

SEP-IRA—A simple, efficient retirement plan program for your business

When setting up a retirement plan for your business, you may automatically think: “401(k).” Not only is a 401(k) probably the best known type of retirement plan, but it may appear to be the likely choice to meet your needs and those of your employees.

However, there’s another type of plan that’s simple, flexible and offers some unique features that might better address your firm’s financial and administrative needs. It’s called a Simplified Employee Pension Plan or SEP-IRA, and it may be worth your consideration.

A practical retirement plan alternative

The SEP-IRA has been around for more than 30 years and, although typically regarded as a “small business retirement plan,” is available to all types of businesses with any number of employees. With a SEP-IRA, each employee establishes his or her own IRA into which the employer makes tax-deductible contributions. These employer contributions may vary each year, and there is no required annual minimum. Other important benefits of a SEP-IRA include the following:

- Since employees have their separate IRAs, they are responsible for making their own investment decisions, including where to have their account held, thus alleviating the employer from fiduciary responsibility over the plan investments.
- There are no recordkeeping or Department of Labor filing requirements, although certain written information must be provided to plan participants and plans are subject to certain non-discrimination requirements. This can minimize the need for a professional plan administrator.
- In addition to being tax-deductible to the employer, SEP contributions are not included as part of employees’ compensation and thus are not taxable to the employee until withdrawn from the account and taken as income, and are not subject to FICA or Medicare taxes.

Employers may make tax deductible contributions up to 25% of compensation, up to the annual dollar limit per plan participant, which is \$49,000 for 2009. This would be a 20% contribution for individuals earning \$245,000 (which is the annual compensation limit for determining an employee’s plan contribution) or more.



Employer contributions are generally required to be an equal percentage contribution of each eligible employee’s compensation. For example, if a business owner contributes 20% for his or her own benefit, a 20% contribution must also be made on behalf of each eligible employee. Employers set the eligibility requirements for plan participation which can include requiring employees to be age 21 and to have three years of service with the employer out of the past five years. (Eligible seasonal and part-time employees must be included, as well.)

With a SEP-IRA, employers may choose to reallocate resources between employees’ salaries and contributions to their retirement accounts. In fact, the amount saved on the employer portion of FICA, FUTA or Medicare taxes may even allow employers to give employees more in the form of a SEP contribution.

Because SEP-IRA contributions are made to individual retirement accounts, the employee has the flexibility to withdraw the money without employer approval since they have complete control over the account’s investments and distributions.¹

Summary of SEP-IRA benefits you and your employees could enjoy

Perhaps the most surprising benefit of setting up a SEP-IRA is that it could work in your favor and put you in a better financial position than you would be in without the plan.

With no plan, you would provide your employees with a gross salary upon which you would pay the usual FICA and Medicare payroll taxes. With a SEP-IRA, you could reallocate employee compensation by directing an amount of employee compensation into employee SEP-IRA accounts. By redirecting compensation, you would pay less FICA and Medicare payroll tax on the remaining lower gross salary amount paid to employees. Let's take a look at how this adds up in dollars and cents:

	With no plan	With SEP-IRA
Initial Gross Salary	\$ 50,000	\$ 50,000 (hypothetical)
16% Gross Salary Reduction to Balance Out SEP-IRA Contribution	(None)	\$ 8,000
Actual Gross Salary	\$ 50,000	\$ 42,000*
FICA (6.2%)	\$ 3,100	\$ 2,604
Medicare (1.45%)	\$ 725	\$ 609
20% SEP Contribution**	(None)	\$ 8,400
Total Cost to Employer	\$ 53,825	\$ 53,613

* A lower gross salary may result in the employee ultimately receiving a reduced Social Security benefit.

** Workers whose compensation is at or above the annual compensation limit for retirement plans (\$245,000 for 2009) reach the maximum contribution of \$49,000 at 20%.

In this scenario, you've essentially taken \$8,000 from the employee's gross salary compensation, and reallocated the compensation by contributing \$8,400 to the employee's SEP-IRA account, saving your business a substantial amount in FICA payments.

Whether or not your employees decide to withdraw the funds from the SEP-IRA, they will benefit from a retirement plan that, in many cases, gives them a higher total compensation after taxes. Here's how it would look using the same assumptions as in the above illustration:

¹ Generally, a distribution is taxed as ordinary income and may be subject to a 10% early distribution penalty for employees below age 59½.

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	With no plan	With SEP-IRA
Gross Salary	\$ 50,000	\$ 42,000*
Effective Federal Tax Rate (25%)	\$ 12,500	\$ 10,500
Effective State Tax Rate (6% assumption)	\$ 3,000	\$ 2,520
FICA (6.2%)	\$ 3,100	\$ 2,604
Medicare (1.45%)	\$ 725	\$ 609
Net Salary Subtotal	\$ 30,675	\$ 25,767
SEP Contribution	\$ 0	\$ 8,400
Net amount if SEP contribution is not withdrawn	\$ 30,675	\$ 34,167
For employee over age 59½ who withdraws SEP contribution		
20% SEP Employer Contribution	\$ 0	\$ 8,400
Withdrawal minus Federal/State taxes	\$ 0	\$ 5,796**
Total Compensation (over age 59½)	\$ 30,675	\$ 31,563
For employee under age 59½ who withdraws SEP contribution		
20% SEP Employer Contribution	\$ 0	\$ 8,400
Withdrawal minus Federal/State taxes and 10% penalty	\$ 0	\$ 4,956***
Total Compensation (under age 59½)	\$ 30,675	\$ 30,723

* A lower gross salary may ultimately result in a reduced Social Security benefit.

** \$8,400 – 25% Federal taxes and 6% State taxes = \$5,796

*** \$8,400 – 25% Federal taxes and 6% State taxes and 10% early distribution penalty = \$4,956

As you can see, with a SEP-IRA, not only do you end up slightly ahead financially, but you and your employees also get the benefit of a simple and efficient way to save for retirement.

Take the next step

Contact your UBS Financial Advisor for more information on SEP-IRAs. Learn how we can also provide you with IRS-approved prototype documents and establish an IRA for each participant in the SEP-IRA program. Each employee would work with a Financial Advisor to choose investments for their SEP-IRA appropriate to their goals and risk tolerance.