

SEPs are intended as an alternative to “qualified” retirement plans, particularly for small businesses like yours. The relative ease of administration and the complete discretion you, as the employer, are permitted in deciding whether or not to make annual contributions, are features that are especially attractive. Here's how these plans work.

If you don't already have a qualified retirement plan, you can set up a SEP simply by using the IRS model SEP, Form 5305-SEP. By adopting this model SEP, which doesn't have to be filed with the IRS, you will have satisfied the SEP requirements. This means that you, as the employer, will get a current income tax deduction for contributions you make on behalf of your employees. Your employees will be taxed not when the contributions are made, but at a later date when distributions are made, usually at retirement. Depending on your specific needs, an individually-designed SEP—instead of the model SEP—may be appropriate.

When you set up a SEP for yourself and your employees, you will make these deductible contributions to each employee's IRA, called a SEP-IRA, which must be IRS-approved. The maximum amount of deductible contributions that you can make to an employee's SEP-IRA, and that he or she can exclude from income, is the lesser of: (i) 25 percent of compensation, and (ii) \$46,000 (for 2008). The deduction for your contributions to employees' SEP-IRAs isn't limited by the deduction ceiling applicable to an individual's own contribution to a regular IRA. Your employees control their individual IRAs and IRA investments, the earnings on which are tax-free.

There are other requirements which you have to meet to be eligible to set up a SEP. Essentially, all regular employees must elect to participate in the program, and contributions can't discriminate in favor of the highly compensated employees. But these requirements are minor compared to the bookkeeping and other administrative burdens connected with traditional qualified pension and profit-sharing plans. The detailed records that traditional plans must maintain to comply with the complex nondiscrimination regulations aren't required for SEPs. And employers aren't required to file annual reports with IRS—Forms 5500—which, for a pension plan, could require the services of an actuary. What record-keeping is required can be done by a trustee of the SEP-IRAs—usually a bank or mutual fund.

Another option for a business with 100 or fewer employees is a “savings incentive match plan for employees” (i.e., a “simple” plan). Under a simple plan, a “simple IRA” is established for each eligible employee, with the employer making matching contributions based on contributions elected by participating employees under a qualified salary reduction arrangement. The simple plan is subject to much less stringent requirements than traditional qualified retirement plans. Or, an employer can adopt a “simple” 401(k) plan, with similar features to a simple plan, and automatic passage of the otherwise complex nondiscrimination test for 401(k) plans.