

# Frequently Asked Questions

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A [Simplified Employee Pension](#) (SEP) plan provides business owners with a simplified method to contribute toward their employees' retirement as well as their own retirement savings. Contributions are made to an Individual Retirement Account or Annuity (IRA) set up for each plan participant (a SEP-IRA).

A SEP-IRA account is a traditional IRA and follows the same investment, distribution, and rollover rules as traditional IRAs. See the [IRA FAQs](#).

See also [Publication 560 PDF](#), [Publication 590-A](#) and [Publication 590-B](#) for detailed information on SEP plans and SEP-IRAs.

- [Establishing a SEP](#)
- [Participation](#)
- [Compensation](#)
- [Contributions](#)
- Distributions (Withdrawals) (same as IRA rules - see [IRA FAQs](#))
- Investments (same as IRA rules - see [IRA FAQs](#))
- [Reporting Requirements](#)
- [Terminating a SEP](#)

## Establishing a SEP

### Who can establish a SEP?

Any employer, including self-employed individuals, can establish a SEP.

### How do I establish a SEP?

There are three basic steps in setting up a SEP, all of which must be satisfied.

1. Adopt a formal written agreement by signing one of these documents:
  - IRS model SEP using [Form 5305-SEP, Simplified Employee Pension - Individual Retirement Accounts Contribution Agreement PDF](#);
  - IRS-approved prototype SEP, offered by banks, insurance companies, and other qualified financial institutions; or
  - individually designed SEP plan document.

2. Provide each eligible employee with information about the SEP. If you established the SEP using the Form 5305-SEP, the information must include a copy of the Form 5305-SEP, its instructions and the other information listed in the Form 5305-SEP instructions. If you used a prototype SEP or individually designed SEP, you must provide similar information.
3. Set up a SEP-IRA for each eligible employee with a bank, insurance company or other qualified financial institution. The employee owns and controls the SEP-IRA.

### **Is there a deadline to set up a SEP?**

You can set up a SEP plan for a year as late as the due date (including extensions) of your business's income tax return for that year.

### **If I have a SEP, can I also have other retirement plans?**

You can maintain both a SEP and another plan. However, unless the other plan is also a SEP, you cannot use Form 5305-SEP; you must adopt either a prototype SEP or an individually designed SEP.

### **Can I set up a SEP for my self-employment income if I participate in my employer's retirement plan?**

Yes, you can set up a SEP for your self-employed business even if you participate in your employer's retirement plan at a second job.

### **Can each partner in a partnership maintain a separate SEP plan?**

No, only an employer can maintain and contribute to a SEP plan for its employees. For retirement plan purposes, each partner or member of an LLC taxed as a partnership is an employee of the partnership.

### **Do I need to update my SEP plan?**

It is your responsibility to ensure that you keep your plan up-to-date with current law. If you set up your plan with a prototype plan document, you should have received an amended plan from the financial institution that provided it. If you didn't receive a new plan document, contact the financial institution. If you set up your plan with Form 5305-SEP, adopt a new form when the IRS updates it. See the instructions to [Form 5305-SEP PDF](#).

### **Can each of my employees choose a different financial institution for his or her SEP-IRA?**

Although the law does not require each participant's SEP-IRA to be at the same financial institution, the institution that offers or administers the SEP may require you to deposit SEP contributions initially into SEP-IRAs maintained at that institution.

## Participation

### Which employees are eligible to participate in my SEP plan?

Employees must be included in the SEP plan if they have:

- attained age 21;
- worked for your business in at least 3 of the last 5 years;
- received at least [\\$650 in 2021 and 2022; \\$600 in compensation \(in 2016 - 2020\)](#) from your business for the year.

Your plan may use less restrictive requirements, for example age 18 or three months of service, to determine which employees are eligible.

### Are the eligibility requirements the same for all employees in a SEP plan, including owners?

Yes. The eligibility provisions stated in the SEP plan document must apply equally to owners and employees.

### My spouse and I own our business. Must we both meet the SEP plan eligibility requirements to receive a plan contribution?

Yes. Each of you must separately meet the plan eligibility requirements to participate.

### I'd like to establish a SEP plan that allows me to participate immediately. Can I establish different SEP plan eligibility requirements for future employees?

Yes. You can initially establish your SEP plan so that you are immediately eligible to participate in the plan. Later, you can amend the plan to have more restrictive eligibility requirements, but you must also meet the new eligibility requirements to continue your participation in the plan.

### What is the 3-of-5 rule?

The 3-of-5 eligibility rule means you must include any employee in your plan who has worked for you in any 3 of the last 5 years (as long as the employee has satisfied the other plan eligibility requirements). This is the most restrictive eligibility requirement allowable. You can choose to use less restrictive participation rules in your plan, such as allowing employees to participate immediately after they start work or after a shorter period of employment (for example, after working for only 1 year).

If you use the 3-of-5 rule, you must count any work, no matter how little, in each of the prior 5 years. Use plan years (often the calendar year), not years based on the date the employee started working for you.

**Example:** Your SEP plan uses the 3-of-5 eligibility rule, uses a calendar year and has no age or compensation requirements. To be eligible for a contribution for 2019, an employee must have worked for you for any length of time in any 3 years in the 5-year period from 2014 to 2018. An employee who worked for you for two months in 2014, 2016 and 2018 must share in the SEP contribution made for 2019.

If you didn't include an employee who worked for you in 3 out of the last 5 years, or if you didn't follow your SEP plan's participation requirements, find out how you can [correct](#) this mistake.

### **Is my new employee eligible to participate in our SEP plan immediately?**

It depends on your SEP plan's eligibility requirements. Review your plan document to determine the plan's eligibility requirements.

### **If our SEP plan document includes the 3-of-5 eligibility rule, do we have to make a 2019 SEP plan contribution for an employee who was hired in December 2016?**

Yes, if the employee meets all the other eligibility requirements of your plan, a SEP contribution is required for 2019 for any employee who worked for you for any length of time in 2016, 2017 and 2018.

Years are counted based on the plan year (usually the calendar year), not from the date the employee started working for you.

### **If our SEP plan's only eligibility requirement is age 21, can we prorate an employee's compensation from the date he turns 21 for his SEP contribution for that year?**

No. You must base the employee's SEP plan contribution on the employee's entire plan-year compensation.

### **Our SEP plan requires employees to earn at least \$650 in compensation for the year to participate in the plan. Can we prorate an employee's compensation from the date he earns more than \$650 in the year for that year's SEP contribution?**

No. Once the employee earns at least \$650 in 2021 or in 2022 (\$600 in 2020 and 2019) in a year and meets any other plan eligibility requirements, you must base the employee's SEP plan contribution on the employee's entire plan-year compensation.

## Which categories of employees may I exclude from my SEP plan?

You may choose to exclude employees who are:

1. covered by a union agreement if retirement benefits were bargained for in good faith by you and the employees' union; or
2. nonresident aliens who have no U.S. source compensation.

As discussed above, you may also choose to exclude employees who have not met the minimum requirements for age, time of service, or compensation received.

If you excluded employees who should have been included in your SEP plan, find out how you can [correct](#) this mistake.

## What happens if an employee elects not to participate?

An employer may establish a SEP-IRA for an employee who is entitled to a contribution under the SEP plan if the employee is unable or unwilling to establish a SEP-IRA.

## Compensation

### What compensation is included in determining SEP contributions for an employee?

For an individual who is not self-employed, compensation included in determining SEP contributions includes:

- wages, tips, and other compensation from the employer subject to income tax withholding under section 3401(a),
- amounts described in Internal Revenue Code Section 6051(a)(8), including elective contributions made under a SIMPLE IRA plan, and
- compensation deferred under a 457 plan.

Compensation doesn't include amounts deferred under a Section 125 cafeteria plan. Compensation is limited to \$305,000 in 2022, \$290,000 in 2021 and \$285,000 in 2020.

### What compensation is included in determining SEP contributions for a self-employed individual?

For purposes of the SEP plan rules, a self-employed individual's compensation means net earnings from self-employment determined under Internal Revenue Code section 1402(a).

# Contributions

## How much can I contribute to my SEP?

The contributions you make to each employee's SEP-IRA each year cannot exceed the lesser of:

1. 25% of compensation, or
2. \$61,000 for 2022 (\$58,000 for 2021; \$57,000 for 2020 and subject to annual [cost-of-living adjustments](#) for later years).

These limits apply to contributions you make for your employees to all defined contribution plans, which includes SEPs. Compensation up to \$305,000 in 2022 (\$290,000 in 2021; \$285,000 in 2020 and subject to cost-of-living adjustments for later years) of an employee's compensation may be considered. If you're self-employed, use a special calculation to determine [contributions for yourself](#).

Contributions must be made in cash; you cannot contribute property.

If you've contributed more than the annual limits to your SEP plan, find out how to [correct](#) this mistake.

## How much can I contribute if I'm self-employed?

The same limits on contributions made to employees' SEP-IRAs also apply to contributions if you are self-employed. However, special rules apply when figuring the maximum deductible contribution. See [Publication 560](#) for details on determining the contribution amount.

## Must I contribute the same percentage of salary for all participants?

Most SEPs, including the IRS model Form 5305-SEP, require you to make allocations proportional to your employees' salary/wages. This means that everyone's contribution is the same percentage of salary.

If you haven't made contributions to participants' SEP-IRAs equal to the same percentage of each participant's compensation, find out how you can [correct](#) this mistake.

If you are self-employed, base your contribution on net profit - minus one-half of the self-employment tax - minus your SEP contribution. See [IRS Publication 560](#) on determining the contribution amount.

## If I participate in a SEP plan, can I also make tax-deductible traditional IRA contributions to my SEP-IRA?

If the SEP-IRA permits non-SEP contributions, you can make regular IRA contributions (including IRA catch-up contributions if you are age 50 and older) to your SEP-IRA, up to the maximum [annual limit](#). However, the amount of the regular IRA contribution that you

can [deduct](#) on your income tax return may be reduced or eliminated due to your participation in the SEP plan.

### **If I participate in a SEP plan, can I contribute to a Roth IRA in addition to receiving contributions under the SEP plan?**

A SEP-IRA is a traditional IRA that holds contributions made by an employer under a SEP plan. You can both receive employer contributions to a SEP-IRA and make regular, annual contributions to a traditional or Roth IRA. Employer contributions made under a SEP plan do not affect the amount you can contribute to an IRA on your own behalf.

Because a SEP-IRA is a traditional IRA, you may be able to make regular, annual IRA contributions to this IRA, rather than opening a separate IRA account. However, any dollars you contribute to the SEP-IRA will reduce the amount you can contribute to other IRAs, including Roth IRAs, for the year.

Example 1: Nancy's employer, JJ Handyman, contributes \$5,000 to Nancy's SEP-IRA at ABC Investment Co. based on the terms of the JJ Handyman SEP plan. Nancy, age 45, is permitted to make traditional IRA contributions to her SEP-IRA account at ABC Investment Co., and she contributes \$3,000 in 2019. If Nancy also wants to contribute to her Roth IRA at XYZ Investment Co. for 2019, she can contribute \$3,000 (\$6,000 maximum contribution less the \$3,000 already contributed to her SEP-IRA) by April 15, 2020.

Example 2: Nancy, age 45, is the owner and sole employee of JJ Investment Advisors. Nancy contributes the maximum allowable amount to her SEP-IRA for 2019, or \$56,000. Nancy may also make regular, annual IRA contributions to her SEP-IRA, if her SEP-IRA allows this, or contribute to her Roth IRA at XYZ Investment Co. Her total traditional IRA and Roth IRA contributions cannot exceed \$6,000 for 2019 and may be made in addition to her SEP contributions.

### **Can I make catch-up contributions to my SEP?**

No, SEPs are funded by employer contributions only. Catch-up contributions apply only to employee elective deferrals. However, if you are permitted to make traditional IRA contributions to your SEP-IRA account, you may be able to make [catch-up IRA contributions](#).

### **Must I contribute to the SEP every year?**

No, you are not required to contribute every year. In years you do contribute to the SEP, the contributions must be made to the SEP-IRAs of all eligible employees.

### **Do I have to contribute for a participant who is no longer employed on the last day of the year?**

Yes, you do, if they are otherwise eligible for a contribution. A SEP cannot have a last-day-of-the-year employment requirement. If the employee is otherwise eligible, they must share in

any SEP contribution. This includes eligible employees who die or quit working before the contribution is made. If you haven't made a contribution for an eligible employee in your SEP plan, find out how you can [correct](#) this mistake.

### **Can I contribute to the SEP-IRA of a participant over age 70 ½?**

You must contribute for each employee eligible to participate in your SEP, even if they are over age 70 ½. The employee must also take minimum distributions, however. If you haven't contributed for an eligible employee in your SEP plan, find out how you can [correct](#) this mistake.

### **When must I deposit the contributions into the SEP-IRAs?**

You must deposit contributions for a year by the due date (including extensions) for filing your federal income tax return for the year. If you obtain an extension for filing your tax return, you have until the end of that extension period to deposit the contribution, regardless of when you actually file the return.

If you did not request an extension to file your tax return and did not deposit the SEP plan contributions by the filing due date for that return, you are not allowed to deduct any SEP plan contributions on that year's return. The contributions may be deducted on the following year's return.

If you improperly deducted SEP plan contributions on your return, you must file an amended tax return as soon as possible.

### **How much of the SEP contributions are deductible?**

The most you can deduct on your business's tax return for contributions to your employees' SEP-IRAs is the lesser of your contributions or 25% of compensation. (Compensation considered for each employee is limited and subject to annual [cost-of-living adjustments](#)). If you are self-employed and contribute to your own SEP-IRA, there is a special computation to figure the [maximum deduction](#).

### **Are employer contributions taxable to employees?**

No, contributions to employees' SEP-IRAs are not included in their gross income, unless they are excess contributions.

### **What are the consequences to employees if I make excess contributions?**

Excess contributions are included in employees' gross income. Employees who withdraw the excess contribution (plus earnings) before the due date for their federal return, including extensions, will avoid the 6% excise tax imposed on excess SEP contributions in an IRA. Excess contributions left in the employee's SEP-IRA after that time will be subject to the 6% tax on the employees' IRAs, and the employer may be subject to a 10% excise tax on the excess

nondeductible contributions. If you've contributed too much to your employees' SEP-IRA, find out how you can [correct](#) this mistake.

### **If my SEP plan fails to meet the SEP requirements, are the tax benefits for me and my employees lost?**

Generally, tax benefits are lost if the SEP fails to satisfy the Internal Revenue Code requirements. However, you can retain the tax benefits if you use one of the [IRS correction programs](#) to correct the failure. In general, your correction should put employees in the position they would have been had the failure not occurred.

## **Reporting Requirements**

### **Why is last year's contribution that was made this year for the SEP-IRA shown on this year's Form 5498 instead of last year's Form 5498?**

The IRS requires contributions to a SEP-IRA to be reported on the Form 5498 for the year they are actually deposited to the account, regardless of the year for which they are made.

## **Terminating a SEP Plan**

### **Do I need to amend my SEP for the new law before I terminate it?**

Generally, the IRS has not required employers to amend their SEPs for new law prior to termination. Check with your plan professional.

### **Do I have to fund my SEP in the year of termination?**

SEPs can be terminated at any time. You can stop funding your plan once it is terminated.

### **What are the notification requirements when a SEP terminates?**

When you terminate your SEP plan, it is a good idea to notify the employees that you are discontinuing the plan. You may need to notify the financial institution that you chose to handle the plan that there will be no more contributions and that you will terminate the contract or agreement with it. Do not notify the IRS of the plan's termination.

### **If I go out of business or my employee terminates service, can the amount in a SEP-IRA be left untouched?**

Yes.

Have a question about retirement plans? [Contact us.](#)