

Internal Revenue Service
Tax Exempt and Government Entities
Employee Plans

SARSEP

Salary Reduction
Simplified Employee
Pension

Key Issues and Assistance



SARSEP Common Mistakes

Knowing the tax rules applicable to your business's retirement plan can help you provide a better plan for you and your employees, and help keep you in compliance with the law. In a national sample of examined SARSEPs, the IRS found the following common mistakes:

Failure of Deferral Percentage Test

The amount each highly compensated employee (HCE) may defer is limited. The deferral percentage test for a SARSEP compares the deferral percentage of each HCE with the average of the deferral percentages of all other eligible employees. For details on how to perform this test, please refer to your plan document, or the Instructions for Form 5305A-SEP, or IRS Publication 560, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*.

Failure To Make the Required Top-Heavy Contribution

Most SARSEPs, including all model SARSEPs (Form 5305A-SEP), require top-heavy contributions. In general, the employer is required to make a 3% minimum top-heavy contribution for each eligible non-key employee. Non-key employees are generally employees who are not owners or high-paid officers.

Violation of the *Greater Than No More Than 25 Eligible Employees Rule*

If you had more than 25 eligible employees at any time during the prior year, you cannot accept deferrals in the current year.

Violation of 50% Rule

At least 50% of all eligible employees must elect to make deferrals to the plan in any year, or all deferrals in that year are disallowed.

Violation of Deductible Employer Contribution Limit

Employer contributions are limited to 25% of each eligible employee's compensation.

Failure To Timely Amend Plan Document

SARSEPs generally must be amended to keep current with the latest tax law changes. For those employers that use the model Form 5305A-SEP as their SARSEP plan document, the most current version of the form must be used. *Note: The revision date is located in the upper left-hand corner of the form.*



SARSEP Solutions

If your SARSEP has mistakes, take steps to bring your plan into compliance so you can continue to provide your employees with retirement benefits on a tax-favored basis. You may want to contact a tax professional for help.

You can correct plan mistakes through the Employee Plans Compliance Resolution System (EPCRS). Information on EPCRS is available through www.irs.gov/ep. Click on *Correction*.

For information on SARSEPs and other retirement plans, please refer to the following free publications at www.irs.gov:

- **Publication 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)**
- **Publication 590, Individual Retirement Arrangements (IRAs)**
- **Publication 3998, Choosing a Retirement Solution for Your Small Business**
- **Publication 4050, Retirement Plan Correction Programs (CD-ROM)**
- **Publication 4224, Retirement Plan Correction Programs**
- **Publication 4286, SARSEP Checklist**
- **Publication 4336, SARSEPs for Small Businesses**

To order publications, call the IRS at (800) 829-3676.



Retirement plans provide significant tax advantages to you and your employees. One such plan is the Salary Reduction Simplified Employee Pension (SARSEP) plan. This brochure addresses key issues, solutions, and resources for assistance with your SARSEP plan.

What Is a Salary Reduction Simplified Employee Pension (SARSEP) Plan?

SARSEP retirement plans are written arrangements set up before 1997. Contributions consist of employer contributions and employee deferrals made directly to an eligible employee's individual retirement arrangement (IRA). An eligible employee is an employee who is at least age 21, has worked for you in three out of the last five years and whose total compensation for the year is at least \$450.

Customer Assistance

For more information about retirement plans, including SARSEPs, see *Retirement Source for Plan Sponsors/Employers* at www.irs.gov/ep.

For technical and procedural answers to your retirement plan tax law inquiries, use the following options:

(877) 829-5500

Tax Exempt and Government Entities
Customer Account Services

www.irs.gov/ep

(Visit *EP Customer Services*
under *Related Topics*)

Internal Revenue Service
Tax Exempt and Government Entities
Customer Account Services

P.O. Box 2508
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