

SEP IRAs: A Retirement Plan for Your Businesses

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Tags: Investing | Retirement | Tax Benefits | Employer-Sponsored Plan

Introduction to the SEP IRA

The Simplified Employee Pension (SEP) IRA is an employer-sponsored, defined-contribution investment account designed for self-employed individuals or small business owners. This account type is easy to set up and operate, with less reporting requirements than other retirement plans, and boasts high contribution limits without imposing contribution obligations on the business. The tax-deferred nature of investments in this account type makes it an effective investment vehicle for retirement.

Why Should I Consider a SEP IRA for My Business?

There are many reasons you should consider a SEP IRA retirement plan for your business. Depending on the profile of your business, the SEP IRA rules may be the most beneficial to you and your employees.

Tax-Deferred Growth for Employee Portfolios

Like other retirement account types, the SEP IRA allows assets invested in the account to grow on a **tax-deferred** basis. This means account owners won't incur any tax liability until withdrawing the assets in retirement, at which point the withdrawals are taxed as ordinary income. The impact of **tax-deferred** growth is massive in the long-term.

Tax Deductibility of Contributions for Your Business

Contributions to employee SEP IRAs are **tax deductible** to the business making the contribution. All contributions made to SEP IRAs may be used to reduce the taxable income of the business, as long as the contributions are made within the stated limits.

Reduced Administrative Burden on the Business

Retirement plans that utilize SEP IRAs are simple to set up and avoid mandatory annual compliance testing and filings required by other retirement plan types, like a 401(k) plan. While businesses are required to provide certain notifications to employees regarding a SEP IRA plan, overall requirements and filings are typically less burdensome than other plans.

Optional and Flexible Contributions

While all employees do need to be given the same contribution rates (as a percentage of total compensation), contributions to SEP IRAs are made on a discretionary basis. Contributions can be made at chosen intervals, such as on a frequent basis (perhaps every pay period) or once per year as a lump sum, or can be skipped entirely for a given year. The frequency of contributions can change at any time, as well.

Who Can Own a SEP IRA?

Only employees of employers that offer a SEP IRA retirement plan can own a SEP IRA account. Employees of companies without a SEP IRA plan in place cannot create and contribute to their own SEP IRAs (although other retirement account options, such as IRAs, do exist).

Employers have the ability to set criteria upon which employee eligibility is determined. Those criteria may include the following: minimum age (not to exceed 21 years old), minimum years of service within the preceding 5 years (not to exceed 3 years), and minimum total compensation during the year (not to exceed \$750). Employer requirements are optional but must be applied uniformly across all employees; there can be no favorable treatment toward certain employees, including owners of the business.

One more stipulation to note: eligibility cannot rely on employment status at the end of the year. Employees who leave a business mid-year but are otherwise eligible for SEP IRA contributions must be included in contributions for that year.

Who Can Contribute to a SEP IRA?

Of the most commonly held retirement accounts, the SEP IRA is unique in that only the employer is allowed to make contributions to the account (on behalf of the employee, that is). Employees cannot directly contribute to their own SEP IRA.

One of the greatest benefits of a SEP IRA plan to employers is that contributions are made on a discretionary basis. The business sponsoring the plan has the option, but not an obligation, to contribute to the SEP IRAs of all employees. Owners of the business can choose to forego contributions to the plan at any time and for any reason they like.

Contributions are often made after the end of the plan year but before the tax filing deadline.

What are the Rules for SEP IRA Contributions?

Contributions to employee SEP IRAs are completely discretionary to the business. However, one rule that business owners must know is that all employees of the business must be treated the same when it comes to contribution rates.

Contributions to SEP IRAs are made on the basis of percentage of compensation, including wages, salaries, tips, bonuses, and commissions. If owners choose to contribute 10% of the total compensation of Employee A into Employee A's SEP IRA, the owners must do the same for Employees B, C, and D.

Contributions to a SEP IRA are immediately vested to the employee, meaning that once the money is deposited into a SEP IRA account, it belongs to the employee.

How Much Can Be Contributed to a SEP IRA?

In 2025, SEP IRA contributions cannot exceed the lesser of (a) 25% of compensation, or (b) \$70,000 for any one employee. Separately, total compensation for any one employee cannot

exceed \$350,000 for the purpose of calculating contribution amounts. These dollar limit amounts are occasionally revised to adjust for cost of living and inflation.

The “catch-up” contribution provision that exists for other retirement accounts, such as a 401(k) or IRA, does not apply to SEP IRAs.

How Can My Business Deduct Contributions to SEP IRA Accounts?

The deadline for taking a tax deduction on SEP IRA contributions is the federal income tax return due date for your business, including any extensions. The tax document on which contributions can be deducted is dependent on how your business is legally organized.

What are the Withdrawal Rules of a SEP IRA?

The withdrawal rules of a SEP IRA are the exact same as a Traditional IRA that, when not followed, could result in a substantial penalty. Starting at age 59½, you may take distributions from your SEP IRA at any time and in any amount without incurring a penalty. These distributions are included in your taxable income for the year in which you take them.

Those who withdraw funds before age 59½ are subject to penalty in an amount of 10% of the distribution, unless the distribution qualifies for an exception. The most common exceptions include distributions related to first-time homebuyers (up to \$10,000), birth or adoption expenses (up to \$5,000 per child), emergency personal expenses (up to \$1,000 per year), higher education expenses, federally declared disasters (up to \$22,000), certain unreimbursed medical expenses, and death or disability of the IRA owner.

SEP IRA account owners must also abide by **required minimum distribution (RMD)** rules. Starting at age 73, account owners are required to withdraw a certain amount from their account each year to avoid a penalty (up to 25% of the value) on the missed RMD. The amount of the RMD is calculated based on life expectancy and account balance.

Can Account Owners Borrow Against the Balance of Their SEP IRA?

No. Assets held in SEP IRA accounts cannot be used as collateral for loans.

What Types of Assets Can Be Invested in with a SEP IRA?

A SEP IRA allows its account owner to invest the same exact way as a Traditional IRA, which includes a fairly broad spectrum of assets. Stocks, exchange-traded funds (ETFs), mutual funds, bonds, money market funds, and certificates of deposit (CDs) are all permitted assets in a SEP IRA. Examples of investments that are prohibited in a SEP IRA include life insurance, artwork and collectibles, S corporation stock, and real estate for personal use, among others.

What Other Forms of Retirement Plans Exist for Businesses Like Mine?

There are many other forms of retirement plans that may be a fit for your business, including:

- 401(k) / Roth 401(k) – A tax-deferred retirement plan commonly offered to the employees of large, private employers.
- Solo 401(k) / Roth Solo 401(k) – A 401(k) for self-employed individuals that allows for higher contribution limits.
- Safe Harbor 401(k) – A 401(k) that avoids the regulation requirements and expenses of Traditional 401(k)s and specifies that all employer contributions are immediately vested.
- SIMPLE 401(k) – A 401(k) plan with more flexibility and less administrative burden for self-employed individuals or small business owners.
- SIMPLE IRA – An IRA with special perks for self-employed individuals or small business owners.
- Payroll Deduction IRA – The easiest retirement plan to establish with the least financial and legal requirements for the sponsoring business.

How Can I Start a SEP IRA Retirement Plan for my Business?

To get started with a SEP IRA retirement plan for your business, reach out to us at **FreeMind Financial Advisory** and we would be happy to provide a **free strategy session** personalized for your business. We can help determine if a SEP IRA is the best retirement plan for your business, and if it is, we can assist in setting up accounts and onboarding employees.

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