Don’t Make Retirement a “Taxing Event”

Retirement Plan Tax Benefits

RETIREMENT PLANNING:

- HELP YOUR CLIENTS WITH UP-TO-DATE INFORMATION ABOUT A VARIETY OF TAX-PREFERENCED RETIREMENT VEHICLES

RETIREMENT PLANS PROVIDE THE BEST DEAL IN TOWN FOR YOUR CLIENTS

- Tax-preference plans provide powerful incentives for employers and their employees to prepare for a comfortable retirement and enjoy current tax advantages
- Small businesses have a variety of plans to choose from

BUSINESSES HAVE A VARIETY OF PLANS TO CHOOSE FROM

- Choices involve tradeoffs between maximizing contributions and minimizing administrative complexity
- Focusing on optimizing plan design decisions for each client will help them make the best use of tax-preference plans

VARIOUS FACTORS SHOULD BE CONSIDERED IN SELECTING A RETIREMENT PLAN

- Employer's business profile, including number of employees, their age and compensation
- Industry standards: What kind of benefit package is necessary to attract and retain the best workforce?
- Owner's retirement plans: Owner's age, family and financial status, and retirement goals

A major factor for a small business in choosing a retirement plan is how much administrative complexity (and expense) a business owner is willing to take on.

YOUR CLIENTS MAY FIND THE RIGHT RETIREMENT PLAN AMONG THESE TYPES OF PLANS:

- Traditional IRAs
- Roth IRAs
- SEP IRA Plans
- SIMPLE IRA Plans
- Qualified Plans such as Profit-Sharing, 401(k)s, Money Purchase and/or Defined Benefit Plans

IRAs COME IN AVARIETY OF "FLAVORS"

- Traditional IRAs have $2,000 annual limit which may be deductible if owner is not covered by a retirement plan
- Roth IRA was new in 1998. Same $2,000 limit, but is after-tax only and earnings are not taxable on qualified distributions
- SIMPLE IRAs accept contributions only under an employer's SIMPLE IRA plan

New IRA Limits

- Traditional and Roth IRAs

• 2002 through 2004	$3,000
• 2005 through 2007	$4,000
• 2008	$5,000

Age 50 & Over?

- Additional IRA and Roth "Catch-up" Contributions

- 2002 through 2005 $500

- 2006 and after $1,000

Pension and IRA Credit

- Applies IRA contributions and elective deferrals
- AGI <\$30,000 if married filing jointly, <\$15,000 if single – 50%
- Phased out for married filing jointly > \$50,000, single > \$25,000

CONTRIBUTIONS TO TRADITIONAL IRAs

- Deduction for contribution is phased out for AGIs above indexed limits ($33,000 for single; $53,000 married filing joint for 2001).
- Phase out rules are detailed in Pub. 590
- Contributions are prohibited for those over 70 1/2

EARLY DISTRIBUTIONS FROM IRAs HAVE SPECIAL RULES

- Extra 10% tax applies to distributions before age 59 1/2, with special exemptions for IRAs
- Extra tax doesn't apply to a distribution up to $10,000 for a first time home purchase or for higher education expenses (with no $ cap)

IRA INVESTMENTS CAN BE VARIED

- Stocks, bonds, partnerships, certain coins and precious metals are ok (trustee may limit these)
- Collectibles (art, antiques, gems, alcoholic beverages) are not acceptable
- No life insurance may be held by IRA
- No loans from or to IRA

ROTH IRAs HAVE SPECIAL RULES

- Like traditional IRAs, with a few special rules
- All contributions are after-tax funds (no deductible contributions permitted)
- Contributions are phased out above $95,000 AGI for single filers and $150,000 for married filing jointly
- Contributions <u>may</u> be made after age 70 1/2

MORE ROTH IRA RULES

- No required minimum distributions while the owner is alive
- Qualified distributions are NOT included in gross income

QUALIFED DISTRIBUTIONS FROM ROTH IRAs

- Must have had Roth IRA for 5 years and distribution is made after age 59 1/2, on account of owner’s disability or death or one that is for a first-time home purchase

CONVERSION CONTRIBUTIONS TO ROTH IRAs

- Roth IRAs may accept funds in two ways:
  - **$2,000 annual after-tax regular contribution and**
  - **Conversion of Traditional or SIMPLE IRA funds (in any amount)**

CONVERSION RULES FOR ROTH IRAs

- AGI must not exceed $100,000 in the year of conversion (married <u>or</u> single)
- Married filing separately may not convert unless spouses have lived apart for the entire year of conversion
- All amounts converted that haven't already been taxed are included in income in the year of conversion (1998 was only year allowing 4-year spread of conversion tax)

SIMPLE IRA PLANS ARE DESIGNED FOR SMALL BUSINESSES

- Employer must have had no more than 100 employees who earned $5,000 or more for the preceding year
- Employer must cover every employee who received at least $5,000 compensation in any 2 preceding years and is expected to earn at least $5,000 in the current year

EMPLOYERS MAKE CONTRIBUTIONS TO SIMPLE IRAs

- Contributions are all made to SIMPLE IRAs established for participants
- Employees may make salary reduction contributions (up to $6,500 for 2001) which may be up to 100% of compensation
- Employer must make a contribution, either a 2% non-elective contribution or an employer matching contribution of 3%

MORE SIMPLE IRA CONTRIBUTION LIMITS

- Instead of matching contributions, an employer may make non-elective contributions (not contingent on an employee's salary deferral contributions)
- Employer non-elective contributions must equal 2% of each employee's compensation

SIMPLE IRAs ARE A POPULAR NEW RETIREMENT OPTION

- SIMPLE IRAs can only accept contributions from the employer's SIMPLE IRA plan or rollover from another SIMPLE IRA

SIMPLE IRA DISTRIBUTIONS ARE LIMITED

- Distributions may not be made within 2 years of establishment without an additional tax of 25 percent being added to the distribution
- Within that 2-year period, SIMPLE IRA assets may not be rolled over into a Traditional or Roth IRA

SIMPLE IRA CONTRIBUTION LIMITS

- **With compensation of $170,000 SIMPLE IRA contributions could be as high as $11,600 for an individual employee**
  - **2001 Salary deferral contribution $6,500**
  - **2001 Employer match <u>5,100</u>**
  - **$11,600**
  - **(Employer match can’t exceed 3 percent of compensation)**
  -

EGTERRA Increased SIMPLE Limit on Salary Reductions

• 2002	$7,000
• 2003	$8,000
• 2004	$9,000
• 2005	$10,000

**Increased in $500 increments thereafter*

THERE ARE A WIDE VARIETY OF QUALIFIED PLANS APPROPRIATE FOR SMALL BUSINESSES

- **Profit-sharing plans may be less complex to administer**
- **401(k) plans are a kind of profit-sharing plan. Trade off employees' ability to make salary reduction contributions with extra administrative complexity**
- **Money purchase plans have higher contribution limits but have fixed employer contribution requirements**
- **Defined benefit plans have highest potential contribution limits but greatest administrative complexity, and have minimum funding requirements**

EGTERRA Changes

- DB Dollar Limit $160,000
- DC Annual Limit $40,000

- Profit-sharing and money purchase deductible limits equalized at 25%

- Catch up for age 50+

Master & Prototype or Volume Submitter Plans may provide cost-effective qualified plan documents for your clients

- Plan documents with language already approved by the IRS
- Some don’t need additional determination letters from IRS on plan language
- Others may use streamlined, less expensive determination letter process to obtain assurance that language of plans meets Code requirements

KEEPING M&P OR VOLUME SUBMITTER PLAN DOCUMENTS AMENDED TO REFLECT LAW CHANGES IS AN IMPORTANT STEP

- **Discuss this aspect of plan sponsorship with a tax professional with retirement benefits expertise**
- **Most small businesses can use these plan documents to provide benefits tailored to their business needs**

NEW DEVELOPMENTS:

MINIMUM DISTRIBUTIONS ARE EASIER TO COMPUTE UNDER NEW PROPOSED REGULATIONS

MINIMUM DISTRIBUTION RULES HAVE BEEN SIMPLIFIED

- There are simplified new rules for computing required minimum distributions from qualified plans, all kinds of IRA’s, and 403(b) tax sheltered annuities.
- Check our web site for help computing these distribution amounts

The new proposed regulations simplify the rules by: Providing a simple, uniform table that all employees can use to determine the minimum distribution required during their lifetime. This makes it far easier to calculate the required minimum distribution because employees would:

1. no longer need to <u>determine their beneficiary</u> by their required beginning date,

2. no longer need to decide whether or not to <u>recalculate their life expectancy each year</u> in determining required minimum distributions, and

3. no longer need to satisfy a separate <u>incidental death benefit</u> rule.

The new minimum distribution regulations:

Permit the required minimum distribution during the employee's lifetime to be calculated without regard to the beneficiary's age (except when required distributions can be reduced by taking into account the age of a beneficiary who is a spouse more than 10 years younger than the employee).

The Required Beginning Date (RBD) with respect to plan participants and 403(b) annuitants is the later of:

- **the April 1 following the calendar year in which an employee attains age 70 1/2**

or, if not a 5% owner,

- **the April 1 following the calendar year in which the employee retires after age 70 1/2**

The <u>Required Beginning Date (RBD)</u> with respect to all IRA's, except Roth IRA, is always April 1 following the calendar year in which an IRA holder attains age 70 1/2.

If the employee dies before reaching his Required Beginning Date, then the entire interest must either:

- **be paid by the end of the calendar year containing the fifth anniversary of the employee's death ("the 5-year method")**

or

- **be paid evenly over the remaining life expectancy of the designated beneficiary, starting in the calendar year following the year of the employee's death ("the beneficiary's life expectancy method")**

The new guidance contains a new default provision: if the Plan document is silent, then the distributions will follow the beneficiary's life expectancy method if the employee has named a beneficiary or the 5-year method if the employee has not named a beneficiary.

The Plan, however, may set its own default provision and the Plan does not need to have the same method of distribution for all employees.

Additionally, the Plan may allow the employee to choose either the 5-year method or the beneficiary's life expectancy method.

The rules for determining the required minimum distribution (RMD) for individual accounts have been simplified.

The RMD for any distribution calendar year equals the account balance as of the last valuation date in the preceding year divided by the Applicable Distribution Period , which is found in a table contained in the regulations (the old MDIB table from the 1987 regulations).

If the spouse is the sole beneficiary and is at least 11 years younger than the IRA holder or plan participant, then the divisor can be the greater of the Applicable Distribution Period or the joint life expectancy of the employee and the spouse. After the employee dies, the divisor becomes the beneficiary's life expectancy factor (which is determined in the year after death, based on the tables in section 1.72-9, and is then reduced by 1.0 in each successive distribution calendar year).

In determining the RMD, the full account balance is taken into account, even if part of the account is not vested.

EXAMPLE: A person turning 75 in 2001 with $100,000 in an IRA at the end of 2000 would divide $100,000 by 21.8

The minimum required withdrawal in 2001 is $4,587.16

Account Balance → $$\frac{\$100{,}000}{21.8} = \$4{,}587.16$$
Divisor →

AGE	DIVISOR	AGE	DIVISOR	AGE	DIVISOR
70	26.2	77	20.1	84	14.6
71	26.3	78	19.2	85	13.8
72	24.4	79	18.4	86	13.1
73	23.5	80	17.6	87	12.4
74	22.7	81	16.8	88	11.8
75	21.8	82	16.0	89	11.1
76	20.9	83	15.3	90	10.5

The Treasury Department and the IRS are making the <u>model amendment set forth in the next frame</u> available to plan sponsors to permit them to apply these proposed regulations in the operation of their plans without violating the requirement that a plan be operated in accordance with its terms. Plan sponsors who adopt the model amendment no later than the end of the remedial amendment period (RAP) applicable to the SPJPA, GATT, etc. will have reliance that, during the term of the amendment, operation of their plans in a manner that satisfies the minimum distribution requirements in these proposed regulations will not cause their plans to fail to be qualified.

"With respect to distributions under the Plan made for calendar years beginning on or after January 1, 2001, (ALTERNATIVELY, SPECIFY A LATER CALENDAR YEAR FOR WHICH THE AMENDMENT IS TO BE INITIALLY EFFECTIVE), the Plan will apply the minimum distribution requirements of section 401(a)(9) of the Internal Revenue Code in accordance with the regulations under section 401(a)(9) that were proposed in January 2001, notwithstanding any provision of the Plan to the contrary. This amendment shall continue in effect until the end of the last calendar year beginning before the effective date of final regulations under section 401(a)(9) or such other date as may be specified in guidance published by the Internal Revenue Service."

Amendment of IRAs and Effective Date

These regulations are proposed to be effective for distributions for calendar years beginning on or after January 1, 2002. For distributions for the 2001 calendar year, IRA owners are permitted, but not required, to follow these proposed regulations in operation, notwithstanding the terms of the IRA documents. IRA owners may therefore rely on these proposed regulations for distributions for the 2001 calendar year.

However, IRA sponsors should not amend their IRA documents to conform their IRAs to the changes in these proposed regulations before the publication of final regulations. The IRS will not issue model IRAs on the basis of the changes in these proposed regulations until the publication of final regulations.

For more information on these and other retirement issues (and to subscribe to our free quarterly on-line newsletter, Employee Plans News) visit our website at:

http.www.irs.gov/ep

CONTACT IRS WITH PENSION QUESTIONS THROUGH SEVERAL AVENUES

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