

# **SIMPLE, SEP, and SARSEP Answer Book**

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*Eighteenth Edition*

**Gary S. Lesser**

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Law & Business

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# **SIMPLE, SEP, and SARSEP**

## **Answer Book**

**Eighteenth Edition**

*by Gary S. Lesser*

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This comprehensive, authoritative volume provides up-to-date coverage of recent legislative and regulatory developments in simplified employee pension (SEP) plans and savings incentive match plans for employees (SIMPLEs). It provides clear and concise guidance on the complex design, administration, and compliance issues that arise in connection with SIMPLEs, SEPs, and salary reduction SEPs (SARSEPs).

### **Highlights of the Eighteenth Edition**

Highlights of *SIMPLE, SEP, and SARSEP Answer Book, Eighteenth Edition*, includes:

- Discussion of the final exemption procedure from the prohibited transaction rules that apply after December 26, 2011. (See Q 4:22.)
- How to compute the compensation a self-employed individual needs to be allocated the maximum amount (\$50,000) for 2012. (See Q 6:30.)
- Why the Code Section 164(f) deduction for half of the self-employment taxes will be close to, but not equal to half, of the self-employment tax shown on Schedule C of Form 1040 or Form 1040NR for 2011 and 2012. (See Q 7:2.)
- The statutory changes under GOZA, TIPRA, HERO, PPA, HEART, and WRERA relating to qualification of IRAs that became effective after the mandatory amendments were announced in 2002. (See Q 3:6.)
- How the deduction for one-half of the self-employed health insurance (SEHI) was treated when calculating one-half of the self-employment tax under Code Section 164(f) for 2011 and 2010. (See Q 7:18.)
- When a person providing investment advice becomes a fiduciary under the proposed fiduciary advice regulations issued in 2010. (See Qs 4:24–4:39.)



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- What an Employer Plans Compliance Unit (EPCU) examination program request involving a SIMPLE or SEP is looking for and how to respond. (See Q 3:7.)
- How a prototype traditional IRA, SEP-IRA, or SIMPLE IRA may be amended to incorporate statutory changes without affecting reliance on a favorable opinion letter. (See Q 3:19 and Appendix G for model language.)
- How the designated Roth account (DRA) rules apply to a 401(k) SIMPLE IRA plan. (See Q 15:21.)
- How the law about retirement plans' death benefits is sometimes similar to, but often quite different from, the law that applies to the disposition of other wealth. (See Chapter 16.)
- How the DOL's seven-day safe harbor rules for elective contribution are applied after a delinquent contribution is made. (See Q 4:45.)
- Why the *pro rata allocation rule* applies to direct rollovers and the *taxable first rule* applies to 60-day rollovers from an employer's plan to an IRA, and why Roth IRAs are treated differently. (See Q 15:51.)
- Whether inherited IRAs are protected from creditors or included in the debtor's bankruptcy estate under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. (See Q 4:79.)
- When an ACA (automatic contribution arrangement) may be used in connection with a SEP or SARSEP arrangement. (See Q 12:1.)
- The extent to which IRAs are protected from creditors and the amount under state and federal law. (See Qs 4:68–4:73.)
- The Form 1099-R reporting codes and changes to Form 5498 and Form 8606. (See Chapter 13.)
- Restorative payments (of a good-faith claim of liability) and the annual IRA and SEP contribution limits. (See Q 5:6.)
- Limitations on deductions to combined plans and their effect on deductions for SEP contributions. (See Q 1:3.)
- Integration and participant exclusion rules that permit larger contributions to be made for employees earning above a specified amount, but that also require that the \$50,000 (for 2012) allocation limit be reduced. (See Chapter 9.)
- Procedures for correcting excess contributions and the reporting of contributions, revocations, rollovers, and conversions. (See Chapters 10, 11, 12, and 13.)

- Review of the tax credits available to individuals for IRA contributions and elective deferrals, as well as the tax credits available to businesses establishing new SIMPLE or SEP arrangements. (See Qs 1:33, 14:168, and 15:61.)

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# Preface

*SIMPLE, SEP, and SARSEP Answer Book, Eighteenth Edition*, provides coverage of recent developments in simplified employee pension (SEP) plans and savings incentive match plans for employees (SIMPLEs) and discusses various technical changes and clarifications reflecting the changes made by the Tax Reform Act of 1986, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, the Economic Growth and Tax Relief Reconciliation Act of 2001, the USA Patriot Act of 2001, the Job Creation and Worker Assistance Act of 2002, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Working Families Tax Relief Act of 2004, American Jobs Creation Act of 2004, the Pension Protection Act of 2006, the Heroes Earnings Assistance and Relief Tax Act of 2008, the Emergency Economic Stabilization Act of 2008, Worker, Retiree, and Employer Recovery Act of 2008, the Small Business Jobs Act of 2010, the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, and other legislation. Additional guidance, many new examples, and illustrations are provided to assist practitioners in complying with the new rules.

Included in this book are several appendices that will also be of assistance to the practitioner. Appendix L contains guidance on appropriate codes to enter on Form 1099-R when reporting revocations of contributions and CIP failure to SEPs, SIMPLEs, and salary reduction SEPs (SARSEPs). Appendix D contains extracts from the Employee Plans Compliance Resolution System applicable to SEP and SIMPLE IRA plans. Updated charts comparing various types of plans and plan features are provided in Appendices E, N, and O. COLA adjusted limits are provided in Appendix G, and an excess SEP/SARSEP contribution flow chart is provided in Appendix M. Appendix H reproduces illustrations of the many examples used in this book.

Designing plans that best meet a specific company's unique requirements is a difficult task. *SIMPLE, SEP, and SARSEP Answer Book* offers practitioners in-depth understanding of such issues as establishing, maintaining, and terminating the plan; employer and employee eligibility; catch-up contributions; SEP integration with Social Security contributions; and the operation and administration of SIMPLEs and SEPs. Among the many other key areas covered are the meaning

of the terms *compensation* and *earned income* for various purposes, IRS reporting requirements, participant disclosures, ERISA fiduciary requirements, and earnings from self-employment.

*SIMPLE, SEP, and SARSEP Answer Book* is the most comprehensive, up-to-the-minute, and authoritative resource on the market, answering the complex questions surrounding SIMPLEs, SEPs, and SARSEPs. The question-and-answer format, with its breadth of coverage and its plain-language explanations, provides practitioners with clear, concise answers to hundreds of practical questions. Practice pointers and numerous examples offer additional insight into the complexities of designing, administering, and reporting SIMPLEs, SEPs, and SARSEPs. Citations to authorities are provided as research aids for those who need to pursue particular subjects in greater detail.

**Numbering System.** The questions are numbered consecutively within each chapter (e.g., Q 1:1, Q 1:2, and Q 1:3).

**List of Questions.** The detailed List of Questions that follows the Contents helps the reader locate areas of immediate interest. The list is similar to a detailed table of contents, providing both the question number and the page on which the question appears.

**Tables.** For easy access to a particular section of the Internal Revenue Code, Treasury regulations, Department of Labor regulations and advisory opinions, the United States Code, and IRS documents (revenue rulings, revenue procedures, letter rulings, notices, and announcements), tables of the sections, documents, and cases cited in the text, referenced by question number, have been included.

**Index.** A detailed topical index is provided at the back of the book as a further aid to locating specific information. All references are to question numbers and appendices.

**Abbreviations and Acronyms.** A number of the terms and statutory references that appear repeatedly in this book are referred to by their abbreviations and/or acronyms after the first mention. The most common of the abbreviations and acronyms are:

- Ann.—IRS Announcement
- BAPCPA—Bankruptcy Abuse Prevention and Consumer Protection Act of 2005
- C.B.—Cumulative Bulletin of the IRS
- CCA—Chief Counsel Advice
- COBRA—Comprehensive Omnibus Budget Reconciliation Act of 1985
- Code; I.R.C.—Internal Revenue Code
- DO—Delegation Order

- DOL—Department of Labor
- DOL Adv. Op.—Department of Labor Advisory Opinion
- EBSA—Employee Benefits Security Administration
- EGTRRA—Economic Growth and Tax Relief Reconciliation Act of 2001
- EPCRS—Employee Plans Compliance Resolution System
- ERISA—Employee Retirement Income Security Act of 1974
- E-SIGN—Electronic Signatures in Global and National Commerce Act
- FUTA—Federal Unemployment Tax Act
- FICA—Federal Insurance Contributions Act
- GOZA—Gulf Opportunity Zone Act of 2005
- HEART—Heroes Earnings Assistance and Relief Tax Act of 2008
- HIPAA—Health Insurance Portability and Accountability Act of 1996
- I.R.C.—Internal Revenue Code
- ILM—IRS Legal Memorandum
- IR—IRS Information Release
- IRA—individual retirement arrangement (account and annuity)
- I.R.B.—Internal Revenue Bulletin
- IRS or I.R.S.—Internal Revenue Service
- JCWAA—Job Creation and Worker Assistance Act of 2002
- JOBS—American Jobs Creation Act of 2004
- KETRA—Katrina Emergency Tax Relief Act of 2005
- Ltr. Rul.—Private Letter Ruling
- PPA—Pension Protection Act of 2006
- Prop. Treas. Reg.—Proposed Treasury Regulation
- P.T.E.—Prohibited Transaction Exemption
- Pub. L.—Public Law
- RA '78—Revenue Act of 1978
- RRA '98—IRS Restructuring and Reform Act of 1998
- Rev. Proc.—Revenue Procedure
- Rev. Rul.—Revenue Ruling
- SBJA—Small Business Jobs Act of 2010
- SBJPA—Small Business Job Protection Act of 1996

- SEC—Securities and Exchange Commission
- SEC Rel.—Securities and Exchange Commission Release
- TAMRA—Technical and Miscellaneous Revenue Act of 1998
- Temp. Treas. Reg.—Temporary Treasury Regulation
- TRA '86—Tax Reform Act of 1986
- TRA '97—Taxpayer Relief Act of 1997
- Treas. Reg.—Treasury Regulation
- USERRA—Uniformed Services Employment and Reemployment Rights Act of 1994
- WRERA—Worker, Retiree, and Employer Recovery Act of 2008.

Gary S. Lesser  
*October 2012*

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## About the Authors

**Gary S. Lesser, Esq.**, is the principal of GSL Galactic Consulting, located in Indianapolis, Indiana. Mr. Lesser maintains a telephone-based consulting practice providing services and plan illustrations to other professionals and business owners. Mr. Lesser is a nationally known author, educator, and speaker on retirement plans for individuals and smaller businesses. He has broad technical and practical knowledge of both qualified and nonqualified retirement plans.

Mr. Lesser is also the technical editor and coauthor of Wolters Kluwer Law & Business' *Health Savings Account Answer Book*, *Roth IRA Answer Book*, *457 Answer Book*, and *Quick Reference to IRAs*. Mr. Lesser is also the principal author and technical editor of *The Adviser's Guide to Retirement Plans for Small Businesses* and other publications of the American Institute of Certified Public Accountants (AICPA). In 2010, Mr. Lesser published *Basic Accounting Simplified*. He has developed several software programs that are used by financial planners, accountants, and other pension practitioners to allocate contributions and market retirement plans for smaller businesses. His two software programs—*QP-SEP Illustrator*<sup>™</sup> and *SIMPLE Illustrator*<sup>®</sup>—are marketed and distributed nationally. He has also been published in the *IRS EP/EO Digest*, *Journal of Taxation of Employee Benefits*, *Journal of Compensation and Benefits*, *Journal of Pension Benefits*, *Life Insurance Selling*, *Rough Notes*, and *NAPFA Advisor*.

In 1974, Mr. Lesser started his employee benefits career with the Internal Revenue Service, as a Tax Law Specialist/Attorney in the Employee Plans/Exempt Organizations (EP/EO) Division. He later managed and operated a pension administration and actuarial service organization, was an ERISA marketing attorney for a national brokerage firm, and was a senior vice president/director of retirement plans for several nationally known families of mutual funds and variable annuity products. Mr. Lesser graduated from New York Law School and received his B.A. in accounting from Fairleigh Dickinson University. He is admitted to the bars of the state of New York and the United States Tax Court. Comments and suggestions can be forwarded to Mr. Lesser at GSL Galactic Consulting, 944 Stockton St., Indianapolis, IN 46260-4925, (317) 254-0385, or to [QPSEP@aol.com](mailto:QPSEP@aol.com). Information is also available on his Web site at <http://www.GaryLesser.com>.

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Ms. Appleby is a frequent speaker at seminars, where she explains the importance of saving for retirement, and how to prevent paying avoidable taxes and penalties on distributions from retirement plans.

Ms. Appleby has appeared on CNBC's "Business News," where she gave insights on saving and planning for retirement. She has earned the following professional designations: The Accredited Pension Administrator (APA) from the National Institute of Pension Administrators, the Certified IRA Services Professional (CISP) designation from the Institute of Certified Bankers; the Chartered Retirement Plans Specialist (CRPS) designation from the College for Financial Planning; Certified Retirement Services Professional (CRSP) designation from the Institute of Certified Bankers; and the Certified Retirement Counselor (CRC) designation from the International Foundation for Retirement Education (InFRE).

**Peter Gulia, Esq.**, is the shareholder of Fiduciary Guidance Counsel, a law firm that advises retirement plans' fiduciaries.

After more than 21 years of experience with one of America's largest retirement services businesses, Mr. Gulia now counsels the people who manage employee-benefit plans. In addition, he offers advice about employers' and executives' smart use of plan designs permitted under Code Sections 125, 401(k), 403(b), 409A, and 457(b) or (f).

Although Mr. Gulia concentrates his practice on advising an employee-benefit plan's lead fiduciary, he also counsels investment advisers about their fiduciary duties and compliance procedures under the Investment Advisers Act, Employee Retirement Income Security Act of 1974 (ERISA), and other laws. Likewise, he advises lawyers and certified public accountants about their professional conduct.

Since 1984, Mr. Gulia has focused on the design, governance, fiduciary investment procedures, and administration of retirement plans. His groundbreaking solutions to resolve then-novel ERISA, tax, and securities issues for asset-allocation investment advice and other retirement plan services remain models that practitioners continue to use today. Beyond ERISA-governed plans, he has

wide experience with church plans and governmental plans, and with how securities law and other laws beyond ERISA and the Internal Revenue Code affect retirement plans.

He is a widely published expert on plan investments (including qualified default investment alternatives), beneficiary designations, and domestic relations orders. Mr. Gulia has published primarily with Wolters Kluwer Law & Business. He is a contributing author of six books in its Answer Book series, and is a contributing editor of *401(k) Advisor*. He is an author of *The CPA's Guide to Retirement Plans for Small Businesses* (AICPA), and recently expanded the book's coverage of fiduciary issues. He is an *Insights* author and speaker with Bloomberg BNA.

Mr. Gulia is an adjunct professor in Temple University's law school, and teaches a broad range of professional-education programs, including for the National Association of Personal Financial Advisors (NAPFA), *Pensions & Investments* magazine, Financial Research Associates, and The American Law Institute Continuing Legal Education. He is a member of the ASPPA Benefits Council of the Delaware Valley, the American Bar Association, and the Philadelphia Bar Association, serving on its Employee Benefits Committee and Professional Guidance Committee.

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Ms. Roberts practices exclusively in the employment benefits and employment law area, with particular emphasis on pension and health plans under the ERISA. She is an author of chapters on voluntary compliance programs in *The Adviser's Guide to Retirement Plans for Small Businesses*, published by the AICPA (3d Ed. 2012), and *Quick Reference to IRAs* (2012), published by Wolters Kluwer Law & Business. Ms. Roberts is a member of the Santa Barbara County Bar Association, the Santa Barbara Human Resources Association, and the Society for Human Resources Management. She currently serves on the board of trustees of the Santa Barbara Public Library. She writes frequently about benefit related topics at <http://www.eforerisa.com>.

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I thank Lawrence C. Starr, President of Qualified Plan Consultants, Inc., in Springfield, Massachusetts, for helping me understand the intricacies of “ultra-net” earned income and how to get there from nowhere.

Over the years contributing authors have changed. I’d like to thank the former contributing author, Susan D. Diehl, for taking the time—when she could and for as long as she could—to share her expertise. Some of her contributions remain intact and we thank her for it.



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*G.S.L.*