

SEP IRA

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Posted Monday, December 30, 2024

Simplified Employee Pension Individual Retirement Arrangement. Yes, the A in IRA does not stand for Account, it technically is Arrangement but if you say Account, it's okay. We know what you mean. But if you call your IRA a 401k, our OCD does not allow us to let that one go. IRAs are not 401ks and 401ks are not IRAs. From what we understand, we can no longer say "our OCD." Our apologies. So many words and phrases we used to say... it's probably better that we don't anymore. We digress...

How about this? Our super highly stressful and highly technical profession coupled with the desire to be hyper accurate cannot let you call your 401k plan and IRA and vice versa. Bagels and donuts are both breakfast foods, but that is where it ends. Hopefully that explanation is better than the OCD reference.

Back to business. As an employee, you do not make contributions to a SEP IRA, the business does so on your behalf. Yes, it is a tax deduction to the business which is essentially a tax deduction to you. The business can contribute 20% of business income (for sole proprietors, single-member LLCs and partnerships) or 25% of your salary (for corporations such as S Corps). There are no catch-up provisions since the business is making the contribution.

All eligible employees must have a pro-rata employer contribution. So, if you make \$100,000 and your assistant makes \$30,000, if the business contributes 10% on your behalf it must do the same for your assistant.

Four reasons why these are fading (but there is a silver lining below)-

- SEP IRAs require much higher salaries to reach the \$70,000 maximum retirement savings for the 2025 tax year,
- Pro-rata contributions strictly based on salaries is no more beneficial or less restrictive than a 401k with Safe Harbor, and
- The administrative costs of 401k plans have been reduced to that of a SEP IRA.
- Another consideration is that the SEP IRA does not allow for plan loans whereas 401k plans do (up to \$50,000 for the 2024 tax year).

SEP IRA contributions are due with the associated tax return including extensions (similar to employer contributions in 401k plans). An interesting yet allowed tactic is to always file an extension for your tax returns. This allows you to file your tax returns any time up to the extension deadline, but not make the employer contribution until the extension deadline. Huh? Hang in there on this one. Here is another way of saying it-

You could file an extension on February 1. File your Form 1040 on March 1. And make the contribution on October 15. However, if you skipped the extension filing and simply filed your Form 1040 on March 1, your SEP IRA contribution is due April 15. Weird. Then again, we don't make the rules, we just tell you about them.

SEP IRAs are old school in favor of the 401k plan. Prior to the SECURE Act, 401k plans must be implemented before the calendar year is over, SEP IRAs can be used for crisis management after the fact. As such, December 31st can come and go blowing up your desire to have a self-employed 401k plan, but a SEP IRA can be created after January 1 and allow for previous year contributions and tax deductions.

However, with the SECURE Act, you can open a 401k plan in 2025, and make employer contributions in 2025 but have them earmarked for the 2024 tax year. Employee deferrals are not available in this fashion. So, your 401k plan is not “retro’d” back to the previous year, but the SECURE Act provisions allows for prior year contributions. Subtle difference. You can think of this similar to a SEP IRA which can be opened in 2025, contributed in 2025, but applied to 2024.

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