

This checklist is *not* a complete description of all plan requirements, and should *not* be used as a substitute for a complete plan review.

**For Business Owner's Use**  
(DO NOT SEND THIS WORKSHEET TO THE IRS)

Every year it is important that you review the requirements for operating your Simplified Employee Pension (SEP) plan. Use this checklist to help you keep your plan in compliance with many of the important rules. See [www.irs.gov/retirement](http://www.irs.gov/retirement) for online versions of this checklist, Fix-It Guides, and other resources for SEPs and other plan types. On the online version of this checklist, click on "(More)" in any of the questions for additional information (including examples) on how to find, fix and avoid each mistake.

**1. Has your SEP been amended for current law?** Yes ☐ No ☐

Laws related to retirement plans change quite frequently. You will need to change plan language and operation to keep the plan within the law.

[\(More\)](#)

**2. Is the business that the SEP covers the only business you own?** Yes ☐ No ☐

Employees of other businesses you and/or your family members own may have to be treated as employees when determining who is an eligible employee under this SEP.

[\(More\)](#)

**3. Are all eligible employees participating in the SEP?** Yes ☐ No ☐

Any employee who is at least 21 years of age, was employed by you for 3 of the immediately preceding 5 years, and received compensation from you of at least \$550 during the year (subject to cost-of-living adjustments after 2013) is eligible to participate in a SEP.

[\(More\)](#)

**4. Are you determining each eligible employee's compensation using the definition in your SEP document?** Yes ☐ No ☐

Compensation used to determine contributions generally includes all bonuses and commissions and is limited to \$255,000 for 2013, subject to cost-of-living adjustments in later years.

[\(More\)](#)

**5. Are contributions to each participant's SEP-IRA a uniform percentage of the participant's compensation?** Yes ☐ No ☐

Employer contributions to a SEP must be the same percentage of compensation for each employee maintaining a SEP-IRA in the plan.

[\(More\)](#)

**6. Are SEP contributions to each participant's IRA limited as required by the Internal Revenue Code?** Yes ☐ No ☐

All SEP contributions must go to traditional IRAs set up for the eligible employees and are limited to the lesser of 25% of compensation or \$51,000 for 2013, subject to cost-of-living adjustments in later years.

[\(More\)](#)

**If you answered "No" to any of the above questions, you may have a mistake in the operation of your SEP plan. This list is only a guide to a more compliant plan, so answering "Yes" to each question may not mean your plan is 100% compliant. Many mistakes can be corrected easily, without penalty and without notifying the IRS.**

■ **contact your tax advisor**      ■ **visit the IRS at [www.irs.gov/retirement](http://www.irs.gov/retirement)**      ■ **call the IRS at (877) 829-5500**

## SEP Plan Fix-It Guide

Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
1) You haven't updated your SEP plan document for current law ( <a href="#">More</a> )	Determine if your <a href="#">Form 5305-SEP</a> is the current revision (December 2004)	Adopt revised Form 5305-SEP	Maintain regular contact with the company that sold you the plan
2) Employees of related businesses were excluded from participating ( <a href="#">More</a> )	Identify any companies that you own or with which you have a financial relationship	Apply reasonable correction method that would place affected employees in the position they would've been in if there were no operational plan mistakes	Determine if you own any other businesses
3) Eligible employees were excluded from participating ( <a href="#">More</a> )	Review eligibility and participation plan document sections. Check when employees are entering the plan	Corrective contribution that would place affected employees in the position they would've been in if there were no operational plan mistakes	Review the participation status of all employees at least once a year
4) Contributions to participants' SEP-IRAs were miscalculated because the wrong definition of compensation was used ( <a href="#">More</a> )	Review the SEP plan document to determine if you're using the proper compensation for allocations	Correction is based on the terms of the plan in effect at the time of the mistake	Review the SEP plan document to ensure that you're considering the correct amount of compensation when calculating contributions
5) Contributions to each participant's SEP-IRA weren't a uniform percentage of the participant's compensation ( <a href="#">More</a> )	Divide contributions by compensation for each employee	Corrective contribution that would place affected employees in the position they would've been in if there were no operational plan mistakes	After the initial calculation of allocations based on the SEP plan document's terms, verify that all proposed contributions are based on a uniform percentage of participants' compensation
6) Contributions to the SEP-IRA exceeded the maximum legal limits ( <a href="#">More</a> )	Determine the total contribution made for each employee and make sure that amount does not exceed the lesser of:  1) 25% of that employee's compensation, or  2) the <a href="#">dollar limitation</a> for that year (\$52,000 for 2014)	Either distribute or retain the excess amount	After the initial calculation of allocations based on the terms of the SEP plan document, check to make sure none of the proposed allocations violate the law

## SEP Plan - Overview

A SEP is a **S**implified **E**mployee **P**ension plan. To establish a SEP, the employer:

- Can be a business of any size, even self-employed
- Must adopt a SEP plan document

Any employer - including a sole proprietorship, partnership, corporation and nonprofit organization - with one or more employees may establish a SEP plan. This includes a self-employed business owner, regardless of whether he or she is the only employee of the business. Individual employees may not establish a SEP plan.

Under a SEP, the employer contributes to traditional IRAs set up for eligible employees (including self-employed individuals), subject to certain limits. A SEP is funded solely by employer contributions. Each employee is always 100% vested in (or, has ownership of) all money in his or her SEP-IRA.

There are three basic steps in setting up a SEP.

- 1) Execute a formal written agreement to provide benefits to all eligible employees.
- 2) Give employees certain information about the SEP.
- 3) Set up a SEP-IRA for each eligible employee.

**Formal written agreement.** You must execute a formal written agreement to provide benefits to all eligible employees under a SEP. You can satisfy the written agreement requirement by adopting an IRS model SEP using [Form 5305-SEP](#).

If you use Form 5305-SEP, no prior IRS approval or determination letter is required. Keep the original form. Don't file it with the IRS. Also, using Form 5305-SEP will usually relieve you from filing annual retirement plan information returns with the IRS and Department of Labor. See the Form 5305-SEP instructions for details.

**When not to use Form 5305-SEP.** You cannot use Form 5305-SEP if you:

- 1) Currently maintain any other qualified retirement plan.
- 2) Have any eligible employees for whom you haven't set up IRAs.
- 3) Use the services of leased employees.
- 4) Are a member of any of the following, unless eligible employees of all the members of these groups, trades or businesses participate under the SEP.
  - a. An affiliated service group described in Internal Revenue Code Section 414(m)
  - b. A controlled group of corporations described in IRC Section 414(b)
  - c. Trades or businesses under common control described in IRC Section 414(c)

**Use of prototype SEPs.** Financial institutions and other approved sponsoring organizations can sponsor a prototype SEP document. The IRS issues opinion letters approving prototypes. Plan sponsors can use individually designed documents, but the IRS hasn't established an approval process for these.

**Information you must give to employees.** You must give each eligible employee a copy of Form 5305-SEP, its instructions and the other information listed in the Form 5305-SEP instructions. An IRS Model SEP isn't considered adopted until you give each employee this information. If you adopt a prototype SEP, you must give each eligible employee similar information.

**Setting up the employee's SEP-IRA.** A SEP-IRA must be set up by or for each eligible employee. SEP-IRAs can be set up with banks, insurance companies or other qualified financial institutions. You send SEP contributions to the financial institution where the SEP-IRA is maintained.

**Deadline for setting up a SEP.** A SEP can be set up for a year as late as the due date (including extensions) of the business's income tax return for that year.

### **Who is eligible to participate?**

Generally, any employee who performs services for the business must be included in a SEP. However, there are some exceptions to this general rule. Among the employees that you may exclude from a SEP are those who:

- Haven't worked for you during three out of the last five years.
- Haven't reached age 21.
- Are employees who are covered by a union agreement and whose retirement benefits were bargained for in good faith by you and the employees' union.
- Are nonresident alien employees who have received no U.S. source wages, salaries or other personal services compensation from you.
- Received less than \$550 in compensation (subject to [cost-of-living adjustments](#)) during the year. Gross wages reported on Form W-2 can be used to determine if an employee is eligible to participate.

### **What are the contribution requirements?**

By establishing a SEP, you've adopted a plan that requires a SEP-IRA to hold the contributions made for each of the eligible employees. A SEP is funded by employer contributions. The SEP plan document will indicate the amounts you've agreed to contribute. This amount can be discretionary, including zero. The SEP document must include a definite written allocation formula for determining how the contribution is allocated to the employees' SEP-IRAs.

SEP contributions must bear a uniform relationship to compensation. Generally, a uniform relationship means that each employee's contribution must represent the same percentage of compensation. Nonuniformity is possible with a permitted disparity formula (see IRC Section 408(k)(3)(D)). The amount of compensation taken into account under the plan can't exceed \$260,000 in 2014, and is subject to [cost-of-living adjustments](#) for later years. "Compensation" may be gross wages reported on Form W-2, or an alternative definition.

Total contributions to each employee's SEP-IRA cannot exceed the lesser of \$52,000 for 2014, (subject to [cost-of-living adjustments](#) for later years) or 25% of compensation. Each employee is always 100% vested in (or, has ownership of) all contributions to his or her SEP-IRA.

After you send the SEP contributions to the financial institution, it will manage the funds. Depending on the financial institution, SEP contributions can be invested in individual stocks, mutual funds and other, similar types of investments.

Each participating employee must receive an annual statement stating the amount contributed to the SEP-IRA for the year.

### **What are the basic distribution/withdrawal rules?**

Employees can withdraw SEP contributions and earnings at any time. A withdrawal is taxable in the year received. If an employee makes a withdrawal before he or she is age 59½, generally a

[10% additional tax](#) applies. Employees may roll over SEP contributions and earnings tax-free to other IRAs and retirement plans.

SEP contributions and earnings must eventually be distributed. A [specific minimum amount](#) must be distributed by April 1 of the year following the year the employee reaches age 70½.

### **What are the filing requirements?**

An employer generally has no filing requirements. The annual reporting required for qualified plans (Form 5500 series) is normally not required for SEPs. The financial institution that holds the plan's SEP-IRAs handles most of the other paperwork, including [Form 5498](#), an annual document issued by the financial institution to report information to the IRS about amounts contributed to the SEP-IRAs.

## Employee Plans Compliance Resolution System (EPCRS) – Overview

If you make mistakes with respect to your SEP plan, you may use the IRS Employee Plans Compliance Resolution System to remedy your mistakes and retain the tax-favored status of your plan. A correction for a mistake should be reasonable and appropriate. The correction methods should resemble one already provided for in the Internal Revenue Code and you should consider all facts and circumstances. [Revenue Procedure 2013-12](#), 2013-04 I.R.B. 313 (previously Revenue Procedure 2008-50, 2008-35 I.R.B 464) is the official guidance governing the EPCRS program.

There are three ways to correct mistakes under EPCRS:

- 1) **Self-Correction Program (SCP)** - permits a plan sponsor to correct certain plan failures without contacting the IRS or paying a fee.
- 2) **Voluntary Correction Program (VCP)** - permits a plan sponsor to, any time before audit, pay a fee and receive IRS approval for correction of plan failures.
- 3) **Audit Closing Agreement Program (Audit CAP)** - permits a plan sponsor to pay a sanction and correct a plan failure while the plan is under audit.

A general description of each component of EPCRS is provided below:

### Self-Correction Program:

- To be eligible for SCP, the plan sponsor or administrator must have established practices and procedures (formal or informal) reasonably designed to promote and facilitate overall compliance with the law. A plan document alone doesn't constitute evidence of established procedures.
- SCP is only available for correcting insignificant operational problems - the failure to follow the terms of your SEP plan document. SCP is not available for correcting problems with the plan document, such as the failure to keep it current to reflect changes in the law. Revenue Procedure 2013-12 Section 8 describes the factors that must be considered when determining whether operational failures are insignificant.
- The plan sponsor should follow general correction principles in Revenue Procedure 2013-12, section 6.
- A plan sponsor that corrects a mistake listed in Appendix A or Appendix B of Revenue Procedure 2013-12 according to the correction methods listed may be certain that their correction is reasonable and appropriate for the failure.
- If needed, the plan sponsor should make changes to its administrative procedures to ensure that the mistakes don't recur.
- When using SCP, the plan sponsor should maintain adequate records to demonstrate correction in the event of a plan audit.
- There is no fee for self-correction.

### Voluntary Correction Program:

- The plan sponsor makes a submission to the IRS that:
  - 1) includes completed Forms [8950](#) and [8951](#).
  - 2) identifies the mistakes.
  - 3) proposes correction using the general correction principles in Revenue Procedure 2013-12, section 6.
  - 4) proposes changes to its administrative procedures to ensure that the mistakes don't recur.
  - 5) may include electronic pre-formatted model documents (Appendix C - Part 1 [Model VCP Submission Compliance Statement](#) and Appendix C - Part II [Schedules](#)) and Acknowledgement Letter ([Appendix D](#)) (to assist applicants making a VCP submission).
  - 6) includes a compliance fee of \$250.

- The IRS issues a Compliance Statement detailing mistakes identified by the plan sponsor and the correction methods approved by the IRS.
- The plan sponsor corrects the identified mistakes within 150 days of the issuance of the Compliance Statement.
- While the IRS is processing the submission, IRS won't audit the plan, except under unusual circumstances.

[Audit Closing Agreement Program:](#)

- The plan sponsor or plan is under examination.
- The plan sponsor:
  - 1) enters into a Closing Agreement with the IRS.
  - 2) makes correction prior to entering into the Closing Agreement.
  - 3) pays a sanction negotiated with the IRS.
    - The sanction paid under Audit CAP should be greater than the fee paid under VCP.
- The sanction under Audit CAP is a negotiated percentage of the **Maximum Payment Amount** based on the sum for all open taxable years of the:
  - 1) Additional income tax resulting from income inclusion for employees in the plan (Form 1040), including the tax on plan distributions that have been rolled over to other IRAs (and any interest and penalties applicable to the employees' tax return).
  - 2) Additional tax resulting from the 6% tax imposed under Internal Revenue Code Section 4973 on excess contributions to IRAs.

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Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
You haven't updated your SEP plan document for current law	Determine if your <a href="#">Form 5305-SEP</a> is the current revision (December 2004)	Adopt revised Form 5305-SEP	Maintain regular contact with the company that sold you the plan

## 1) You haven't updated your SEP plan document for current law.

Laws related to retirement plans change frequently. There are statutory deadlines for which many provisions must become effective. The IRS generally establishes a firm deadline for adopting these changes. Also, these law changes might mean you can simplify some areas of plan administration or improve benefits. You'll need to change plan language and operation to keep the plan within the law and to take advantage of increased benefit limits.

### How to find the mistake:

At some point in the plan's existence, you may be asked to demonstrate your plan has been in compliance with the law. This request may come from a financial institution, third-party administrator or other plan service provider, or it may come from the IRS during an audit. They may ask you to demonstrate the plan has complied with all current and prior law, sometimes reaching back several years.

You may have a plan document that is a model SEP ([Form 5305-SEP](#), *Simplified Employee Pension - Individual Retirement Accounts Contribution Agreement*) or a pre-approved plan. The IRS has already favorably reviewed both model SEPs and pre-approved plans.

If your plan is a Form 5305-SEP that is the current revision (December 2004), you can be assured that it complies with the law. If your plan is a pre-approved plan, you have a level of assurance that the plan is written in compliance with the law even if you don't apply for a determination letter. Individually designed SEPs must be updated for law changes. If you have this situation, consult your tax advisor.

### How to fix the mistake:

#### Corrective action:

If you haven't amended your plan timely for law changes, you should adopt the latest revision of Form 5305-SEP (December 2004) or adopt the latest revised document (approved for EGTRRA) provided by your financial institution. You'll need to confirm that the plan operation is consistent with the plan's terms.

#### Example:

Employer Y established a SEP in 1995 using a prototype plan and hasn't amended the plan document for any subsequent tax law changes.

The [Economic Growth and Tax Relief Reconciliation Act](#) of 2001 changed many of the Internal Revenue Code requirements and limits for qualified plans and IRAs. To benefit under these new provisions, employers must amend their SEP prototype and individually designed plans for current law. For employers with model SEP plans to avail themselves of the latest law changes, they must adopt the latest model Form 5305-SEP (for EGTRRA it must have a revision date of March 2002 or later).



## **Correction programs available:**

### **Self-Correction Program:**

This mistake cannot be corrected under SCP.

### **Voluntary Correction Program:**

Employer Y didn't adopt an updated plan document timely and the plan isn't under audit, so Y may make a VCP submission to the IRS under Revenue Procedure 2013-12. Y is encouraged to make its VCP submission using the model documents in [Appendix C](#), including Forms [8950](#) and [8951](#). The fee for the VCP submission is \$250.

### **Audit Closing Agreement Program:**

If this mistake is discovered on audit, it may be corrected under Audit CAP. Correction of the mistake under Audit CAP should be very similar to correction under VCP. The sanction under Audit CAP is a percentage of the [maximum payment amount](#).

### **How to avoid the mistake:**

If you're using an IRS SEP model plan (Form 5305-SEP), visit the IRS website before the end of each calendar year to see if the IRS has updated the model plan. If there's a newer version of the form, read the instructions to determine if it's necessary to adopt it.

If you're using a financial institution's SEP prototype, check with that financial institution to ensure that there are proper procedures in place ensuring that they send any required updates you need to sign in a timely manner. Keep signed and dated copies of your plan document and any amendments for your records.

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Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
Employees of related businesses were excluded from participating	Identify any companies that you own or with which you have a financial relationship	Apply reasonable correction method that would place affected employees in the position they would've been in if there were no operational plan mistakes	Determine if you own any other businesses

## 2) Employees of related businesses were excluded from participating.

“Employees” for purposes of determining who’s an eligible employee under a SEP includes all employees of all related employers. Related employers include controlled groups of corporations that include your business, trades or businesses under common control with your business and affiliated service groups that include your business. This means, for example, that if you and/or your family members own a controlling interest in another business, employees of that other business are “employees” for purposes of determining who’s eligible to participate in your SEP.

### How to find the mistake:

All owners or partners of your business should identify any companies they own or with which they have a financial relationship. If any of these companies or relationships exist, review the requirements of Internal Revenue Code Sections 414(b), (c) and (m) to ensure that all required employees are included in the plan.

### How to fix the mistake:

#### Corrective action:

Generally, if you didn’t provide an employee the opportunity to participate in your SEP plan, you must make a contribution to the employee’s SEP-IRA to make up for the missed contribution. You should treat employees of the related business as improperly excluded employees, and you should make corrective contributions for each excluded employee of the related business. The corrective contribution is an employer contribution that is intended to place the employee in the same position had the employee participated in the SEP plan timely.

#### Example:

Edward owns Business A, a restaurant that has 40 employees. Edward also owns Business B, a copy shop that has 30 employees. Edward established a SEP plan in 2012 and only included the eligible employees of Business A in the plan.

#### Reasonable correction:

The 30 employees of Business B are eligible employees who Edward’s business improperly excluded. Revenue Procedure 2013-12 provides different safe harbor methods for correcting eligible employees who’ve been improperly excluded from participating. The contribution method requires the employer to open a SEP-IRA for each improperly excluded employee and make a corrective contribution to each of those SEP-IRAs. The corrective contribution is determined taking into account the excluded employees’ compensation and must be adjusted for earnings through the date of correction. No adjustments are made to the SEP-IRAs of employees who shared in the prior allocation, even though their allocations would’ve been different had the excluded employee not been excluded. For the above example, Edward would contribute to each of the 30 improperly excluded employees an amount equal to the same percentage of compensation as was made to the 40 included employees for the 2012-year (adjusted for earnings) or an alternative correction method that satisfies Revenue Procedure 2013-12’s general correction principles. If it isn’t feasible to determine what the actual

investment results would've been, you may use a reasonable rate of interest, such as the interest rate used by the Department of Labor's Voluntary Fiduciary Correction Program [Online Calculator](#).

#### **Correction programs available:**

##### **Self-Correction Program:**

The example illustrates a significant operational problem, because Edward failed to follow the terms of the plan by improperly excluding Business B employees. Because it's a significant operational failure, SCP isn't available for the mistake and it must be corrected using VCP.

##### **Voluntary Correction Program:**

If the plan isn't under audit, Edward may make a VCP submission using the [model documents](#) in Appendix C, including [Schedule 3](#). He must include Forms 8950 and 8951. The fee for the VCP submission is \$250.

##### **Audit Closing Agreement Program:**

Under Audit CAP, correction is the same as described above under "Corrective action." Edward and the IRS enter into a Closing Agreement outlining the corrective action and negotiate a sanction based on the [maximum payment amount](#).

#### **How to avoid the mistake:**

You and all owners or partners of your business should review the participation status of all employees at least once a year. The person assigned the task should have a good understanding of the eligibility requirements and have access to the employment and payroll records necessary to make eligibility decisions for all employees of all related employers.

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Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
Eligible employees were excluded from participating	Review eligibility and participation plan document sections. Check when employees are entering the plan	Corrective contribution that would place affected employees in the position they would've been in if there were no operational plan mistakes	Review the participation status of all employees at least once a year

### 3) Eligible employees were excluded from participating.

You must allow all eligible employees to participate in the SEP, including part-time employees, seasonal employees and employees who die or terminate employment during the year. An eligible employee is an employee who:

- a) Is at least 21 years of age.
- b) Has performed service for you in at least three of the immediately preceding five years.

The term “employee” includes both a self-employed individual who has earned income and a working business owner.

You must treat certain leased employees as “employees.”

Your SEP document can provide for less (but not more) restrictive eligibility requirements. “Service” means any work performed for you for any period of time, however short. A SEP may not impose an hours-of-service requirement.

**Excludable employees:** You don’t need to cover the following employees under a SEP:

- Employees covered by a union agreement whose retirement benefits were bargained for in good faith by you and their union.
- Nonresident alien employees who didn’t earn U.S. source income from you.
- Employees who received less than \$550 in compensation during the year. This amount is subject to [cost-of-living adjustments](#) after 2014.

You may not exclude employees simply because they’re classified as “part-time” or “seasonal.” When determining who’s an eligible employee, you must include all employees of controlled groups of corporations that include your business, trades or businesses under common control with your business and affiliated service groups that include your business. This means, for example, that if you and/or your family members own a controlling interest in another business, employees of that other business are “employees” for purposes of determining who is eligible to participate in your SEP.

**Example 1:** Employer X maintains a calendar year SEP. The eligibility requirements under the SEP are an employee must perform service in at least three of the immediately preceding five years, reach age 21 and earn the minimum amount of compensation during the current year. Andy worked for Employer X during his summer breaks from school in 2010, 2011 and 2012, but never more than 34 days in any year. In July 2012, Andy turned 21. In August 2013, Andy began working full-time for Employer X, earning \$12,000 in 2013. Andy is an eligible employee in 2013 because he met the minimum age requirement, worked for Employer X in three of the five preceding years and met the 2013 minimum compensation requirement.

**Example 2:** Employer Y designs its SEP to provide for immediate participation regardless of age, service or compensation. Bill is age 18 and began working part-time for Employer Y in 2013. Bill is an eligible employee for 2013.

**How to find the mistake:**

Review the section of your plan document concerning eligibility and participation. Check when employees are entering the plan.

- Make a list of all employees who received a W-2.
- Compare the employees' dates of hire and annual compensation against the eligibility and participation requirements in the plan document.
- Determine the date that each employee is entitled to become a participant in the plan according to the plan document.
- Inspect plan records to make certain the employees timely entered the plan.

**How to fix the mistake:****Corrective action:**

Generally, if you didn't provide an employee the opportunity to participate in your SEP plan, you must make a contribution to the plan for the employee that makes up for the missed contribution. The corrective contribution is an employer contribution that's intended to place the employee in the same position had the employee participated in the plan timely. Open a SEP-IRA for the excluded employee and make contributions to the SEP-IRA equal to the same percentage of compensation received by other employees. Increase the amount contributed to reflect missed earnings through the date of correction. Do not reduce other employees' SEP-IRAs. If it isn't feasible to determine what the actual investment results would've been, you may use a reasonable rate of interest, such as the interest rate used by the Department of Labor's Voluntary Fiduciary Correction Program [Online Calculator](#).

**Example:**

Employer D maintains a SEP plan for its 20 employees. The plan provides that contributions are allocated to the SEP-IRAs in the ratio that each eligible employee's compensation for the year bears to the compensation of all eligible employees for the year. For 2012, Employer D made a contribution to the plan. However, Employer D inadvertently excluded one part-time employee who met the plan eligibility requirements, but had terminated during the plan year. The contribution resulted in an allocation for each of the eligible employees, other than the excluded employee, equal to 10% of compensation. If the excluded employee had shared in the original allocation, the allocation made for each employee would've equaled 9% of compensation.

**Reasonable correction:**

Revenue Procedure 2013-12 provides different safe harbor methods for correcting eligible employees who've been improperly excluded from participating. The contribution method requires the employer to make a corrective contribution to the SEP-IRA of each improperly excluded employee. The corrective contribution is determined taking into account the excluded employee's compensation, and must be adjusted for earnings through the date of correction. No adjustments are made to the SEP-IRAs of employees who shared in the prior allocation, even though their allocations would have been different had the excluded employee not been excluded. For the above example, Employer D would contribute an amount equal to 10% of the excluded employee's compensation for the 2012 year (adjusted for earnings), and doesn't adjust the 10% allocations that were made to the other employees.

**Correction programs available:****Self-Correction Program:**

The example illustrates an operational problem, because the employer failed to follow the terms of the SEP plan by failing to give one employee an allocation of the employer contribution. If the other eligibility requirements of SCP are satisfied, Employer D might be able to use SCP to correct the failure. Employer D would have to determine whether:

- Practices and procedures were originally in place to facilitate compliance with requirements regarding participant eligibility
- The failure is [insignificant](#).

**Voluntary Correction Program:**

If the plan is not under audit, Employer D may make a VCP submission using the [model documents](#) in Appendix C, including [Schedule 3](#), and Forms 8950 and 8951. The fee for the VCP submission is \$250.

**Audit Closing Agreement Program:**

Under Audit CAP, correction is the same as described above under “Corrective action.” Employer D and the IRS enter into a Closing Agreement outlining the corrective action and negotiate a sanction based on the [maximum payment amount](#).

**How to avoid the mistake:**

Review the participation status of all employees at least once a year. The person assigned the task should have a good understanding of the eligibility requirements and have access to the employment and payroll records necessary to make eligibility decisions for all employees.

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Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
Contributions to participants' SEP-IRAs were miscalculated because the wrong definition of compensation was used	Review the SEP plan document to determine if you're using the proper compensation for allocations	Correction is based on the terms of the SEP plan document at the time of the mistake	Review the SEP plan document terms to ensure that you're considering the correct amount of compensation when calculating contributions

#### **4) Contributions to participants' SEP-IRAs were miscalculated because the wrong definition of compensation was used.**

A SEP plan's definition of employee compensation must satisfy rules for determining the amount of contributions. The [amount of compensation](#) taken into account under the plan is limited.

You must follow the definition of compensation stated in the plan document in the operation of the plan. Compensation generally includes the pay an employee received from you for personal services for a year including:

- Wages and salaries
- Fees for professional services
- Other amounts received (cash or non-cash) for personal services actually rendered by an employee, including, but not limited to, the following items:
  - Commissions and tips
  - Overtime
  - Fringe benefits
  - Bonuses

You may use an alternative definition of compensation, permitted under Internal Revenue Code Section 414(s) that excludes some of the above listed items. Any exclusions of compensation must be specified in your plan document.

If you are a self-employed person sponsoring a SEP, the compensation on which you calculate your maximum contribution is your net earnings from self-employment. Publication 560 provides a [worksheet](#) for this calculation.

##### **How to find the mistake:**

To determine if you're using the proper compensation for allocations, you'll need to review your SEP plan document.

Spot-check allocations to see if you're using the correct employee compensation as defined in your SEP plan document. If you're using Form 5305-SEP, make sure you're basing allocations on total compensation. If you have a plan with a complicated definition of compensation, develop a worksheet to calculate the correct amounts. Some of these definitions can get very complicated with expense reimbursements, car allowances, bonuses, commissions and overtime pay that may or may not be included in the definition of compensation.

##### **How to fix the mistake:**

##### **Corrective action:**

You would make a corrective contribution, including earnings through the date of correction, to each affected employee's SEP-IRA.



**Example:**

Employer G operates a restaurant with 15 employees. Under the terms of the SEP document, compensation for determining allocations of the employer contribution is total wages earned including bonuses, tips and other income reported on the Form W-2. Since the inception of the plan, it was determined that Employer G considered bonuses and other income for the contribution allocation, but tips hadn't been included.

**Reasonable correction:**

Recalculate the contribution amounts based on the correct definition of compensation. If compensation was understated, make corrective contributions to the SEP-IRAs of affected employees, adjusted for earnings through the date of correction. If it isn't feasible to determine what the actual investment results would've been, you may use a reasonable rate of interest, such as the interest rate used by the Department of Labor's Voluntary Fiduciary Correction Program [Online Calculator](#).

**Correction programs available:****Self-Correction Program:**

The example illustrates an operational problem, because Employer G failed to follow the SEP plan terms by not including tips in compensation used to determine allocations under the plan. If the other eligibility requirements of SCP are satisfied, Employer G might be able to use SCP to correct the mistake. Employer G would have to determine whether:

- Practices and procedures were originally in place to facilitate compliance with requirements regarding employee compensation and allocations under the plan.
- The failure is [insignificant](#).

**Voluntary Corrections Program:**

If the plan is not under audit, Employer G may make a VCP submission using the [model documents](#) in Appendix C, including [Schedule 3](#), and Forms 8950 and 8951. The fee for the VCP submission is \$250.

**Audit Closing Agreement Program:**

Under Audit CAP, correction is the same as described above under "Corrective action." Employer G and the IRS enter into a Closing Agreement outlining the corrective action and negotiate a sanction based on the [maximum payment amount](#).

**How to avoid the mistake:**

When calculating allocations, it's important to review the plan terms to ensure that you're using the correct amounts of compensation. If necessary, you may wish to include in your payroll program an account that accumulates the proper compensation figures for all employees.

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Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
Contributions to each participant's SEP-IRA weren't a uniform percentage of the participant's compensation	Divide contributions by compensation for each employee	Corrective contribution that would place affected employees in the position they would've been in if there were no operational plan mistakes	After the initial calculation of allocations based on the SEP plan document terms, verify that all proposed contributions are based on a uniform percentage of participants' compensation

## 5) Contributions to each participant's SEP-IRA weren't a uniform percentage of the participant's compensation.

Unless the SEP plan has an allocation formula that involves permitted disparity (and most SEP documents, including Form 5305-SEP, don't allow for permitted disparity), employer contributions to participants' SEP-IRAs must be equal to the same percentage of compensation (as limited - see [Mistake 4](#)) of each participant.

### How to find the mistake:

Divide contributions made to each employee's SEP-IRA by their compensation for the year. The resulting percentage should be the same for all participating employees.

### How to fix the mistake:

#### Corrective action:

Generally, if you didn't provide an employee the correct contribution in your SEP plan, you must make a contribution to the plan for the employee that places the employee in the position he would've been in if you hadn't made the mistake. Make a contribution to the SEP-IRA equal to the same percentage of compensation received by other employees. Increase the amount contributed to reflect missed earnings through the date of correction. Don't reduce other employees' SEP-IRAs.

#### Example:

Employer Q maintains a SEP plan for its 20 employees. The plan provides that the contributions are allocated to participants' SEP-IRAs in the ratio that each eligible employee's compensation for the year bears to the compensation of all eligible employees for the year. For 2012, Employer Q made a contribution to the plan of a fixed dollar amount. All of the employees except Jim received a contribution in the amount of 8% of compensation. Jim's contribution was in the amount of 5% of his compensation.

#### Reasonable correction:

Employer Q should make an additional contribution to Jim's SEP-IRA in the amount of 3% (8% allocation to other employees less 5% already made to Jim's SEP-IRA) of his compensation plus earnings through the date of correction. No adjustments are made to the SEP-IRAs of employees who shared in the prior allocation, even though their allocations would've been different had Employer Q not made the mistake. If it isn't feasible to determine what the actual investment results would've been, Q may use a reasonable rate of interest, such as the interest rate used by the Department of Labor's Voluntary Fiduciary Correction Program [Online Calculator](#).

## **Correction programs available:**

### **Self-Correction Program:**

The example illustrates an operational problem, because Employer Q failed to follow the SEP plan terms by not giving one employee the proper allocation of the employer contribution. If the other eligibility requirements of SCP are satisfied, Employer Q might be able to use SCP to correct the failure. Employer Q would have to determine whether:

- Practices and procedures were originally in place to facilitate compliance with requirements regarding the accuracy of employee compensation and allocations under the plan.
- The failure is [insignificant](#).

### **Voluntary Correction Program:**

If the plan isn't under audit, Employer Q may make a VCP submission using the [model documents](#) in Appendix C, including [Schedule 3](#), and Forms 8950 and 8951. The fee for the VCP submission is \$250.

### **Audit Closing Agreement Program:**

Under Audit CAP, correction is the same as described above under "Corrective action." Employer Q and the IRS enter into a Closing Agreement outlining the corrective action and negotiate a sanction based on the [maximum payment amount](#).

### **How to avoid the mistake:**

After the initial calculation of allocations based on the terms of the plan, you should check to make sure all of the proposed allocations are in an equal percentage of compensation. If there's a problem, you can adjust it before you transfer the money into the SEP-IRAs.

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Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
Contributions to the SEP-IRA exceeded the maximum legal limits	Determine the total contribution made for each employee and make sure that amount does not exceed the lesser of: 1) 25% of that employee's compensation, or 2) the <a href="#">dollar limitation</a> for that year (\$52,000 for 2014)	Either distribute or retain the excess amount	After the initial calculation of allocations based on the terms of the SEP plan document, check to make sure none of the proposed allocations violate the law

## 6) Contributions to an employee's SEP-IRA exceeded the maximum legal limits.

All contributions made to a SEP are employer contributions.

Internal Revenue Code Sections 402(h) and 415 limit the amount of contributions made to an employee's SEP-IRA to the lesser of the [dollar limitation](#) for the year (\$52,000 for 2014) or 25% of the employee's compensation. The [amount of compensation](#) taken into account is also limited (\$260,000 in 2014). If your SEP plan document specifies lower contribution limits, then the lower limits control.

There are special rules if you're self-employed, such as a partner or owner-employee. When calculating the deduction for contributions made to your own SEP-IRA, compensation is your net earnings from self-employment, which takes into account both the deduction for one-half of your self-employment tax and the deduction for contributions to your own SEP-IRA. For this reason, you determine the deduction for contributions to your own SEP-IRA indirectly by reducing the contribution rate called for in your plan. For more information on the deduction limitations for self-employed individuals, see [Publication 560](#), *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*.

Employer contributions to a SEP-IRA won't affect the amount you can contribute to a Roth IRA or a traditional IRA. However, it may preclude you from receiving a tax deduction for contributions to a traditional IRA. See [Publication 590](#), *Individual Retirement Arrangements (IRAs)*, for details.

### How to find the mistake:

Calculate 25% of each employee's compensation (limited to \$260,000 in 2014) and compare the total contribution made for the employee to the lesser of that amount or the dollar limitation for that year (\$52,000 for 2014). Review the special calculations in Publication 560 for self-employed individuals.

### How to fix the mistake:

#### Corrective action:

There are two alternative methods to correct a failure to limit employer contributions to employees.

The amount in excess of the annual limit, adjusted for earnings through the date of correction, should be distributed from the affected employee's SEP-IRA and returned to the employer. The distributed amount is not included in the income of the affected employee, but is reported on Form 1099-R with a taxable amount of zero. If it isn't feasible to determine what the actual investment results would've been, you may use a reasonable rate of interest, such as the

interest rate used by the Department of Labor's Voluntary Fiduciary Correction Program [Online Calculator](#).

Alternatively, if a submission is made under the VCP program, the excess amount may be retained in the SEP-IRA, but only if the plan sponsor pays an additional compliance fee of 10% of the excess amount, excluding earnings. Note that the additional compliance fee will only apply if the excess amount is under \$100. Under both correction methods, the plan sponsor is not entitled to a deduction for the excess contributions.

**Example:**

Employer I maintains a SEP plan. For the 2012 year, the contributions made for two employees, T and U, exceeded the limit in IRC Section 415. Employee T had an excess of \$3,000 and U had an excess of \$300.

Generally, Employer I would have to get employees T and U to take the excess monies, as adjusted for earnings, out of each SEP-IRA by taking distributions and returning the funds adjusted for earnings to the plan sponsor.

**Correction programs available:**

**Self-Correction Program:**

The example illustrates an operational problem, because the employer failed to follow the terms of the plan by improperly exceeding the 402(h) and 415 limitations provided for in the plan document and the Internal Revenue Code. If the other eligibility requirements of SCP are satisfied, Employer I might be able to use SCP to correct the mistake. Employer I would have to determine whether:

- Practices and procedures were originally in place to facilitate compliance with requirements regarding maximum contribution limits.
- The failure is [insignificant](#).

**Voluntary Correction Program:**

Under VCP, correction is the same as described above under "Corrective action." If the plan is not under audit, Employer I may make a VCP submission using the [model documents](#) in Appendix C, including [Schedule 3](#), and Forms 8950 and 8951. The fee for the VCP submission is \$250. If Employer I corrects under the alternative retention method, there's a fee equal to at least 10% of the excess amount excluding earnings in addition to the \$250 submission fee.

**Audit Closing Agreement Program:**

Under Audit CAP, correction is the same as described above under "Corrective action." Employer I and the IRS enter into a Closing Agreement outlining the corrective action and negotiate a sanction based on the [maximum payment amount](#).

**How to avoid the mistake:**

After the initial calculation of allocations based on the terms of the SEP plan document, you should check to make sure none of the proposed allocations would violate IRC Sections 402(h) and 415. If there's a problem, you can adjust it before you transfer the money into the SEP-IRAs.

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