

THE SIMPLIFIED EMPLOYEE PENSION: THERE MAY STILL BE TIME TO MAKE A DEDUCTIBLE 1991 CONTRIBUTION

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As a self-employed author, perhaps you have explored the possibility of setting up a Keogh or other qualified retirement plan but found it too expensive or cumbersome. There is an alternative. It's called a **Simplified Employee Pension or SEP**, and it allows you to establish and contribute to a retirement plan in an easy and economical fashion. Contributions to a SEP are tax deductible and grow tax deferred, as in a qualified plan but no complicated IRS Forms 5500 need be filed. And, perhaps best of all, it's not too late to get started. Establishment of a SEP for 1991 and tax deductible contribution to it can be done as late as April 15th (even later in some cases).

Am I eligible to establish a SEP?

As an author, you engaged in a business. Whether you are a self-employed author or structure your business as a corporation, partnership, sole proprietorship you are eligible to establish a SEP.

What if I have employees?

Like most of us, you may hire proofreaders, indexers, typists and other assistants to help with the preparation of your manuscripts. In most cases these individuals are independent contractors, not employees, and as such do not have to be covered under your SEP. If your authoring business does have bona fide employees, the rules governing your contributions on their behalf are more stringent than

with many other retirement plans. In particular, you must contribute for all full- and part-time employees who are at least 21 years of age and have worked for you during 3 of the last 5 years earning at least \$363 in 1991.

How are SEP contributions determined?

Each year, you, as the employer, specify a percentage of compensation that will be used in funding the SEP. The same percentage must be applied to all eligible employees.

What are the maximum allowable contributions?

Contributions to a SEP for an individual may not exceed 15% of "compensation." For self-employed individuals, compensation is defined to be net earnings *after* deduction of the SEP contribution. The way to compute this is to take 13.043% of your pre-SEP earnings (income minus expenses). There is a further restriction that in no case may the contribution for any individual exceed \$30,000 in any year. (Note: This further restriction will affect you only if your pre-SEP earnings exceed \$230,000 in a given year since 13.043% of \$239,000 is (approximately) \$30,000.)

Are annual contributions mandatory?

Contributions to a SEP are discretionary. In any given year

you may elect to omit all contributions by setting the contribution level for that year at 0%.

How are SEP contributions treated for tax purposes?

Contributions to your SEP (and to the SEP accounts of any employees) are fully tax-deductible and are not included in your taxable income for the year. In addition, once inside a SEP, funds grow tax-deferred until withdrawn.

The power of tax-deferred compounding

The money you invest in your SEP grows tax-deferred, that is, no income tax is due on the earnings or capital gains until you actually withdraw your funds. Over a period of years, tax deferral enhances your returns significantly, even though taxes must be paid eventually.

For example, suppose two authors, each in the 28% tax bracket, invest \$10,000 for retirement and each earns the same return of 8%. Suppose further that one invests outside a SEP or other tax-sheltered plan and pays taxes on the earnings each year before reinvesting, while the other's investment compounds tax deferred in a SEP. As the following table shows, the cash value of the SEP grows to more than \$46,000 in 20 years, while the taxed investment grows to less than \$31,000. Even if the entire value of the SEP is withdrawn all at once at the end of the 20 years and a 28% tax is paid, the SEP will be worth \$33,588, which is almost 10% more than the value of the taxable investment.

<u>End of Year</u>	<u>Taxable Account</u>	<u>SEP</u>
1	\$10,567	\$10,800
5	\$13,231	\$14,693
10	\$17,507	\$21,589
15	\$23,164	\$31,721
20	\$30,649	\$46,609

How are SEP contributions held and invested?

Each participant maintains a

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separate self-directed SEP account. In fact, a participant's SEP and personal IRA can be combined in a single account. The participant makes his or her own investment decisions and may choose a variety of investments including certificates of deposit, stocks and bonds, mortgage-backed securities, mutual funds, managed accounts and annuities.

What special IRS filings are required with a SEP?

None! As a result, a SEP is less costly and cumbersome to maintain than a Keogh or other qualified retirement plan.

What are the deadlines for establishing and funding a SEP?

Unlike other retirement plans that must be established by December 31st, the deadline for both establishing and funding a SEP for a given year is April 15th of the following year (or later if an income-tax extension is taken). Thus, if you failed to establish a retirement plan for your royalties by year end, you can still have a plan for 1991 by establishing a SEP before tax time.

What are the rules governing SEP distributions?

Withdrawals from a SEP are treated just like withdrawals from an IRA. In particular, you may withdraw any amount after age 59 1/2 and will pay ordinary income tax on the amount withdrawn. Withdrawals must begin by April 1st following the end of the year in which you reach age 70 1/2. Except in the case of death or disability, withdrawals made prior to age 59 1/2 are subject to a penalty tax of 10%. (An exception to this penalty is made if the withdrawals are part of series of "substantially equal periodic payments" based on your life expectancy which continue for at least 5 years and until you reach 59 1/2.)

What is "integration with Social Security" and is it available with a SEP?

William P. Berlinghoff
TAA #867

A Mathematics Sampler: Topics for the Liberal Arts, 3rd Ed., by William P. Berlinghoff and Kerry E. Grant. Ardsley House Publishers, 320 Central Park West, New York, NY 10025, 1992.

A Mathematics Sampler is a collection of independent chapters covering a broad spectrum of mathematics. Its course was cited as an innovative approach to liberal-arts mathematics in Lynne Cheney's 1989 NEH report, *50 HOURS*. The *MAA Monthly* (Jan., 1991) said of the Second Edition: "A book with genuine mathematical content in each area sampled: number theory, geometry, probability and statistics, computers (Basic programming), infinity (countability), groups, the fourth dimension. Each chapter closes with the subheading LINK that describes an area of applications. Worth consideration ..." It also contains a 40-page synoptic history of mathematics,

a problem-solving chapter, and an appendix on logic.

The Third Edition, expanded to include a chapter on graph theory, contains a truly unique feature--**Writing Exercises**, which come in two forms: (1) short questions at the end of each section, calling for answers of more than a sentence but less than a page; and (2) topics for longer, more formal projects at the end of each chapter.

Format: 526 pages, 2-color, cloth. Instructor's Guide available.

Alan O. Ross
TAA #811

The Sense of Self: Research and Theory. Springer, 1992.

and

Personality: Theories and Processes. HarperCollins, 1992.

The latter book is part of an outline series called HarperCollins College Outline, under the Harper-Perennial imprint. This series is reminiscent of the old Barnes & Noble outlines.

Social Security integration is a technique by which an employer can reduce the contributions made for participants in a retirement plan by using partial credits for contributions made to Social Security on behalf of the participants. Use of this technique can reduce the cost of retirement funding for lower-paid employees and favor the employer and other highly-compensated personnel. Thus, Social Security integration may be an attractive feature for a successful author with employees on the payroll. Integration with Social Security is an available option in a SEP.

Can I roll my existing qualified plan into my SEP?

If you discontinue an existing qualified retirement plan such as a defined-benefit plan or Keogh (profit-sharing or money-purchase

plan), you may be able to roll the assets of that plan into your SEP/IRA account without incurring any tax liability. Be advised that certain government forms and reports may be required when a qualified plan is discontinued.

Conclusion

A SEP may be the ideal retirement plan for your royalty income. It is economical and easy to administer. No complicated IRS reporting is required. Contributions, which are made at your discretion up to certain limits, reduce your current income-tax liability. SEP assets grow tax deferred until withdrawn and can be combined in a single self-directed account with your IRAs. The deadline for establishing a SEP is in most cases April 15th, so there's still time to set up your SEP for your 1991 royalties.