns the entire interest in an unincorporated business, wants to make the maximum deductible contribution to a SEP, where the SEP plan contribution rate is 25%. The maximum deductible amount that Sam (as an employer) may contribute is .25 ÷ 1.25. This is .20, or 20%. Assume Sam's net earnings for the year from this business are $100,000 (net of one-half of the social security tax and one-half of the Medicare tax, which are deductible under the Code. The maximum deductible contribution Sam can make for the year is $20,000.

Note, however, that net earnings are computed without regard to the additional 0.9% additional Medicare self-employment tax.

- **SIMPLE-IRAs.**

A SIMPLE-IRA retirement plan can be adopted by an employer who meets both of the following requirements:

(a) it has 100 or fewer employees who received at least $5,000 of compensation from the employer for the preceding year; and

(b) it doesn't have another employer-sponsored retirement plan (except for a collectively bargained plan covering employees ineligible to participate in the SIMPLE plan) to which contributions were made or benefits accrued for the year.

"Employee" includes a self-employed individual.

Employees designate contributions to be made to a SIMPLE plan under a "qualified salary reduction arrangement." This is a written arrangement under which an employee may elect to have the employer make elective employer contributions (expressed as a percentage of compensation, or, if the employer permits, a specific dollar amount) to a SIMPLE-IRA on behalf of the employee, or to the employee directly in cash. The amount which an employee may elect for any year can't exceed $12,000 for 2013 or 2014. SIMPLE-IRA participants who are age 50 or over by the end of the plan year may make additional catch-up contributions of up to $2,500 for 2013 or 2014.

The employer must make either:

- A matching contribution equal to the amount the employee contributes, up to

3% of the employee's compensation for the year, or, electively, as little as 1% in no more than two out of the previous five years, if the employer timely notifies the employees of the lower percentage; or

- A nonelective contribution of 2% of compensation for each employee eligible to participate who has at least $5,000 of compensation from the employer for the year.

The employer's contributions for himself or herself must be the same type and rate as the contribution made for common-law employees.

- **Timing of contributions.**

IRS's Retirement News for Employers reminds business owners different timing rules apply to salary reduction contributions and employer contributions.

Salary reduction contributions for regular employees must be deposited not later than the close of the 30-day period following the last day of the month in which amounts otherwise would have been payable to the employee in cash. The Department of Labor (DOL) has indicated most SIMPLE-IRA plans are also subject to Title I of ERISA, and under DOL regulations, salary reduction contributions to these plans must be made to the SIMPLE-IRA as of the earliest date on which the contributions can reasonably be segregated from the employer's general assets, but in no event later than the 30-day deadline described above. However, IRS's Retirement News for Employers points out, alternatively, salary reduction contributions may be made within seven business days after the employee would have otherwise received the money, to meet the DOL's 7-day safe harbor for plans with fewer than 100 participants. Under the rules, payments which meet the safe harbor are deemed to be contributed on the earliest date on which such contributions or participant loan repayments can reasonably be segregated from the employer's general assets.

Salary reduction contributions for business owners, however, may be made, according to IRS's Retirement News for Employers, within 30 days after the end of the tax year. For most people, this means salary reduction contributions for a year must be made by January 30st of the following year.

Employer contributions, whether matching contributions or nonelective contributions, whether for the owner or his or her employees, must be deposited by the due date (including extensions) of the federal income tax return for the tax year which includes the last day of the calendar year for which the employer made the contributions. For most people, this means employer contributions for a year must be made by April 15th of the following year, or by October 15th if on extension.

IRS's Retirement News for Employers, illustrates the timing rules for SIMPLE-IRA contributions with the following example:

> Janice's business sponsors a SIMPLE IRA plan. In 2013, her employee, John, earned $25,000 and chose to defer 5% of his salary. Janice's net earnings from self-employment were $40,000 (as reported on Form 1040, Schedule SE, and

she chose to defer 10% of her earnings to her SIMPLE IRA. Janice elected to make 3% matching contributions for 2013 for all employees.

The total SIMPLE IRA plan contribution for John is $2,000, made up of John's $1,250 salary reduction contributions ($25,000 × 5%), plus the $750 employer matching contribution ($25,000 × 3%). John's $1,250 salary reduction contributions must be deposited to his SIMPLE IRA at the earliest date on which Janice can reasonably segregate them from her business' general assets, but no later than 30 days following the month in which John would have otherwise received the money. Alternatively, the money can be deposited within seven business days after John would have otherwise received the money, to meet the DOL's 7-day safe harbor for small plans.

Janice must deposit her business's $750 employer matching contribution for John no later than the due date of her federal income tax return, including extensions. Janice's total plan contribution is $5,200, made up $4,000 of salary reduction contributions ($40,000 × 10%), plus a $1,200 employer matching contribution ($40,000 × 3%). The $4,000 of salary reduction contributions must have been deposited no later than January 30, 2014. Janice must deposit the $1,200 employer matching contribution no later than the due date of the federal income tax return, including extensions.