

**Salary Reduction and Other Elective Simplified
Employee Pension-Individual Retirement Accounts
Contribution Agreement**
(Under section 408(k) of the Internal Revenue Code)

**DO NOT File with
the Internal
Revenue Service**

_____ amends its elective SEP by adopting the following Model Elective SEP under section 408(k) of the Internal Revenue Code and the instructions to this form. (**Important:** An employer may not establish an elective SEP after 1996.)
Name of employer

Article I—Eligibility Requirements (Check appropriate boxes—see instructions.)

Provided the requirements of Article III are met, the employer agrees to permit elective deferrals to be made in each calendar year to the individual retirement accounts or individual retirement annuities (IRAs), established by or for all employees who are at least _____ years old (not to exceed 21 years) and have performed services for the employer in at least _____ years (not to exceed 3 years) of the immediately preceding 5 years. This simplified employee pension (SEP) ☐ includes ☐ does not include employees covered under a collective bargaining agreement, ☐ includes ☐ does not include certain nonresident aliens, and ☐ includes ☐ does not include employees whose total compensation during the year is less than \$400*.

Article II—Elective Deferrals (See instructions.)

A. Salary Reduction Option. An eligible employee may elect to have his or her compensation reduced by the following percentage or amount per pay period, as designated in writing to the employer. Check appropriate box(es) and fill in the blanks.

1. ☐ An amount not in excess of _____ % (not to exceed 15%) of an eligible employee's compensation.
2. ☐ An amount not in excess of \$ _____.

B. Cash Bonus Option. An eligible employee may base elective deferrals on bonuses that, at the employee's election, may be contributed to the SEP or received in cash during the calendar year. Check if elective deferrals on bonuses may be made to this SEP . . . ☐

C. Timing of Elective Deferrals. No deferral election may be based on compensation an eligible employee received, or had a right to receive, before execution of the deferral election.

Article III—SEP Requirements (See instructions.)

The employer agrees that each employee's elective deferrals to the SEP will be:

- A.** Based only on the first \$160,000* of compensation.
- B.** Limited annually to the smaller of: **(1)** 15% of compensation; **or (2)** \$9,500* for 1997 (\$10,000* for 1998).
- C.** Limited further, under section 415, if the employer also maintains another SEP.
- D.** Paid to the employee's IRA trustee, custodian, or insurance company (for an annuity contract) or, if necessary, an IRA established for an employee by the employer.
- E.** Made only if at least 50% of the employer's employees eligible to participate elect to have amounts contributed to the SEP. If the 50% requirement is not satisfied as of the end of any calendar year, then all of the elective deferrals made by the employees for that calendar year will be considered "disallowed deferrals," i.e., IRA contributions that are not SEP-IRA contributions.
- F.** Made only if the employer had 25 or fewer employees eligible to participate at all times during the prior calendar year.
- G.** Adjusted only if deferrals to this SEP for any calendar year do not meet the "deferral percentage limitation" described on page 3.

Article IV—Excess SEP Contributions (See instructions.)

Elective deferrals by a "highly compensated employee" must satisfy the deferral percentage limitation under section 408(k)(6)(A)(iii). Amounts in excess of this limitation will be deemed excess SEP contributions for the affected highly compensated employee or employees.

Article V—Notice Requirements (See instructions.)

A. The employer will notify each highly compensated employee, by March 15 following the end of the calendar year to which any excess SEP contributions relate, of the excess SEP contributions to the highly compensated employee's SEP-IRA for the applicable year. The notification will specify the amount of the excess SEP, the calendar year in which the contributions are includible in income, and must provide an explanation of applicable penalties if the excess contributions are not withdrawn on time.

B. The employer will notify each employee who makes an elective deferral to a SEP that, until March 15 after the year of the deferral, any transfer or distribution from that employee's SEP-IRA of SEP contributions (or income on these contributions) attributable to elective deferrals made that year will be includible in income for purposes of sections 72(t) and 408(d)(1).

C. The employer will notify each employee by March 15 of each year of any disallowed deferrals to the employee's SEP-IRA for the preceding calendar year. Such notification will specify the amount of the disallowed deferrals and the calendar year in which those deferrals are includible in income and must provide an explanation of applicable penalties if the disallowed deferrals are not withdrawn on time.

Article VI—Top-Heavy Requirements (See instructions.)

A. Unless paragraph B below is checked, the employer will satisfy the top-heavy requirements of section 416 by making a minimum contribution each year to the SEP-IRA of each employee eligible to participate in this SEP (other than a key employee as defined in section 416(i)). This contribution, in combination with other nonelective contributions, if any, is equal to the smaller of 3% of each eligible nonkey employee's compensation or a percentage of such compensation equal to the percentage of compensation at which elective and nonelective contributions are made under this SEP (and any other SEP maintained by the employer) for the year for the key employee for whom such percentage is the highest for the year.

B. ☐ The top-heavy requirements of section 416 will be satisfied through contributions to nonkey employees' SEP-IRAs under this employer's nonelective SEP.

* Except where stated otherwise, this amount reflects the cost-of-living increase in effect for 1997 and 1998. The amount is adjusted annually. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS's Internet Web Site at www.irs.ustreas.gov.

Article VI—Top-Heavy Requirements *(Continued)*

C. To satisfy the minimum contribution requirement under section 416, all nonelective SEP contributions will be taken into account but elective deferrals will not be taken into account.

Article VII—Effective Date (See instructions.)

This SEP will be effective upon adoption and establishment of IRAs for all eligible employees.

Employer's signature

Date

Name and title

Changes To Note

The Small Business Job Protection Act of 1996 ("The Act") made several changes to the laws affecting simplified employee pensions (SEPs). Most importantly, it prohibited the establishment of new elective SEPs after 1996. The Act also repealed the family aggregation rules, under which the compensation and elective deferrals of certain "highly compensated employees" was combined with the compensation and elective deferrals of family members for purposes of determining the compensation and deferral percentages of participants. The definition of "highly compensated employee" was also changed beginning in 1997.

Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Form

Form 5305A-SEP is a model elective simplified employee pension (SEP) used by an employer to permit employees to make elective deferrals to a SEP described in section 408(k). **DO NOT** file this form with the IRS.

Instructions for the Employer

Important. SEPs permitting elective deferrals **cannot** be established after 1996. If you established a SEP before 1997 that permitted elective deferrals, under current law you may continue to maintain such SEP for years after 1996.

If you wish to continue using a model elective SEP, this version of Form 5305A-SEP **must** be adopted by December 31, 1998.

What Is A SEP?

A SEP is a written arrangement (a plan) that provides you with a simplified way to make contributions towards your employees' retirement income. Under an elective SEP, employees may choose whether or not to make elective deferrals to the SEP or to receive the amounts in cash. If elective deferrals are made, you contribute the amounts deferred by your employees directly into an individual retirement arrangement (IRA) set up by or for each employee with a bank, insurance company, or other qualified financial institution. The IRA, established by or for an employee, must be one for which the IRS has issued a favorable opinion letter or a model IRA published by the Service as **Form 5305**, Individual Retirement Trust Account, or **Form 5305-A**, Individual Retirement Custodial Account. It cannot be a SIMPLE IRA (an IRA designed to accept contributions made under a SIMPLE IRA Plan

described in section 408(p)). Adopting Form 5305A-SEP does not establish an employer IRA described in section 408(c).

The information provided below is intended to help you understand and administer the elective deferral rules of your SEP.

When To Use Form 5305A-SEP

Use this form only if you intend to permit elective deferrals to a SEP. If you want to establish a SEP to which nonelective employer contributions may be made, use **Form 5305-SEP**, Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement, or a nonmodel SEP instead of, or in addition to, this form.

Do not use Form 5305A-SEP if you:

1. Have any leased employees as defined in section 414(n)(2).
2. Previously maintained or have maintained a defined benefit plan that is now terminated.
3. Currently maintain any other qualified retirement plan. This does not prevent you from also maintaining a Model SEP (Form 5305-SEP) or other SEP to which either elective or nonelective contributions are made.
4. Have more than 25 employees eligible to participate in the SEP at any time during the prior calendar year. (If you are a member of one of the groups described in paragraph 2 under **Excess SEP Contributions—Deferral Percentage Limitation** on page 3, you may use this SEP only if in the prior year there were never more than 25 employees eligible to participate in this SEP, in total, of all the members of such groups, trades, or businesses. In addition, all eligible employees of all the members of such groups, trades, or businesses must be eligible to make elective deferrals to this SEP).
5. Are a state or local government or a tax-exempt organization.

Completing the Agreement

This SEP agreement is considered adopted when:

1. You have completed all blanks on the form.
2. You have given all eligible employees the following information:
 - a. A copy of Form 5305A-SEP. (Any individual who in the future becomes eligible to participate in this SEP must be given Form 5305A-SEP, upon becoming an eligible employee.)
 - b. A statement that IRAs other than the IRAs into which employer SEP contributions will be made may provide different rates of return and different terms concerning, among

other things, transfers and withdrawals of funds from the IRAs.

c. A statement that, in addition to the information provided to an employee at the time the employee becomes eligible to participate, the administrator of the SEP must furnish each participant within 30 days of the effective date of any amendment to the SEP, a copy of the amendment and a written explanation of its effects.

d. A statement that the administrator will give written notification to each participant of any employer contributions made under the SEP to that participant's IRA by the later of January 31 of the year following the year for which a contribution is made or 30 days after the contribution is made.

Employers who have established an elective SEP using Form 5305A-SEP and have provided each participant a copy of the completed Form 5305A-SEP and the other documents and disclosures described in **Instructions for the Employer** and **Instructions for the Employee**, are not required to file the annual information returns, Forms 5500, 5500-C/R, or 5500-EZ, for the SEP. However, under Title I of ERISA, this relief from the annual reporting requirements may not be available to an employer who selects, recommends, or influences its employees to choose IRAs into which contributions will be made under the SEP, if those IRAs are subject to provisions that impose any limits on a participant's ability to withdraw funds (other than restrictions imposed by the Code that apply to all IRAs). For additional information on Title I requirements, see the Department of Labor regulations at 29 CFR 2520.104-49.

Forms and Publications You May Use

An employer may need to use any of the following forms or publications:

- **Form W-2**, Wage and Tax Statement.
- **Form 5330**, Return of Excise Taxes Related to Employee Benefit Plans. Employers who are liable for the 10% tax on excess contributions use this form to pay the excise tax.
- **Pub. 560**, Retirement Plans for the Self-Employed.
- **Pub. 590**, Individual Retirement Arrangements (IRAs).

Deducting Contributions

You may deduct, subject to any applicable limits, contributions made to a SEP. This SEP is maintained on a calendar year basis, and contributions to the SEP are deductible for your tax year with or within which the particular calendar year ends. See section 404(h). Contributions made for a particular tax

year and contributed by the due date of your income tax return, including extensions, are deemed made in that tax year and the contributions are deductible if they would otherwise be deductible had they actually been contributed by the end of that tax year. See Rev. Rul. 90-105, 1990-2 C.B. 69. However, the deductibility of your contributions may be limited if the contributions are excess contributions. See **Excess SEP Contributions—Deferral Percentage Limitation** below and the **Deferral Percentage Limitation Worksheet** on page 8.

Effective Date

Insert the date the provisions of this agreement are effective. This date will be January 1, 1997, the first time you adopt this version of Form 5305A-SEP to continue to use a model elective SEP.

Eligible Employees

All eligible employees must be allowed to participate in the SEP. An eligible employee is any employee who: **(1)** is at least 21 years old, and **(2)** has performed "service" for you in at least 3 of the immediately preceding 5 years.

Note: You can establish less restrictive eligibility requirements, but not more restrictive ones.

Service means any work performed for you for any period of time, however short. If you are a member of an affiliated service group, a controlled group of corporations, or trades or businesses under common control, service includes any work performed for any period of time for any other member of such group, trades, or businesses.

Excludable Employees

The following employees do not have to be covered by the SEP: **(1)** employees covered by a collective bargaining agreement whose retirement benefits were bargained for in good faith by you and their union, **(2)** nonresident alien employees who did not earn U.S. source income from you, and **(3)** employees who received less than \$400* in compensation during the year.

Elective Deferrals

You may permit your employees to make elective deferrals through salary reduction or on the basis of bonuses that, at the employee's option, may be contributed to the SEP or received by the employee in cash during the year.

You must inform your employees how they may make, change, or terminate elective deferrals based on either salary reduction or cash bonuses. You must also provide a form on which they may make their deferral elections. You may use the **Model Elective SEP Deferral Form** (elective form) on page 5, or a form that explains the information contained in this form in a way that is written to be understood by the average plan participant.

SEP Requirements

- Elective deferrals may not be based on more than \$160,000* of compensation. Compensation, for purposes other than the \$400* rule (see **Excludable Employees** above), is defined as wages under section 3401(a) for income tax withholding at the source but without regard to any rules that

limit the remuneration included in wages based on the nature or location of the employment or the services performed (such as the exception for agricultural labor in section 3401(a)(2)). Compensation also includes earned income under section 401(c)(2). Compensation does not include any employer SEP contributions. Compensation, for purposes of the \$400* rule, is the same, except it includes deferrals made to this SEP or under a "cafeteria plan" described in section 125.

- The maximum limit on the amount an employee may elect to defer under this SEP for a year is the smaller of 15% of the employee's compensation or the limitation under section 402(g), as explained below.

Note: The deferral limit is 15% of compensation (minus any employer SEP contributions). Compute this amount using the following formula: Compensation (before subtracting employer SEP contributions) × 13.0435%.

- If you make nonelective contributions to this SEP for a calendar year, or maintain any other SEP to which contributions are made for that calendar year, then contributions to all such SEPs may not exceed the smaller of \$30,000* or 15% of compensation for any employee.

Excess Elective Deferrals

Section 402(g) limits the maximum amount of compensation an employee may elect to defer under a SEP (and certain other arrangements) during the calendar year. This limit is \$9,500* for 1997 (\$10,000* for 1998). Amounts deferred for a year in excess of this limit are considered "excess elective deferrals" and are subject to the rules described below.

The limit applies to the **total** elective deferrals the employee makes for the calendar year, from all employers, under the following arrangements:

- Elective SEPs under section 408(k)(6);
- Cash or deferred arrangements under section 401(k);
- Salary reduction arrangements under section 403(b); and
- SIMPLE IRA Plans under section 408(p).

Thus, an employee may have excess elective deferrals even if the amount deferred under this SEP alone does not exceed the section 402(g) limit.

If an employee who elects to defer compensation under this SEP and any other SEP or arrangement has made excess elective deferrals for a calendar year, the employee must withdraw those deferrals by April 15 following the calendar year to which the deferrals relate. Deferrals not withdrawn by April 15 will be subject to the IRA contribution limits of sections 219 and 408 and may be considered excess contributions to the employee's IRA. For the employee, these excess elective deferrals are subject to a 6% tax on excess contributions under section 4973.

Income on excess elective deferrals is includible in the employee's income in the year it is withdrawn from the IRA. The income must be withdrawn by April 15 following the calendar year for which the deferrals were made. If the income is withdrawn after that

date and the recipient is not 59½ years of age, it may be subject to the 10% tax on early distributions under section 72(t).

Excess SEP Contributions—Deferral Percentage Limitation

The amount each of your "highly compensated employees" may contribute to an elective deferral SEP is also limited by the "deferral percentage limitation." This is based on the amount of money deferred, on average, by your nonhighly compensated employees. Deferrals made by a highly compensated employee that exceed this deferral percentage limitation for a calendar year are considered "excess SEP contributions" and must be removed from the employee's SEP-IRA, as discussed below.

The deferral percentage limitation for your highly compensated employees is computed by first averaging the "deferral percentages" (defined below) for the eligible nonhighly compensated employees for the year and then multiplying this result by 1.25. The deferral percentage for a calendar year of any highly compensated employee eligible to participate in this SEP may not be more than the resulting product, the "deferral percentage limitation."

Only elective deferrals are included in this computation. Nonelective SEP contributions may not be included. The determination of the deferral percentage for any employee is made under section 408(k)(6).

For purposes of this computation, the calculation of the number and identity of highly compensated employees, and their deferral percentages, is made on the basis of the entire "affiliated employer" (defined below).

A worksheet is provided on page 8 to assist in figuring the deferral percentage. You may want to photocopy it for yearly use.

The following definitions apply for purposes of computing the deferral percentage limitation under this SEP:

1. Deferral percentage is the ratio (expressed as a percentage to 2 decimal places) of an employee's elective deferrals for a calendar year to the employee's compensation for that year. No more than \$160,000* per individual is taken into account. The deferral percentage of an employee who is eligible to make an elective deferral, but who does not make a deferral during the year, is zero. If a highly compensated employee also makes elective deferrals under another elective SEP maintained by the employer, then the deferral percentage of that highly compensated employee includes elective deferrals made under the other SEP.

2. Affiliated employer includes **(a)** any corporation that is a member of a controlled group of corporations, described in section 414(b) that includes the employer, **(b)** any trade or business that is under common control, defined in section 414(c) with the employer, **(c)** any organization that is a member of an affiliated service group, defined in section 414(m) that includes the employer, and **(d)** any other entity required to be aggregated with the employer under regulations under section 414(o).

3. A highly compensated employee is an individual described in section 414(q) who:

*Except where stated otherwise, this amount reflects the cost-of-living increase in effect for 1997 and 1998. The amount is adjusted annually. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS's Internet Web Site at www.irs.ustreas.gov.

- a. Was a 5% owner defined in section 416(i)(1)(B)(i) during the current or preceding year; or
- b. For the preceding year had compensation in excess of \$80,000* and was in the top-paid group (the top 20% of employees, by compensation).

Excess SEP Contributions— Notification

You must notify each affected employee, if any, by March 15 of the amount of any excess SEP contributions made to that employee's SEP-IRA for the preceding calendar year. (If needed, use the model form on page 5 of these instructions.) These excess SEP contributions are includible in the employee's gross income in the preceding calendar year. However, if the excess SEP contributions (not including allocable income) total less than \$100, then the excess contributions are includible in the employee's gross income in the calendar year of notification. Income allocable to the excess SEP contributions is includible in gross income in the year of withdrawal from the IRA.

If you do not notify any of your employees by March 15 of an excess SEP contribution, you must pay a 10% tax on the excess SEP contribution for the preceding calendar year. The tax is reported in Part XII of Form 5330. If you do not notify your employees by December 31 of the calendar year following the calendar year in which the excess SEP contributions arose, the SEP no longer will be treated as meeting the rules of section 408(k)(6). In this case, any contribution to an employee's IRA will be subject to the IRA contribution limits of sections 219 and 408 and thus may be considered an excess contribution to the employee's IRA.

Your notification to each affected employee of the excess SEP contributions must specifically state in a manner written to be understood by the average employee:

- The amount of the excess SEP contributions attributable to that employee's elective deferrals;
- The calendar year in which the excess SEP contributions are includible in gross income; and
- Information stating that the employee must withdraw the excess SEP contributions (and allocable income) from the SEP-IRA by April 15 following the calendar year of notification by the employer. Excess contributions not withdrawn by April 15 following the year of notification will be subject to the IRA contribution limits of sections 219 and 408 for the preceding calendar year and may be considered excess contributions to the employee's IRA. For the employee, the excess contributions may be subject to the 6% tax on excess contributions under section 4973. If income allocable to an excess SEP contribution is not withdrawn by April 15 following the calendar year of notification by the employer, the employee may be subject to the 10% tax on early distributions under section 72(t) when withdrawn.

For information on reporting excess SEP contributions, see Notice 87-77, 1987-2 C.B. 385, Notice 88-33, 1988-1 C.B. 513, Notice 89-32, 1989-1 C.B. 671, and Rev. Proc. 91-44, 1991-2 C.B. 733.

To avoid the complications caused by excess SEP contributions, you may want to monitor elective deferrals on a continuing basis throughout the calendar year to insure that the deferrals comply with the limits as they are paid into each employee's SEP-IRA.

Disallowed Deferrals

If you determine at the end of any calendar year that more than half of your eligible employees have chosen **not** to make elective deferrals for that year, then **all** elective deferrals made by your employees for that year will be considered **disallowed deferrals**, i.e., IRA contributions that are not SEP-IRA contributions.

You must notify each affected employee by March 15 that the employee's deferrals for the previous calendar year are no longer considered SEP-IRA contributions. Such disallowed deferrals are includible in the employee's gross income in that preceding calendar year. Income allocable to the disallowed deferrals is includible in the employee's gross income in the year of withdrawal from the IRA.

Your notification to each affected employee of the disallowed deferrals must clearly state:

- The amount of the disallowed deferrals;
- The calendar year in which the disallowed deferrals and earnings are includible in gross income; and
- That the employee must withdraw the disallowed deferrals (and allocable income) from the IRA by April 15 following the calendar year of notification by the employer. Those disallowed deferrals not withdrawn by April 15 following the year of notification will be subject to the IRA contribution limits of sections 219 and 408 and thus may be considered an excess contribution to the employee's IRA. For the employee, these disallowed deferrals may be subject to the 6% tax on excess contributions under section 4973. If income allocable to a disallowed deferral is not withdrawn by April 15 following the calendar year of notification by the employer, the employee may be subject to the 10% tax on early distributions under section 72(t) when withdrawn.

Disallowed deferrals should be reported the same way excess SEP contributions are reported.

Restrictions on Withdrawals

Your highly compensated employees may not withdraw or transfer from their SEP-IRAs any SEP contributions (or income on these contributions) attributable to elective deferrals made for a particular calendar year until March 15 of the following year. Before that date, however, you may notify your employees when the deferral percentage limitation test has been completed for a particular calendar year and that this withdrawal restriction no longer applies. In general, any transfer or distribution made before March 15 of the following year (or notification, if sooner) will be includible in the employee's gross income and the employee may also be subject to a 10% tax on early withdrawal. This restriction does not apply to an employee's excess elective deferrals.

Top-Heavy Requirements

Elective deferrals may not be used to satisfy the minimum contribution requirement under section 416. In any year in which a **key employee** makes an elective deferral, this SEP is deemed top-heavy for purposes of section 416, and you are required to make a minimum top-heavy contribution under either this SEP or another SEP for each nonkey employee eligible to participate in this SEP.

A key employee under section 416(i)(1) is any employee or former employee (and the beneficiaries of these employees) who, at any time during the **determination period**, was:

- An officer of the employer (if the employee's compensation exceeds 50% of the section 415(b)(1)(A) limit, which was \$125,000* for 1997 (\$130,000* for 1998);
- An owner of one of the 10 largest interests in the employer (if the employee's compensation exceeds 100% of the section 415(c)(1)(A) limit, which is \$30,000*);
- A 5% owner of the employer, as defined in section 416(i)(1)(B)(i); or
- A 1% owner of the employer (if the employee has compensation in excess of \$150,000).

The determination period is the current calendar year and the 4 preceding years.

*Except where stated otherwise, this amount reflects the cost-of-living increase in effect for 1997 and 1998. The amount is adjusted annually. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS's Internet Web Site at www.irs.ustreas.gov.

Model Elective SEP Deferral Form**I. Salary reduction deferral**

Subject to the requirements of the Model Elective SEP of _____, I authorize the following amount
(name of employer)
or percentage to be withheld from each of my paychecks and contributed to my SEP-IRA:

(a) _____ % (not to exceed 15%) of my salary; or (b) \$ _____.

This salary reduction authorization shall remain in effect until I provide written modification or termination of its terms to my employer.

II. Cash bonus deferral

Subject to the requirements of the Model Elective SEP of _____, I authorize the following amount
(name of employer)

to be contributed to my SEP-IRA rather than being paid to me in cash: \$ _____.

III. Amount of deferral

I understand that the total amount I defer in any calendar year may not exceed the smaller of:

(a) 15% of my compensation (determined without including any SEP-IRA contributions); or (b) \$9,500* for 1997 (\$10,000* for 1998).

IV. Commencement of deferral

The deferral election specified in either I or II, above, shall not become effective before _____.
(Specify a date no earlier than the first day of the first pay period beginning after this authorization.) (Month, day, year)

V. Distributions from SEP-IRAs

I understand that I should not withdraw or transfer any amounts from my SEP-IRA that are attributable to elective deferrals and income on elective deferrals for a particular calendar year (except for excess elective deferrals) until March 15 of the subsequent year or, if sooner, when my employer notifies me that the deferral percentage limitation test for that plan year has been completed. Any such amounts that I withdraw or transfer before this time will be includible in income for purposes of sections 72(t) and 408(d)(1).

Signature of employee ►

Date ►

**This amount is adjusted annually. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS's Internet Web Site at www.irs.ustreas.gov.*

Notification of Excess SEP Contributions

To: _____
(name of employee)

Our calculations indicate that the elective deferrals you made to your SEP-IRA for calendar year _____ exceed the maximum permissible limits under section 408(k)(6). You made excess SEP contributions of \$ _____ for that year.

These excess SEP contributions are includible in your gross income for the _____ (insert the year identified above, or if less than \$100, the following year) calendar year.

These excess SEP contributions must be distributed from your SEP-IRA by April 15, 19 _____ (insert year after the calendar year in which this notice is given) in order to avoid possible penalties. Income allocable to the excess amounts must be withdrawn at the same time and is includible in income in the year of withdrawal. Excess SEP contributions remaining in your SEP-IRA account after that time are subject to a 6% excise tax, and the income on these excess SEP contributions may be subject to a 10% penalty when finally withdrawn.

Signature of employer ►

Date ►

Instructions for the Employee

The following instructions explain what a simplified employee pension (SEP) is, how contributions to a SEP are made, and how to treat these contributions for tax purposes. For more information, see the SEP agreement on pages 1 and 2 and the **Instructions for the Employer** beginning on page 2.

What Is A SEP?

A SEP is a written arrangement (a plan) that allows an employer to make contributions toward your retirement without becoming involved in more complex retirement plans. A SEP may include a **salary reduction arrangement**, like the one provided on this form. Under this arrangement, you can elect to have your employer contribute part of your pay to your own individual retirement account or annuity (IRA), set up by you or on your behalf with a bank, insurance company, or other qualified financial institution. The part contributed is tax deferred. Only the remaining part of your pay is currently taxable. This type of SEP is available only to an employer with 25 or fewer eligible employees.

The IRA must be one for which the IRS has issued a favorable opinion letter or a model IRA published by the IRS as **Form 5305**, Individual Retirement Trust Account, or **Form 5305-A**, Individual Retirement Custodial Account. It cannot be a SIMPLE IRA (an IRA designed to accept contributions made under a SIMPLE IRA Plan described in section 408(p)).

Your employer must provide you with a copy of the SEP agreement containing eligibility requirements and a description of the basis upon which contributions may be made.

All amounts contributed to your IRA belong to you, even after you quit working for your employer.

Forms and Publications You May Use

An employee may use either of the two forms and the publication listed below.

- **Form 5329**, Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts. Use Form 5329 to pay tax on excess contributions and/or tax on early distributions.
- **Form 8606**, Nondeductible IRAs (Contributions, Distributions, and Basis). Use Form 8606 to report nondeductible IRA contributions.
- **Pub. 590**, Individual Retirement Arrangements (IRAs).

Elective Deferrals

Annual Limitation

The maximum amount that you may defer to a SEP for any calendar year is limited to the smaller of 15% of compensation or \$9,500* for 1997 (\$10,000* for 1998).

The 15% limit may be reduced if your employer also maintains a SEP to which **nonelective contributions** are made for a year. In this case, total contributions on your behalf to all such SEPs may not exceed the smaller of \$30,000* or 15% of your compensation. If these limits are exceeded, the amount you may elect to contribute to this SEP for the year will be reduced.

The \$9,500* limit for 1997 (\$10,000* for 1998), imposed under section 402(g), is an overall limit on the maximum amount that you may defer in each calendar year to all elective SEPs, SIMPLE IRA Plans under section 408(p), and cash or deferred arrangements under section 401(k), regardless of how many employers you may have worked for during the calendar year.

For a **highly compensated employee**, there may be a further limit on the amount you can defer. Figured by your employer and known as the **deferral percentage limitation**, it limits the percentage of pay that a highly compensated employee can elect to defer to a SEP-IRA. Your employer will notify any highly compensated employee who has exceeded the limitation.

Tax Treatment

Elective deferrals that do not exceed the limits discussed above are excluded from your gross income in the year of the deferral. They are not included as taxable wages on **Form W-2**, Wage and Tax Statement. However, elective deferrals are treated as wages for social security, Medicare, and unemployment (FUTA) tax purposes.

Excess Amounts

There are three ways in which you may have excess amounts in an elective SEP-IRA.

1. Making **excess elective deferrals** (i.e., amounts in excess of the section 402(g) limit). You must determine whether you have exceeded the limit in the calendar year. For 1997, the section 402(g) limit for contributions made to an elective SEP is \$9,500* (\$10,000* for 1998).
2. Highly compensated employees who make **excess SEP contributions** (i.e., amounts in excess of the deferral percentage limitation referred to above). The employer must determine if an employee has made excess SEP contributions.
3. Having **disallowed deferrals** (i.e., more than half of your employer's eligible employees choose not to make elective deferrals for a year). All elective deferrals made by employees for that year are considered disallowed deferrals, as discussed below. Your employer must also determine if there are disallowed deferrals.

Excess Elective Deferrals

Excess elective deferrals are includible in your gross income in the calendar year of deferral. Income earned on the excess elective deferrals is includible in the year of withdrawal from the IRA. You should withdraw excess elective deferrals and any allocable income by April 15 following the year to which the deferrals relate. These amounts **may not** be transferred or rolled over tax-free to another SEP-IRA.

If you do not withdraw excess elective deferrals and any allocable income by April 15, the excess elective deferrals will be subject to the IRA contribution limits of sections 219 and 408 and will be considered excess contributions to your IRA. Such excess deferrals are subject to a 6% excise tax for each year they remain in the SEP-IRA. The excise tax is reported in Part II of Form 5329.

Income earned on excess elective deferrals is includible in your gross income in the year you withdraw it from your IRA. The income

should be withdrawn by April 15 following the calendar year in which the deferrals were made. If the income is withdrawn after that date and you are not 59½ years of age, it may be subject to the 10% tax on early distributions. Report the tax in Part I of Form 5329. Also see Pub. 590 for a discussion of exceptions to the age 59½ rule.

Excess SEP Contributions

If you are a **highly compensated employee**, your employer must notify you of any excess SEP contributions you made in a calendar year. This notification should show the amount of the excess SEP contributions, the calendar year to include the contributions in income, and the penalties that may be assessed if the contributions are not withdrawn from your IRA within the applicable time period.

Your employer must notify you of the excess SEP contributions by March 15 following the calendar year for which you made the excess SEP contributions. Generally, you include the excess SEP contributions in income for the calendar year in which you made the original deferrals. This may require you to file an amended individual income tax return. However, any excess SEP contribution less than \$100 (not including allocable income) must be included in income in the calendar year of notification. Income earned on these excess contributions must be included in your gross income when you withdraw it from your IRA.

You must withdraw these excess SEP contributions (and allocable income) from your IRA. You may withdraw these amounts without penalty, until April 15 following the calendar year in which you were notified by your employer of the excess SEP contributions. Otherwise, the excess SEP contributions are subject to the IRA contribution limits of sections 219 and 408 and will be considered an excess contribution to your IRA. Thus, the excess SEP contributions are subject to a 6% excise tax reportable in Part II of Form 5329 for each year the contributions remain in your IRA.

If you do not withdraw the income earned on the excess SEP contributions by April 15 following the calendar year of notification by your employer, the income may be subject to a 10% tax on early distributions if you are not 59½ years of age when you withdraw it. Report the tax in Part I of Form 5329. Also see Pub. 590.

If you have both **excess elective deferrals** and **excess SEP contributions**, the amount of excess elective deferrals that you withdraw by April 15 will reduce any excess SEP contributions that must be withdrawn for the corresponding calendar year.

Disallowed Deferrals

You are not required to make elective deferrals to a SEP-IRA. However, if more than 50% of your employer's eligible employees choose not to make elective deferrals in a calendar year, then no employee may participate for that calendar year. If you make elective deferrals during a year in which this happens, then your deferrals for that year will be "disallowed," and the deferrals will be treated as ordinary IRA contributions (which may be excess IRA contributions) rather than SEP-IRA contributions.

*Except where stated otherwise, this amount reflects the cost-of-living increase in effect for 1997 and 1998. The amount is adjusted annually. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS's Internet Web Site at www.irs.ustreas.gov.

Disallowed deferrals and any income the deferrals have earned may be withdrawn, without penalty until April 15 following the calendar year in which you are notified of the disallowed deferrals. Amounts left in the IRA after that date will be subject to the same penalties discussed in **Excess SEP Contributions** above.

Income Allocable To Excess Amounts

The rules for determining and allocating income to excess elective deferrals, excess SEP contributions, and disallowed deferrals are the same as those governing regular IRA contributions. The trustee or custodian of your SEP-IRA will inform you of the income allocable to these amounts.

Additional Top-Heavy Contributions

If you are not a **key employee**, your employer must make an additional contribution to your SEP-IRA for a year in which the SEP is considered "top heavy." (Your employer can tell you if you are a key employee. Also, see **Top-Heavy Requirements** on page 4 for the definition of a key employee.) This additional contribution will not exceed 3% of your compensation. It may be less if your employer has already made a contribution to your SEP-IRA, and for certain other reasons.

IRA Contribution for SEP Participants

In addition to any SEP amounts, you may contribute the smaller of \$2,000 or 100% of your compensation to an IRA. However, the amount of your contribution that you may deduct on your income tax return is subject to various income limits. Get Form 8606. Also, you may want to get Pub. 590.

SEP-IRA Amounts—Rollover or Transfer To Another IRA

If you are a highly compensated employee, you may not withdraw or transfer from your SEP-IRA any SEP contributions (or income on these contributions) attributable to elective deferrals made during the year until March 15 of the following year or, if sooner, at the time your employer notifies you that the deferral percentage limitation test (discussed under **Annual Limitation** on page 6) has been completed for that year. In general, any transfer or distribution made before this time is includible in your gross income and may also be subject to a 10% tax on early distribution. Report this tax in Part I of Form 5329. You may, however, remove excess elective deferrals from your SEP-IRA before this time but you may not roll over or transfer these deferrals to another IRA.

If the restrictions above do not apply, you may withdraw funds from your SEP-IRA and no more than 60 days later place those funds in another IRA, but not in a SIMPLE IRA. This is called a "rollover" and can be done without penalty only once in any 1-year period. However, there are no restrictions on the number of times that you may make "transfers" if you arrange to have these funds transferred between the trustees or the custodians so that you never have possession of the funds.

You may not, however, roll over or transfer excess elective deferrals, excess SEP contributions, or disallowed deferrals from your SEP-IRA to another IRA. These amounts may be reduced only by a distribution to you.

Employer To Provide Information on SEP-IRAs and Form 5305A-SEP

Your employer must give you a copy of the following information:

1. A copy of a completed Form 5305A-SEP, the **Model Elective SEP Deferral Form** (used to defer amounts to the SEP), and, if applicable, a copy of the **Notice of Excess SEP Contributions**. Your employer should also provide you with a statement of any contributions made during the calendar year to your SEP-IRA. Highly compensated employees must also be notified at the time the deferral percentage limitation test is completed.

2. A statement that IRAs other than SEP-IRAs receiving contributions under this SEP may have different rates of return and different terms (e.g., transfers and withdrawals from the IRAs).

3. A statement that the administrator of an amended SEP must furnish to each participant within 30 days of the amendment, a copy of the amendment and an explanation of its effects.

4. A statement that the administrator must notify each participant in writing of any employer contributions to the SEP-IRA. The notification must be made by the later of January 31 following the year of the contribution or 30 days after the contribution is made.

Financial Institution Requirements

The financial institution where your IRA is maintained must provide you with a **disclosure statement** that contains the following information in plain, nontechnical language:

1. The law that relates to your IRA.
2. The tax consequences of various options concerning your IRA.
3. Participation eligibility rules, and rules on the deductibility of retirement savings.

4. Situations and procedures for revoking your IRA, including the name, address, and telephone number of the person designated to receive notice of revocation. (This information must be clearly displayed at the beginning of the disclosure statement.)

5. A discussion of the penalties that may be assessed because of prohibited activities concerning the IRA.

6. Financial disclosure that provides the following information.

- a. Projects value growth rates of the IRA under various contribution and retirement schedules, or describes the method of computing and allocating annual earnings and charges that may be assessed.

- b. Describes whether, and for what period, the growth projections are guaranteed, or a statement of earnings rate and the terms on which these projections are based.

- c. States the sales commission to be charged in each year expressed as a percentage of \$1,000.

In addition, the financial institution must provide you with a financial statement each year. You may want to keep these statements to evaluate your IRA's investment performance and to report IRA distributions for tax purposes.

Paperwork Reduction Act Notice. You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is:

Recordkeeping		3 hr., 52 min.
Learning about the law or the form		3 hr., 57 min.
Preparing the form		50 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **DO NOT** send this form to this address. Instead, keep it for your records.

Deferral Percentage Limitation Worksheet (See instructions on page 3.)

(a) Employee Name	(b) Status H = HCE* O = Other	(c) Compensation (see below)	(d) Deferrals (see below)	(e) Ratio (d) ÷ (c)	(f) Permitted ratio (for HCE* only, see below)	(g) Permitted amount (for HCE* only) (c) × (f)	(h) Excess (for HCE* only) (d) minus (g)
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
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22							
23							
24							
25							

* **Highly compensated employee.**—See the definition beginning on page 3.

Column (c). Compensation.—Enter compensation from this employer and any related employers.

Column (d). Deferrals.—Enter all SEP elective deferrals.

Column (f). Permitted ratio.—

A Enter the total of the ratios in column (e) for the employees marked as "O" in column (b) _____

B Divide line A by the number of employees marked as "O" in column (b) _____

C Permitted ratio.—Multiply line B by 1.25 and enter the permitted ratio here _____

