Retirement Plans for Small Business
(SEP, SIMPLE, and Qualified Plans)

For use in preparing 2001 Returns

Important Changes for 2001
Notification of significant benefit accrual reduction. For plan amendments taking effect after June 6, 2001, the employer or the plan will have to pay an excise tax if both the following apply.
- A defined benefit plan or money purchase pension plan is amended to provide for a significant reduction in the rate of future benefit accrual.
- The plan administrator fails to notify each affected participant and alternate payee, and each employee organization representing them, of the reduction in writing.

For more information, see Notification of Significant Benefit Accrual Reduction in chapter 4.

Third-party authorization. You can check a box and authorize the IRS to discuss your Form

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FAX • 703-368-9694 (from your FAX machine)

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starting a SEP, SIMPLE, or qualified plan. The limit equals 50% of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of $500 per year for each of the first 3 years of the plan. You can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective.

You must have had 100 or fewer employees who received at least $5,000 in compensation from you for the preceding year. At least one participant must be a non-highly compensated employee. The employees generally must be substantially the same employees for whom contributions were made or benefits accrued under a plan of any of the following employers in the 3-tax-year period immediately before the first year to which the credit applies.

1) You.
2) A member of a controlled group that includes you.
3) A predecessor of (1) or (2).

The credit is part of the general business credit, which can be carried back or forward to other tax years if it cannot be used in the current year. However, the part of the general business credit attributable to the small employer pension plan startup cost credit cannot be carried back to a tax year beginning before January 1, 2002. You cannot deduct the part of the startup costs equal to the credit claimed for a tax year, but you can choose not to claim the allowable credit for a tax year.

Compensation limit. For years beginning after December 31, 2001, the maximum compensation used for figuring the amount you can deduct for employer contributions and benefits increases to $200,000. This amount is subject to cost-of-living increases after 2002.

Deduction limits. After 2001, certain deduction limits change as explained next.

Elective deferrals. For years beginning after December 31, 2001, elective deferrals are not subject to the deduction limit that applies to profit-sharing plans (discussed next). Also, elective deferrals are not taken into account when figuring the amount you can deduct for employer contributions that are not elective deferrals.

SEP and profit-sharing plans. For years beginning after December 31, 2001, your maximum deduction for contributions to a SEP or a profit-sharing plan increases to 25% of the compensation paid or accrued during the year to your eligible employees participating in the plan. Compensation for figuring the deduction for contributions includes elective deferrals.

Defined benefit plans. For plan years beginning after December 31, 2001, your deduction for contributions to a defined benefit plan can be as much as the plan’s unfunded current liability.

Elective deferrals. The limit on elective deferrals increases to $11,000 for tax years beginning in 2002 and then increases $1,000 each tax year thereafter until it reaches $15,000 in 2006. These new limits will apply for participants in SARSEPs, 401(k) plans (excluding SIMPLE plans), and deferred compensation plans of state or local governments and tax-exempt organizations. The $15,000 figure is subject to cost-of-living increases after 2006.

Catch-up contributions. For tax years beginning after 2001, a plan can permit participants who are age 50 or over at the end of the plan year to also make catch-up contributions. The catch-up contribution limit for 2002 is $1,000. This limit increases by $1,000 each year thereafter until it reaches $5,000 in 2006. The limit is subject to cost-of-living increases after 2006. The catch-up contribution a participant can take into account cannot exceed the lesser of the following amounts.

- The catch-up contribution limit.
- The excess of the participant’s compensation over the elective deferrals that are not catch-up contributions.

SIMPLE plan salary reduction contributions. The limit on salary reduction contributions to a SIMPLE plan increases to $7,000 beginning in 2002 and then increases $1,000 each tax year thereafter until it reaches $10,000 in 2005. The $10,000 figure is subject to adjustment after 2005 for cost-of-living increases.

Catch-up contributions. For years beginning after 2001, a SIMPLE plan can permit participants who are age 50 or over at the end of the year to make catch-up contributions. The catch-up contribution limit for 2002 is $500. This limit increases by $500 each year thereafter until it reaches $2,500 in 2006. The limit is subject to cost-of-living increases after 2006. The catch-up contributions a participant can make for a year cannot exceed the lesser of the following amounts.

- The catch-up contribution limit.
- The excess of the participant’s compensation over the elective deferrals that are not catch-up contributions.

User fee. The user fee for requesting a determination letter does not apply to certain requests made after December 31, 2001, by employers who have 100 or fewer employees, at least one of whom is a non-highly compensated employee participating in the plan. See User fee under Setting Up a Qualified Plan in chapter 4.

Limits on contributions and benefits. For years ending after December 31, 2001, the maximum annual benefit for a participant under a defined benefit plan increases to the lesser of

- 100% of the participant’s average compensation for his or her highest 3 consecutive calendar years.
- $160,000 (subject to cost-of-living increases after 2002).

For years beginning after December 31, 2001, a defined benefit plan’s maximum annual contributions and other additions (including earnings) to the account of a participant increases to the lesser of the following amounts.

- 100% of the compensation actually paid to the participant.
- $40,000 (subject to cost-of-living increases after 2002).

For years beginning after December 31, 2001, the maximum compensation that can be taken into account for this limit increases to $200,000.
This amount is subject to cost-of-living increases after 2002.

Excise tax for nondoctributions. For years beginning after December 31, 2001, in figuring the 10% excise tax, you can choose not to take into account as nondoctributions for any year contributions to a defined benefit plan that are no more than the full funding limit figured without considering the current liability limit. Apply the overall limits on deductible contributions first to contributions to defined benefit plans, then to contributions to defined benefit plans. If you use this new exception, you cannot also use the existing exception. See Publication 549, Taxing Employee Retirement Plans.

Rollover distributions. A hardship distribution made after December 31, 2001, will not qualify as an eligible rollover distribution.

Involuntary payment of benefits. If a participant’s employment is terminated, a plan may provide for immediate distribution of the participant’s benefit under the plan if the present value of the benefit is no greater than $5,000. For distributions after December 31, 2001, benefits attributable to rollover contributions and earnings on the contributions can be ignored in determining the value of these benefits.

Saver’s tax credit. Beginning in 2002, retirement plan participants (including self-employed individuals) who make contributions to their plan may qualify for the saver’s tax credit. The amount of the credit is based on the contributions participants make and their credit rate. The maximum contribution eligible for the credit is $2,000. The credit rate can be as low as 10% or as high as 50%, depending on the participant’s adjusted gross income. The credit also depends on the participant’s filing status. For more information, see Publication 590, Highlights of 2001 Tax Changes.

Important Reminders

Plan amendments required by changes in the law. If you must revise your qualified plan to conform to recent legislation, you may choose to get a determination letter from the IRS approving the revision. Generally, master and prototype plans are amended by sponsoring organizations. However, there are instances when you may need plans and a determination letter regarding a master or prototype plan that is a nonstandardized plan you maintain. Your request should be made on the appropriate form (generally Form 5300 or Form 5307). The request should be filed with Form 8717 and the appropriate user fee.

You may have to amend your plan to comply with tax law changes made by the following laws.


You generally need to make these amendments by February 28, 2002. Plans directly affected by these amendments, see Publication 553, Highlights of 2001 Taxation, may provide for immediate distribution of the participant’s benefit under the plan if the present value of the benefit is no greater than $5,000. For distributions after December 31, 2001, benefits attributable to rollover contributions and earnings on the contributions can be ignored in determining the value of these benefits.

Saver’s tax credit. Beginning in 2002, retirement plan participants (including self-employed individuals) who make contributions to their plan may qualify for the saver’s tax credit. The amount of the credit is based on the contributions participants make and their credit rate. The maximum contribution eligible for the credit is $2,000. The credit rate can be as low as 10% or as high as 50%, depending on the participant’s adjusted gross income. The credit also depends on the participant’s filing status. For more information, see Publication 590, Highlights of 2001 Tax Changes.

Introduction

This publication discusses retirement plans you can set up and maintain for yourself and your employees. In this publication, “you” refers to the employer. See chapter 1 for the definition of the term employer and the definitions of other terms used in this publication. This publication covers the following types of retirement plans.

- SEP (simplified employee pension) plans.
- SIMPLE (savings incentive match plan for employees) plans.
- Qualified plans (also called Keogh plans when covering self-employed individuals).

SEP, SIMPLE, and qualified plans offer you and your employees a tax-favored way to save for retirement. You can deduct contributions you make to the plan for your employees. If you are a sole proprietor, you can deduct contributions you make to the plan for yourself. You can also deduct trustees’ fees if contributions to the plan do not cover them. Earnings on the contributions are generally tax free until you or your employee receives distributions from the plan.

Under certain plans, employees can have nonforfeitable accumulations that can be used for various purposes. While these accumulations may be deductible, they are not distributions. Earnings on the contributions may be taxable to the employee. For more information, see Publication 575, Earnings on Distributions from Retirement Plans.

What this publication covers. This publication contains the information you need to understand the following topics.

- What type of plan to set up.
- How to set up a plan.
- How much you can contribute to a plan.
- How much of your contribution is deductible.
- How to treat certain distributions.
- How to report information about the plan to the IRS and your employees.

Basic features of retirement plans. Basic features of SEP, SIMPLE, and qualified plans are discussed below. The key rules for SEP, SIMPLE, and qualified plans are outlined in Table 1.

**SEP plans.** SEPs provide a simplified method for you to make contributions to a retirement plan for yourself. Instead of setting up a profit-sharing or money purchase plan with a trust, you can adopt a SEP agreement and make contributions directly to a traditional individual retirement annuity (SEP-IRA) set up for each eligible employee.

**SIMPLE plans.** A SIMPLE plan can be set up by an employer who had 100 or fewer employees who received at least $5,000 in compensation from the employer for the preceding calendar year and who meets certain other requirements. Under a SIMPLE plan, employees can choose to make salary reduction contributions rather than receiving these amounts as part of their regular pay. In addition, you may contribute matching or nonelective contributions. The two types of SIMPLE plans are the SIMPLE IRA plan and the SIMPLE 401(k) plan.

**Qualified plans.** The qualified plan rules are more complex than the SEP plan and SIMPLE plan rules. However, there are advantages to qualified plans, such as increased flexibility in designing plans and increased contribution and deduction limits in some cases.

What this publication does not cover. Although the purpose of this publication is to provide general information about retirement plans you can set up for your employees, it does not contain all the rules and exceptions that apply to these plans. You may also need professional help and guidance.

Also, this publication does not cover all the rules that may be of interest to employees. For example, it does not cover the following topics.

- The comprehensive IRA rules an employee needs to know. These rules are covered in Publication 590, Individual Retirement Arrangements (IRAs).
- The comprehensive rules that apply to distributions from retirement plans. These rules are covered in Publication 720, Pension and Annuity Income.

Comments and suggestions. We welcome your comments and suggestions for future editions. You can e-mail us while visiting our web site at www.irs.gov. You can write to us at the following address.

Internal Revenue Service
Technical Publications Branch
W-CAR-MP-FP-P
1111 Constitution Ave. NW
Washington, DC 20224
Table 1. Key Retirement Plan Rules for 2001

<table>
<thead>
<tr>
<th>Type of Plan</th>
<th>Last Date for Contribution</th>
<th>Maximum Contribution</th>
<th>Maximum Deduction</th>
<th>When To Set Up Plan</th>
</tr>
</thead>
<tbody>
<tr>
<td>SEP</td>
<td>Due date of employer’s return (including extensions).</td>
<td>Smaller of $35,000 or 15% of participant’s compensation.</td>
<td>15% of all participants’ compensation excluding SEP contributions.</td>
<td>Any time up to due date of employer’s return (including extensions).</td>
</tr>
<tr>
<td>Defined Contribution Plans</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SEP</td>
<td>Due date of employer’s return (including extensions).</td>
<td>Employer: Salary reduction contribution, up to $6,500.</td>
<td>Same as maximum contribution.</td>
<td>Any time between 1/1 and 10/1 of the calendar year. For a new employer coming into existence after 10/1, as soon as administratively feasible.</td>
</tr>
<tr>
<td>SIMPLE IRA and SIMPLE 401(k)</td>
<td>Elective employer contributions: 30 days after the end of the month for which the contributions are to be made.</td>
<td>Employer contribution: Either dollar-for-dollar matching contributions, up to 3% of employee’s compensation, or fixed nonelective contributions of 2% of compensation.</td>
<td>Same as maximum contribution.</td>
<td></td>
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<tr>
<td>MATCHING OR NONELECTIVE CONTRIBUTIONS: Due date of employer’s return (including extensions).</td>
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<td></td>
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</tr>
<tr>
<td>SIMPLE IRA and SIMPLE 401(k)</td>
<td>Money Purchase: Smaller of $35,000 or 25% of participant’s compensation.</td>
<td>Money Purchase: Same as maximum contribution.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIMPLE IRA and SIMPLE 401(k)</td>
<td>Profit-Sharing: Smaller of $35,000 or 25% of participant’s compensation.</td>
<td>Profit-Sharing: 15% of all participants’ compensation excluding plan contributions.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIMPLE IRA and SIMPLE 401(k)</td>
<td>Defined Benefit Plans: Amount needed to provide an annual benefit no larger than the smaller of $140,000 or 100% of the participant’s average taxable compensation for his or her highest 3 consecutive years.</td>
<td>Defined Benefit Plans: Based on actuarial assumptions and computations.</td>
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</tr>
</tbody>
</table>

1. Net earnings from self-employment must take the contribution into account.
2. Compensation is generally limited to $170,000.
3. Does not apply to SIMPLE 401(k) plans. The deadline for qualified plans applies instead.
4. Under a SIMPLE 401(k) plan, compensation is generally limited to $170,000.

We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

Help from the Internal Revenue Service (IRS). See chapter 6 for information about getting publications and forms. For further information, call Employee Plans’ customer service at 1–877–829–5500 (toll-free) from 8:00 a.m. to 6:30 p.m. Eastern Time, Monday through Friday.

Note: All references to “section” in the following discussions are to sections of the Internal Revenue Code (which can be found at most libraries) unless otherwise indicated.

1. Definitions You Need To Know

Certain terms used in this publication are defined below. The same term used in another publication may have a slightly different meaning.

Annual additions. Annual additions are the total of all your contributions in a year, employee contributions (not including rollovers), and forfeitures allocated to a participant’s account.

Annual benefits. Annual benefits are the benefits to be paid yearly in the form of a straight life annuity (with no extra benefits) under a plan to which employees do not contribute and under which no rollover contributions are made.

Business. A business is an activity in which a profit motive is present and economic activity is involved. Service as a newspaper carrier under age 18 is not a business, but service as a newspaper dealer is. Service as a sharecropper under an owner-tenant arrangement is a business. Service as a public official is not.

Common-law employee. A common-law employee is any individual who, under common law, would have the status of an employee. A leased employee can also be a common-law employee.
A common-law employee is a person who performs services for an employer who has the right to control, in all material respects, the manner in which the work is done, and the way in which it is done. For example, the employer:

- Provides the employee’s tools, materials, and workplace, and
- Can fire the employee.

Common-law employees are not self-employed and cannot set up retirement plans for income from their work, even if that income is self-employment income for social security tax purposes. For example, common-law employees are members of religious orders, full-time insurance salespeople, and U.S. citizens employed in the United States by foreign governments cannot set up retirement plans for their earnings from those employments, even though their earnings are treated as self-employment income.

However, a common-law employee can be self-employed as well. For example, an attorney can be a corporate common-law employee during regular working hours and also practice law in the evening as a self-employed person. In another example, a minister employed by a congregation for a salary is a common-law employee even though the salary is treated as self-employment income for social security tax purposes. However, fees reported on Schedule C (Form 1040), Profit or Loss From Business, for performing marriages, baptisms, and other personal services are self-employment earnings for qualified plan purposes.

Compensation. Compensation for plan allocations is the pay a participant received from you for personal services for a year. You can generally define compensation as including all the following payments:

1) Wages and salaries.
2) Fees for professional services.
3) Other amounts received (cash or noncash) for personal services actually rendered by an employee, including, but not limited to, the following items:
   a) Commissions and tips.
   b) Fringe benefits.
   c) Bonuses.

For a self-employed individual, compensation means the earned income, discussed later, of that individual.

Compensation also includes amounts deferred in the following employee benefit plans, unless you choose not to include any amount contributed under a salary reduction arrangement that is not included in the gross income of the employee. These amounts are elective deferrals.

- Qualified cash or deferred arrangement (section 401(k) plan).
- Salary reduction agreement to contribute to a tax-sheltered annuity (section 403(b) plan), a SIMPLE IRA plan, or a SARSEP.
- Section 457 nonqualified deferred compensation plan.
- Section 125 cafeteria plan.

The limit on elective deferrals is discussed in chapter 2 under Salary Reduction Simplified Employee Pension (SARSEP) and in chapter 4.

Other options. In figuring the compensation of a participant, you can treat any of the following amounts as the employee’s compensation.

- The employee’s wages as defined for income tax withholding purposes.
- The employee’s wages you report in box 1 of Form W–2, Wage and Tax Statement.
- The employee’s self-employment income (including elective deferrals).

Compensation generally cannot include either of the following items:

- Reimbursements or other expense allowances (unless paid under a nonaccountable plan).
- Deferred compensation (either amounts going in or amounts coming out) other than certain elective deferrals unless you choose not to include those elective deferrals in compensation.

Contribution. A contribution is an amount you pay into a plan for all those participating in the plan, including self-employed individuals. Limits apply to how much, under the contribution formula of the plan, can be contributed each year for a participant.

Deduction. A deduction is the plan contributions you can subtract from gross income on your federal income tax return. Limits apply to the amount deductible.

Earned income. Earned income is net earnings from self-employment, discussed later, from a business in which your services materially helped to produce the income. You can also have earned income from property your personal efforts helped create, such as royalties from your books or inventions. Earned income includes net earnings from selling or otherwise disposing of the property, but it does not include capital gains. It includes income from licensing the use of property other than goodwill. If you have more than one business, but only one has a retirement plan, only the earned income from that business is considered for that plan.

Employer. An employer is generally any person for whom an individual performs or did perform any service, of whatever nature, as an employee. A sole proprietor is treated as his or her own employer for retirement plan purposes. However, a partner is not an employer for retirement plan purposes. The partnership is treated as the employer of each partner.

Highly compensated employee. A highly compensated employee is an individual who:

- Owns more than 5% of the capital or profits in your business at any time during the year or the preceding year, or
- For the preceding year, received compensation from you of more than $85,000 and, if you so choose, was in the top 20% of employees when ranked by compensation.

Leased employee. A leased employee is one who is not your common-law employee but generally must be treated as your employee for retirement plan purposes if he or she does all the following.

- Provides services to you under an agreement between you and a leasing organization.
- Has performed services for you (or for you and related persons) substantially full time for at least 1 year.
- Performs services under your primary direction or control.

Exception. A leased employee is not treated as your employee if all the following conditions are met.

1) Leased employees are not more than 20% of your non-highly compensated work force.
2) The employee is covered by the leasing organization under its qualified pension plan.
3) The leasing organization’s plan is a money purchase pension plan that has all the following provisions.
   a) Immediate participation.
   b) Full and immediate vesting.
   c) A nonintegrated employer contribution rate of at least 10% of compensation for each participant.

However, if the leased employee is your common-law employee, that employee will be your employee for all purposes, regardless of any pension plan of the leasing organization.

Net earnings from self-employment. For SEP and qualified plans, net earnings from self-employment is your gross income from your trade or business (provided your personal services are material income-producing factor) minus allowable business deductions. Allowable deductions include contributions to SEP and qualified plans for common-law employees and the deduction allowed for one-half of your self-employment tax.

Net earnings from self-employment do not include items excluded from gross income (or their related deductions) other than federal income and foreign housing cost amounts.

For the deduction limits, earned income is net earnings for personal services actually rendered to the business. You take into account the income tax deduction for one-half of self-employment tax and the deduction for contributions to the plan made on your behalf when figuring net earnings.

Net earnings include a partner’s distributive share of partnership income or loss (other than separately stated items, such as capital gains and losses). It does not include income passed through to shareholders of S corporations. Guaranteed payments to limited partners are net earnings from self-employment if they are paid for services to or for the partnership. Distributions of other income or loss to limited partners are not net earnings from self-employment.

For SIMPLE plans, net earnings from self-employment is the amount on line 4 of Short
Useful Items
You may want to see:

<table>
<thead>
<tr>
<th>Publication</th>
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<tr>
<td>590 Individual Retirement Arrangements (IRAs)</td>
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<th>Forms (and Instructions)</th>
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<tr>
<td>W-2 Wage and Tax Statement</td>
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<tr>
<td>1040 U.S. Individual Income Tax Return</td>
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<tr>
<td>5305–SEP Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement</td>
</tr>
<tr>
<td>5305A–SEP Salary Reduction and Other Elective Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement</td>
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</table>

A simplified employee pension (SEP) is a written plan that allows you to make contributions toward your retirement plan (if you are self-employed) and your employees' retirement without getting involved in a more complex qualified plan.

Under a SEP, you make the contributions to a traditional individual retirement arrangement (called a SEP-IRA) set up by or for each eligible employee. A SEP-IRA is owned and controlled by the employee, and you make contributions to the financial institution where the SEP-IRA is maintained.

SEP-IRAs are set up for, at a minimum, each eligible employee (defined later). A SEP-IRA may have to be set up for a leased employee (defined in chapter 1), but does not need to be set up for excludable employees (defined later).

**Eligible employee.** An eligible employee is an individual who meets all the following requirements:

- Has reached age 21.
- Has worked for you in at least 3 of the last 5 years.
- Has received at least $450 in compensation from you for 2001.

You can use less restrictive participation requirements than those listed, but not more restrictive ones.

**Excludable employees.** The following employees can be excluded from coverage under a SEP:

- Employees covered by a union agreement and whose retirement benefits were bargained for in good faith by the employees' union and you.
- Nonresident alien employees who have received no U.S. source wages, salaries, or other personal services compensation from you. For more information about nonresident aliens, see Publication 519, U.S. Tax Guide for Aliens.
- Employees covered by a union agreement and whose retirement benefits were bargained for in good faith by the employees' union and you.
- Nonresident alien employees who have received no U.S. source wages, salaries, or other personal services compensation from you. For more information about nonresident aliens, see Publication 519, U.S. Tax Guide for Aliens.

**Setting Up a SEP**

There are three basic steps in setting up a SEP.

1. You must execute a formal written agreement to provide benefits to all eligible employees.
2. You must give each eligible employee certain information about the SEP.
3. A SEP-IRA must be set up by or for each eligible employee.

Many financial institutions will help you set up a SEP.

**Formal written agreement.** You must execute a formal written agreement to provide benefits to all eligible employees. When not to use Form 5305–SEP. You can satisfy the written agreement requirement by adopting an IRS model SEP using Form 5305–SEP. However, see When not to use Form 5305–SEP.

If you adopt an IRS model SEP using Form 5305–SEP, no prior IRS approval or determination letter is required. Keep the original form. Do not file it with the IRS. Also, using Form 5305–SEP will usually relieve you from filing annual retirement plan information returns with the IRS and the Department of Labor. See the Form 5305–SEP instructions for details.

**When not to use Form 5305–SEP.** You cannot use Form 5305–SEP if any of the following apply:

1. You currently maintain any other qualified retirement plan. This does not prevent you from maintaining another SEP.
2. You have any eligible employees for whom IRAs have not been set up.
3. You use the services of leased employees (as described in chapter 1).
4. You are a member of any of the following unless all eligible employees of all the members of these groups, trades, or businesses participate under the SEP:
   a) An affiliated service group described in section 414(m).
   b) A controlled group of corporations described in section 414(b).
   c) Trades or businesses under common control described in section 414(c).
5. You do not pay the cost of the SEP contributions.

Information you must give to employees. You must give each eligible employee a copy of Form 5305–SEP, its instructions, and the other information listed in the Form 5305–SEP instructions. An IRS model SEP is not considered adopted until you give each employee this information.

**Setting up the employee’s SEP-IRA.** A SEP-IRA must be set up by or for each eligible employee. SEP-IRAs can be set up with banks, insurance companies, or other qualified financial institutions. You send SEP contributions to...
How Much Can I Contribute?

The SEP rules permit you to contribute a limited amount of money each year to each employee’s SEP-IRA. If you are self-employed, you can contribute to your own SEP-IRA. Contributions must be in the form of money (cash, check, or money order). You cannot contribute property. However, participants may be able to transfer or roll over certain property from one retirement plan to another. See Publication 590 for more information about rollovers.

You do not have to make contributions every year. But if you make contributions, they must be based on a written allocation formula and must not discriminate in favor of highly compensated employees (defined in chapter 1). When you contribute, you must contribute to the SEP-IRAs of all participants who actually performed personal services during the year for which the contributions are made, even employees who die or terminate employment before the contributions are made.

The contributions you make under a SEP are treated as if made to a qualified pension, stock bonus, profit-sharing, or annuity plan. Consequently, contributions are deductible within limits, as discussed later, and generally are not taxable to the plan participants.

A SEP-IRA cannot be designated as a Roth IRA. Employer contributions to a SEP-IRA will not affect the amount an individual can contribute to a Roth IRA.

Time limit for making contributions. To deduct contributions for a year, you must make the contributions by the due date (including extensions) of your tax return for the year.

Contribution Limits

Contributions you make for 2001 to a common-law employee’s SEP-IRA cannot exceed the lesser of 15% of the employee’s compensation or $35,000 ($40,000 for 2002). Compensation generally does not include your personal services during the year for which the compensation is your net earnings from self-employment (limited to $170,000 or more. The annual compensation limit increases to $200,000 for 2002.)

More than one plan. If you contribute to a defined contribution plan (defined in chapter 4), annual additions to an account are limited to the lesser of $35,000 or 25% of the participant’s compensation. (For 2002, annual additions are limited to the lesser of $40,000 or 100% of the participant’s compensation.) When you figure this limit, you must add your contributions to all defined contribution plans. Because a SEP is considered a defined contribution plan for this limit, your contributions to a SEP must be added to your contributions to other defined contribution plans.

Tax treatment of excess contributions. Excess contributions are your contributions to an employee’s SEP-IRA (or to your own SEP-IRA) for 2001 that exceed the lesser of the following amounts:

• 15% of the employee’s compensation (or, for you, 13.0435% of your net earnings from self-employment).

• $35,000 ($40,000 for 2002).

Excess contributions are included in the employee’s income for the year and are treated as contributions by the employee to his or her SEP-IRA. For more information on employee tax treatment of excess contributions, see chapter 4 in Publication 590.

Reporting on Form W–2. Do not include SEP contributions on your employee’s Form W–2 unless contributions were made under a salary reduction arrangement (discussed later).

Deducting Contributions

Generally, you can deduct the contributions you make each year to each employee’s SEP-IRA. If you are self-employed, you can deduct the contributions you make each year to your own SEP-IRA.

Deduction Limit for Self-Employed Individuals

If you contribute to your own SEP-IRA, you must make a special computation to figure your maximum deduction for these contributions. When figuring the deduction for contributions made to your own SEP-IRA, compensation is your net earnings from self-employment (defined in chapter 1), which takes into account both the following deductions:

• The deduction for one-half of your self-employment tax.

• The deduction for contributions to your own SEP-IRA.

The deduction for contributions to your own SEP-IRA and your net earnings depend on each other. For this reason, you figure the deduction for contributions to your own SEP-IRA indirectly by reducing the contribution rate called for in your plan. To do this, use the Rate Table for Self-Employed or the Rate Worksheet for Self-Employed, whichever is appropriate for your plan’s contribution rate, in chapter 5. Then figure your maximum deduction by using the Deduction Worksheet for Self-Employed in chapter 5.

Deduction Limits for Multiple Plans

For the deduction limits, treat all your qualified defined contribution plans as a single plan and all your qualified defined benefit plans as a single plan. See Kinds of Plans in chapter 4 for the definitions of defined contribution plans and defined benefit plans. If you have both kinds of plans, a SEP is treated as a separate profit-sharing (defined contribution) plan. A qualified plan is a plan that meets the requirements discussed under Qualification Rules in chapter 4. For information about the special deduction limits, see Deduction limit for multiple plans under Employer Deduction in chapter 4.

SEP and profit-sharing plan. If you also contribute to a qualified profit-sharing plan, you must reduce the 15% deduction limit for that profit-sharing plan by the allowable deduction for contributions to the SEP-IRAs of those participating in both the SEP plan and the profit-sharing plan.

Carryover of Excess SEP Contributions

If you made SEP contributions that are more than the deduction limit (nondeductible contributions), you can carry over and deduct the difference in later years. However, the carryover, when combined with the contribution for the later year, is subject to the deduction limit for that year. If you also contributed to a defined benefit plan or defined contribution plan, see Carryover of Excess Contributions under Employer Deduction in chapter 4 for the carryover limit.

Excise tax. If you made nondeductible (excess) contributions to a SEP, you may be subject to a 10% excise tax. For information about the excise tax, see Excise Tax for Nondeductible (Excess) Contributions under Employer Deduction in chapter 4.
When To Deduct Contributions

When you can deduct contributions made for a year depends on the tax year on which the SEP is maintained.

- If the SEP is maintained on a calendar year basis, you deduct contributions made for a year on your tax return for the year with or within which the calendar year ends.
- If you file your tax return and maintain the SEP using a fiscal year or short tax year, you deduct contributions made for a year on your tax return for that year.

**Example.** You are a fiscal year taxpayer who files your tax return on March 30. You maintain the SEP on a calendar year basis. You deduct SEP contributions made for calendar year 2001 on your tax return for your tax year ending June 30, 2002.

### Where To Deduct Contributions

Deduct contributions for yourself on line 29 of Form 1040. You deduct contributions for your employees on Schedule C (Form 1040), Profit or Loss From Business, on Schedule F (Form 1040), Profit or Loss From Farming, on Form 1065, U.S. Return of Partnership Income, on Form 1120, U.S. Corporation Income Tax Return, on Form 1120-A, U.S. Corporation Short-Form Income Tax Return, or on Form 1120S, U.S. Income Tax Return for an S Corporation, whichever applies to you.

If you are a partner, the partnership passes its deduction to you for the contributions it made for you. The partnership will report these contributions on Schedule K–1 (Form 1065), Partner’s Share of Income, Credits, Deductions, etc. You deduct the contributions on line 29 of Form 1040.

### Salary Reduction

**Simplified Employee Pension (SEP)**

A SEP is a set up before 1997 that includes a salary reduction arrangement. (See the Caution, next). Under a SEP, your employees can choose to have you contribute part of their pay to their SEP-IRAs rather than receive it in cash. This contribution is called an “elective deferral” because employees choose (elect) to set aside the money, and you defer the tax on the money until it is distributed to them.

You are not allowed to set up a SEP after 1996. However, participants (including employees hired after 1996) in a SEP set up before 1997 can continue to have you contribute part of their pay to the plan. If you are interested in setting up a retirement plan that includes a salary reduction arrangement, see chapter 3.

Who can have a SEP? A SEP set up before 1997 is available to you and your eligible employees only if all the following requirements are met:

- At least 50% of your eligible employees to participate choose the salary reduction arrangement.
- You have 25 or fewer employees who were eligible to participate in the SEP (or would have been eligible to participate if you had maintained a SEP) at any time during the preceding year.
- The elective deferrals of your highly compensated employees meet the SEP-IRA ADP test.

**SARSEP ADP Test.** Under the SARSEP ADP test, the amount deferred each year by each eligible highly compensated employee as a percentage of pay (the deferral percentage) cannot be more than 125% of the average deferral percentage (ADP) of all non-highly compensated employees eligible to participate. A highly compensated employee is defined in chapter 1.

**Deferral Percentage.** The deferral percentage for an employee for a year is figured as follows:

\[ \text{Deferral Percentage} = \left( \frac{\text{Elective Deferrals}}{\text{Employee Compensation}} \right) \times 100 \]

The instructions for Form 5305A—SEP have a worksheet you can use to determine whether the elective deferrals of your highly compensated employees meet the SARSEP ADP test.

**Who cannot have a SEP?** A state or local government, any of its political subdivisions, agencies, or instrumentalities, or a tax-exempt organization cannot have a SEP. No SEP includes a salary reduction arrangement.

**Limit on Elective Deferrals**

The most a participant can choose to defer for calendar year 2001 is the lesser of the following amounts:

1. 15% of the participant’s compensation (limited to $170,000 of the participant’s compensation).
2. $10,500.

In 2002, the compensation limit in (1) increases to $200,000. The amount in (2) increases to $11,000 and participants who are age 50 or over can make a catch-up contribution of up to $1,000.

The $10,500 limit applies to the total elective deferrals the employee makes for the year to a SEP and any of the following:

- Cash or deferred arrangement (section 401(k) plan).
- Salary reduction arrangement under a tax-sheltered annuity plan (section 403(b) plan).

### SIMPLE IRA plan

**Overall Limit on SEP contributions.** If you also make nonelective contributions to a SEP-IRA, the total of the nonelective and elective contributions to that SEP-IRA cannot exceed the lesser of 15% of the employee’s compensation or $35,000 ($40,000 for 2002).

The same rule applies to contributions you make to your own SEP-IRA. See Contribution Limits, earlier.

**Employee compensation.** For figuring the elective deferral compensation, generally the amount you pay to the employee for the year. Compensation includes the elective deferral and other amounts deferred in certain employee benefit plans. See Compensation in chapter 1. These amounts are included in figuring your employees’ total contributions even though they are not included in the income of your employees for income tax purposes.

**You can choose not to treat the deferral as compensation, as discussed later.**

To figure the deferral, multiply the employee’s compensation by the deferral contribution rate. However, you must always use the reduced rate method to determine the maximum deductible contribution (13.0435% of unreduced compensation). This is the same method you use to figure your deduction for contributions you make to your own SEP-IRA.

**Example 1.** Jim’s SEP calls for a deferral contribution rate of 10% of his salary. Jim’s salary for the year is $30,000 (before reduction for the deferral). You multiply Jim’s salary by 10% to get his deferral of $3,000. Your maximum deduction for elective deferrals and any nonelective contributions would be $3,913.05 ($30,000 x .130435).

On Jim’s Form W–2, you show his total wages as $27,000 ($30,000 – $3,000). Social security wages and Medicare wages will each be $30,000. Jim will report $27,000 as wages on his individual income tax return.

**Choice not to treat deferrals as compensation.** You can choose not to treat elective deferrals (and other amounts deferred in certain employee benefit plans) for a year as compensation under your SEP. You can use this method for calculating deferral percentages for the SARSEP ADP test defined earlier.

The deferral and the compensation (minus the deferral) depend on each other. For this reason, you figure the deferral indirectly by reducing the contribution rate for deferrals called for under the salary reduction arrangement. This method is the same one you use to figure your deduction for contributions you make to your own SEP-IRA. You must also use the reduced rate method to determine the maximum deductible contribution (13.0435% of unreduced compensation).

To figure the deferral, use either the rate table or rate worksheet in chapter 5. Use the rate table if the deferral contribution rate called for under the SEP equals a whole percentage. Otherwise, use the rate worksheet. When using the rate table, first locate the deferral contribution rate in Column A. Then read across to find the reduced rate in Column B. Multiply the re-
duced rate by your employee’s compensation to get the deferral.

**Example 2.** The facts are the same as in Example 1 except you chose not to treat deferrals as compensation under the arrangement. To figure the deferral, you multiply Jim’s salary of $30,000 by 0.090909 (the reduced rate equivalent of 10%) to get the deferral of $2,727.27. Your maximum deduction for elective deferrals and any noncontributory elections would be $3,913.05 ($30,000 × 0.130435).

On Jim’s Form W–2, you will show his total wages as $27,272.73 ($30,000 – $2,727.27). Social security wages and Medicare wages will each be $30,000. Jim will report $27,272.73 as wages on his individual income tax return.

**Alternative definitions of compensation.** In addition to the general definition of compensation in chapter 1 and the choice described in the preceding paragraphs, you can use any definition of compensation that meets all the following conditions.

- It is reasonable.
- It is not designed to favor highly compensated employees.
- It provides that the average percentage of total compensation used for highly compensated employees as a group for the year is not more than minimally higher than the average percentage of total compensation used for all other employees as a group.

**Compensation of self-employed individuals.** If you are self-employed, compensation is your net earnings from self-employment as defined in chapter 1.

To figure the deferral, you must use a reduced rate instead of the deferral contribution rate called for under the SARSEP. Use either the rate table or rate worksheet in chapter 5 to get the reduced rate. Then use the deduction worksheet to figure the deferral.

Compensation does not include tax-free items (or deductions related to them) other than foreign earned income and housing cost amounts.

**Compensation of disabled participant.** You may be able to choose to use special rules to determine compensation for a participant who is permanently and totally disabled. Under these rules, compensation means the compensation the participant would have received if paid at the rate paid immediately before becoming permanently and totally disabled. See Internal Revenue Code section 415(c)(3)(C) for details.

**Tax Treatment of Deferrals.** You can deduct your deferrals that, when added to your other SEP contributions, are not more than the limits under Deducing Contributions, earlier.

Elective deferrals that are not more than the limit discussed earlier are excluded from your employees’ wages subject to federal income tax in the year of deferral. However, these deferrals are included in wages for social security, Medicare, and federal unemployment (FUTA) tax.

**Excess deferrals.** For 2001, excess deferrals are the elective deferrals for the year that are more than the $10,500 limit discussed earlier. The treatment of excess deferrals made under a SARSEP is similar to the treatment of excess deferrals made under a qualified plan. See Treatment of Excess Deferrals under Elective Deferrals (401(k) Plans) in chapter 4.

**Excess SEP contributions.** Excess SEP contributions are elective deferrals of highly compensated employees that are not more than the amount permitted under the SARSEP ADP test. You must notify your highly compensated employees within 2½ months after the end of the plan year of their excess SEP contributions. If you do not notify them within this time period, you must pay a 10% tax on the excess. For an explanation of the notification requirements, see Revenue Procedure 91–44 in Cumulative Bulletin 1991–2. If you adopted a SARSEP using Form 5305A–SEP, the notification requirements are explained in the instructions for that form.

**Reporting on Form W–2.** Do not include elective deferrals in the “Wages, tips, other compensation” box of Form W–2. You must, however, include them in the “Social security wages” and “Medicare wages and tips” boxes. You must also include them in box 12. Mark the “Retirement plan” checkbox in box 13. For more information, see the Form W–2 instructions.

**Distributions (Withdrawals).** As an employer, you cannot prohibit distributions from a SEP-IRA. Also, you cannot make your contributions on the condition that any part of them must be kept in the account. Distributions are subject to IRA rules. For information about IRA rules, including the tax treatment of distributions, rollovers, required distributions, and income tax withholding, see Publication 590.

**Additional Taxes.** The tax advantages of using SEP-IRAs for retirement savings can be offset by additional taxes. There are additional taxes for all the following actions.

- Making excess contributions.
- Making early withdrawals.
- Not making required withdrawals.

For information about these taxes, see chapter 1 in Publication 590. Also, a SEP-IRA may be disqualified, or an excise tax may apply, if the account is involved in a prohibited transaction, discussed next.

**Prohibited transaction.** If an employee improperly uses his or her SEP-IRA, such as by borrowing money from it, the employee has engaged in a prohibited transaction. In that case, the SEP-IRA will no longer qualify as an IRA. For a list of prohibited transactions, see Prohibited Transactions in chapter 4.

**Effects on employee.** If a SEP-IRA is disqualified because of a prohibited transaction, the assets in the account will be treated as having been distributed to the employee on the first day of the year in which the transaction occurred. The employee must include in income the fair market value of the assets (on the first day of the year) that is more than any cost basis in the account. Also, the employee may have to pay the additional tax for making early withdrawals.

**Reporting and Disclosure Requirements.** If you set up a SEP using Form 5305–SEP, you must give your eligible employees certain information about the SEP when you set it up. See Setting Up a SEP, earlier. Also, you must give your eligible employees a statement each year showing any contributions to their SEP-IRAs. You must also give them notice of any excess contributions. For details about other information you must give them, see the instructions for Form 5305–SEP or Form 5305A–SEP (for a salary reduction SEP).

Even if you did not use Form 5305–SEP or Form 5305A–SEP to set up your SEP, you must give your employees information similar to that described above. For more information, see the instructions for either Form 5305–SEP or Form 5305A–SEP.

3. **SIMPLE Plans**

**Topics**
This chapter discusses:
- **SIMPLE IRA plan**
- **SIMPLE 401(k) plan**

**Useful Items**
You may want to see:

- **Forms (and instructions)**
  - W–2 Wage and Tax Statement
  - 5304–SIMPLE Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) (Not Subject to the Designated Financial Institution Rules)
  - 5305–SIMPLE Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) (for Use With a Designated Financial Institution)
A savings incentive match plan for employees (SIMPLE plan) is a written arrangement that provides you and your employees with a simplified way to make contributions to provide retirement income. Under a SIMPLE plan, employees can choose to make salary reduction contributions to the plan rather than receiving these amounts as part of their regular pay. In addition, you will contribute matching or nonelective contributions. SIMPLE plans can only be maintained on a calendar-year basis.

A SIMPLE plan can be set up in either of the following ways:
- Using SIMPLE IRAs (SIMPLE IRA plan).
- As part of a 401(k) plan (SIMPLE 401(k) plan).

Many financial institutions will help you set up a SIMPLE plan.

A SIMPLE IRA plan is a retirement plan that uses SIMPLE IRAs for each eligible employee. Under a SIMPLE IRA plan, a SIMPLE IRA must be set up for each eligible employee. For the definition of an eligible employee, see Who Can Participate in a SIMPLE IRA plan, later.

Who Can Set Up a SIMPLE IRA Plan?

You can set up a SIMPLE IRA plan if you meet both the following requirements.
- You meet the employee limit.
- You do not maintain another qualified plan unless the other plan is for collective bargaining employees.

Employee limit. You can set up a SIMPLE IRA plan only if you had 100 or fewer employees who received $5,000 or more in compensation from you for the preceding year. Under this rule, you must take into account all employees employed at any time during the calendar year regardless of whether they are eligible to participate.

Once you set up a SIMPLE IRA plan, you must continue to meet the 100-employee limit each year you maintain the plan.

Grace period for employers who cease to meet the 100-employee limit. If you maintain the SIMPLE IRA plan for at least 1 year and you cease to meet the 100-employee limit in a later year, you will be treated as meeting it for the 2 calendar years immediately following the calendar year for which you last met it.

A different rule applies if you do not meet the 100-employee limit because of an acquisition, disposition, or similar transaction. Under this rule, the SIMPLE IRA plan will be treated as meeting the 100-employee limit for the year of the transaction and the 2 following years if both the following conditions are satisfied.

- Coverage under the plan has not significantly changed during the grace period.
- The SIMPLE IRA plan would have continued to qualify after the transaction if you had remained a separate employer.

The grace period for acquisitions, dispositions, and similar transactions also applies if, because of these types of transactions, you do not meet the rules explained under Other qualified plan or Who Can Participate in a SIMPLE IRA Plan, below.

Other qualified plan. The SIMPLE IRA plan generally must be the only retirement plan to which you make contributions, or to which benefits accrue, for service in any year beginning with the year the SIMPLE IRA plan becomes effective.

Exception. If you maintain a qualified plan for collective bargaining employees, you are permitted to maintain a SIMPLE IRA plan for other employees.

Who Can Participate in a SIMPLE IRA Plan?

Eligible employee. Any employee who received at least $5,000 in compensation during any 2 years preceding the current calendar year and is reasonably expected to receive at least $5,000 during the current calendar year is eligible to participate. The term “employee” includes a self-employed individual who received earned income.

You can use less restrictive eligibility requirements (but not more restrictive ones) by eliminating or reducing the prior year compensation requirements, the current year compensation requirements, or both. For example, you can allow participation for employees who received at least $3,000 in compensation during any preceding calendar year. However, you cannot impose any other conditions for participating in a SIMPLE IRA plan.

Excludable employees. The following employees do not need to be covered under a SIMPLE IRA plan.
- Employees who are covered by a union agreement and whose retirement benefits were bargainated for in good faith by the employees’ union and you.
- Nonresident alien employees who have received no U.S. source wages, salaries, or other personal services compensation from you.

Compensation. Compensation for employees is the total wages required to be reported on Form W–2. Compensation also includes the salary reduction contributions made under this plan, compensation deferred under a section 457 plan, and the employees’ elective deferrals under a section 401(k) plan, a SARSEP, or section 403(b) annuity contract. If you are self-employed, compensation is your net earnings from self-employment (line 4 of Short Schedule SE (Form 1040)) before subtracting any contributions made to the SIMPLE IRA plan for yourself.

How To Set Up a SIMPLE IRA Plan

You can use Form 5304–SIMPLE or Form 5305–SIMPLE to set up a SIMPLE IRA plan. Each form is a model savings incentive match plan for employees (SIMPLE) plan document. Which form you use depends on whether you select a financial institution or your employees select the institution that will receive the contributions.

Use Form 5304–SIMPLE if you allow each plan participant to select the financial institution for receiving his or her SIMPLE IRA plan contributions. Use Form 5305–SIMPLE if you require that all contributions under the SIMPLE IRA plan be deposited initially at a designated financial institution.

The SIMPLE IRA plan is adopted when you have completed all appropriate boxes and blanks on the form and you (and the designated financial institution, if any) have signed it. Keep the original form. Do not file it with the IRS.

Other uses of the forms. If you set up a SIMPLE IRA plan using Form 5304–SIMPLE or Form 5305–SIMPLE, you can use the form to satisfy other requirements, including the following.
- Meeting employer notification requirements for the SIMPLE IRA plan.
- Using SIMPLE IRAs (SIMPLE IRA plan).
- Coverage under the plan has not significantly changed during the grace period.
- The SIMPLE IRA plan would have continued to qualify after the transaction if you had remained a separate employer.

Deadline for setting up a SIMPLE IRA plan.

You can set up a SIMPLE IRA plan effective on any date between January 1 and October 1 of a year, provided you did not previously maintain a SIMPLE IRA plan. If you previously maintained a SIMPLE IRA plan, you can set up a SIMPLE IRA plan effective only on January 1 of a year. This requirement does not apply if you are a new employer that comes into existence after October 1 of the year the SIMPLE IRA plan is set up and you set up a SIMPLE IRA plan as soon as administratively feasible after you come into existence. A SIMPLE IRA plan cannot have an effective date that is before the date you actually adopt the plan.

Setting up a SIMPLE IRA. SIMPLE IRAs are the individual retirement accounts or annuities into which the contributions are deposited. A SIMPLE IRA must be set up for each eligible employee. Forms 5305–S, SIMPLE Individual Retirement Trust Account, and 5305–SA, SIMPLE Individual Retirement Custodial Account, are model trust and custodial account documents the participant and the trustee (or custodian) can use for this purpose.

A SIMPLE IRA cannot be designated as a Roth IRA. Contributions to a SIMPLE IRA will not affect the amount an individual can contribute to a Roth IRA.

Deadline for setting up a SIMPLE IRA. A SIMPLE IRA must be set up for an employee before the first date by which a contribution is
required to be deposited into the employee’s IRA. See Time limits for contributing funds, later, under Contribution Limits.

**Notification Requirement**

If you adopt a SIMPLE IRA plan, you must notify each employee of the following information before the beginning of the election period.

1. The employee’s opportunity to make or change a salary reduction choice under a SIMPLE IRA plan.
2. Your choice to make either reduced matching contributions or nonelective contributions (discussed later).
3. A summary description and the location of the plan document that the financial institution should provide you with this information.
4. Written notice that his or her balance can be transferred without cost or penalty if you use a designated financial institution.

**Election period.** The election period is generally the 60-day period immediately preceding January 1 of a calendar year (November 2 to December 31 of the preceding calendar year). However, the dates of this period are modified if you set up a SIMPLE IRA plan in mid-year (for example, on July 1) or if the 60-day period falls before the first day an employee becomes eligible to participate in the SIMPLE IRA plan.

A SIMPLE IRA plan can provide longer periods for permitting employees to enter into salary reduction agreements or to modify prior agreements. For example, a SIMPLE IRA plan can provide a 90-day election period instead of the 60-day period. Similarly, in addition to the 60-day period, a SIMPLE IRA plan can provide quarterly election periods during the 30 days before each calendar quarter, other than the first quarter of each year.

**Contribution Limits**

Contributions are made up of salary reduction contributions and employer contributions. You, as the employer, must make either matching contributions or nonelective contributions, de- fined later. No other contributions can be made to the SIMPLE IRA plan. These contributions, which you can deduct, must be made timely. See Time limits for contributing funds, later.

**Salary reduction contributions.** The amount the employee chooses to have you contribute to a SIMPLE IRA on his or her behalf cannot be more than $10,500 for 2001 (or more than $10,500 for 2001, but reduced by $2,000 if you adopt a SIMPLE IRA plan in mid-year). The contribution amount must be as follows:

| Employer Matching Contribution (2%) Limit | $5,200 |
| Employer Matching Contribution (3%) Limit | $7,800 |
| Nonelective Contributions Limit | $6,500 |
| Total Limit | $19,500 |

**Example 2.** Using the same facts as in Example 1, above, the maximum contribution you can make for Jane or for yourself if you each earned $75,000 is $8,000, figured as follows.

**When To Deduct Contributions**

You can deduct SIMPLE IRA contributions in the tax year with or within which the calendar year for which contributions were made ends. You can deduct contributions for a particular tax year if they were made for that tax year and are made by the due date (including extensions) of your federal income tax return for that year.

**Example 1.** Your tax year is the fiscal year ending June 30. Contributions under a SIMPLE IRA plan for the calendar year 2001 (including contributions made in 2001 before July 1, 2001) are deductible in the tax year ending June 30, 2002.

**Example 2.** You are a sole proprietor whose tax year is the calendar year. Contributions under a SIMPLE IRA plan for the calendar year 2001 (including contributions made in 2002 by April 15, 2002) are deductible in the 2001 tax year.

**Where To Deduct Contributions**

Deduct the contributions you make for your common-law employees on your tax return. For example, sole proprietors deduct them on Schedule C (Form 1040), Profit or Loss From Business, or Schedule F (Form 1040), Profit or Loss From Farming, partnerships deduct them on Form 1065, U.S. Return of Partnership Income, and corporations deduct them on Form 1120.

Sole proprietors and partners deduct contributions for themselves on line 29 of Form 1040, U.S. Individual Income Tax Return. (If you are a partner, contributions for yourself are shown on the Schedule K-1 (Form 1065), Partner’s Share of Income, Deductions, etc., you get from the partnership.)

Qualified Plans

Tax Treatment of Contributions

You can deduct your contributions and your employees’ contributions from your gross income. SIMPLE IRA contributions are not subject to federal income tax withholding. However, salary reduction contributions are subject to social security, Medicare, and federal unemployment (FUTA) taxes. Matching and nonelective contributions are not subject to these taxes.

Reporting on Form W–2. Do not include SIMPLE IRA contributions in the “Wages, tips, other compensation box” of Form W–2. However, salary reduction contributions must be included in the boxes for social security and Medicare wages. Also include the proper code in box 12. For more information, see the instructions for Forms W–2 and W–3.

Distributions (Withdrawals)

Distributions from a SIMPLE IRA are subject to IRA rules and generally are includible in income for the year received. Tax-free rollovers can be made from one SIMPLE IRA into another SIMPLE IRA. However, a rollover from a SIMPLE IRA to a non-SIMPLE IRA can be made tax free only after a 2-year participation in the SIMPLE IRA plan.

Early withdrawals generally are subject to a 10% additional tax. However, the additional tax is increased to 25% if funds are withdrawn within 2 years of beginning participation.

More information. See Publication 590, Individual Retirement Arrangements, for information about IRA rules, including those on the tax treatment of distributions, rollovers, required distributions, and income tax withholding.

More Information on SIMPLE IRA Plans

If you need more help to set up and maintain a SIMPLE IRA plan, see the following IRS notice and revenue procedure.

Notice 98–4. This notice contains questions and answers about the implementation and operation of SIMPLE IRA plans, including the election and notice requirements for these plans. Notice 98–4 is in Cumulative Bulletin 1998–1.

Revenue Procedure 97–29. This revenue procedure provides guidance to drafters of prototype SIMPLE IRAs on obtaining opinion letters. Revenue Procedure 97–29 is in Cumulative Bulletin 1997–1.

SIMPLE 401(k) Plan

You can adopt a SIMPLE plan as part of a 401(k) plan if you meet the 100-employee limit as discussed earlier under SIMPLE IRA Plans. A SIMPLE 401(k) plan is a qualified retirement plan and generally must satisfy the rules discussed under Qualification Rules in chapter 4. However, a SIMPLE 401(k) plan is not subject to the nondiscrimination and top-heavy rules in that discussion if the plan meets the conditions listed below.

1) Under the plan, an employee can choose to have you make salary reduction contributions for the year to a trust in an amount expressed as a percentage of the employee’s compensation, but not more than $6,500 for 2001. (For 2002, the contribution limit increases to $7,000 and participants who are age 50 or over can make a catch-up contribution of up to $500.)

2) You must make either:

   a) Matching contributions up to 3% of compensation for the year, or
   b) Nonelective contributions of 2% of compensation on behalf of each eligible employee who has at least $5,000 of compensation from you for the year.

3) No other contributions can be made to the trust.

4) No contributions are made, and no benefits accrue, for services during the year under any other qualified retirement plan of the employer on behalf of any employee eligible to participate in the SIMPLE 401(k) plan.

5) The employee’s rights to any contributions are nonforfeitable.

No more than $170,000 ($200,000 for 2002) of the employee’s compensation can be taken into account in figuring salary reduction contributions, matching contributions, and nonelective contributions.

Employee notification. The notification requirement that applies to SIMPLE IRA plans also applies to SIMPLE 401(k) plans. See Notification Requirement in this chapter.

More Information on SIMPLE 401(k) Plans

If you need more help to set up and maintain a SIMPLE 401(k) plan, see Revenue Procedure 97–9 in Cumulative Bulletin 1997–1. This revenue procedure provides a model amendment you can use to adopt a plan with SIMPLE 401(k) provisions. This model amendment provides guidance to plan sponsors for incorporating 401(k) SIMPLE provisions in plans containing cash or deferred arrangements.

4.

Qualified Plans

Topics

This chapter discusses:

- Kinds of plans
- Setting up a qualified plan
- Minimum funding requirement
- Contributions
- Employer deduction
- Elective deferrals (401(k) plans)
- Distributions
- Prohibited transactions
- Reporting requirements
- Qualification rules

Useful Items

You may want to see:

- Publication
  - 575 Pension and Annuity Income
- Forms (and Instructions)
  - Schedule C (Form 1040) Profit or Loss From Business
  - Schedule F (Form 1040) Profit or Loss From Farming
  - Schedule K-1 (Form 1065) Partner’s Share of Income, Credits, Deductions, etc.
  - W-2 Wage and Tax Statement
  - 1040 U.S. Individual Income Tax Return
  - 1099–R Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
  - 5330 Return of Excise Taxes Related to Employee Benefit Plans
  - Form 5500 Annual Report/Report of Employee Benefit Plan
  - 5500–EZ Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan
  - Schedule A (Form 5500) Insurance Information

Qualified retirement plans set up by self-employed individuals are sometimes called Keogh or H.R. 10 plans. A sole proprietor or a partner cannot set up a qualified plan. The plans discussed here apply to corporations except where specifically limited to the self-employed.
The plan must be for the exclusive benefit of employees or their beneficiaries. A qualified plan can include coverage for a self-employed individual. A self-employed individual is treated as both an employer and an employee.

As an employer, you can usually deduct, subtract from income, contributions to a qualified plan, including those made for your own retirement. The contributions (and earnings and gains on them) are generally tax free until distributed by the plan.

Kinds of Plans

There are two basic kinds of qualified plans—defined contribution plans and defined benefit plans—and different rules apply to each. You can have more than one qualified plan, but your contributions to all the plans must not total more than the overall limits discussed under Contributions and Employer Deduction, later.

Defined Contribution Plan

A defined contribution plan provides an individual account for each participant in the plan. It provides benefits to a participant largely based on the amount contributed to that participant’s account. Benefits are also affected by any income, expenses, gains, losses, and forfeitures of other accounts that may be allocated to an account. A defined contribution plan can be either a profit-sharing plan or a money purchase pension plan.

Profit-sharing plan. A profit-sharing plan is a plan for sharing your business profits with your employees. However, you do not have to make contributions out of net profits to have a profit-sharing plan. The plan does not need to provide a definite formula for figuring the profits to be shared. But, if there is no formula, there must be systematic and substantial contributions.

The plan must provide a definite formula for allocating the contribution among the participants and for distributing the accumulated funds to the employees after they reach a certain age, after a fixed number of years, or upon certain other occurrences. In general, you can be more flexible in making contributions to a profit-sharing plan than to a money purchase pension plan (discussed next) or a defined benefit plan (discussed later). But the maximum deductible contribution may be less under a profit-sharing plan (see Limits on Contributions and Benefits, later).

A defined benefit plan is a plan for providing a defined benefit to each employee at retirement. A money purchase pension plan is a defined contribution plan that provides a definite formula for determining the benefits to be paid to each participant at retirement. A profit-sharing plan is a defined contribution plan that provides a formula for figuring the profits to be shared. But, if you are self-employed, it is not necessary to have employees besides yourself to sponsor and set up a qualified plan.

Forfeitures under a defined benefit plan cannot be used to increase the benefits any employee would otherwise receive under the plan. Forfeitures under a profit-sharing plan can be used instead to reduce employer contributions.

Setting Up a Qualified Plan

There are two basic steps in setting up a qualified plan. First you adopt a written plan. Then you invest the plan assets.

You, the employer, are responsible for setting up and maintaining the plan. If you are self-employed, you must be the one to set up the plan. You can adopt a written plan in the form of a trust, custodial account, life insurance, or any form of arrangement the IRS approves. The written plan should clearly state the plan’s purpose, the plan’s fund arrangement, the plan’s benefits, and the plan’s provisions for distributing the accumulated funds to the employees after they reach a certain age, after a fixed number of years, or upon certain other occurrences. It must also state how contributions will be made, how the plan will be administered, how the plan will be funded, and how the plan will be terminated and distributed.

Adopting a Written Plan

You must adopt a written plan. The plan can be an IRS-approved master or prototype plan offered by a sponsoring organization. Or it can be an individually designed plan.

Written plan requirement. To qualify, the plan you set up must be in writing and must be communicated to your employees. The plan’s provisions must be stated in the plan. It is not sufficient for the plan to merely refer to a requirement of the Internal Revenue Code.

Master or prototype plans. Most qualified plans (or a standard form of plan (a master or prototype plan) approved by the IRS. Master and prototype plans are plans made available by plan providers for adoption by employers (including self-employed individuals). Under a master plan, a single trust or custodial account is established, as part of the plan, for the joint use of all adopting employers. Under a prototype plan, a separate trust or custodial account is established for each employer.

Plan providers. The following organizations generally can provide IRS-approved master or prototype plans.

- Banks (including some savings and loan associations and federally insured credit unions).
- Trade or professional organizations.
- Insurance companies.
- Mutual funds.

Individually designed plan. If you prefer, you can set up an individually designed plan to meet specific needs. Although advance IRS approval is not required, you can apply for approval by paying a fee and requesting a determination letter. You may need professional help for this. The following revenue procedure and announcement may help you decide whether to pay for approval.


Internal Revenue Bulletins are available on the IRS web site at www.irs.gov. They are also available at most IRS offices and at certain libraries.

User fee. The fee mentioned earlier for requesting a determination letter does not apply to certain requests made after December 31, 2001, by employers who have 100 or fewer employees, at least one of whom is a non-highly compensated employee participating in the plan. The fee does not apply to requests made by the later of the following dates:

- The end of the 5th plan year the plan is in effect.
- The end of any remedial amendment period for the plan that begins within the first 5 plan years.

The request cannot be made by the sponsor of a prototype or similar plan the sponsor intends to market to participating employers.

Investing Plan Assets

In setting up a qualified plan, you arrange how the plan’s funds will be used to build its assets.

- You can establish a trust or custodial account to invest the funds.
- You, the trust, or the custodial account can buy an annuity contract from an insurance company. Life insurance can be included only if it is incidental to the retirement benefits.
- You, the trust, or the custodial account can buy face-amount certificates from an insurance company. These certificates are treated like annuity contracts.

You set up a trust by a legal instrument (written document). You may need professional help to do this.

You can set up a custodial account with a bank, savings and loan association, credit union, or other person who can act as the plan trustee.

You do not need a trust or custodial account, although you can have one, to invest the plan’s funds in annuity contracts or face-amount certificates. If anyone other than a trustee holds them, however, the contracts or certificates must state they are not transferable.
Minimum Funding Requirement

In general, if your plan is a money purchase pension plan or a defined benefit plan, you must actually pay enough into the plan to satisfy the minimum funding standard for each year. Determining the amount needed to satisfy the minimum funding standard is complicated. The amount is based on what should be contributed under the plan formula using actuarial assumptions and formulas. For information on this funding requirement, see section 412 and its regulations.

Quarterly installments of required contributions. If your plan is a defined benefit plan subject to the minimum funding requirements, you must make quarterly installment payments of the required contributions. If you do not pay the full installments timely, you may have to pay interest on any underpayment for the period of the underpayment.

Due dates. The due dates for the installments are 15 days after the end of each quarter. For a calendar year plan, the installments are due April 15, July 15, October 15, and January 15 (of the following year).

Installment percentage. Each quarterly installment must be 25% of the required annual payment.

Extended period for making contributions. Additional contributions required to satisfy the minimum funding requirement for a plan year will be considered timely if made by 8½ months after the end of that year.

Contributions

A qualified plan is generally funded by your contributions. However, employees participating in the plan may be permitted to make contributions.

Contributions deadline. You can make deductible contributions for a tax year up to the due date of your return (plus extensions) for that year.

Self-employed individual. You can make contributions on behalf of yourself only if you have net earnings (compensation) from self-employment in the trade or business for which the plan was set up. Your net earnings must be from your personal services, not from your investments. If you have a net loss from self-employment, you cannot make contributions for yourself for the year, even if you can contribute for common-law employees based on their compensation.

When Contributions Are Considered Made

You generally apply your plan contributions to the year in which you make them. But you can apply them to the previous year if all the following requirements are met.

1) You make them by the due date of your tax return for the previous year (plus extensions).

2) The plan was established by the end of the previous year.

3) The plan treats the contributions as though it had received them on the last day of the previous year.

4) You do either of the following.

   a) You specify in writing to the plan administrator or trustee that the contributions apply to the previous year.

   b) You deduct the contributions on your tax return for the previous year. (A partnership shows contributions for partners on Schedule K (Form 1065), Partners’ Shares of Income, Credits, Deductions, etc.)

Employer’s promissory note. Your promissory note made out to the plan is not a payment and allocate (and reallocate) it to participants’ accounts in the following year.

Employer Contributions

There are certain limits on the contributions and other annual additions you can make each year for plan participants. There are also limits on the amount you can deduct. See Deduction Limits, later.

Limits on Contributions and Benefits

Your plan must provide that contributions or benefits cannot exceed certain limits. The limits differ depending on whether your plan is a defined contribution plan or a defined benefit plan.

Defined benefit plan. For 2001, the annual benefit for a participant under a defined benefit plan cannot exceed the lesser of the following amounts.

1) 100% of the participant’s average compensation for his or her highest 3 consecutive calendar years.

2) $140,000 ($160,000 for 2002).

Defined contribution plan. For 2001, a defined contribution plan’s annual contributions and other additions (excluding earnings) to the account of a participant cannot exceed the lesser of the following amounts.

1) 25% of the compensation actually paid to the participant.

2) $35,000.

The maximum compensation that can be taken into account for this limit is $170,000.

For 2002, the percentage in (1) increases to 100%, and the amount in (2) increases to $40,000. Also for 2002, the maximum compensation that can be taken into account for this limit is $200,000.

Excess annual additions. Excess annual additions are the amounts contributed that are more than the limits discussed previously. A plan can correct excess annual additions caused by any of the following actions.

- A reasonable error in estimating a participant’s compensation.
- A reasonable error in determining the elective deferrals permitted (discussed later).
- Forfeitures allocated to participants’ accounts.

Correcting excess annual additions. A plan can provide for the correction of excess annual additions in the following ways.

1) Allocate and reallocate the excess to other participants in the plan to the extent of their unused limits for the year.

2) If these limits are exceeded, do one of the following.

   a) Hold the excess in a separate account and allocate (and reallocate) it to participants’ accounts in the following year (or years) before making any contributions for that year (see also Carryover of Excess Contributions, later).

   b) Return employee after-tax contributions or elective deferrals (see Employer Contributions and Elective Deferrals (401(k) Plans), later).

Tax treatment of returned contributions or distributed elective deferrals. The return of employee after-tax contributions or the distribution of elective deferrals to correct excess annual additions is considered a corrective payment rather than a distribution of accrued benefits. The penalties for early distributions and excess distributions do not apply. These disbursements are not wages reportable on Form W-2. You must report them on a separate Form 1099-R as follows.

- Report the total distribution, including em- employee contributions, in box 1. If the distribu tion includes any gain from the contribution, report the gain in box 2a. Re- port the return of employee contributions in box 5. Enter Code E in box 7.


Participants must report these amounts on the line for Total pensions and annuities on Form 1040 or Form 1040A, U.S. Individual Income Tax Return.

Employee Contributions

Participants may be permitted to make nondeductible contributions to a plan in addition to your contributions. Even though these em-
employee contributions are not deductible, the earnings on them are tax free until distributed in later years. If you contribute to a defined benefit plan, these contributions must satisfy the nondiscrimination test of section 401(m). See Notice 98–1 for further guidance and transition relief relating to recent statutory amendments to the nondiscrimination rules under sections 401(k) and 401(m). Notice 98–1 is in Cumulative Bulletin 1998–1.

**Employer Deduction**

You can usually deduct, subject to limits, contributions you make to a qualified plan, including those made for your own retirement. Contributions (and earnings and gains on them) are generally tax free until distributed by the plan.

**Deduction Limits**

The deduction limit for your contributions to a qualified plan depends on the kind of plan you have.

- **Defined contribution plans.** The deduction limit for a defined contribution plan depends on whether it is a profit-sharing plan or a money purchase pension plan.
- **Profit-sharing plan.** Your deduction for contributions to a profit-sharing plan cannot be more than 15% of the compensation paid to eligible employees participating in the plan. You must reduce this 15% limit in figuring the deduction for contributions you make for your own account. See Deduction Limit for Self-Employed Individuals.
- **Money purchase pension plan.** Your deduction for contributions to a money purchase pension plan is generally limited to 25% of the compensation paid (or accrued) during the year to your eligible employees participating in the plan. You must reduce this 25% limit in figuring the deduction for contributions you make for your own account. A SEP is treated as a qualified plan.
- **Defined benefit plans.**
  - The deduction for contributions to a defined benefit plan is based on actuarial assumptions and computations. Consequently, an actuary must figure your deduction limit.

*CAUTION* In figuring the deduction for contributions, you cannot take into account any carryovers or other benefits that are more than the limitations discussed earlier under Limits on Contributions and Benefits. However, for plan years beginning after December 31, 2001, your deduction can be as much as the plan’s unfunded current liability.

**Deduction limit for multiple plans.** If you contribute to both a defined contribution plan and a defined benefit plan and at least one employee is covered by both plans, your deduction for those contributions is limited. Your deduction cannot be more than the greater of the following amounts:

- 25% of the compensation paid (or accrued) during the year to your eligible employees participating in the plan. You must reduce this 25% limit in figuring the deduction for contributions you make for your own account.
- Your contributions to the defined benefit plan, but not more than the amount needed to meet the year’s minimum funding standard for any of these plans.

For this rule, a SEP is treated as a separate profit-sharing (defined contribution) plan.

**Deduction Limit for Self-Employed Individuals**

If you make contributions for yourself, you need to make a special computation to figure your maximum deduction for these contributions.

- The deduction for one-half of your self-employment tax.
- The deduction for contributions on your behalf to the plan.

The deduction for your own contributions and your net earnings depend on each other. For this reason, you determine the deduction for your own contributions indirectly by reducing the contribution rate called for in your plan. To do this, use either the Rate Table for Self-Employed or the Rate Worksheet for Self-Employed in chapter 5. Then figure your maximum deduction by using the Deduction Worksheet for Self-Employed in chapter 5.

**Multiple plans.** The deduction limit for multiple plans (discussed earlier) also applies to contributions you make as an employer on your own behalf.

Where To Deduct Contributions

Deduct the contributions you make for your common-law employees on Schedule C (Form 1040), on Schedule F (Form 1040), on Form 1065, U.S. Return of Partnership Income, Form 1120, U.S. Corporation Income Tax Return, on Form 1120-A, U.S. Short-Form Corporation Income Tax Return, or on Form 1120S, U.S. Income Tax Return for an S Corporation, whichever applies.

You take the deduction for contributions for yourself on line 29 of Form 1040. If you are a partner, the partnership passes its deduction to you for the contributions it made for you. The partnership will report these contributions on Schedule K–1 (Form 1065).

**Carryover of Excess Contributions**

If you contribute more to the plans than you can deduct for the year, you can carry over and deduct the difference in later years, combined with your contributions for those years. Your combined deduction in a later year is limited to 25% of the participating employees’ compensation for that year. The limit is 15% (25% for years beginning after December 31, 2001) if you have only profit-sharing plans (including SEPs). However, these percentage limits must be reduced to figure your maximum deduction for contributions you make for yourself. See Deduction Limit for Self-Employed Individuals, earlier. The amount you carry over and deduct may be subject to the excise tax discussed next.

Table 4–1 illustrates the carryover of excess contributions to a profit-sharing plan.

**Excise Tax for Nondeductible (Excess) Contributions**

If you contribute more than your deduction limit to a retirement plan, you have made nondeductible contributions and you may be liable for an excise tax. In general, a 10% excise tax applies to nondeductible contributions made to qualified pension, profit-sharing, stock bonus, or annuity plans and to SEPs.

Special rule for self-employed individuals. The 10% excise tax does not apply to any contribution made to meet the minimum funding requirements in a money purchase pension plan or a defined benefit plan. Even if that contribu-

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<th>Deductible limit for current year (15% of compensation)</th>
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<th>Excess contributions carryover used</th>
<th>Total deduction including carryovers</th>
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* There were no carryovers from years before 1998.
Excess withdrawn by April 15. If the employee takes out the excess deferral by April 15, 2002, it is not included in the employee’s gross income for 2002. However, any income earned on the excess deferral taken out is taxable in the tax year in which it is taken out. The distribution is not subject to the additional 10% tax on early distributions.

If the employee takes out part of the excess deferral by April 15, the amount contributed after April 15, 2001, is not included in the employee’s cost basis in figuring the taxable amount of any eventual benefits or distributions under the plan. If the employee takes out part of the excess deferral by April 15, the distribution is taxable in the tax year in which it is taken out.

Excess not withdrawn by April 15. If the employee does not take out the excess deferral by April 15, 2002, the excess, though taxable in 2001, is not included in the employee’s cost basis in figuring the taxable amount of any eventual benefits or distributions under the plan.

Excess not withdrawn by April 15, may be included in the employee’s cost basis in figuring the taxable amount of any eventual benefits or distributions under the plan. If the employee takes out part of the excess deferral by April 15, the amount is not included in the employee’s gross income for 2002. However, any income earned on the excess deferral taken out is taxable in the tax year in which it is taken out. The distribution is not subject to the additional 10% tax on early distributions.

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Excess not withdrawn by April 15, the distribution is not subject to the additional 10% tax on early distributions. If the employee takes out part of the excess deferral by April 15, the amount contributed after April 15, 2001, is not included in the employee’s cost basis in figuring the taxable amount of any eventual benefits or distributions under the plan. If the employee takes out part of the excess deferral by April 15, the distribution is taxable in the tax year in which it is taken out.

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Required Distributions

A qualified plan must provide that each partici-
pant will either:
• Receive his or her entire interest (benefits) in the plan by the required beginning date (defined later), or
• Begin receiving regular periodic distribu-
tions by the required beginning date. Annual amounts calculated to distribute the participant’s entire interest (benefits) over his or her life expectancy or over the joint life expectancy of the participant and the designated beneficiary (or over a shorter period).

These distribution rules apply individually to each qualified plan. You cannot satisfy the re-
quirement for one plan by taking a distribution from another. These rules may be incorporated in the plan by reference. The plan must provide that these rules override any inconsistent distribu-
tion options previously offered.

Minimum distribution. If the account balance of a qualified plan participant is to be distributed (other than as an annuity), the plan administra-
tor must figure the minimum amount required to be distributed each distribution calendar year. This minimum is figured by dividing the account balance by the applicable life expectancy. For details on figuring the minimum distribution, see Tax on Excess Accumulation in Publication 575.

Minimum distribution incidental benefit re-
quirement. Minimum distributions must also meet the minimum distribution incidental benefit requirement. This requirement ensures the plan is used primarily to provide retirement benefits to the employee. After the employee’s death, only “incidental” benefits are expected to remain distribution for the employee’s beneficiary (or beneficiaries). For more information about other distribution requirements, see Publication 575.

Required beginning date. Generally, each participant must receive his or her entire bene-
fits in the plan or begin to receive periodic distribu-
tions of benefits from the plan by the required beginning date. A participant must begin to receive distributions from his or her qualified retirement plan by April 1 of the first year after the later of the following years:
1) Calendar year in which he or she reaches age 70 1/2.
2) Calendar year in which he or she retires. However, your plan may require you to begin receiving distributions by April 1 of the year after you reach age 70 1/2 even if you have not retired.
If the participant is a 5% owner of the em-
ployer maintaining the plan or if the distribution is a rollover of any cost basis are subject to in-
come tax in the year they are distributed. Since most recipients have no cost basis, a distribution generally is fully taxable. An exception is a distri-
tution that is properly rolled over as discussed next under Rollover.
The tax treatment of distributions depends on whether they are made periodically over sev-
eral years or life (periodic distributions) or are nonperiodic distributions. See Taxation of Peri-
odic Payments and Taxation of Nonperiodic Payments in Publication 575 for a detailed description of how distributions are taxed, in-
cluding the 10-year tax option or capital gain treatment of a lump-sum distribution.
Rollover. The recipient of an eligible rollover distribution from a qualified plan can defer the tax on it by rolling it over into a traditional IRA or another eligible retirement plan. However, it may be subject to withholding as discussed under Withholding requirement, later.
Eligible rollover distribution. This is a dis-
tribution of all or any part of an employee’s balance in a qualified retirement plan that is not any of the following:
1) A required minimum distribution. See Re-
quired Distributions, earlier.
2) Any of a series of substantially equal pay-
ments made at least once a year over any of the following periods:
a) The employee’s life or life expectancy.
b) The joint lives or life expectancies of the employee and beneficiary.
c) A period of 10 years or longer.
3) A hardship distribution from a 401(k) plan. (No hardship distribution made after De-
cember 31, 2001, will qualify as an eligible rollover distribution.)
4) The portion of a distribution that repre-
sents the return of an employee’s nonde-
spicable contributions to the plan. See Employee Contributions, earlier.
5) A corrective distribution of excess contri-
butions or deferrals under a 401(k) plan and any income allocable to the excess, or of excess annual additions and any alloca-
tion gains. See Correcting excess annual additions, earlier, under Limits on Contri-
butions and Benefits.
6) Loans treated as distributions.
7) Dividends on employer securities.
8) The cost of life insurance coverage.

More information. For more information about rollovers, see Rollovers in Publications 575 and 590.

Withholding requirement. If, during a year, a qualified plan pays to a participant one or more rollover distributions (defined earlier) that are reasonably expected to total $200 or more, the payor must withhold 20% of each distribution for federal income tax.

Exceptions. If, instead of having the distri-
bution paid to him or her, the participant chooses to have the plan pay it directly to an IRA or another eligible retirement plan (a direct rol-
lover), no withholding is required.
If the distribution is not an eligible rollover distribution, defined earlier, the 20% withholding requirement does not apply. Other withholding rules apply to distributions such as long-term periodic distributions and required distributions (periodic or nonperiodic). However, the partici-
pant can still choose not to have tax withheld from these distributions. If the participant does not make this choice, the following withholding rules apply:
• For periodic distributions, withholding is based on their treatment as wages.
• For nonperiodic distributions, 10% of the “taxable part is withheld.

Estimated tax payments. If no income tax is withheld or not enough tax is withheld, the recip-
cient of a distribution may have to make estimated tax payments. For more information, see Withholding Tax and Estimated Tax in Public-
lication 575.

Tax on Early Distributions

If a distribution is made to an employee under the plan before he or she reaches age 59 1/2, the employee may have to pay a 10% additional tax
on the distribution. This tax applies to the amount received that the employee must include in income.

**Exceptions.** The 10% tax will not apply if distributions before age 59 1/2 are made in any of the following circumstances.

- Made to a beneficiary (or to the estate of the employee) on or after the death of the employee.
- Made due to the employee having a qualifying disability.
- Made as part of a series of substantially equal payments or substantially equal payments beginning after separation from service and made at least annually for the life or life expectancy of the employee or the joint lives or life expectancies of the employee and his or her designated beneficiary. (The payments under this exception, except in the case of death or disability, must continue for at least 5 years or until the employee reaches age 59 1/2, whichever is the longer period.)
- Made to an employee after separation from service if the separation occurred during or after the calendar year in which the employee reached age 55.
- Made to an alternate payee under a qualified domestic relations order (QDRO).
- Made to an employee for medical care up to the amount allowable as a medical expense deduction (determined without regard to whether the employee itemizes deductions).
- Timely made to reduce excess contributions under a 401(k) plan.
- Timely made to reduce excess employee or matching employer contributions (excess aggregate contributions).
- Timely made to reduce excess elective deferrals.
- Made because of an IRS levy on the plan.

**Reporting the tax.** To report the tax on early distributions, file Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts. See the form instructions for additional information about this tax.

**Tax on Excess Benefits**

If you are or have been a 5% owner of the business maintaining the plan, amounts you receive at any age that are more than the benefits provided for you under the plan formula are subject to an additional tax. This tax also applies to amounts received by your successor. The tax is 10% of the excess benefit includible in income.

**5% owner.** You are a 5% owner if you meet either of the following conditions at any time during the 5 plan years immediately before the plan year that ends within the tax year you receive the distribution.

- You own more than 5% of the capital or profits interest in the employer.
- You own or are considered to own more than 5% of the outstanding stock (or more than 5% of the total voting power of all stock) of the employer.

**Reporting the tax.** Include on Form 1040, line 58, any tax you owe for an excess benefit. On the dotted line next to the total, write "Sec. 72(m)(5)" and write in the amount.

**Lump-sum distribution.** The amount subject to the additional tax is not eligible for the optional methods of figuring income tax on a lump-sum distribution. The optional methods are discussed under Lump-Sum Distributions in Publication 575.

**Reversion of Plan Assets**

A 20% or 50% excise tax is generally imposed on the cash and fair market value of other property an employer receives directly or indirectly from a qualified plan. If you owe this tax, report it in Part XIII of Form 5330. See the form instructions for more information.

**Notification of Significant Benefit Accrual Reduction**

For plan amendments taking effect after June 6, 2001, the employer or the plan will have to pay an excise tax if both the following occur.

- A defined benefit plan or money purchase pension plan is amended to provide for a significant reduction in the rate of future benefit accrual.
- The plan administrator fails to notify the affected individuals and the employee organizations representing them of the reduction in writing. Affected individuals are the participants and alternate payees whose rate of benefit accrual under the plan may reasonably be expected to be significantly reduced by the amendment.

A plan amendment that eliminates or significantly reduces any early retirement benefit or retirement-type subsidy significantly reduces the rate of future benefit accrual.

The notice must be written in a manner to be understood by the average plan participant and provide enough information to allow each individual to understand the effect of the plan amendment. It must be provided within a reasonable time before the amendment takes effect or September 7, 2001, whichever is later.

The tax is $100 per participant or alternate payee for each day the notice is late. It is imposed on the employer, or, in the case of a multi-employer plan, on the plan.

There are certain exceptions to, and limitations on, the tax. The tax does not apply in any of the following situations.

- The amendment takes effect after June 6, 2001, and notice was provided before April 25, 2001, to participants and beneficiaries adversely affected by the amendment (or their representatives) to notify them of the nature and effective date of the amendment.
- The person liable for the tax was unaware of the failure and exercised reasonable diligence to meet the notice requirements.
- The person liable for the tax exercised reasonable diligence to meet the notice requirements and provided the notice within 30 days starting on the date the person knew or would have known that the failure to provide notice existed.

If the person liable for the tax exercised reasonable diligence to meet the notice requirement, the tax cannot be more than $500,000 during the tax year. The tax can also be waived to the extent it would be excessive or unfair if the failure is due to reasonable cause and not to willful neglect.

**Prohibited Transactions**

Prohibited transactions are transactions between the plan and a disqualified person that are prohibited by law. (However, see Exemption, later.) If you are a disqualified person who takes part in a prohibited transaction, you must pay a tax (discussed later).

Prohibited transactions generally include the following transactions.

1. A transfer of plan income or assets to, or use of them by or for the benefit of, a disqualified person.
2. Any act of a fiduciary by which he or she deals with plan income or assets in his or her own interest.
3. The receipt of consideration by a fiduciary for his or her own account from any party dealing with the plan in a transaction that involves plan income or assets.
4. Any of the following acts between the plan and a disqualified person.
   a) Selling, exchanging, or leasing property.
   b) Lending money or extending credit.
   c) Furnishing goods, services, or facilities.

**Exemption.** Certain transactions are exempt from being treated as prohibited transactions. For example, a prohibited transaction does not take place if you are a disqualified person and receive any benefit to which you are entitled as a plan participant or beneficiary. However, the benefit must be figured and paid under the same terms as for all other participants and beneficiaries. For other transactions that are exempt, see section 4975 and the related regulations.

**Disqualified person.** You are a disqualified person if you are any of the following.

1. A fiduciary of the plan.
2. A person providing services to the plan.
3. An employer, any of whose employees are covered by the plan.
4. An employee organization, any of whose members are covered by the plan.
The initial tax on a prohibited transaction is 15% and the capital interest or profits interest of a partnership that is an employer or employee organization described in (3) or (4).

6) A member of the family of any individual described in (1), (2), (3), or (5). (A member of a family is the spouse, ancestor, lineal descendant, or any spouse of a lineal descendant.)

7) A corporation, partnership, trust, or estate of which (or in which) any direct or indirect owner described in (1) through (5) holds 50% or more of any of the following.

8) An officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10% or more shareholder, or highly compensated employee (earning 10% or more of the yearly wages of an employer) of a person described in (3), (4), (5), or (7).

9) A 10% or more (in capital or profits) partner or joint venturer of a person described in (3), (4), (5), or (7).

10) Any disqualified person, as described in (1) through (9) above, who is a disqualified person with respect to any plan to which a section 501(c)(22) trust is permitted to make payments under section 4223 of ERISA.

A plan does not cover a business that is a member of an affiliated service group, a controlled group of corporations, or a group of businesses under common control.

The plan does not cover a business that leases employees.

One-participant plan. Your plan is a one-participant plan if, as of the first day of the plan year for which the form is filed, either of the following is true.

Form 5500–EZ required. You do not have to file Form 5500–EZ (or Form 5500) if you meet the conditions mentioned above and either of the following conditions.

Example. You are a sole proprietor and your plan meets all the conditions for filing Form 5500–EZ. The total plan assets are more than $100,000. You should file Form 5500–EZ.

All one-participant plans must file Form 5500–EZ for their final plan year, even if the total plan assets have always been less than $100,000. The final plan year is the year in which distribution of all plan assets is completed.

Form 5500. If you do not meet the requirements for filing Form 5500–EZ, you must file Form 5500.

Schedule A (Form 5500).

Schedule B (Form 5500).

Schedule P (Form 5500).

The tax on prohibited transactions is imposed. For information on correcting the transaction, see Correcting a prohibited transaction, later.

Both taxes are payable by any disqualified person who participated in the transaction (other than a fiduciary acting only as such). If more than one person takes part in the transaction, each person can be jointly and severally liable for the entire tax.

Amount involved. The amount involved in a prohibited transaction is the greater of the following amounts.

- The money and fair market value of any property given.
- The money and fair market value of any property received.

If services are performed, the amount involved is any excess compensation given or received.

Taxable period. The taxable period starts on the transaction date and ends on the earliest of the following days.

- The day the IRS mails a notice of deficiency for the tax.
- The day the IRS assesses the tax.
- The day the correction of the transaction is completed.

Payment of the 15% tax. Pay the 15% tax with Form 5320.

Correcting a prohibited transaction. If you are a disqualified person who participated in a prohibited transaction, you can avoid the 100% tax by correcting the transaction as soon as possible. Correcting the transaction means undoing it as much as you can without putting the plan in a worse financial position than if you had acted under the highest fiduciary standards.

Correction period. If the prohibited transaction is not corrected during the taxable period, you usually have an additional 90 days after the day the IRS mails a notice of deficiency for the 100% tax to correct the transaction. This correction period (the taxable period plus the 90 days) can be extended if either of the following occurs.

- The IRS grants reasonable time needed to correct the transaction.
- You petition the Tax Court.

If you correct the transaction within this period, the IRS will abate, credit, or refund the 100% tax.

Reporting Requirements.

You may have to file an annual return/report form by the last day of the 7th month after the plan year ends. See the following list of forms to choose the right form for your plan.

Form 5500–EZ. You can use Form 5500–EZ if the plan meets all the following conditions.

- The plan is a one-participant plan, defined below.
- The plan meets the minimum coverage requirements of section 410(b) without being combined with any other plan you may have that covers other employees of your business.
- The plan only provides benefits for you, your spouse, or one or more partners and their spouses.

- Your plan meets all the conditions for filing Form 5500–EZ.

Chapter 4 Qualified Plans Page 19
trust described in section 401(a) or a custodial account described in section 401(f) to protect it under the statute of limitations provided in section 6501(a). The filing of a completed Schedule P (Form 5500), Annual Return of Fiduciary of Employee Benefit Trust, by the fiduciary satisfies the annual filing requirement under section 6033(a) for the trust or custodial account created as part of a qualified plan. This filing starts the running of the 3-year limitation period that applies to the trust or custodial account. For this protection, the trust or custodial account must qualify under section 401(a) and be exempt from tax under section 501(a). The fiduciary should file, under section 6033(a), a Schedule P as an attachment to Form 5500 or Form 5500—EZ for the plan year in which the trust year ends. The fiduciary cannot file Schedule P separately. See the Schedule P instructions for more information.

Form S310. If you terminate your plan and are the plan sponsor or plan administrator, you can file Form S310, Application for Determination for Terminating Plan. Your application must be accompanied by the appropriate user fee and Form 8717, User Fee for Employee Plan Determination Letter Request.

More information. For more information about reporting requirements, see the forms and instructions.

**Qualification Rules**

To qualify for the tax benefits available to qualified plans, a plan must meet certain requirements (qualification rules) of the tax law. Generally, unless you write your own plan, the financial institution that provided your plan will take the continuing responsibility for meeting qualification rules that are later changed. The following is a brief overview of important qualification rules that generally have not yet been discussed. It is not intended to be all-inclusive. See Setting Up a Qualified Plan, earlier.

Generally, the following qualification rules also apply to a SIMPLE 401(k) plan. A SIMPLE 401(k) plan is, however, not subject to the top-heavy plan rules and nondiscrimination rules if the plan satisfies the provisions discussed in chapter 3 under SIMPLE 401(k) Plan.

Plan assets must not be diverted. Your plan must make it impossible for its assets to be used for, or diverted to, purposes other than the benefit of employees and their beneficiaries. As a general rule, the assets cannot be diverted to the employer.

Minimum coverage requirement must be met. To be a qualified plan, a defined benefit plan must benefit at least the lesser of the following:

1. 50 employees.
2. The greater of:
   a) 40% of all employees, or
   b) Two employees.

If there is only one employee, the plan must benefit that employee.

**Early retirement.** Your plan can provide for payment of retirement benefits before the normal retirement age. If your plan offers an early retirement benefit, a participant who separates from service before satisfying the early retirement age requirement is entitled to that benefit if he or she meets both the following requirements.

- Satisfies the service requirement for the early retirement benefit.
- Separates from service with a nonforfeitable right to an accrued benefit. The benefit, which may be actuarially reduced, is payable when the early retirement age requirement is met.

**Survivor benefits.** Defined benefit and certain money purchase pension plans must provide automatic survivor benefits in both the following forms.

- A qualified joint and survivor annuity for a vested participant who does not die before the annuity starting date.
- A qualified pre-retirement survivor annuity for a vested participant who dies before the annuity starting date and who has a surviving spouse.

The automatic survivor benefit also applies to any participant under a profit-sharing plan unless all the following conditions are met.

- The participant does not choose benefits in the form of a life annuity.
- The plan pays the full vested account balance to the participant’s surviving spouse (or other beneficiary if the surviving spouse consents or if there is no surviving spouse) if the participant dies.
- The plan is not a direct or indirect transfer of a plan that must provide automatic survivor benefits.

**Loan secured by benefits.** If survivor benefits are required for a spouse under a plan, he or she must consent to a loan that uses as security the accrued benefits in the plan.

**Waiver of survivor benefits.** Each plan participant may be permitted to waive the joint and survivor annuity or the pre-retirement survivor annuity (or both), but only if the participant has the written consent of the spouse. The plan also must allow the participant to withdraw the waiver. The spouse’s consent must be witnessed by a plan representative or notary public.

**Waiver of 30-day waiting period before annuity starting date.** A plan may permit a participant to waive (with spousal consent) the 30-day minimum waiting period after a written explanation of the terms and conditions of a joint and survivor annuity is provided to each participant.

The waiver is allowed only if the distribution begins more than 7 days after the written explanation is provided.

**Involuntary cash-out of benefits not more than dollar limit.** A plan may provide for the immediate distribution of the participant’s bene-
5. Table and Worksheets for the Self-Employed

As discussed in chapters 2 and 4, if you are self-employed, you must use the following rate table or rate worksheet and deduction worksheet to figure your deduction for contributions you made for yourself to a SEP-IRA or qualified plan.

First, use either the rate table or rate worksheet to find your reduced contribution rate. Then complete the deduction worksheet to figure your deduction for contributions.

The table and the worksheets that follow apply only to unincorporated employers who have only one defined contribution plan, such as a profit-sharing plan. A SEP plan is treated as a profit-sharing plan.

Rate table for self-employed. If your plan’s contribution rate is a whole percentage (for example, 10%, 12%), you can use the table to find your reduced contribution rate. Otherwise, use the worksheet provided later.

First, find your plan contribution rate (the contribution rate stated in your plan) in Column A of the table. Then read across to the rate under Column B. Enter the rate from Column B in step 1 of the Deduction Worksheet for Self-Employed.
Deduction Worksheet for Self-Employed

Step 1
Enter your rate from the Rate Table for Self-Employed or Rate Worksheet for Self-Employed.

Step 2
Enter your net earnings (net profit) from line 31, Schedule C (Form 1040); line 3, Schedule C-EZ (Form 1040); line 36, Schedule F (Form 1040); or line 15a, Schedule K-1 (Form 1065).

Step 3
Enter your deduction for self-employment tax from line 27, Form 1040.

Step 4
Subtract step 3 from step 2 and enter the result.

Step 5
Multiply step 4 by step 1 and enter the result.

Step 6
Multiply $170,000 by your plan contribution rate. Enter the result, but not more than $35,000.

Step 7
Enter the lesser of step 5 or step 6.

Example. You are a sole proprietor and have employees. The terms of your plan provide that you contribute 8½% (.085) of your compensation and 8½% of your participants’ compensation. Your net profit from line 31, Schedule C (Form 1040) is $200,000. In figuring this amount, you deducted your common-law employees’ compensation of $100,000 and contributions for them of $8,500 (8½% x $100,000). Your self-employment tax deduction on line 27 of Form 1040 is $7,663. See the filled-in portions of both Schedule SE (Form 1040), Self-Employment Income, and Form 1040, later.

You figure your self-employed rate and maximum deduction for employer contributions you made for yourself as follows.

Rate Worksheet for Self-Employed

1) Plan contribution rate as a decimal (for example, 10½% = 0.105) ........ 0.085
2) Rate in line 1 plus 1 (for example, 0.105 + 1 = 1.105) ........ 1.085
3) Self-employed rate as a decimal rounded to at least 3 decimal places (line 1 + line 2) ........ 0.078

Deduction Worksheet for Self-Employed

Step 1
Enter your rate from the Rate Table for Self-Employed or Rate Worksheet for Self-Employed.

Step 2
Enter your net earnings (net profit) from line 31, Schedule C (Form 1040); line 3, Schedule C-EZ (Form 1040); line 36, Schedule F (Form 1040); or line 15a, Schedule K-1 (Form 1065) .... $200,000

Step 3
Enter your deduction for self-employment tax from line 27, Form 1040 .... 7,663

Step 4
Subtract step 3 from step 2 and enter the result .... 192,337

Step 5
Multiply step 4 by step 1 and enter the result .... 15,002

Step 6
Multiply $170,000 by your plan contribution rate. Enter the result, but not more than $35,000 .... 14,450

Step 7
Enter the lesser of step 5 or step 6. This is your maximum deductible contribution. Enter your deduction on line 29, Form 1040 .... $14,450
### Portion of Schedule SE (Form 1040)

#### Section A—Short Schedule SE. Caution: Read above to see if you can use Short Schedule SE.

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<tr>
<td><strong>1</strong></td>
<td>Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a</td>
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<td><strong>2</strong></td>
<td>Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), line 15a (other than farming); and Schedule K-1 (Form 1065-B), box 9. Ministers and members of religious orders, see page SE-1 for amounts to report on this line. See page SE-2 for other income to report.</td>
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<td><strong>3</strong></td>
<td>Combine lines 1 and 2</td>
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<td><strong>4</strong></td>
<td>Net earnings from self-employment. Multiply line 3 by 92.35% (.9235). If less than $400, do not file this schedule; you do not owe self-employment tax.</td>
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<td><strong>5</strong></td>
<td>Self-employment tax. If the amount on line 4 is:</td>
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<td>● $80,400 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 53.</td>
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<td>● More than $80,400, multiply line 4 by 2.9% (.029). Then, add $9,969.60 to the result. Enter the total here and on Form 1040, line 53.</td>
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<td><strong>6</strong></td>
<td>Deduction for one-half of self-employment tax. Multiply line 5 by 50% (.5). Enter the result here and on Form 1040, line 27</td>
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For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11358Z

### Portion of Form 1040

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<tr>
<td><strong>23</strong></td>
<td>IRA deduction (see page 27)</td>
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<tr>
<td><strong>24</strong></td>
<td>Student loan interest deduction (see page 28)</td>
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<tr>
<td><strong>25</strong></td>
<td>Archer MSA deduction. Attach Form 8853</td>
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<tr>
<td><strong>26</strong></td>
<td>Moving expenses. Attach Form 3903</td>
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<tr>
<td><strong>27</strong></td>
<td>One-half of self-employment tax. Attach Schedule SE</td>
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<tr>
<td><strong>28</strong></td>
<td>Self-employed health insurance deduction (see page 30)</td>
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<tr>
<td><strong>29</strong></td>
<td>Self-employed SEP, SIMPLE, and qualified plans</td>
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<tr>
<td><strong>30</strong></td>
<td>Penalty on early withdrawal of savings</td>
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<tr>
<td><strong>31a</strong></td>
<td>Alimony paid</td>
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<tr>
<td><strong>31b</strong></td>
<td>Recipient’s SSN</td>
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<tr>
<td><strong>32</strong></td>
<td>Add lines 23 through 31a</td>
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<tr>
<td><strong>33</strong></td>
<td>Subtract line 32 from line 22. This is your adjusted gross income</td>
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For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see page 72. Cat. No. 11300B

### How To Get Tax Help

#### 6. **How To Get Tax Help**

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

**Contacting your Taxpayer Advocate.** If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate. The Taxpayer Advocate represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate at 1–877–777–4778.
- Call the IRS at 1–800–829–1040.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call 1–800–829–4059 if you are a TTY/TDD user.

For more information, see Publication 1546, The Taxpayer Advocate Service of the IRS.

**Free tax services.** To find out what services are available, get Publication 910, Guide to Free Tax Services. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.

**Personal computer.** With your personal computer and modem, you can access the IRS on the Internet at www.irs.gov. While visiting our web site, you can:

- Find answers to questions you may have.
- Download forms and publications or search for forms and publications by topic or keyword.
- View forms that may be filled in electronically, print the completed form, and then save the form for recordkeeping.
- View Internal Revenue Bulletins published in the last few years.
- Search regulations and the Internal Revenue Code.
- Receive our electronic newsletters on hot tax issues and news.
- Get information on starting and operating a small business.

You can also reach us with your computer using File Transfer Protocol at ftp.irs.gov.

**TaxFax Service.** Using the phone attached to your fax machine, you can receive forms and instructions by calling 703–368–9694. Follow the directions from the prompts. When you order forms, enter the catalog number for the form you need. The items you request will be faxed to you.
The type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.

For help with transmission problems, call the FedWorld Help Desk at 703—487—4608.

Phone. Many services are available by phone.

- Ordering forms, instructions, and publications. Call 1—800—829—3676 to order current and prior year forms, instructions, and publications.
- Asking tax questions. Call the IRS with your tax questions at 1—800—829—1040.
- TTY/TDD equipment. If you have access to TTY/TDD equipment, call 1—800—829—4059 to ask tax questions or to order forms and publications.
- TeleTax topics. Call 1—800—829—4477 to listen to pre-recorded messages covering various tax topics.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer’s name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers’ opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Walk-in. You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county governments, credit unions, and office supply stores have an extensive collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.

Mail. You can send your order for forms, instructions, and publications to the Distribution Center nearest to you and receive a response within 10 workdays after your request is received. Find the address that applies to your part of the country.

- Western part of U.S.: Western Area Distribution Center Rancho Cordova, CA 95743—0001
- Eastern part of U.S. and foreign addresses: Eastern Area Distribution Center P.O. Box 85074 Richmond, VA 23261—5074
- Central part of U.S.: Central Area Distribution Center P.O. Box 8903 Bloomington, IL 61702—8903
- CD-ROM. You can order IRS Publications 1796, Federal Tax Products on CD-ROM, and obtain:
  - Current tax forms, instructions, and publications.
  - Prior-year tax forms and instructions.
  - Popular tax forms that may be filled in electronically, printed out for submission, and saved for recordkeeping.
  - Internal Revenue Bulletins.

The CD-ROM can be purchased from National Technical Information Service (NTIS) by calling 1—877—233—6767 or on the Internet at www.irs.gov. The first release is available in mid-December and the final release is available in late January.

IRS Publication 3207, Small Business Resource Guide, is an interactive CD-ROM that contains information important to small businesses. It is available in mid-February. You can get one free copy by calling 1—800—829—3676 or visiting the IRS Web site at www.irs.gov.
The type and rule above prints on all proofs including departmental reproduction proofs. MUST be removed before printing.

**Index**

To help us develop a more useful index, please let us know if you have ideas for index entries. See “Comments and Suggestions” in the “Introduction” for the ways you can reach us.

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<th>Annual additions ..................... 4</th>
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<td>Annual benefits .................... 4</td>
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**General Guides**
- 1 Your Rights as a Taxpayer
- 17 Your Federal Income Tax (For Individuals)
- 334 Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)
- 509 Tax Calendars for 2002
- 553 Highlights of 2001 Tax Changes
- 910 Guide to Free Tax Services

**Employer’s Guides**
- 15 Circular E, Employer’s Tax Guide
- 15-A Employer’s Supplemental Tax Guide
- 15-B Employer’s Tax Guide to Fringe Benefits
- 51 Circular A, Agricultural Employer’s Tax Guide
- 80 Circular SS, Federal Tax Guide For Employers in the U.S. Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands
- 179 Circular PR Guia Contributiva Federal Para Patrones Puertorriqueños
- 926 Household Employer’s Tax Guide

**Specialized Publications**
- 225 Farmer’s Tax Guide
- 378 Fuel Tax Credits and Refunds
- 463 Travel, Entertainment, Gift, and Car Expenses

**Commonly Used Tax Forms**

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**Spanish Language Publications**
- 1SP Derechos del Contribuyente
- 579SP Cómo Preparar la Declaración de Impuesto Federal
- 594SP Comprendiendo el Proceso de Cobro
- 850 English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
- 1544SP Reporting Cash Payments of Over $10,000 (Recibidos en una Operación o Negocio)

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