Retirement... Individual and Employer Sponsored Plans

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Retirement... Individual & Employer Sponsored Plans
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Saving & Retirement Introduction

Overview and Objectives

This section was designed, constructed and written to provide you with important information in the area of individual saving and retirement.

Each Chapter “Objectives” heading will further define the specific objectives to be covered and benefit derived from that specific Chapter.

Besides the goal of acquiring additional credits toward continuing education requirements, it is our hope that our students will acquire a new level of competency and insight into this highly critical area of people’s financial future...saving and accumulating dollars for use in the future.

We explore in this section Retirement Savings and Retirement Fundamentals as they are the most critical needs that people plan and save for. Yet, both of these objectives and needs compete for a limited amount of money available in most situations.

Yet, some things are fundamental and seldom, if ever, change. Accumulating funds for the future depends on money, time, a vehicle, and consistency. With so many places to save or invest in, the real key is to start putting aside something so that something is available down the road. The more put away today, the more it grows to. The higher yield or growth each dollar earns makes it compound faster and greater. The fewer taxes we pay when we put it away, as it grows, and when we take it out allows for each dollar to work harder and provide for more of its intended usage. And, to the extent we have planned ahead for certain amounts to be available at specific times in the future, the more motivated we are to put aside on a regular basis an amount that will grow to what is needed in the future (consistency).

This section is comprised of 2 chapters to enhance your understanding and thus your value to clients armed with information regarding Savings and Retirement as well as Retirement and Planning.

Whether you are a newer agent, planner, or a veteran, we’re confident that you will gain new insight into this critical area for Americans as well as brush up on current info and insight pertinent to this area of your expertise.
Chapter 1 Objectives

Upon completion of this section, you will:

- Gain increased awareness of key facts about retirement savings and fundamentals.
- Learn about basics retirement precepts, options, and the effects on money at retirement.

Chapter One: Our Savings & Retirement Environment

Some Facts Regarding Saving for Retirement

Many individuals needlessly struggle before and after retirement. Many never attain their other financial goals simply because they were never exposed to the financial facts of life. “They didn’t plan to fail, but rather failed to plan” as the age-old phrase goes. Some suffer financial upset and losses because they do not realize or want to accept the fact that our financial markets can go down as well as up. Many are not aware of or do not heed the timeless fundamentals like “Don’t put all your eggs in one basket” and “Buy low, sell high.”

Frequently, government agencies, consumer organizations, and financial industry groups get together and share information on a lot of key areas that are important to be aware of as we look to the future in helping a larger number of citizens to get ready financially for retiring. The things they look at and what they find go a long way in giving us valuable insight and information in the key areas for making sure we are informed and current as advisors and teachers for our clients and prospects.

Being well grounded in the financial fundamentals makes a big difference in the quality of life for all of us. It also makes a big difference in the quality and overall financial health of our Nation, as well. In the United States, numerous studies and surveys show that many Americans—especially young adults—fail to be up to speed on the financial basics. Many do not understand how our securities markets work, how to evaluate the risks and rewards of investment products, and how to calculate what they need to save for retirement.

Low Financial IQ’s Overall

An informed and knowledgeable prospect or existing client is the best kind. They play a more active role in the process of providing solutions to their needs. They are more
capable of making decisions from the alternatives that we provide for them. “Knowledge is power” is what we have heard repeatedly over time.

More Americans than ever before are investing in the securities markets. They are buying more stocks, bonds, and mutual funds than ever before. Numerous studies show, however, at the same time many lack the financial basics to make sound judgments in this arena. They need to learn more about what questions to ask before investing, how to evaluate financial products and professionals, and how to protect themselves in the marketplace.

A well-educated investor provides the best defense—and offense—against those who would take advantage of their lack of knowledge. They also need to learn the basics, mechanics, and benefits of financial planning. Few have developed financial plans to save for their important financial goals, such as retirement or their children’s education. Yet those who do develop a plan, regardless of income level, consistently save more.

Here are some interesting facts that will give you a better sense and talking knowledge of the state of affairs in relation to your marketplace’s Financial IQ:

- Only 5 percent of investors believe they know “everything” they need to know to make good investment decisions.

- Two out of three households in America estimated 65 million households, will probably fail to realize one or more of their major life goals because they’ve failed to develop a comprehensive financial plan.

- More than half, 55 percent, of all current workers have never even tried to figure out how much they need to save and accumulate for retirement.

- An alarming number of high school students (66 percent) flunked a basic economic literacy test. Among adults taking the same test, only one-third achieved a score of C or better, and nearly half (49 percent) failed.

These facts represent a tremendous opportunity for you to see to it that your clients and your prospects are armed with the information they need to make sound financial decisions, protect their hard-earned savings, and have enough to retire when they want to, not when they have to.

**It’s a New World Out There**

One thing we have all witnessed, experienced, and are reminded of constantly are the far reaching global changes that have occurred in the last few decades. The world has become smaller and has been transformed on almost every front. Governments and national boundaries have come and gone.
The tremendous advances and progress in technology allow us to routinely communicate with the farthest corners of the earth in a matter of seconds. Markets across the globe have an influence on and impact every market worldwide. In addition to governments and economic markets being affected, these global changes also have an influence on the financial realities for all of us on an individual level.

The widespread availability of credit cards and automated teller machines makes spending much easier today than in days gone by. And the expansion and availability of “at home” and “on line” banking and investing services allows us to act more quickly than ever before when making financial decisions. Sometimes this ease of access allows us to act more impulsively, as well.

These changes have an effect on virtually everyone in the United States, from our youngest workers and students to our eldest retirees. Most young people in America begin their financial lives unschooled in the basics of saving and investing. They find out quickly and frequently are unaware of how quickly “easy credit” can add up to big debt.

To get a sense for the challenges that face our younger citizens, their approach to spending money, and a preview of how they are developing their capacity for potentially making financial decisions in the future can be dramatized by the following statistic:

“Forty percent of students are likely to buy a pair of jeans (or something similar) they really want even if they do not have the money to pay for it. And 22 percent would pay for it with a credit card.”

And, so that we do not only think that the young face a wake-up call for their future financial stability and success, the following goes for the not so young adults as well:

“Most adults have high expectations for retirement. Many will fail to maintain the lifestyle and standard of living to which they have become accustomed because they failed to plan and save. More than half of American workers—55 percent—have no idea how much they will need to put aside on a regular basis to make their retirement dreams a reality.”

**If It Is to Be...It’s Up to Me**

Planning and putting aside money for retirement as well as for other financial needs has changed. In the past, most people relied on the government through Social Security and Medicare in addition to their employer’s pension plan to provide the needed funds and benefits when they found themselves at retirement age. These are often regarded as
“external” sources of financial support that were counted on to come to the rescue when a worker aged to retirement status.

Today, however, responsibility for one’s financial and retirement future has shifted to “me”…the individual. Many American workers no longer expect Social Security to be their major source of retirement income. Consider the following in light of this change in thinking:

One study suggests that 55% of current workers expect personal savings through a retirement plan at work to be a major source of retirement income and 39% expect other personal saving to be a major source. By contrast, only 12% believe that Social Security would be their most important source of retirement income, while 22% did not expect it to be an income source at all.”

The Longer We Wait, the More Money It Takes

Most Americans now find themselves in a precarious and challenging position, possibly facing an underfunded retirement unless they start saving and investing more now. They are generally not equipped to handle this important new “me” focused responsibility and lack critical money management and investment skills.

The Rule of 72 mathematically shows us how long it takes for money to double at certain interest rates. Divide 72 by the interest or growth rate you want to assume ie 4, 5 or 10 and this will tell you how many years it will take for a given amount put aside one time will take to double. At 4% it will take (72 ÷ 4=18) 18 years for $1 to grow to $2…and at 6% it will take 12 years to double to $2, and @ 10% it would take 7.2 years to double to $2.

Younger income earners have the advantage of “time” and “compounding” and can put smaller amounts away over a longer period of time to develop a sizable fund. Older adults who have less time to build their nest egg face the double challenge of putting aside much larger amounts out of current income and having less of the advantage of accumulation power through “time” and “compounding”.

The Longer We Live, the More Money It Takes

Americans are living longer. With advances in research, science and medical care, life expectancy for Americans is generally on the rise. It can be said that the longer we live, the longer we live. (see the life expectancy table in the back). Retirees at 65 can expect to live twenty years or more in retirement. With the continuing rapid medical and scientific developments, we see today, this trend is likely to continue into the future. To illustrate this, we saw in 1998 that there were 40,000 people who were 100 years old or older. Experts predict that by 2050 nearly one million people will live to be 100. This is a result of our increased longevity and clear signs of progress.
Longer life adds years to the time we will spend in the retirement phase of our lives and will create the need for greater financial planning focus, increased availability of funds, and more sources of adequate income to provide the financial capacity to enjoy this additional slice of life. While most look forward to the leisure and travel associated with retirement, it can be a time of deteriorating health as well. Insurance and other medical safety nets will often cover a portion of these health costs. But in many cases, the remainder can only be defrayed by the retiree’s personal resources.

Many Americans are finding that they are closing in on their retirement age and looking back to what they have done or should have done to prepare better for it. The following research findings statement brings home this condition quite simply:

“Nearly half of all Americans in their 50s or early 60s (49 percent) believe strongly that they should have begun to save for retirement much earlier than they did. When asked to identify the ideal time to start retirement planning, the "group picked age 22 . . . eight years earlier than they themselves began to plan.”

**Heading for a Train Wreck?**

If starting earlier in life to plan, prepare, and put aside funds to be ready to retire is what most see as the way to do it with foresight, the realities of youth do not seem to be in sync with what others have learned in hindsight. Let’s look at some interesting facts that look at the financial world of younger Americans.

According to research a few years back, teenagers in the United States have become a formidable economic force. In recent years, teenagers 12 to 19 years old spent in the area of $94 billion of their own money including money earned or received from allowances, gifts, or employment, compared with $84 billion in the prior year. In addition, teens also influence the spending of additional family spending on their behalf of an additional $47 billion. That’s a total of $141 billion!

Even though they are a huge economic factor, teens generally have few, if any skills to manage their money wisely. A recent poll of 14 to 16-year-olds revealed that:

“53 percent received little to no financial advice from their parents.” According to a recent survey of 13 to 21-year olds, only 26 percent reported that their parents actively taught them how to manage money. A 2009 poll of young people ages 9 to 17 found that 59 percent worry about not having enough money, compared with 65 percent who worry about not doing well in school and 52 percent who worry about getting cancer.”

Younger Americans are also taking on more and more of the responsibility for their own college expenses. They are shouldering more debt than ever before earlier in life.
The average college student who takes out student loans graduates with a loan debt of $20,000 or more.

In addition, “Sixty-four percent of college students have a credit card in their name, and 20 percent have four or more cards.” Information gathered on young adults ages 16 to 22, shows that students not only use credit card frequently, but they also do not pay them off each month. “28 percent of students with a credit card roll over debt each month.” And a the average college student with a credit card who is responsible for paying his or her charges has an unpaid balance of nearly $1000. A further disturbing fact is the revelation that of all individuals who file for personal bankruptcy protection, 8.7 percent of these bankruptcy filings are for young adults ages 18 to 25 years old.

**My Company Pension Will Take Care of Me**

In the distant past, many workers started their jobs with a company and retired with that same company. For a long time, this has not been the case, but many have acted like this was what would happen to them. This has not happened. In most industries and across all job sectors benefits have declined, Workers have increasingly come to realize that they will need to save for themselves to have economic security for retirement. In reality the “security blanket” of a lifetime job was never available for most.

In the late 90’s only twenty eight percent of workers ages 55 and older had been on their job 20 years or more. This means that a large majority of workers change jobs more frequently and do not have the time and tenure with one company to maximize the company's retirement plans. In addition, in the past:

“Only about one-quarter of workers participated in “defined benefit” plans. These are pension plans that provided lifetime monthly annuities payments commencing at retirement. While few had access to these and the benefits from them, many Americans were under the false impression and acted like all had this benefit.”

As an alternative approach to providing a measure of financial security at retirement, employers today try to fill the void for their employees need to establish retirement funds by providing and offering “defined contribution” plans, such as 401(k) plans, rather than defined benefit plans. With defined contribution plans, employees often have the option to decide among different investments and bear the entire risk and reward of their investment decisions.

The need for, increased participation in, and continuing growth in popularity of such individual plans requires that American workers have a better handle on planning and learn the basics of investing. They must also become disciplined about making regular contributions to their plan.
At the same time, it needs to be noted that not every worker enjoys the benefits of nor the availability of employer sponsored plans. They must plan for and arrange their retirement funding through individual sources, both government sponsored and those vehicles available in the private sector. In order to assist you in becoming more familiar with tools to help your clients and prospects who fall into this latter category with no pension plan available to them at their place of employment, this course focuses on the most popular and widely used arrangements, the traditional IRA and the Roth IRA.

To gain a wider understanding of the size of the marketplace that has a need for preparing individually for their future retirement years consider the following statistics from the Department of Labor which shows that “slightly less than half of America’s wage-earning and salaried workers are covered by some type of pension plan. In addition, of the approximately 120.4 million American workers, about 60.4 million public and private sector workers have no pension plans.”

More Americans are working for smaller companies and these companies are less likely to have pension plans, or even voluntary retirement plans. A study several years ago showed that only half of all workers in businesses with 25 to 99 workers had the option of an employer-sponsored retirement plan. And further, it revealed that in businesses with fewer than 25 employees, only one-fifth had access to such plans.

Contrast this with the fact that at the same time, at businesses with 100 or more employees, 85 percent of workers could take advantage of an employer-sponsored plan frequently. In addition, it is important to note that 15% of full-time and part-time workers, even if they are working with larger companies are less likely to have adequate retirement savings because they leave before being vested or before they can accumulate significant amounts in retirement plans.

It has been found that even when frequent job-changers stay in a job long enough for retirement benefits to vest, many of them with smaller retirement accounts request a lump sum payment when they quit or leave for other employment opportunities. They do this instead of transferring their accumulated benefits to a new retirement savings plan being offered at their new place of employment. Income needed during their transition to their new position or spending on things needed or wanted in the shorter term are the most frequent uses of the funds previously earmarked for developing their retirement fund.

Those with larger accounts at termination of employment typically transfer them over to a new plan with their new employer. Three quarters of the total dollars have been tracked and found to be “rolled over” according to studies performed in this area. On the flip side, however, most distributions, an estimated 60 percent of the number of the accounts, result in a cash-out rather than a rollover.
It appears that the lack of preservation of small accounts indicates that many workers do not realize what these dollars could translate into at retirement if saved. Too many Americans evidently don’t know how to manage their retirement funds or don’t realize the consequences such as tax liabilities and other penalties of failing to do so.

**Whoops, Where Did It Go?**

Many people think in general that they will be able to retire financially set when the time comes. This is usually when there is not a time crunch looming over them and most feel that they can make up for lost time when they get ready to be serious and take action to start putting aside funds for retirement. They say that they will be able to start when the next promotion or the next raise comes.

However, time has a way of zooming past as we all know and frequently additional expenses and purchases coincide with promotions and pay raises. Sound familiar? As time goes by, and as funds are not put away, and as more toys are accumulated in the home and in the garage the stark reality begins to set in that something has to be done to get moving on the retirement dream.

A study performed in the late 90’s found that 51 percent of workers anticipated that personal savings would serve as their “most important” source of income in retirement. But, a year later that statistic dropped sharply to only 39 percent. It was suggested that as these people began to seriously look at their retirement, they realized that their plan was not adequate, that the number of years to retirement was shrinking, and their current savings levels were far short of what would be needed to retire adequately down the road.

As more people focus on retirement, determine what they will need, and consider what they have already put aside, their confidence in their ability to save enough for retirement decreases. It has been found that only 25 percent of workers are very confident that they are doing a good job of preparing financially for retirement compared with higher percent in previous years. While this indicates that American’s confidence in their ability or willingness to do what is necessary to retire well is waning, it was also found that they are more focused than ever before on their retirement and planning for it.

To give you a better perspective on who plans and who does not, consider the following. These facts represent a large opportunity for you to make people aware of your capacity to assist them in the planning process. Most times, those who help others to find direction and methods for having what they want and need eventually are looked for to also provide funding vehicles for putting their money away.

“Approximately half of all working Americans have attempted to calculate how much they’ll need to save for retirement, Nevertheless, almost 60 percent of women and 51
percent of men have not yet tried to figure out how much they need to save for retirement.”

It is also interesting and valuable for us to know that the so called Generation X members (those generally those born from 1964 to 1980) are more confident than the members of any other generation about their retirement prospects. One in three is “very confident” they’ll have enough money for a comfortable retirement, compared with 18 percent of older Baby Boomers and 22 percent of younger Baby Boomers.

It has even been estimated by some experts that 55 to 64 percent of Generation X have already begun to save for retirement. This may not be as surprising as we might think as the prevalence of 401(k) in the workplace is far more widespread than ever before. They also have greater reservations and doubts about the availability of Social Security and its value to them at their retirement as a source of retirement income

Women, Minorities, and Ethnics

They are less likely than men to have begun planning and saving for retirement. For women, it is reported that over 40% have not yet begun to save for retirement, compared with 32 percent of men. Most women do not know how to plan adequately for retirement. Only a very small percent of women considers themselves as knowing “a great deal” about retirement planning.

In fact, almost half of all women including African American and Hispanic women fear that they will live at or near the poverty level because they cannot adequately save for retirement. Well over half of women expect to have to work beyond and during retirement to provide enough money to support themselves.

Overall ethnic Americans have not yet begun to save for retirement as illustrated by the following: Hispanic-Americans 62%, African-Americans 52%, Asian-American 36%, White 33%

Social Security and Medicare

The “Average” retiree in America today receives about 40% of their pre-retirement income when they retire. That’s a 60% pay cut! If a person couldn’t afford this pay cut the day before they retired, how can they afford it the day they retire? The answer will be different from whomever you talk to. And what’s worse is the fact that workers that earned more than the “average” find that their income from Social Security is well below the 40% mentioned above. Their pay cut is, therefore, greater than 60%.

In addition, the confidence level among future retirees is down when they regard the viability of Social Security and MediCare as a safety net for them to count on to any significant degree. More than two thirds of Americans believe that neither Social
Security nor Medicare will continue to provide benefits equivalent to the benefits received by retirees today. It may be startling for you to learn that over two thirds of retirees today rely almost totally on Social Security. This may be for many because they did not know they needed to save. But, it may well be that they did not have the money to put aside, or they did, but for a whole host of reasons did not plan and did not put aside funds based on the plan.

Social Security should certainly be acknowledged and calculated in the retirement planning, but is should be considered as a piece of the overall puzzle to be looked at during the process. Kenneth Apfel, former Commissioner of Social Security, testified before the Senate Committee on Aging, that Americans need to understand that “Social Security was never intended to provide for all of a worker's retirement income needs. Pensions and personal savings have always been and should always be part of a sound financial retirement plan.”

It is also beneficial to be aware of the confidence levels of different groups of people both past and present. Forty two percent of current retirees say Social Security is their most important source of retirement income. Twenty two percent cite money from an employer-funded plan as their most important source. And, nineteen percent say that their personal savings is their most important source.

Most importantly to be aware of is that today only about 13 percent of current workers believe that Social Security will be their most important source. The 87% represents a significant number of people who need your help in finding their way through the challenges of determining what their personal gap in income will be and how to go about helping them fill in the gap.

**A Penny Saved is a Penny Earned and Vice Versa**

Would you believe first that the saving rate of Americans in 1997 was 2.1%? That’s the rate of what Americans put aside out of every dollar of their income after taxes. Would you also believe that the rate dropped to .05% one year later? It’s true. In fact, during that year it actually dipped below 0% in September. This was the first time since the 1930’s that this rate fell below 0%. Overall spending, not savings, grew robustly during the same period which might explain for some of the drop from an already low number. Others have said that capital gains from an increase in investing instead of saving would account for some of the drop as well. Capital gains growth is not calculated in the savings rate. Regardless, the amount being set aside is dropping from levels that are not very high to begin with.

For a $30,000 net income, a 2% saving rate would result in a $600 savings amount. At $60,000 net income at 2%, this amount would be $1,200 and so forth. Using the Rule of 72 at 5% interest rate the $600 put aside would grow to $1,200 in 14+ years...double that for the $1,200 saver.
The point is that funds for the future are relatively small when 2% or lower amounts of net income are set aside at smaller interest rates. In the early 2000s the rates on saving accounts were in the 1.5 to 2.5% rate area depending on how much was being put away lump sum. During that point where the savings rate was –0.2%, it was better understood by thinking of it as $100.20 was being spent for every dollar earned net of taxes. This is obviously not going to get very many people to the level they want to be for retirement…is it?

Others at the same time are not concerned with these low rates of savings as they rationalize that at the same time, those investing in the securities markets were earning more through capital gains in their investments and moving forward financially. Because the personal saving rate doesn’t account for capital gains, some economists argue that its decline is not cause for alarm. The boom in the stock market significantly increased the overall wealth of many U.S. households.

The consequences of declining saving rates and increased borrowing has proved troubling, particularly in the presence of the downturn. In a recession, increased corporate debt service burdens put additional pressure on profits, which, in turn, lower stock prices. As unemployment rises, high levels of household debt will require that more savings be drawn down to make payments, increasing the downward pressure on asset prices. We know also, however, that the market will go up and it will go down. Hopefully those with most of their money invested will need it when the market is up.

It is also interesting to note that although the personal saving rate is low, total saving in the U.S. economy is not. The U.S. national saving rate, which unlike the personal saving rate, includes business and government saving during the same time as 17.3 percent, a little higher than the average rate for the past two decades. This is an important part of the discussion for you to have with those you come into contact.

Less Time, Lower Rates and More Risk

Generations ago, Americans routinely put their money in savings accounts and generally did not consider alternative savings and investing mechanisms. If they thought about or discussed it at all, Americans viewed the stock market as a pastime of rich. They saw it as “playing” the market or an elite version of playing the lottery. Today, however, there is little “play” involved as investing in the market is serious business. And for some it is a necessity for accumulating the funds essential for retirement or other financial goals. Now, more than ever before, Americans of all income levels are investing in the securities markets, both directly through the purchase and sale of stocks and bonds and indirectly through investment in mutual funds:

The percentage of families having direct or indirect stock ownership has increased dramatically from 32% in 1989 to well over 40% in the late 90’s and estimates now are
that one half have direct ownership at one level or another if all areas of investing are included as we begin march forward in time.

### Year Percentage of Households

Americans today have more of their money in the stock market than ever before. Estimates put the total in excess of $11 Trillion, which is one quarter of all U.S. household assets. And it appears that it doesn’t matter what household income is. Twenty five percent of households earning less than $25,000 owned securities, either directly or through 401(k)s, IRAs, or other retirement accounts. Sixty percent of those earning between $50,000 and $99,000 own securities, as did eighty four percent of those earning more than $100,000.

### Shifting Gears …Varoom!

At the same time, it was noted that there was a dramatic shift from traditional bank products to securities. Liquid assets in the late 90’s held in bank deposits were double of those same holdings back in 1975. In 1975 securities accounted for 45 percent of households’ liquid financial assets with 29 percent in stocks, 14 percent in bonds, and 2 percent in mutual funds. In the last few years, securities accounted for 77 percent of households’ liquid financial assets with 44 percent in stocks, 17 percent in mutual funds, and 16 percent in bonds and money market funds.

This certainly points to and strongly suggests that more Americans are willing to take more risks in their pursuit of accumulating funds for the future. Or, they realize more and more that it is the only way to even have a chance to have their dollars that they set aside grow to what they need in a short period of time. With the age for getting started seriously in building the retirement nest egg increasing into the early 50s, they have left less of a window of opportunity for themselves to develop enough funds to be able to retire.

While income levels do not necessarily keep anyone from investing in mutual funds, the higher incomes still out invest all other groups in the percentage of their net incomes that they put aside in these popular investments

### Saving Is Hard

The idea that one must save to have the financial resources necessary for retirement seems so simple. But saving is often given a low priority or overlooked altogether. And many individuals who do attempt to plan for their future retirement needs find that their savings fall far short of the minimum necessary. The reasons for this shortfall vary.
There are so many other things that distract, prevent, and otherwise put planning and taking action on getting things put together for retirement on the back burner. Retirement is not a priority for most people. They feel too overwhelmed by daily concerns like monthly bills, work, healthcare costs to give much attention to retirement. In addition, most Americans simply do not earn enough. About one-third of Americans are convinced that they cannot save more for their retirement because they do not have the money to do so.

Knowledge and a clear-cut plan for what is needed for retirement is a key essential to getting there. Many Americans lack knowledge. Over two thirds of Americans do not know how much money they need for retirement and a third of them substantially underestimate the percentage of their yearly income they will need in retirement.

“Keeping up with the Joneses” is a full-time job and requires spending as much as the Joneses spend. But, the Joneses are not finding much left over to put away for retirement either because of the luxuries and non-essentials price tags. This is a significant detractor for the middle class in their efforts to prepare in advance enough to have a retirement that will allow them to live in a manner that they have grown accustomed to. Some Americans are clearly struggling to make ends meet, and have extreme difficulty saving money for any purpose, including retirement.

But even more comfortable middle-class Americans strongly resist cutting back on luxuries or nonessentials to save for their retirement. About two-thirds of them say they could cut back on their spending by eating out less often to save more for retirement. But of those, only 1 out of 5 say they are very likely to actually cut back.

Not everything is cut and dried and a matter of words, plans and numbers. We are human beings and are governed by basic personality signatures like being Planners, Strugglers, Deniers, and Impulsives. About 25% of Americans fit into each category. The “Planners” are in control of their financial affairs. “Strugglers” clearly have trouble keeping their heads above rough financial waters. “Deniers” are almost deliberate in their refusal to deal with retirement. “Impulsives” are driven to seek immediate gratification—spending today and letting tomorrow take care of itself.

There is also the ‘fear factor’ that comes into play with many people and their approach to accumulating for the future. Lots of people seem so concerned with avoiding investment disasters that they make do with overly conservative investments. Much of the public is intimidated by the stock market and frightened of its volatility. So, they are captive to typically lower fixed rates of return and are more subject to less growth in the time and compounding equation that cramps substantial funds development, especially if a shorter horizon to retirement is ahead of them.
Credit is Easy?

There are over six times as many personal bankruptcies today there were 20 years ago. From 200,000 back then to well over a million+ of late speaks more to the ease of credit than to any other factor. The obvious companion to a lack of savings is a potentially dangerous dependence on credit. The annual number of personal bankruptcy filings has risen from less than 200,000 in 1978 to more than 1.4 million in 2009 to 600,885 in 2014 to 770,846 in 2017 and the first half of 2018 saw 324,471. According to the FDIC, the rise in the personal bankruptcy rate in 2008-2010 coincided with a marked increase in consumer loan “charge offs” at FDIC-insured institutions” and “continues a steady upward trend in personal bankruptcies nationwide that goes back to the late 1970s.”

Credit has become an easy way for Americans to spend money they do not have and to maintain lifestyles that they could not otherwise afford. This has even become the case for young people. College students make up 10 to 15 percent of those seeking money management help.

The problem of overspending on credit, however, is not limited to the young. Among all Americans with credit cards, almost half carry finance charges on their balances every month. Most of these individuals are not going into debt to stay out of poverty or to stretch meager financial resources. Only when the balance becomes too large do these individuals realize they have a problem.

Ignorance is Not Bliss

Americans find themselves floundering because they do not know what to do. Nothing is simple anymore. The days of standard pensions and straightforward savings accounts are over. Americans are left to plan their financial futures on their own and must figure out how to do it on their own. They lack the expertise and knowledge of how to build a diversified portfolio of stocks, bonds, and cash.

This, you would think, would present Americans with an opportunity to take charge of their own destiny and give great freedom for creativity and potential for accelerated growth of their money and their financial destiny. But, not so in reality and not in everyday practice. We in the financial industry and those in government must make sure that individuals are informed of the risks and rewards of the market as well as be schooled and reminded often about the need for them to be diversified in their approach...“not all eggs in one basket”.

Testing, Testing...123!

When an audio engineer sets up his microphones, he usually does a test through the mike to make sure it is working or to find out how well it is working. He usually says something like “Testing…. Testing...123...Can you hear me in the back?...etc. Similarly,
in the quest to find out how the American population is working in relation to information and education on the basics of saving and investing, they were asked simple questions on the fundamentals.

And you might not be surprised that many of the microphones were not working at all, while others were only working part of the time. All this to underscore the findings that in the area of ‘Financial 101’ most were found to be far more familiar with the difference between a halfback and a quarterback than they were between a growth stock and an income stock. In fact, 63% knew about the quarterback / halfback and only 14% knew about the difference between the stocks. In the TV realm, it was found that 78 percent of Americans can name a character on a television sitcom while only 12 percent know the difference between a “load” and “no-load” fund.

People who were asked questions like “What investment has offered the best return over the last 20 years?” found it difficult and didn’t have any idea which was the best answer out of possible answers like stock, bonds, savings accounts, and certificates of deposit. When asked “If you deposited $1,000 in an account and earned 8 percent, compounded annually, over 30 years, at the end of this period would you have more or less than $5,000?” most had to guess at the answer because they did not have a clue as to how to go about doing even a rough calculation for the solution to the problem. The U.S. is facing an economic comprehension gap of serious proportions. Not only for those individuals who have discretionary funds to put aside should be well informed and educated in the basics, but even those with relatively modest means and monetary goals cannot afford to have a lack of understanding of the financial basics. For both and all it can have serious consequences. Putting money in an IRA, for example, is generally considered one of the best investments for retirement.

Yet, only a small percent of all workers report that they have a very clear understanding of the eligibility rules for making tax-deductible IRA contributions. And, a third of the people don’t know one way or the other whether the rules are clear because they’ve never even looked into making an IRA contribution.

Americans remain also uncertain about their 401(k) or similar retirement plans. While over 70% of them contribute to these plans at work, only two thirds of them know what the maximums allowable are for them to make contributions and less than half of them actually make the maximum contribution. Those who do not contribute to their company sponsored plan generally give reasons like inability to save, saving elsewhere for other things already, and not wanting to put dollars in a plan that makes it tough to make withdrawals.

What a great opportunity to offer education and personal assistance for others to get a better handle on their situation and things available for them to maximize and begin to take more control over their financial destiny and independence!
Like Father and Mother, Like Son and Like Daughter

I have heard many times that if you look at one’s father or mother today you will be looking at what their sons and daughters will look similar to when they arrive at the same age. Like their parents, many of America’s students and young workers fail to understand the basics of saving and investing. In fact, two thirds of American high school students and nearly half of all adults fail tests of their knowledge of basic economic principles.

Perhaps the best way in a short time to illustrate this point is to give you a shotgun spray of facts that together will give you the best sense of the work that needs to be done to bring our youth up to speed on the fundamentals of financial workings.

Two thirds do not know that in times of inflation money does not hold its value. Only 58 percent of the students understand that when the demand for a product goes up but the supply doesn’t, its price is likely to increase. Half of the adults and about two thirds of students do not know that the stock market brings people who want to buy stocks together with those who want to sell them.

An alarming number of high school seniors flunk when it comes to knowing about money. Thirty percent of students think that “retirement income from a company is called Social Security.”

Only 15 percent think that stocks would achieve a higher rate of growth over 18 years than savings accounts, checking accounts, or U.S. Government savings bonds. More than half think that U.S. Government Savings Bonds will provide the highest yield over the long term. And, more than one-quarter think that a savings account would provide the best return over time.

Enough said. Parents, family financial advisors, schools, companies, and the government all need to take a more proactive role in educating our youth about basic financial fundamentals. Their future financial success and financial stability depends on their having good working, practical, competency in financial matters across the board.

If You Don’t Know Where You’re Going, Any Road Will Get You There

A “financial plan” can be regarded as a road map that helps the traveler get to where he or she is going. Yet, a surprising number of people (two out of three savers in America) have never prepared one.

Most financial planners want their clients to begin retirement planning before age 39, but few of their clients actually do. Most of their clients wait until they are in their forties, and many refuse to focus on retirement planning until they reach their fifties. This, as we have discussed previously, shortens the number of years that funds can be set aside prior to retirement and reduces the number of years for interest to compound.
The same goes for the capacity for investments to provide greater returns given the ups and downs and their sensitivity to time and economic conditions over time.

Experts have estimated that 65+ million American households will probably fail to realize one or more of their major life goals because they have failed to develop a comprehensive financial plan. They go on to say that only one in five American households describe themselves as “non-savers” who have not yet put aside any money for any of their financial goals.

Further they have found that only one-third of Americans who describe themselves as “savers” have developed a comprehensive financial plan. And, even more telling is the fact that in households with annual incomes of less than $100,000, savers who say they have financial plans report having twice as much in saving and investments as do savers who do not have plans.

It is safe to say that those who do not have adequate funds to retire did not plan to fail. They failed to plan. And whether there is a plan or not, just putting money aside by itself is better than having no plan and not putting anything away. Pretty simple, huh?

**Competency = Confidence = Success**

As Americans take it upon themselves to become more educated on the ins and outs of investing and planning through a wide variety of sources, including what you do with those you come into contact with in the normal course of your client base development, their competency will increase. With this increase in competency come confidence and thus a higher degree of success in planning, preparing and developing funds adequate for their retirement.

The massive movement of Middle America into the securities markets has provided new opportunities for investors. This has also occurred amidst considerable confusion on their part. And, in situations like this there is a great potential for abuse by some in the industry who provide products and services to an uneducated and under-informed consumer. Not all investors are as informed as they should be on how the securities markets work, and the risks and rewards of investing. Less than a fifth of investors are truly literate about financial matters specifically related to investing. Most lack basic knowledge about the meaning of financial terms and about the way different investments work.

Many investors mistakenly believe that a “no-load” mutual fund involves no sales charges or other fees. A small percentage knows that when interest rates go up the prices of bonds usually go down. Even less of them correctly understand that the purpose of diversification is to balance both risk and return in achieving their financial goals. And some even mistakenly believe that diversification provides a guarantee that their portfolio won’t suffer if the stock market falls.
It should also be noted that many investors do not understand the impact of expenses on mutual fund results. There are many investors today who have unrealistic expectations of the long-term performance of the securities markets they believe that when times are good and mutual funds are delivering high rates of return that these times will continue to return these high rates ongoing into the future.

Our job is to encourage and inform people on having realistic expectations about how different types of asset have performed and will perform over the long term.

**What the History Books Say**

Your having a little history on returns from different types of assets and classes of asset serves you well as well as puts you in a position to give others information to have some good fundamental understanding of overall growth in the past. While past history is no prediction of the future, it can serve to position discussions in a more appropriate light.

For the period of time from 1926 to 2017, according to Morningstar, the compound annual returns for different asset classes look like the following:

- Small Companies: 12.1 percent
- Large Companies: 10.2 percent
- Long-term Corporate Bonds: 5.6 percent
- Long-term Government Bonds: 5.5 percent
- Treasury Bills: 3.4 percent

With this peek at history, it underscores the need for people to be encouraged to and informed more about diversification and a better understanding of risk. A balanced mix of stocks, bonds, and cash provides investors with a cushion should any single asset class in their portfolio decrease in value during any given period. Because greater return usually correlates with greater risk, investors should know what their risk tolerance is and how risk fits in with their long- and short-term financial goals.

**What are the Options**

Many Americans are just not aware of the many options and opportunities that have been created for them and made available to them by the government and private sectors. When Congress was trying to get a handle on retirement issues for the benefit of their constituencies and the American population as a whole they found that a leading obstacle to expanding retirement savings is the simple fact that far too many Americans, particularly the young, are either unaware of, or without the knowledge and resources necessary to take advantage of the extensive benefits offered by our retirement savings system.”
To combat this, Congress directed the U.S. Department of Labor to develop a program
to promote saving for retirement and reach out to the public through public service
announcements, public meetings, educational materials, and an Internet site. They
developed formal recommendations and regulations and enacted legislation that is
known today as the “SAVER Act”. It required, among other things, that the Department
of Labor hold a series of nation-wide summits on retirement savings. The first of these
brought together leaders from the private and public sectors, including organizations
dedicated to employee benefits, personal finance, and retirement issues.

A major thrust of this governmental focus is to have more Americans get a better grasp
of what they specifically need to do and how much they actually need to have and save
for to be able to retire. They found and were disturbed by the finding that when asked
to include anything and everything they’ve stored in any type of savings vehicle, nearly
half of all Americans report nothing or less than $10,000 in retirement savings.

While perhaps understandable in today’s complex and difficult financial environment,
the widespread failure to adequately plan does not bode well for Americans looking
forward to retirement. That is why one of the goals is for as many Americans as
possible to fill out the Ballpark Estimate. The Ballpark Estimate is a single sheet
planning document that helps individuals calculate what they need to save each year
for their retirement.

You probably have available to you through your company similar retirement planning
factfinds and planning tools. If you would like to have a sample of this tool to use for
the benefit of yourself, your prospects, and your clients you can obtain info and samples
at the web site (www.asec.org).

Back to School

No two places stand out more as places where the most dramatic increase in financial
education is possible than in our schools and in the workplace. Certainly the ‘one on
one’ role that you play with a segment of the population is key in this area, but the
wider need for the masses to be brought forward in this area is paramount.

Even though there is a large degree of financial illiteracy in America today, the good
news is that education can help. Educational programs play a critical role in motivating
Americans to save and invest wisely. Competency = Confidence = Success…remember?

In our schools it has been found that American teen-agers “can and do respond
positively to instruction aimed at improving their money management skills.” It was
further demonstrated that “as little as 10 hours of classroom instruction” can make a
tremendous difference. When younger Americans received instruction, a high
percentage of them demonstrated an increase in financial knowledge or improved
money management behavior.
More importantly, the knowledge they gained sticks over time. Many continue to improve their spending and savings habits. In states where this type of education is mandated and where they provide financial education to their high school students the result is that they actually elevate the rates at which individuals save and accumulate wealth during their adult lives. Adults who grow up in states where personal finance education is mandated in high school are saving more money than their peers.

**On the Job Financial Education**

We have all heard about and even been the recipient of “on the job training”. But, for most of us, we have probably not been the recipients of “on the job financial education”.

Experts agree that financial education is one of the most critical needs facing the American worker today. Employee benefits specialists both within businesses and outside consultants regard educating employees about investing as their top priority.

In addition, employee benefit specialists are focusing on steps to work with their employees to evaluate whether their current level of retirement planning and saving levels are adequate. They know that large numbers of their employees are dissatisfied with their personal financial situations. They are aware that some feel like they are always in financial trouble and find it hard to pay bills. A large number worry about how much they owe, and their financial stress level is high. They know also that many do not set money aside for retirement.

There is a strong correlation between “financial wellness” and worker productivity. Employers who provide financial education in the workplace are repaid threefold for the cost through fewer absences from work, less time spent at work dealing with personal financial matters and increases in job productivity.”

It is clear that workers and investors want to be educated. Financial and retirement education programs in the workplace raise overall saving rates, saving for retirement, participation in 401(k)’s, and improve the employees positive regard for their employers and the company as a whole. These positive effects of retirement education at the workplace are most pronounced among those employees who are otherwise least inclined to save, as well.

There is a great need for and a hungry audience of uninformed investors in the workplace who want to be educated about how to invest wisely. In particular, they want to learn the “basics” of investing, asset allocation, retirement planning, and risk management. Few employees and the investing public at large believe they know everything they need in order to make good investment decisions.
Chapter 2 Objectives

Upon completion of this section, you will:

- Gain increased awareness of and be reminded of key retirement fundamentals.
- Learn about key basics of time, compounding, and effects of inflation/taxation on money.

Chapter Two: Retirement and Planning Overview

Before getting into the specifics of the many and varied types of Employer-Sponsored retirement plans, we want to take an overall look at the subject of retirement saving and tax favored principles, in general. This will set the stage for further discussion and insight into the varying types and special aspects of different approaches in creating earnings and growth on money to be set aside in qualified retirement plans.

In looking ahead to their retirement years, many individuals plan on Social Security and pension plans from their employers to provide needed income and funds for their retirement. However, Social Security in most cases will only provide for a small portion of what is needed and desired for income security at retirement. Because of this shortfall, people want to supplement this with additional sources of funds at retirement. The participation in Employer-Sponsored qualified retirements is one way to accomplish this.

Investing for retirement is definitely in peoples’ best interest. It would behoove them not to rely on Social Security as a saving grace in their Golden years. What’s more is that it doesn’t really take much to secure for themselves an attractive amount of cash for retirement.

The key is for them to act now. The more time their money has to grow, the better. Here’s a great example of this in fundamentals of investing, but there’s also a similar example of how advantageous time is.

At age 25, Mary invested $7000 in a 401k plan and $2000 in an IRA in 2018. She will not invest another dime, but she assumes her money will grow for 40 years at 5%, and all dividends will be reinvested. An average growth of 5% a year is assumed. At age 65, Mary will have $203,666 from a $9000 initial investment.
Joe, her big brother, wanted to wait a few more years and live the “good life.” Right now, Joe wants a fast car and insurance payments that resemble car payments. He plans to invest, but not now. Joe will invest $20,000 at age 45. He has a broker friend who will handle his money for him. This will be allowed to grow for 20 years at 5%, just like “sis”. At age 65, Joe will have $67,225 minus his broker friend’s fees.

That’s less than a third of what his little sister Mary will have. Time plays a very big role in long-term investing. People should not feel discouraged if they are over 50 and are just starting to invest. They still should invest.

The advantage a more experienced worker may have over a younger one is that they will probably make more money. If that’s the case, then they may have more money to invest. They just might have to take a different approach than someone who is still in their twenties. Whatever their age, if they haven’t already done so, they should start investing as soon as possible.

**Retirement Plans**

The purpose of any retirement plan or account is to provide a vehicle for making investments on a tax-deferred or tax-free basis to supply an income for the future. It is worthwhile to consider that one’s plan might also be regarded as a wealth accumulation vehicle.

- There are two major Retirement Vehicles: Individual Retirement Arrangements and Qualified Plans.

- Individual Retirement Arrangements are those available to individuals only and are opened for individual benefit only.

Qualified Plans are those which are qualified by the Internal Revenue Service and are only available to employers who will open such plans for the benefit of their employees.

Although there are simplified plans for employers to use for employees under Individual Retirement Arrangements, these plans are not qualified or covered under the Employee Retirement Income Security Act (ERISA). The two major classifications of Retirement Arrangements are elaborated below.

**Individual Retirement Arrangements**

There are two major kinds of Individual Retirement Arrangements: One is tax deferred, on which taxes on earnings and income is not paid until withdrawn at retirement (traditional), and the other where retirement withdrawals are tax free.
Individual retirement arrangements are personal savings plans that offer tax advantages to set aside money for retirement. These include:

**Tax Deferred IRAs**

- Traditional Individual Retirement Accounts (IRA)
- Simplified Employee Plan IRAs (SEP IRA)
- Savings Incentive Match Plans for Employees (SIMPLE)
- Education IRAs

**Tax Free IRA**

- Roth Individual Retirement Accounts (Roth IRA)

Individual retirement accounts are trusts or custodial accounts set up in the United States for your exclusive benefit or for the benefit of your beneficiaries. An account is created by a written document.

In our course, we focus on several of the most common and widely used strategies used by individuals to save and invest for their retirement...Employer Sponsored Retirement Plans.

**Qualified vs. Non-qualified - Clarified**

**Qualified**

Qualified plans refer to whether the plan is a part of an employee benefit plan that has met certain requirements or becomes “qualified” under the Internal Revenue code such as a 401(k) plan, an IRA (Individual Retirement Account) or a TSA 403(B) (Tax Sheltered Annuity). A qualified retirement account is one that is used as a part of or in connection with a qualified retirement plan. Simply put, a qualified retirement plan is one that differs from a non-qualified arrangement in that contributions made into the qualified plan are income tax deductible to the employee and to the account holder in the case of an IRA and TSA.

Qualified retirement plans generally are referred to as either defined benefit or defined contribution plans. Defined contribution plans typically provide for an employer contribution but do not specify the benefit that will be paid from the plan. The amount of a participant’s retirement benefit is based on the value of the participant’s account balance at retirement. Defined contribution plans are also referred to as individual account plans, since each participant’s plan funds are maintained in an individual account.
In contrast, defined benefit plans specify the retirement benefit to be paid from the plan. Plan funds are pooled; the periodic valuation of each participant’s benefit is expressed as an “accrued benefit.” And, since the promised benefit may not be delivered for years, an actuary must certify that the plan is adequately funded each year. To say it differently, the actuary must certify that the plan is on time for meeting its scheduled obligations.

Qualified retirement plans also may be referred to as either pension or profit sharing plans. Pension plans are those that provide “definitely determinable benefits”—either a fixed annual contribution or a specific retirement benefit funded by mandatory annual contributions. (Plans that require an annual contribution are described as subject to the minimum funding standard.) When qualified plans are grouped this way, profit sharing plans stand alone since they do not require fixed annual contributions and thus are not subject to minimum funding standards.

Qualified plans offer significant advantages to employers and employees. The tax-deferred status of qualified plan investment earnings is beneficial to both the employer and employees because investment earnings are not taxed to either while the funds remain in the plan.

The tax-favored treatment of qualified plans generally is an important consideration for the employer who is installing a qualified plan. This is because the employer is allowed to deduct contributions to a qualified plan in the year the contributions are made. This deduction is especially valuable to the business owner, since, in many small businesses, it will offset the cost of including the rank-and-file employees in the qualified plan.

**Non-Qualified**

A non-qualified retirement plan may be purchased by any individual and is not associated with an employer-sponsored retirement plan or with IRAs or TSAs. The contributions to a non-qualified plan are not tax deductible. While “non-qualified” may sound like a negative to some, it has nothing to do with the qualifications of the accumulation vehicle or the company issuing the plan or product, or investment vehicle.

Nonqualified plans generally do not have to comply with any nondiscrimination rules and, therefore, are not given similar tax-advantaged treatment. (To obtain tax deferral, a nonqualified plan essentially must put the employee’s retirement benefits at risk.) Another important difference between qualified and nonqualified retirement plans is that, in determining annual contributions or benefits, qualified plans may only take into account up to $275,000 (2018) of an individual’s compensation.

**What's the difference between saving money in my company's retirement plan and putting money into a mutual fund or bank account?**
Taxes, taxes, taxes! An ordinary savings account or mutual fund doesn't allow one to save on a tax-deferred basis. So, in an ordinary savings account, they're saving money that has already been taxed, and they continue to pay tax annually on the earnings of that account, too. The money they contribute to their employer-sponsored retirement plan, however, comes out of their paycheck before taxes are taken out. Plus, they don't pay income tax on the money they contribute to their employer-sponsored account or on any earnings until they take it out, which is usually at retirement, when they may be in a lower tax bracket.

The bottom line: More of their money is working for them instead of going toward taxes. Keep in mind, however, that investing in their company's retirement plan is only a part of a sound retirement saving plan. It is still important to have personal savings aside from their retirement savings, too.

**Tax-Deferred**

Tax-deferred means postponing taxes on interest and/or earnings until a future point in time. In the meantime, they earn interest/growth on the money they're not paying in taxes. They can accumulate more money over a shorter period of time, which ultimately will provide them with a greater income.

**Tax-deferral Advantages**

Many people today are using tax-deferred retirement plan saving and investing as the foundation of their overall financial plan instead of certificates of deposit or savings accounts. Although qualified and non-qualified plans, products, and investments are very similar there are significant differences between the two.

No taxes are payable while their money is compounding in a qualified plan. Their money can grow faster in a tax deferred annuity retirement plan than in a taxable investment with a similar interest rate. This is because earnings normally lost to taxes remain in their plan and can generate additional earnings through the effects of compounding.

They can also pay a lower tax on random withdrawals because they control the tax year in which the withdrawals are made, and only pay taxes on the interest withdrawn. Tax deferral gives them control over an important expense – their taxes. Any time they control an expense, they can minimize it. The longer they can postpone this particular expense, the greater their gain when compared to the gain they would make with a fully taxable account.

Later, if they decide to take a monthly retirement income, their taxes can be less because they will be spread out over a period of years. Like Certificates of Deposits and
annuities, employer sponsored retirement plans have a penalty for early surrender, however most plans have a liberal “free withdrawal” provision. And, if they wait until retirement to receive their annuity income, they may be in a lower tax bracket, adding to the value of the income they receive.

What are “Pre-Tax” contributions?

"Pre-tax contributions" refers to the amount that employees have deducted from their paycheck before income taxes are calculated and invested into their company retirement plan. Making pre-tax contributions helps lower their taxable income each year that they contribute. For example, if they made $30,000 last year, and put $3,000 in their retirement account on a pre-tax basis, their taxable income for the year would have been $27,000. Because of these tax advantages, the IRS puts many restrictions on withdrawing this money before they reach retirement age. After-tax contributions are those they make from their net pay, their income after taxes.

Pre-tax Contributions vs. After-Tax...What's the Difference?

<table>
<thead>
<tr>
<th>Pre-tax contributions...</th>
<th>After-tax contributions...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Come out of your pay <em>before</em> taxes</td>
<td>Come out of your pay <em>after</em> taxes</td>
</tr>
<tr>
<td>Lower your current taxable income, so you pay less in taxes now</td>
<td>Do not lower your current taxable income</td>
</tr>
<tr>
<td>Increase your take home pay now</td>
<td>Do not increase your take home pay</td>
</tr>
<tr>
<td>Are taxed as ordinary income when you take money out of the plan</td>
<td>Are not taxed at withdrawal because you've already paid it--but you do have to pay tax on any earnings</td>
</tr>
<tr>
<td>Have restrictions on withdrawals before age 59½ to encourage you to save for when you'll need it most: at retirement. If you withdraw before-tax contributions before you reach age 59½ you pay ordinary income tax and possibly a 10 percent early withdrawal penalty.</td>
<td>Have fewer restrictions on withdrawals before age 59½. If you withdraw from your after-tax savings before you're 59½, you must also withdraw part of the earnings on that money, which is taxable, and may be subject to the 10 percent early withdrawal penalty.</td>
</tr>
</tbody>
</table>

* Note: You do not have to withdraw earnings on any money you invested in 1986 or earlier.
The Tax-Deferred Advantage

To illustrate the increased earnings capacity of tax-deferred interest/earnings, let’s compare it to fully taxable earnings. $100,000 at 6.5% 3.25% will earn $6,500 $3,250 of interest in a year. A 28% tax bracket means that approximately $1,820 $910 of those earnings will be lost in taxes, leaving only $4,680 $2,340 to compound the next year. If these same earnings were tax-deferred, the full $6,500 $3,250 would be available to earn even more interest. The longer they can postpone taxes, the greater the gain.

<table>
<thead>
<tr>
<th></th>
<th>Certificate of Deposit</th>
<th>Annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before-tax yield</td>
<td>6.50%</td>
<td>3.25%</td>
</tr>
<tr>
<td>After-tax yield</td>
<td>3.90%</td>
<td>1.95%</td>
</tr>
<tr>
<td>1 year</td>
<td>$103,900</td>
<td>$51,950</td>
</tr>
<tr>
<td>5 years</td>
<td>$121,081</td>
<td>$60,540</td>
</tr>
<tr>
<td>10 years</td>
<td>$146,607</td>
<td>$73,303</td>
</tr>
<tr>
<td>15 years</td>
<td>$177,514</td>
<td>$88,757</td>
</tr>
<tr>
<td>20 years</td>
<td>$214,937</td>
<td>$107,468</td>
</tr>
</tbody>
</table>

Compare the Return

$352,365 ($176,182) Accumulated in a Tax-Deferred Annuity
$214,937 ($107,468) Accumulated in a Taxable Account
The Difference: $138,428 ($69,214)

Choosing the Right Investment Mix

An important consideration before one enters the wild and woolly world of investing in their employer-sponsored retirement plan is how to mix up a great recipe of investments offered inside most plans. Common sense suggests that they don't want to put all their eggs into one basket.

Diversifying their investments within the options offered in the plan helps buffer their portfolio from being sunk by one or two poor performers: While some investments periodically visit the doghouse, others rise to the occasion.

Consider Their Age

The younger they are and the more years they have until they plan to use their money, the greater the amount of their longer-term investment money should be in growth

Retirement Individual and Employer Sponsored Plans
(ownership) vehicles, such as options that invest in stocks, real estate, and small businesses.

The attraction of these types of investments is the potential to really grow their money. The risk is that the value of their portfolio can plunge from time to time. The younger they are, the more time their investments have to recover from a bad fall.

An old guideline says to subtract their age from 100 and invest the resulting number as a percentage of money to place in growth (ownership) investments. So, if they're 35 years old...

\[100 - 35 = 65\% \text{ of their investment money can be in growth investments.}\]

If they want to be more aggressive, subtract their age from 120...

\[120 - 35 = 85\% \text{ of their investment money can be in growth investments.}\]

Note that even someone retired should still have a healthy chunk of investment dollars in growth vehicles like stocks. A 70-year old person may want to totally avoid risk but doing so is generally a mistake. Such a person can live another two or three decades. Living longer than anticipated can lead to running out of money if the money does not continue to grow.

**Making the Most of Investment Options**

The following tips are only guidelines and apply to money that they invest for the long term (ideally for 10 years or more). For money that they need to use in the shorter term, such as within the next several years, more-aggressive growth investments aren’t appropriate.

No hard-and-fast rules exist that show them how to allocate the percentage that they've earmarked for growth investments among specific investments, like stocks and real estate. Part of how they decide to allocate their investments depends, for example, on the types of investments that they want to focus on. Here are some general guidelines to keep in mind:

Take advantage of retirement accounts. Unless they need accessible money for shorter-term non-retirement goals, why pass up the free extra returns from the tax benefits of retirement accounts?

Don't pile into investments that gain lots of attention. Many investors make this mistake, especially those who lack a thought-out plan to buy stocks.
Have the courage to be contrary. No one likes to feel that they are jumping on board a sinking ship or a losing cause. However, just like shopping for something at retail stores, the best time to buy something is when it's on sale.

**Diversify, Diversify, Diversify**

Different investments' values don't move in tandem. So, when investing in growth vehicles such as stocks or real estate, their portfolio's value will have a smoother ride if they diversify properly.

Invest more in what is known. Over the years, a number of successful investors have built substantial wealth without spending gobs of free time by investing in what they know. Some investors, for example, concentrate more on real estate because that's what they best understand and feel comfortable with. Others put more money in stocks for the same reason. No one-size-fits-all dress code exists for successful investors. Just be careful that one doesn't put all of their investing eggs in the same basket.

Don't invest in too many different things. Diversification is good to a point. If one purchases so many investments that they can't perform a basic annual review of them (for example, with a mutual fund, reading the annual report), then they may have too many different investments.

Be more aggressive inside retirement accounts. When they hit their retirement years, they'll probably begin to live off their non-retirement account investments first. Why? For the simple reason that allowing their retirement accounts to continue growing will save them tax dollars. Therefore, they should be relatively less aggressive with investments outside of retirement accounts because that money will be invested for a shorter time period.

Individual stock markets may crash. However, the various stock markets around the world have never all crashed at the same time.

One can invest overseas to reduce their investment risk if they worry about the health of the U.S. economy, the government, and the dollar. Most large U.S. companies do business overseas, so when they invest in larger U.S. company stocks, they get some international investment exposure. They can also invest in international company stocks, ideally via mutual funds.

Diversifying investments can involve more than just stock portfolio, however. They can also hold some real estate investments to diversify their investment portfolio. Some real estate markets actually appreciated in the late 1980s while the U.S. stock market was in the doghouse.
Investors who seek growth invest in securities such as stocks. Placing significant amounts of their capital in one or a handful of securities is risky, particularly if the stocks are in the same type of industry. To reduce this risk, purchase stocks in a variety of industries and companies within each industry.

**Tackling Asset Allocation**

One wouldn't have to worry about asset allocation if it weren't for a simple investment truth: The greater an investment's potential return, generally the greater the chance of a short-term loss. Asset allocation, then, is all about striking the right balance between their desire for high returns and their ability to withstand a short-term loss.

**Looking at One’s Time Horizon**

Although each person has a different personality and temperament about accepting risk, their realistic ability to withstand a loss depends primarily on their time horizon. For example, if they're 30 years old and want to retire by age 60, then the time horizon of their retirement investments is 30+ years. (Even though they’ll begin to use some of their retirement money at age 60, some of it won't be spent until later in their retirement.) If they’re saving to buy a home by the time they're 35 years old, then the time horizon of that goal is five years.

The longer their time horizon, the better able they are to withstand a short-term loss their investments have plenty of time to recover. Thus, they want their retirement dollars in growth investments, such as stocks. If they're investing money that they'll need in a year, however, a money market fund or other short-term investment would be better suited to their needs.

**Short-Term Goals**

Asset allocation for goals with short time horizons is quite simple:

- Less than two years: Stick to money market funds. Stocks and bonds are volatile, and although they have the potential for earning higher returns in stocks and bonds, a money market fund offers a great combination of safety and decent returns.

- Between three and seven years: They should consider using shorter-term bonds or bond funds. (If they have between two and three years, they can use both money market and bond funds.) When they're able to keep their money in an investment for at least several years, the potential returns for bonds begin to outweigh the risk of short-term loss from possible bond market fluctuations.

- Seven or more: They should start investing in stocks as well as bonds because their time horizon is long enough to ride out the risks.
Long-term goals, such as retirement and college tuition, require more complex asset allocation decisions.

**Long-Term Goals**

If they’re like most people and retire in their mid-60s, their retirement portfolio will need to fund their living expenses for 20 or more years. Unless they have vast wealth in comparison to their spending desires, their retirement money will need to work hard for them. That’s why a retirement portfolio, particularly during their earlier working years, should be heavily weighted toward growth investments like stocks.

Their current age and the number of years they must wait until they retire should be the biggest factors in their retirement asset allocation decision. The younger they are and the more years they have before retirement, the more comfortable they should be with growth-oriented (and more volatile) investments, such as stock mutual funds.

As they approach retirement age, however, they should gradually scale back the risk and volatility of their portfolio, making bonds an increasingly bigger slice of their portfolio pie. Although their returns are lower, bonds are less likely to suffer a sharp downswing in value that could derail their retirement plans.

**Factoring in Investment Personality**

A variable to the asset allocation decision: their investment personality or tolerance for risk. Even if they and another investor are the same age, and they both have the same time horizon for their investments, they could very well have different tolerances or desires to accept and deal with risk.

**Asset Allocation for the Long Haul**

<table>
<thead>
<tr>
<th>Investment Attitude</th>
<th>Bond Allocation (%)</th>
<th>Stock Allocation (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;Play it safe&quot;</td>
<td>Age</td>
<td>100 – age</td>
</tr>
<tr>
<td>&quot;Middle of the road&quot;</td>
<td>Age – 10</td>
<td>110 – age</td>
</tr>
<tr>
<td>&quot;Aggressive&quot;</td>
<td>Age – 20</td>
<td>120 – age</td>
</tr>
</tbody>
</table>

Here's how to categorize someone:

“**Play it safe**”... Little or no experience or success investing in stocks or other growth investments, fear of the financial markets, and risk-averse behavior in other aspects of life. (They may also want to be conservative with their investments if they have enough saved already to afford a lower rate of return on their investments.)
"Middle of the road"... Some experience and success investing in stocks or other growth investments and some comfort with risk-taking behavior in other aspects of life.

"Aggressive"... Past experience and success investing in stocks or other growth investments, and a healthy desire and comfort with risk-taking behavior in other aspects of life. (They may also want to be aggressive if they're behind in saving for retirement and want their money to work as hard as possible.)

For example, if they're 35 years old, don't like a lot of risk but want to strive for some growth to make their money work harder (a middle-of-the-road type), they should put 25 percent (35 – 10) into bonds and 75 percent (110 – 35) into stocks.

**Allocating at Home and Abroad**

Next, they need to divide up their stock money between U.S. and international securities to keep their portfolio properly diversified. Although some consider international markets risky, what's riskier is putting all their money into just one country. When the U.S. market slumps, some markets overseas continue to do well. Moreover, developing countries have the potential for greater economic growth and stock market returns than the U.S. market. Here's a suggested guideline for investing a portion of their stock allocation overseas:

20 percent-play it safe, 33 percent-middle-of-the-road, 40–50 percent aggressive

If they've had little or no experience or success investing in stocks, it's better to start with the "play it safe" allocation and work their way to more aggressive allocations as they develop more comfort and knowledge.

**Allocating for College**

The strategy for developing a college savings portfolio is similar to allocating for retirement. Assuming that their child is young, the goal is relatively long-term; therefore, the portfolio should emphasize growth investments such as stocks. However, as the time horizon decreases, bonds should play a bigger role. Here's a suggested guideline for investing college money for their kids:

Take the following number:

50 to 60 for “play-it-safe”

40 to 50 for “middle-of-the-road”

30 to 40 for “aggressive”
...and add it to their child's age. That's the percentage they should put in bonds; the rest should go into stocks (with at least a third of those stocks overseas). Using this rule, adjust the mix as their child gets older.

Evaluating Risk

Although the stock market can help them build wealth, most people recognize that it can also plunge quite a bit - 10, 20, 30 percent or more in no time. In a mere six weeks (from mid-July 1998 to early September 1998), large company U.S. stocks plunged about 20 percent. Real estate exhibits similar unruly annoying tendencies. Although real estate has been a terrific long-term investment (like stocks), various real estate markets get clobbered from time to time.

However, if one passes up the stock and real estate markets simply because of the potential market value risk, they miss out on a historic, time-tested method of building substantial wealth. The following sections suggest some simple things they can do to lower their investing risk and help prevent their portfolio from suffering a huge fall.

Check Their Time Horizon

Investors who worry that the stock market may take a dive and take their capital down with it should first consider the time period that they plan to invest. In a one-year time period in the stock and bond markets, anything can happen. History shows that once in every three years that they invest in the stock and bond markets, they lose money. However, stock market investors make money two-thirds of the time over a one-year time period. (Bond investors make money about two-thirds of the time, too, although they make a good deal less.)

Although the stock market is more volatile in the short-term than the bond market, stock market investors earn far better long-term returns than do bond investors. Remember, however, that bonds generally outperform keeping their money in a boring old bank account.

As the holding period during which they own stocks increases from 1 year to 3 years to 5 years to 10 years, and then to 20 years, their likelihood of making a profit increases. In fact, over any 20-year time span, U.S. stock market investors have never lost money, even after we subtract for the effects of inflation.

Pare Down Holdings in Bloated Markets

Although one can't “time” the markets (that is, predict the most profitable time to buy and sell), spotting a greatly overpriced market isn't too difficult. They want to avoid overpriced investments for two reasons.
If and when these overpriced investments fall, they may fall farther and faster than more fairly priced investments.

They can always find other investments that offer higher potential returns.

Practically speaking, avoiding overvalued markets doesn't mean that they sell their holdings in such markets with the vain hope of buying them back at a much lower price. However, they may benefit from the following strategies:

As they save new investment money, put it into investments that offer better values so that their overpriced investments become a smaller portion of their total holdings. If they hold investments outside tax-sheltered retirement accounts, focusing their money elsewhere also avoids the taxes incurred by selling appreciated investments.

If they need to raise money to live on, such as for retirement or for a major purchase, sell the expensive stuff. As long as the taxes aren't too troublesome, it's better to sell high and lock in their profits.

**Protect Against Individual Investment Risk**

A downdraft can put an entire investment market on a roller-coaster ride, but healthy markets can also produce losers, and individual real estate property prices can plummet despite a generally rising trend.

Here are some simple steps they can take to lower the risk of individual investments that can upset their goals:

**Doing the Homework**

When they purchase real estate, a whole host of inspections can save them from buying a money pit. With stocks, they can examine some measures of value and the company's financial condition and business strategy to reduce their chances of buying into an overpriced company or one on the verge of major problems.

**Hiring Someone to Invest**

Increasing numbers of investors turn to mutual funds that offer professional management and oversight, as well as diversification. Stock mutual funds typically own 25 or more securities in a variety of companies in different industries.
Preserving Purchasing Power

The erosion of the purchasing power of their investment dollar can be, over longer time periods, as bad as or worse than the effect of a major market crash. The table shows the effective loss in purchasing power of money at various rates of inflation and over differing time periods.

Table 1- Inflation's Effect on Money's Purchasing Power

<table>
<thead>
<tr>
<th>Inflation Rate</th>
<th>10 years</th>
<th>15 years</th>
<th>25 years</th>
<th>40 years</th>
</tr>
</thead>
<tbody>
<tr>
<td>2%</td>
<td>-18%</td>
<td>-26%</td>
<td>-39%</td>
<td>-55%</td>
</tr>
<tr>
<td>4%</td>
<td>-32%</td>
<td>-44%</td>
<td>-62%</td>
<td>-81%</td>
</tr>
<tr>
<td>6%</td>
<td>-44%</td>
<td>-58%</td>
<td>-77%</td>
<td>-90%</td>
</tr>
<tr>
<td>8%</td>
<td>-54%</td>
<td>-68%</td>
<td>-85%</td>
<td>-95%</td>
</tr>
<tr>
<td>10%</td>
<td>-61%</td>
<td>-76%</td>
<td>-91%</td>
<td>-98%</td>
</tr>
</tbody>
</table>

Skittish investors who keep their money in bonds and money market accounts risk that their money won’t grow enough over the years for them to accomplish their financial goals. The lower the return, the more they’ll need to save to reach a particular financial goal. A 40-year-old wanting to accumulate $500,000 by age 65 would need to save $722 per month if she earns a 6-percent annual return, but only needs to save $377 per month if she earns 10-percent return per year.
INDIVIDUAL SAVINGS & RETIREMENT PROGRAMS

Overview and Objectives

This section was designed, constructed and written to provide you with continuing education in the area of individual saving for retirement with special attention to IRAs.

It also acknowledges and includes some examination of the Educational IRA (now, Coverdell Education Savings Accounts), as well, due to the competing money needs of retirement and education. It also reviews withdrawals for education expenses (“QHEE’s” Qualified Higher Education Expenses) that receive acknowledgement, special treatment, and are a common component of the 3 government sponsored accumulation programs.

Besides the goal of acquiring additional credits toward continuing education requirements, it is our hope that our students will acquire a new level of competency and insight into this highly critical area of people’s financial future...saving and accumulating dollars for use in the future.

Retirement and Education are the two most critical needs that people plan and save for. Yet, both of these objectives and needs compete for a limited amount of money available in most situations. As time goes by, individuals’ situations change with respect to their available discretionary income, tax brackets, and family situations. In addition, tax law changes, program availability, and feature modifications are constantly being reviewed and changed. Some save separately specifically for retirement and education. Some save for the future (retirement), and take care of education as best they can when it occurs prior to their retirement...or some combination of both!

Yet some things are fundamental and seldom, if ever, change. Accumulating funds for the future depends on money, time, a vehicle, and consistency. With so many places to save or invest in, the real key is to start putting aside something so that something is available down the road. The more put away today, the more it grows to. The higher yield or growth each dollar earns makes it compound faster and greater. The fewer taxes we pay when we put it away, as it grows, and when we take it out allows for each dollar to work harder and provide for more of its intended usage. And, to the extent we have planned ahead for certain amounts to be available at specific times in the future, the more motivated we are to put aside on a regular basis an amount that will grow to what is needed in the future (consistency).

This section is comprised of 6 chapters with additional pages with charts, graphs, and other visual tools for enhancing the value of the information for you as well as to enhance your recall beyond the course.
Whether you are a newer agent, planner, or a veteran, we’re confident that you will gain new insight into this critical area for Americans as well as brush up on current info and regulations pertinent to this area of your expertise.
Chapter 3 Objectives

Upon completion of this section, you will:

- Gain insight into key features and benefits of individual savings and retirement programs.
- Be able to differentiate between Traditional IRA and Roth IRA plan characteristics.

Chapter Three: Individual Savings & Retirement Programs

The Traditional IRA

What Is a Traditional IRA?

A traditional IRA is an income tax benefited way for people to put aside money for the future and have this money treated differently in how it is taxed under current income tax regulations. It was created and made available as an incentive to put aside money for retirement as well as a way to have every dollar you put away have the potential to grow to a larger amount than it normally would if it was taxed before it was put aside, taxed while it was growing, and taxed when withdrawn as is with non-tax favored money.

Recognizing that many citizens of the U.S. were not preparing financially for retirement, were relying too heavily on Social Security, and also that they needed a way to put away special funds earmarked specifically for retirement, laws and regulations were put into place for the creation of Individual Retirement Accounts.

I will use YOU as the example to describe all the key fundamentals and provisions as they relate to the IRA.

Who Can Set One Up

You can set up and make contributions to a traditional IRA if you and/or your spouse received taxable compensation during the year and you were not age 70½ by the end of the year. You can have a traditional IRA whether or not you are covered by any other retirement plan.

However, you may not be able to deduct all of the contributions if you or your spouse is covered by an employer retirement plan. We will take a look at how much you can
deduct later. If both you and your spouse have compensation and are under age 70½, each of you can set up separate IRA’s. However, you cannot both participate in the same IRA.

**What’s What with Compensation?**

Generally, compensation is what you earn from working. In calculating and determining what compensation is, the following are a sample of some of the different types of Compensation that the IRS looks at in applying their regulations and formulas:

- Wages
- Salaries
- Tips
- Professional Fees
- Bonuses
- Commissions
- Self-employment income
- Alimony and separate maintenance

**When Can One be Set Up?**

You can set up a traditional IRA at any time…the earlier in your income earning life, the better. The earlier you start putting money aside, the longer you leave it to grow in whatever vehicle you have chosen to put it, the better it will be for you financially when you retire.

However, the time for making contributions for any year is limited, generally, up to the time you file your income taxes, typically April 15th. We will look at this a little more closely later on.

**Who, How, and What to get Started**

You can set up different kinds of IRAs with a variety of organizations. You can set up an IRA at a bank or other financial institution or with a mutual fund or life insurance company. You can also set up an IRA through your stockbroker. Of course, your IRA must meet Internal Revenue Code requirements. Your traditional IRA can be an individual retirement account or annuity.

We’ll discuss the requirements for the various arrangements as we go along. Stay tuned!
Kinds...Individual Retirement Account

In technical terms, an individual retirement account is a trust or custodial account set up in the United States for the exclusive benefit of you or your beneficiaries. The account is created by a written document. The institutions and companies that offer IRA’s for you to choose from in building your retirement account have built them to meet and comply with IRS regulations and requirements. But, it is still important for you to know what these are as you become more well-versed in the subject.

The document must show that the account meets all of the following requirements.

- The trustee or custodian must be a bank, a federally insured credit union, a savings and loan association, or an entity approved by the IRS to act as trustee or custodian.
- The trustee or custodian generally cannot accept contributions of more than $5,500 for 2018 or $6,500 for 2018 if you are 50 or older).
- Contributions, except for rollover contributions, must be in cash. We’ll talk a bit more about this later, as well.
- You must have a non-forfeitable right, the ability to make all decisions and choices, to the amount at all times.
- Money in your account cannot be used to buy a life insurance policy.
- Assets in your account cannot be combined with other property, except in a common trust fund or common investment fund.
- You must start receiving distributions by April 1 of the year following the year in which you reach age 70½. We’ll also talk more about this further on.

Kinds...Individual Retirement Annuity

You can set up an individual retirement annuity by purchasing an annuity contract or an endowment contract from a life insurance company. An individual retirement annuity must be issued in your name as the owner, and either you or your beneficiaries who survive you are the only ones who can receive the benefits or payments. Again, to be technically knowledgeable, it is important for you to know what these are, as well, to demonstrate competency in this area.

An individual retirement annuity must meet all the following requirements.

- Your entire interest in the contract must be non-forfeitable.
- The contract must provide that you cannot transfer any portion of it to any person other than the issuer.
- There must be flexible premiums so that if your compensation changes, your payment can also change. This provision applies to contracts issued after November 6, 1978.
• The contract must provide that contributions cannot be more than $5,500 in 2018 or $6,500 in 2018 if 50 or older), and that you must use any refunded premiums to pay for future premiums or to buy more benefits before the end of the calendar year after the year in which you receive the refund.
• Distributions must begin by April 1 of the year follow the year in which you reach age 70½.

**How Much $ Can I Put In?**

Since IRA’s came into existence, the amounts allowable for current contributions have increased over the years. Current limits for 2018 are 100% of your income up to $5,500 with $6,500 as the limit if you are age 50 or older. This is the most that can be contributed regardless of whether the contributions are to one or more traditional IRAs or whether all or part of the contributions are nondeductible. (We’ll talk more about this down the road.) These amounts are up from $3,000 previously in early 2000s. The additional amounts possible for age 50 and older Americans is a newer distinction by age and will hopefully prompt and promote more pre-retirees to catch up a little before retirement. They have less and less years to put aside dollars and have less time and compounding time to grow their accounts as much as possible for availability at retirement age.

*Examples.*
George, who is single, earns $24,000 in 2018. His IRA contributions for 2018 are limited to $5,500 ($6,500 if age 50 and over).
Danny, a college student working part time, earns $1,500 in 2018. His IRA contributions for 2018 are limited to $1,500, the amount of his compensation.
Jim, married to Sandy, earns $52,000. They do not plan to put aside anything for Sandy this year. His IRA contributions for 2018 are limited to $5,500 ($6,500 if age 50 and over).

**Maximum Contribution IRA Amounts**

<table>
<thead>
<tr>
<th>Year</th>
<th>All Ages</th>
<th>50 &amp; Older</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>3,000</td>
<td>500</td>
<td>3,500</td>
</tr>
<tr>
<td>2005</td>
<td>4,000</td>
<td>500</td>
<td>4,500</td>
</tr>
<tr>
<td>2006</td>
<td>4,000</td>
<td>1,000</td>
<td>5,000</td>
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<tr>
<td>2007</td>
<td>4,000</td>
<td>1,000</td>
<td>5,000</td>
</tr>
<tr>
<td>2008</td>
<td>5,000</td>
<td>1,000</td>
<td>6,000</td>
</tr>
</tbody>
</table>
2009  5,000  1,000  6,000
2010  5,000  1,000  6,000
2011  5,000  1,000  6,000
2014  5,500  1,000  6,500
2015  5,500  1,000  6,500
2016  5,500  1,000  6,500
2017  5,500  1,000  6,500
2018  5,500  1,000  6,500

Like most other things, there are limits and other rules that affect the amount that you and your spouse can contribute to a traditional IRA. Again, regardless whether or not they apply to you, it is important for you to know that they exist and have a working familiarity with them should they arise in situations or conversations with prospects and clients who are seeking your wise counsel and advice.

These limits and rules are explained below:

- **Community property laws.** Each spouse figures his/her limit separately, using his/or her own compensation. This applies in states with community property laws.
- **Brokers’ commissions.** Brokers’ commissions paid in connection with your traditional IRA are subject to the contribution limit.
- **Trustees’ fees.** Trustees’ administrative fees are not subject to the contribution limit.

**More than One IRA?**

If you have more than one IRA, the 100% up to $5,500 (2018) limit applies to the total contributions made on your behalf to all your traditional IRAs for the year. ($6,500 for age 50 and older - 2018)

**How about Annuity or Endowment contracts?**

If you invest in an annuity under an individual retirement annuity, no more than $5,500 or $6,500 for 2018 if 50 or older can be contributed toward its cost for the tax year, including the cost of life insurance coverage. If more than this amount is contributed, the annuity or endowment contract is disqualified.
How About My Spouse?

Marriage. It is one of the sacred and fulfilling of institutions that we have, but, it can also be a lot of work. When you get married there is so much to be done in the financial realm including setting up joint bank accounts, bringing together disparate accounting methods, doing your taxes together. Those things can definitely be a positive or negative depending upon your situation, past life history for the partners and so on, but in my opinion coming together in all things, including financial, can only be a positive in the long run.

Among the benefits of being married is the Spousal IRA, and the ability for a non-working spouse to contribute retirement funds to an IRA. Now that my wife is staying at home with our first son, it’s something that we’ll be looking into. There are however quite a few rules and restrictions when it comes to these Spousal IRA accounts, so you need to be cognizant of those rules when selecting the right account for your family.

Both you and your spouse will probably be retiring together, or within a few years of each other. If both of you are working and earning an income, replacing a portion of both incomes at retirement is essential to maintaining some proportion of pre-retirement income and your overall retirement financial picture.

If you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following two amounts:

- $5,500 for 2018 or $6,500 if you are 50 or older, or
- The total compensation includable in the gross income of both you and your spouse for the year, reduced by the following two amounts:
  - Your spouse’s IRA contribution for their year to a traditional IRA.
  - Any contributions for the year to a Roth IRA for you on behalf of your spouse.

This means that the total combined contributions that can be made for the year to your IRA and your spouse’s IRA can be as much as $11,000 for 2018, or $12,000 if only one of you is 50 or older, or $13,000 for 2018 if both of you are 50 or older.

Note. This traditional IRA limit is reduced by any contributions to a section 501(c)(18) plan contributions).

Example.
Jim in our previous example decides to put aside earnings for Sandy, a full-time mom with no taxable compensation. They are both under 50 years old. For the year, Jim has
taxable compensation of $52,000. He plans to contribute (and deduct) $5,500 to a traditional IRA. If he and Sandy file a joint return, each can contribute $5,500 for 2018 to a traditional IRA. This is because Sandy, who has no compensation, can add Jim’s compensation, reduced by the amount of his IRA contribution, ($52,000 – $5,000 = $49,000) to her own compensation figure her maximum contribution to a traditional IRA. In her case, $5,500 is her contribution limit, because $5,500 is less than $49,000 (her compensation for purposes of figuring her contribution limit).

**What if I’m Single, Married, Filing Jointly?**

Generally, your filing status has no effect on the amount of allowable contributions to your traditional IRA. However, if during the year either you or your spouse was covered by a retirement plan at work, your deduction may be reduced or eliminated, depending on your filing status and income. This area of other retirement plans at work issue and its effects on your IRA contributions will be discussed later when we review deductibility of contributions.

*Example.*
Tom and Rosa are married, and both are under age 70½. They both work, and each has a traditional IRA. Tom earned $1,800 and Rosa earned $48,000 in 2018. Because of the spousal IRA limit rule, even though Tom earned less than $3,000, they can contribute up to $5,500 to his IRA for 2018 if they file a joint return. They can contribute up to $5,500 to Rosa’s IRA. If they file separate returns, the amount that can be contributed to Tom’s IRA is limited to $1,800.

**How About Carryover if I Don’t Put in the Max?**

Forget about it! If contributions to your traditional IRA for a year were less than the limit, you cannot contribute more in a later year to make up the difference.

*Example.*
Justin earns $30,000 in 2018. Although he can contribute up to $5,500 for 2018, he contributes only $1,000. After April 15, 2018, Justin cannot make up the difference between his actual contributions for 2018 ($1,000) and his 2018 limit ($5,500). He cannot contribute more than the limit for any later year.

**What if I overdo it?**

While it is unlikely that you would want to put in more than the limit for yourself in any year it could occur. If your contributions to your IRA for a year were more than the limit, you can apply the excess contribution in one year to a later year if the contributions for that later year are less than the maximum allowed for that year. A special form is needed to declare this excess amount non-deductible (other excess
contributions in specific situations to be discussed later have a 6% penalty applied to the excess amount until they are withdrawn).

**When and What Kind of $ Can I Contribute?**

Good news! As soon as you set up your traditional IRA, you can make deposits into it through your chosen sponsor (trustee or other administrator). You should be aware that your contributions must be in the form of money (cash, check, or money order). Property cannot be contributed. However, you may be able to transfer or roll over certain property from one retirement plan to another. We’ll talk about this when we review Rollovers later.

Contributions can be made to your traditional IRA for each year that you receive compensation and have not reached age 70½. For any year in which you do not work, contributions cannot be made to your IRA unless you receive alimony or file a joint return with a spouse who has compensation.

Even if you cannot contribute for the current year for some reason, the amounts you put in for years in which you did qualify can remain in your IRA. After this year in which you might not have qualified, you can resume after that for any years that you do qualify to put in a contribution. In addition, you do not have to contribute to your traditional IRA for every tax year, even if you can.

**When is the Latest I can Put $ in for This Year...and Other Timing Stuff?**

You can put money into your traditional IRA for a year at any time during the year or by the due date for filing your return for that year, not including extensions. This means that your contributions for 2018 must be made by April 15, 2019. In addition, there are a few more timing issues to explore, as well.

If you put a contribution into your traditional IRA between January 1 and April 15, you should tell the sponsor of your IRA which year (the current year or the previous year) the contribution is for. If you do not tell the sponsor which year it is for, the sponsor can assume, and report to the IRS, that the contribution is for the current year (the year the sponsor received it) even if you had wanted it to be credited to your last year.

Here’s an interesting bit of news. You can file your return claiming a traditional IRA contribution before the contribution is actually made. However, the contribution must be made by the due date of your return, not including extensions.

**When do I Have to Stop Putting $ In?**

Age 70½. Contributions cannot be made to your traditional IRA for the year in which you reach age 70½ or for any later year.
How Much Can I Deduct?

You can generally deduct 100% of your income up to the limit allowable in any given year. Remember that if you were also covered by a company pension plan during the year, this may reduce the limits that can be put aside in your IRA.

You can take a deduction for total contributions to one or more of your traditional IRAs in any year you qualify. The full deduction, if neither you nor your spouse was covered for any part of the year by an employer retirement plan, is $5,500 for 2018 or $6,500 if you are 50 or older (this was $2,000 for 2001 or 100% of your income if it was below $2,000 in 2002) You should also know that the limit is reduced by any contributions made to a 501(c)(18) plan on your behalf.

Income Limits for Deductibility?

Yes. Simply put you can make any amount of income and still deduct the full amount of your IRA contribution if you are single. However, if you are married, filing jointly, you can take the full deduction of a spousal IRA if your income is below $189,000, and a partial deduction of your contribution if your income is between $189,000 and $199,000 (2018). (The table at the back of this book is a good chart for quick reference to how income levels affect deductibility as well as reduced levels if employer plan participation exists)

Employer got you covered?

Up to now we have alluded to the fact that being covered by a employer retirement plan such as a 401(k) will have an effect on what you are able to contribute and deduct in your traditional IRA. If your Form W-2 that you receive from your employer has a checkmark in the box used to indicate whether you were covered for the year this will have to be figured into what you can and cannot do in your IRA.

Special rules apply to determine the tax years for which you are covered by an employer plan. These rules differ depending on whether the plan is a defined contribution plan or a defined benefit plan. Your tax year is the annual accounting period you use to keep records and report income and expenses on your income tax return. For most people, the tax year is the calendar year.

Defined Contribution Plan:

Generally, you are considered covered by a defined contribution plan such as a 401(k) for a tax year if amounts are contributed by you or if your employer puts any money into your plan during the plan year that also ends within the tax year. A defined contribution plan is a plan that provides for a separate account for you in the plan. Also, in a defined contribution plan, the amount to be contributed to your account is spelled
out in the plan. The level of benefits actually provided to you depends on the total amount contributed to your account and any earnings on those contributions. Some names of different types of defined contribution plans are profit-sharing plans, stock bonus plans, and money purchase pension plans.

**Example.** Company A has a money purchase pension plan. Its plan year is from July 1 to June 30. The plan provides that contributions must be allocated as of June 30. Bob, an employee, leaves Company A on December 31, 2018. The contribution for the plan year ending on June 30, 2018, is made February 15, 2018. Because an amount is contributed to Bob’s account for the plan year, Bob is covered by the plan for his 2018 tax year.

You should also be aware that you if an amount is contributed to your account for a plan year, you are considered to be covered by that plan even if you have not vested or have current ownership or interest (legal right to) funds in your account.

**Defined benefit plan:**
If you are eligible to participate in your employer’s defined benefit plan for the plan year that ends within your tax year, you are covered by the plan. This rule applies even if you declined to participate in the plan, did not make a required contribution, or did not perform the minimum service required to accrue a benefit for the year. A defined benefit plan is any plan that is not a defined contribution plan. In a defined benefit plan, the level of benefits to be provided to each participant is spelled out in the plan. The plan administrator figures the amount needed to provide those benefits and those amounts are contributed to the plan. Defined benefit plans include pension plans and annuity plans.

**Example.** Nick, an employee of Company B, is eligible to participate in Company B’s defined benefit plan, which has a July 1 to June 30 plan year. Nick leaves Company B on December 31, 2018. Since Nick is eligible to participate in the plan for its year ending June 30, 2018, he is covered by the plan for his 2018 tax year.

Also, like defined contribution plans, if you accrue a benefit for a plan year in a defined benefit plan, you are considered to be covered by that plan even if you have no current vested interest in (legal right to) the accrual.

There are also some situations to be aware of for which you would not be considered to be covered by a employer plan. Those situations being covered by social security or a railroad retirement plan, receive benefits from a previous employer plan, or have a plan based on being a Reservist.

**Am I Limited if Covered by My Employer Plan?**

As discussed earlier, the deduction you can take for contributions made to your traditional IRA depends on and is affected by whether you or your spouse was covered.
for any part of the year by an employer retirement plan. Your deduction is also affected by how much income you had and by your filing status (single, married, joint filing, etc.). Your deduction may also be affected by any social security benefits you received.

If either you or your spouse was covered by an employer retirement plan, you may be entitled to only a partial (reduced) deduction or no deduction at all, depending on your level of income and your filing status. Your deduction begins to decrease (phase out) when your income rises above a certain amount and is eliminated altogether when it reaches a higher amount. These amounts vary depending on your filing status. To determine if your deduction is subject to the phaseout, you must determine your modified adjusted gross income (AGI) and your filing status.

**Deduction Phaseout**
If you are covered by an employer retirement plan, your 2018 IRA deduction is reduced or eliminated entirely depending on your filing status and modified AGI:

<table>
<thead>
<tr>
<th>If Your Filing Status Is...</th>
<th>And Your Modified AGI Is...</th>
<th>Then You Can Take...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, head of household</td>
<td>$63,000 or less</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td></td>
<td>more than $63,000 but less than $71,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$73,000 or more</td>
<td>no deduction.</td>
</tr>
<tr>
<td>Married filing jointly or qualifying widow(er)</td>
<td>$101,000 or less</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td></td>
<td>more than $101,000 but less than $121,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$121,001 or more</td>
<td>no deduction.</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>less than $10,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$10,000 or more</td>
<td>no deduction.</td>
</tr>
</tbody>
</table>

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.
If you are not covered by a retirement plan at work or one isn’t offered, use this IRS table to determine if you can deduct your 2018 Traditional IRA contribution:

<table>
<thead>
<tr>
<th>If Your Filing Status Is...</th>
<th>And Your Modified AGI Is...</th>
<th>Then You Can Take...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, head of household, or qualifying widow(er)</td>
<td>any amount</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td>Married filing jointly or separately with a spouse who is not covered by a plan at work</td>
<td>any amount</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td>Married filing jointly with a spouse who is covered by a plan at work</td>
<td>$189,000 or less</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td></td>
<td>more than $189,000 but less than $199,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$199,000 or more</td>
<td>no deduction.</td>
</tr>
<tr>
<td>Married filing separately with a spouse who is covered by a plan at work</td>
<td>less than $10,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$10,000 or more</td>
<td>no deduction.</td>
</tr>
</tbody>
</table>

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.

Can I Make Nondeductible Contributions?

You can make the maximum contribution allowed even if your being covered by an employer plan will not allow it to be fully deductible or not deductible at all. This allows you to still put aside funds for retirement and still enjoy tax deferred growth on your growth in the fund.

*Example.* Sonny Martin is single. In 2018, he was covered by a retirement plan at work. His salary is $80,000. His modified adjusted gross income (modified AGI) is $75,312. Sonny makes a $5,500 IRA contribution for 2018. Because he was covered by a retirement plan and his modified AGI is above $73,000, he cannot deduct his $5,500 IRA contribution. However, he can designate this contribution as a nondeductible contribution by reporting it on Form 8606.
Nondeductible Contributions...Tax on Growth?

As long as your contributions are within the contribution limits, none of the earnings or gains on those contributions (deductible or nondeductible) will be taxed until they are distributed. When you withdraw funds at retirement these non-deductible contributions have a cost basis and will be able to be withdrawn without tax at that time as those funds were already taxed when originally contributed.

My Spouse Died and I Inherit Her IRA?

If you inherit a traditional IRA from your deceased spouse, you can generally roll it over into another traditional IRA established for you or you can choose to keep it in its current form and treat the inherited IRA as your own. You designate yourself as the account owner rather than the beneficiary. You will be considered to have chosen to treat it as your own if you contribute new money or to your inherited IRA. You must be the sole beneficiary of it and have full rights to make withdrawals from it. You can also just roll it over to your own IRA.

Note...If, in the unlikely event that you inherit an IRA from someone who is not your spouse, you are allowed to have it continue to be tax favored until you make withdrawals from it. It will then be treated like any other IRA withdrawal rules.

What about Moving Things Around?

Yes! You have flexibility within certain guidelines to move things around. The IRS permits you to transfer, tax free, the assets, both money or property, from one IRA account to another and from other retirement programs to your traditional IRA. There are trustee to trustee rollovers and transfer involved in a divorce. Let’s take a look at it...

Can you say Rollover?

A rollover is a tax-free distribution to you of cash or other assets from one retirement plan that you contribute to another retirement plan. They call the contribution to the second retirement plan is called a “rollover contribution”. The amount you rollover tax free is generally taxable when you withdraw amounts from the new plan.

There are two kinds of rollover to a traditional IRA.

- You put amounts you receive from one traditional IRA into the same or another traditional IRA. You can withdraw, tax free, all or part of the assets from one traditional IRA if you reinvest them within 60 days in the same or another traditional IRA.
You put amounts you receive from your employer’s qualified retirement plan into your traditional IRA.

Your rollover contribution is obviously not deductible again, but it maintains its former tax deferred status. You do have to report the rollover distribution on your tax return. Rollovers must be completed in 60 days from the time you received the funds from the account you are rolling from. There are some exceptions to the 60-day period requirement that arise from disaster, casualty event, and other situations beyond your reasonable control. Amounts not rolled over within the 60-day period do not qualify for tax free rollover treatment. You must treat them as a taxable distribution from either your IRA or your employer’s plan. If you miss the 60-day tax free rollover period, these amounts are taxable in the year distributed. You may also have to pay a 10% tax penalty.

**Hurry Up and Wait…Between Rollovers**

If you make a tax-free rollover of all or any part of your traditional IRA, you have to wait a year to make another rollover from any balance still in this IRA as well wait a year to roll any account assets that are in the one you rolled over into.

**Moving your Employer’s Plan into an IRA?**

If you receive an eligible rollover distribution from your employer’s qualified pension, profit-sharing or stock bonus plan, annuity plan, or tax-sheltered annuity plan (403(b) plan, you can roll over all or part of it into a traditional IRA.

Note: Transfers, under certain conditions are, are permitted to be placed in a Roth IRA. We’ll cover this in the next section when we review the Roth IRA.

**What’s a Trustee to Trustee transfer?**

A transfer of funds in your traditional IRA from one trustee directly to another, either at your request or at the trustee’s request, is not a rollover. Because there is no distribution directly to you to redeposit in another account, the transfer is tax free. Also, because it is not a rollover, it is not affected by the 1-year waiting period required between rollovers.

**What Happens When I Withdraw from My IRA?**

Since the purpose of having an IRA is to set aside your money to have funds for your retirement, it was created for you as a tax-favored means of saving for that purpose. If you need any of the money before then, a penalty in the form of a 10% additional tax generally applies if you withdraw money before you are age 59½.
Whoops...I changed my mind!

If you make a contribution before you file your taxes and then change your mind and want to withdraw it, you can. You can make a tax-free withdrawal of this contribution if you do it before the due date for your filing your tax return for the year in which you made them. This is a withdrawal situation that, even if you are under age 59½, the 10% additional tax may not apply.

Age 59½ Rule

If you are under age 59½, in addition to current income taxes on withdrawals, you must pay a 10% additional tax on the distribution you take from your traditional IRA. Distributions before you are age 59½ are called “early distributions”.

After you reach age 59½, you can take money out of your traditional IRA without having to pay the 10% additional tax, just current income tax. You do not have to take the money out starting at 59½ as you are not required to begin withdrawals until you reach age 70½.

Any Exceptions to the 59½ Rule?

As in most things in life, there are exceptions to most rules, even with the IRS. If you receive a distribution before you are age 59½, you may not have to pay the 10% additional tax if you are in one of the following situations.

- You have unreimbursed medical expenses that are more than 7.5% of your adjusted gross income (10% if under age 65).
- The distributions are not more than the cost of your medical insurance.
- You are disabled.
- You are the beneficiary of a deceased IRA owner.
- You are receiving distributions in the form of an annuity.
- The distributions are not more than your qualified higher education expenses.
- You use the distributions to buy, build, or rebuild a first home.
- The distribution is due to an IRS levy of the qualified plan.

Do I Have to Take Money Out...Ever?

Yes! You cannot keep funds in a traditional IRA forever. Eventually you must take withdrawals. You must start receiving distributions from your IRA by April 1 of the year following the year in which you reach age 70½. April 1 of the year following the year in which you reach age 70½. This is referred to as the required beginning date. If there are no distributions, or if the distributions are not large enough as required by the IRS guidelines, you may have to pay a 50% excise tax on the amount not distributed as
required. The required minimum distribution for any year after your 70½ year must be made by December 31 of that later year.

**How Little can I Take?**

Minimum distributions from your traditional IRA must begin at age 70½ and may be figured differently depending on whether they are paid out of an individual retirement account or an individual retirement annuity. If you are the owner of a traditional IRA that is an individual retirement account, you or your trustee must figure the minimum amount required to be distributed each year. If your traditional IRA is an individual retirement annuity, special rules apply to figuring the required minimum distribution. In general, the amounts to be withdrawn are based on your account balance and the amounts that would have to be taken out to exhaust your full account by the age that a mortality table determines you will live to be from age 70½.

**What’s Fully or Partly Taxable?**

While most people put in all tax-deductible amount into their IRA, there are some who make non-deductible deposits. Withdrawals from your traditional IRA may be fully or partly taxable, depending on whether your IRA includes any nondeductible contributions.

If only deductible contributions were made to your traditional IRA, you have no basis in your IRA and any distributions are fully taxable when received. If you made nondeductible contributions to any of your traditional IRAs, you have a cost basis (investment in the contract) equal to the amount of those contributions and these nondeductible contributions are not taxed when they are withdrawn by you. They are essentially a return of your investment to you. Only the part of the distribution that represents nondeductible contributions (your cost basis) is tax free. Your distributions consist partly of nondeductible contributions (basis) and partly of deductible contributions, earnings, and gains (if there are any). Until all of your non-deductible contributions have been distributed, each distribution is partly nontaxable and partly taxable.
Chapter 4 Objectives

Upon completion of this section, you will:

- Gain insight into key features and benefits of payroll deduction Roth retirement plans.
- Be able to differentiate between payroll deduct Roth IRA and Traditional IRA plans.

Chapter Four: Individual Savings & Retirement Programs

...The Roth IRA

What Is a Roth IRA?

In a brief overview, a Roth IRA is an individual retirement plan that is subject to the rules that apply to a traditional IRA. It can be either an individual retirement account or an annuity. Regardless of your age, you are able to establish and make nondeductible contributions up to the date of your tax filing up to April 15th. You do not have to report Roth IRA contributions on your return. To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up.

Like a Traditional IRA the growth is not subject to current income taxes. Unlike a traditional IRA, you cannot deduct contributions to a Roth IRA. But, if you satisfy the requirements, qualified distributions are tax-free. Contributions can be made to your Roth IRA after you reach age 70½ and you can leave amounts in your Roth IRA as long as you live.

Can I contribute to a Roth IRA?

<table>
<thead>
<tr>
<th>Year</th>
<th>If your tax status is...</th>
<th>...you can contribute to a Roth IRA if your modified adjusted gross income is less than...</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>Married, filing jointly</td>
<td>$189,000</td>
</tr>
<tr>
<td>2018</td>
<td>Single</td>
<td>$135,000</td>
</tr>
</tbody>
</table>

Retirement Individual and Employer Sponsored Plans
You can contribute to a Roth IRA, regardless of your age and if you have taxable compensation and, after adjustments, it is less than:

- $189,000 for married filing jointly,
- $135,000 for married filing separately
- $135,000 for single, head of household, qualifying widow(er)

How About a Roth IRA for My Spouse?

Yes! You can contribute to a Roth IRA for your spouse under the same requirements as a Traditional IRA discussed previously in this course.

What’s Considered Compensation?

Compensation is regarded similar to the traditional IRA which as you will recall includes wages, salaries, tips, professional fees, bonuses, other amounts received for providing personal services, commissions, self-employment income, and taxable alimony and separate maintenance payments.

MAGI (Modified Adjusted Gross Income)?

Your modified AGI for Roth IRA purposes is your adjusted gross income (AGI) as shown on your return modified as follows:

- **Subtract** any income resulting from the conversion of an IRA to a Roth IRA.
- **Add** the following deductions and exclusions:
  
  a) Traditional IRA deduction,
  b) Student loan interest deduction,
  c) Foreign earned income exclusion,
  d) Foreign housing exclusion or deduction,
  e) Exclusion of qualified bond interest, and
  f) Exclusion of employer-paid adoption expenses
  g) Any deduction for qualified tuition and related expenses.

How Much Can I Put In?

What you put aside and the limit on it depends on whether your contributions are made only to Roth IRAs or to both traditional IRAs and Roth IRAs.

If you are only putting money into a Roth IRA and not any into a traditional IRA, then you can put in 100% of your income up to $5,500 or $6,500 if you are age 50 or over (2018).
This is also conditioned on the fact that your MAGI is less that $184,000 for married filing jointly, and $135,000 for single, head of household, qualifying widow(er).

These limits are for 2018 of $5,500 and $6,500 for age 50 and older. Future years beyond 2018 will see this amount adjusted for inflation. (Add $1000 extra for 50+ year old individuals)

**Can I Put into Both Traditional and Roth?**

Yes, but they are coordinated and have a limit together. If you contribute to both Roth IRAs and traditional IRAs, your contribution limit is the limit for your Roth IRAs. This means that your combined contribution limit is $5,500 (2018) and $6,500 (2018) for age 50 and older in 2018 and the higher limits in the future as shown previously.

**When Can I Make Contributions?**

You can make contributions to a Roth IRA for a year at any time during the year or by the due date of your return for that year.

**What About Excess Contributions?**

A 6% excise tax applies to any excess contribution to a Roth IRA, just as it does to the traditional IRA. You can avoid this is if you withdraw the excess contributions and any earnings on the excess contribution prior to your filing due date, including extensions.

In addition, if your contributions to your Roth IRA for a year were more than the limit, you can apply the excess contribution in one year to a later year if the contributions for that later year are less than the maximum allowed for that year.

**Can I Move Amounts Into a Roth IRA?**

Yes. You can convert amounts from a traditional IRA, SEP, or SIMPLE IRA into a Roth IRA. You may be able to recharacterize contributions made to one IRA as having been made directly to a different IRA. You can roll amounts over from one Roth IRA to another Roth IRA.

You can convert a traditional IRA to a Roth IRA. The conversion is treated as a rollover, regardless of the conversion method used. These methods are similar to those reviewed earlier in the traditional IRA section. If your AGI any level and you are not filing as married, filing separately, you can convert amounts from a traditional IRA into a Roth IRA. You can withdraw all or part of your traditional IRA and reinvest it (within 60 days) in a Roth IRA. If properly rolled over, the 10% additional tax on early distributions will not apply. You must roll over into the Roth IRA the same type of property you received from the traditional IRA. You can roll over part of the
withdrawal into a Roth IRA and keep the rest of it. The amount you keep that is earning will generally be taxable and will subject to the 10% tax

Rollover from a Roth IRA?

You can withdraw, tax free, all or part of your Roth IRA if you roll them within 60 days to another Roth IRA. However, no deductible contributions can be made to Roth IRAs, and rollovers from retirement plans other than Roth IRAs are disregarded for purposes of the 1-year waiting period between rollovers. A rollover from a Roth IRA to an employer retirement plan is not allowed.

What’s this Recharacterization Stuff?

You may be able to treat a contribution made to one type of IRA as having been made to a different type of IRA. This is called recharacterizing the contribution. If you make a contribution to a traditional IRA and decide you wanted it to go into a Roth that year instead, you can do this by recharacterizing it. This is done from the trustee of one to the trustee of the other, internally. If the transfer is made by the due date (including extensions) for your tax return for the year during which the contribution was made, you can elect to treat the contribution as having been originally made to the Roth instead of to the traditional IRA. It will be treated as having been made to the second IRA on the same date that it was actually made to the first IRA. You must report the recharacterization and must treat the contribution as having been made to the second IRA, instead of the first IRA on your tax return for the year during which the contribution was made. If you file your return timely without making the election, you can still make the choice by filing an amended return within six months of the due date of the return.

Tax on My Roth Withdrawals?

Unlike traditional IRAs, not all of your withdrawals from your Roth are taxable. The after-tax contributions that you put in are not taxable when you make a withdrawal. You do not include in your gross income qualified distributions or distributions that are a return of your regular contributions from your Roth IRA(s).

You also do not include distributions from your Roth IRA that you roll over tax free into another Roth IRA. You only include the earnings portion of your withdrawals. You may consider withdrawals of your non-taxable portion first, then your taxable earnings last.

What Are Qualified Distributions?

A qualified distribution is any payment or distribution from your Roth IRA that meets the following requirements:
1) It is made after the 5 taxable year period beginning with the first taxable year for which you made a contribution to a Roth IRA, and
2) The payment or distribution is:
   a) Made on or after the date you reach age 59½,
   b) Made because you are disabled,
   c) Made to a beneficiary or to your estate after your death, or
   d) One that meets the *First home* requirements discussed previously ($10,000 lifetime limit).

**Roth Withdrawal Penalties?**

**Early distributions.** You must pay the 10% additional tax penalty on early distributions on the taxable part (earnings) of any distributions that are not qualified distributions.

You may not have to pay the 10% additional tax on early distributions in the following situations.

- You have reached age 59½.
- You are disabled.
- You are the beneficiary of a deceased IRA owner.
- You use the distribution to pay certain qualified first-time homebuyer amounts.
- The distributions are part of a series of substantially equal payments.
- You have significant unreimbursed medical expenses.
- You are paying medical insurance premiums after losing your job.
- The distributions are not more than qualified higher education expenses.
- The distribution is due to an IRS levy of the qualified plan.

**Introducing the myRA**

In 2014, the Treasury introduced a new type of retirement account, the myRA, beginning in late 2014, that was guaranteed by the government to never lose value. Deposits are made via payroll deduction, and accounts can be opened with an initial deposit of as little as $25 up to $5,500 (2018) and then direct deposits of $5 or more each payday. But these accounts are not tied to your job and are portable if you change jobs. Savers with a 2018 annual income of less than $135,000 for individuals and $199,000 for couples will be eligible to participate. These new accounts “target low- and middle-income Americans who don’t currently have access to an employer-sponsored plan,” says Mikio Thomas, a senior tax analyst for the Internal Revenue Service.

The myRA is a Roth account, which means contributions can be withdrawn tax-free at any time, and earnings can be distributed without triggering an additional tax once the account is five years old and the account owner is at least age 59½. However, myRAs differ from Roth IRAs in that myRAs will hold a new retirement savings bond backed by
the U.S. Treasury that is guaranteed not to lose value, and there are no fees. Savers can use the accounts for up to 30 years or until their balance grows to $15,000, at which point the balance will transfer to a private-sector retirement account.

**Update: Treasury Announces Steps to Wind Down myRA Program**

Washington, D.C. 7/28/2017 – The U.S. Department of the Treasury today announced that it will begin to wind down the myRA program after a thorough review by Treasury that found it not to be cost effective. This review was undertaken as part of the Administration’s effort to assess existing programs and promote a more effective government.

Demand for and investment in the myRA program has been extremely low. American taxpayers have paid nearly $70 million to manage the program since 2014.

“The myRA program was created to help low to middle income earners start saving for retirement. Unfortunately, there has been very little demand for the program, and the cost to taxpayers cannot be justified by the assets in the program. Fortunately, ample private sector solutions exist, which resulted in less appeal for myRA. We will be phasing out the myRA program over the coming months. We will be communicating frequently with participants to help facilitate a smooth transition to other investment opportunities,” said Jovita Carranza, U.S. Treasurer.

Participants in the myRA program are being notified of the upcoming changes, including information on moving their myRA savings to another Roth IRA.
Chapter 5 Objectives

Upon completion of this section, you will:

- Gain insight into key features and benefits of Coverdell Education Savings Accounts.
- Be able to differentiate between payroll deduct Roth, Traditional, and ESA plans.

Chapter Five: Individual Savings & Retirement Programs...Educational IRA

Coverdell Education Savings Account
formerly Educational IRA

What Is a Coverdell ESA?

The IRS definition is “A Coverdell ESA is a trust or custodial account created or organized in the United States only for the purpose of paying the qualified education expenses of the designated beneficiary of the account.”

In simpler terms, it is an account that can be set up for the future educational expenses of a family member who is typically under 18 years old. This person is called the beneficiary. With the ever-increasing focus on education at all levels from our government as well as in the public and private sectors, a special tax benefited account was created to provide the capacity to build additional sums of money to pay for certain Qualified Higher Education Expenses (QHEE’s) for specific beneficiaries. Generally, when the account is established, the designated beneficiary must be under age 18.

To be treated as a Coverdell ESA, the account must be designated as a Coverdell ESA when it is created. The designated beneficiary can be 18 or older if he or she is a special needs beneficiary.

The document creating and governing the account must be in writing and must satisfy the following requirements.

1) The trustee or custodian must be a bank, or an entity approved by the IRS.
2) The document must provide that the trustee or custodian can only accept a contribution that meets all of the following conditions.
   a) Is in cash.
b) Is made before the beneficiary reaches age 18 (This does not apply if the beneficiary is a special needs beneficiary).
c) Would not result in total contributions for 2015 (not including rollover contributions) being more than 2,000.

3) Money in the account cannot be invested in life insurance contracts.
4) Money in the account cannot be combined with other property except in a common trust fund or common investment fund.
5) The balance in the account generally must be withdrawn within 30 days after the earlier of the following events.
   a) The beneficiary reaches age 30. (This rule does not apply if the beneficiary is a special needs beneficiary).
   b) The beneficiary’s death.

Contributions

You may be able to establish a Coverdell ESA to finance the qualified education expenses of a child (the designated beneficiary). Prior to 2001, this type of account was called an education individual retirement arrangement (or Education IRA).

Contributions to a Coverdell ESA are not deductible, but amounts deposited in the account grow tax free until withdrawn. And, if withdrawn for QHEE’s the withdrawals are tax free.

For 2018, you can contribute up to $2,000 cash and, in some cases, the beneficiary can be 18 or older. There is no limit on the number of separate Coverdell ESAs that can be established for a designated beneficiary. However, total contributions for the beneficiary cannot be more than 2,000 for 2018 no matter how many accounts have been established. If, for a year, withdrawals from an account are not more than a designated beneficiary’s qualified education expenses at an eligible educational institution, the beneficiary will not owe tax on the withdrawals.

Input Inching Up

Prior to 2002 the amount that could be contributed was $500. Now, the most you can contribute each year to a Coverdell ESA was increased from $500 to $2,000, as of 2002. In 2018, it is $2,000.

Income Limitations

Yes. If you are married and filing a joint return, your contribution limit is not reduced if your modified adjusted gross income (MAGI) is $220,000 or less. Your contribution limit is gradually reduced (phased out) if your MAGI is more than $190,000 but less than $220,000. If your MAGI is $220,000 or more, you cannot contribute to a Coverdell ESA.
If you are single or a head of household your contribution limit is not reduced if your modified adjusted gross income (MAGI) is $110,000 or less. Your contribution limit is gradually reduced (phased out) if your MAGI is more than $95,000 but less than $110,000. If your MAGI is $110,000 or more, you cannot contribute to a Coverdell ESA. (All figures are for 2018)

**When Can I Contribute?**

The final date on which you can make contributions to a Coverdell ESA for any year has been extended to the due date of your return for that year (not including extensions). If you are a calendar year taxpayer, you generally will have until April 15, 2019, to make your contribution for the 2018 tax year.

**What Are These QHEE’s Anyway?**

Qualified Higher Educational Expenses relate to post-secondary school’s expenses required for the enrollment or attendance of the designated beneficiary at an eligible educational institution.

The following items are qualified education expenses:

- Tuition and fees.
- The cost of books, supplies, and equipment.
- Amounts contributed to a qualified state tuition program.
- In some situations, the cost of room and board. The cost of room and board is a qualified education expense if the designated beneficiary is at least a *half-time student* at an eligible educational institution.
- The expense for room and board is limited to one of the following two amounts.
  - a) The school’s posted room and board charge for students living on campus.
  - b) $2,500 each year for students living off campus and not at home.

**Half a Student**

A student is enrolled “at least half-time” if he or she is enrolled for at least half the full-time academic work load for the course of study the student is pursuing as determined under the standards of the school where the student is enrolled.

**What About Elementary and Secondary education?**

You can also use withdrawals from a Coverdell ESA account for certain elementary and secondary education expenses. The definition of qualified education expenses has been expanded to include elementary and secondary education expenses. Qualified elementary and secondary education expenses include expenses for:
- Tuition, fees, academic tutoring, special needs services in the case of a special needs beneficiary, books, supplies, and other equipment incurred in connection with enrollment or attendance as an elementary or secondary school student at a public, private, or religious school,
- Room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance, and
- The purchase of computer technology or equipment or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary’s family during any of the years the beneficiary is in school (not including expenses for computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature).

Special Needs Beneficiaries

You can continue to make contributions to a Coverdell ESA for a special needs beneficiary after his or her 18th birthday. You can leave assets in a Coverdell ESA set up for a special needs beneficiary after the beneficiary reaches age 30, as well.

Coordination with Hope and Lifetime Learning Credits

Yes. You can claim the Hope, where available, or lifetime learning credit in the same year you take a tax-free distribution from a Coverdell ESA, provided that the distribution from the Coverdell ESA is not used for the same expenses for which the credit is claimed.

Coordination with Qualified Tuition Programs (QTPs)

You can make contributions to Coverdell ESAs and qualified tuition programs in the same year for the same beneficiary.

What Schools Pass the Test?

An eligible educational institution is any college, university, vocational school, or other post-secondary educational institution eligible to participate in a student aid program administered by the Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary, post-secondary institutions. The educational institution should be able to tell you if it is an eligible educational institution.
More About Contributions

Any individual (including the designated beneficiary for whose benefit the account is established) can contribute to a Coverdell ESA if the single individual’s *modified adjusted gross income* for the year is less than $110,000. The income limit for making a maximum contribution now stands at $190,000 for married couples filing joint tax returns, and contributions phase out at $220,000 in 2018.

Organizations, such as corporations, can also contribute to Coverdell ESAs. There is no requirement that an organization’s income be below a certain level. Contributions must be in cash.

For 2018, contributions:

- Cannot be made after the beneficiary reaches age 18, and
- Must be made by tax filing date up to April 15, 2019. For 2018, contributions:
  - Can be made after the beneficiary reaches age 18 if the beneficiary is a special needs beneficiary, and
  - Must be made by the due date of the return (not including extensions). Contributions can be made to one or several Coverdell ESAs for the same designated beneficiary provided that the total contributions are not more than the contribution limits for a year.

Penalties on Excess Contributions

The beneficiary must pay a 6% excise tax each year on excess contributions that are in a Coverdell ESA at the end of the year. For 2018, excess contributions are the *total* of the following amount: Contributions to any designated beneficiary’s Coverdell ESA for the year that are more than $2000.

Rollovers and Other Transfers

Assets can be rolled over from one Coverdell ESA to another. The designated beneficiary can be changed, and the beneficiary’s interest can be transferred to a spouse or former spouse because of divorce.

Rollovers

Any amount withdrawn from a Coverdell ESA and rolled over to another Coverdell ESA for the benefit of the same beneficiary or a member of the beneficiary’s family who is under age 30 is not taxable. An amount is rolled over if it is paid to another Coverdell ESA within 60 days after the date of the withdrawal.
Designated Beneficiary Changes

Yes. The designated beneficiary can be changed to a member of the beneficiary’s family. There are no tax consequences if, at the time of the change, the new beneficiary is under age 30.

The beneficiary’s spouse and the following individuals (and their spouses) are members of the beneficiary’s family.

- The beneficiary’s child, grandchild, or stepchild.
- A brother, sister, half-brother, half-sister, stepbrother, or stepsister of the beneficiary.
- The father, mother, grandfather, grandmother, stepfather, or steppmother of the beneficiary.
- A brother or sister of the beneficiary’s father or mother.
- A son or daughter of the beneficiary’s brother or sister.
- The beneficiary’s son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law.

Accounts and Divorced

If a spouse or former spouse receives a Coverdell ESA under a divorce or separation instrument, it is not a taxable transfer. After the transfer, the spouse or former spouse treats the Coverdell ESA as his or her own.

Withdrawals - How Much, How, and For What?

The designated beneficiary of a Coverdell ESA can take withdrawals at any time. When the withdrawals are used for QHEE’s they are tax free. Whether other withdrawals are tax free depends, in part, on whether the withdrawals are more than the amount of qualified education expenses that the beneficiary has in the tax year. Withdrawals are tax free if they are not more than the beneficiary’s qualified education expenses for the tax year.

When withdrawals are non-qualified, a portion of the withdrawals is taxable to the beneficiary if these withdrawals are more than the beneficiary’s qualified education expenses for the tax year. Also, if you receive a taxable withdrawal, you also must pay a 10% additional tax on the amount included in income.

There are, however, exceptions to this: The 10% additional tax does not apply to withdrawals described in the following list:

- Paid to a beneficiary (or to the estate of the designated beneficiary) on or after the death of the designated beneficiary.
• Made because the designated beneficiary is disabled. A person is considered to be disabled if he or she shows proof that he or she cannot do any substantial gainful activity because of his or her physical or mental condition. A physician must determine that his or her condition can be expected to result in death or to be of long-continued and indefinite duration.
• Made because the designated beneficiary received:
  o A qualified scholarship excludable from gross income,
  o An educational assistance allowance, or
  o Payment for the designated beneficiary’s education expenses that is excludable from gross income under any law of the United States.
• Included in income only because the beneficiary waived the tax-free treatment of the withdrawal.
• A return of an excess 2018 contribution (and any earnings on it) made before the due date of the beneficiary’s tax return (including extensions). If the beneficiary does not have to file a return, the excess (and any earnings) must be withdrawn by April 15, 2019. The beneficiary must include in gross income for the year the contribution is made, any income earned on the excess contribution.

Waiver of Any Tax-Free Treatment

For 2018, the designated beneficiary can waive the tax-free treatment of the withdrawal and elect to pay any tax that would otherwise be owed on the withdrawal. The beneficiary or the beneficiary’s parents may then be eligible to claim a Hope credit or Lifetime Learning Credit for qualified education expenses paid in that tax year.

When Must It All be Withdrawn?

Any assets remaining in a Coverdell ESA must be withdrawn when either one of the following two events occurs.

• The designated beneficiary reaches age 30. In this case, the designated beneficiary must withdraw the remaining assets within 30 days after reaching age 30.
• The designated beneficiary dies before reaching age 30. In this case, the remaining assets must generally be withdrawn within 30 days after the date of death.
Chapter 6 Objectives

Upon completion of this section, you will:

- Understand what SEP IRAs are, what’s unique, and how they work.
- Know key attributes about SEPs “with” and “without” employees involved.

Chapter Six: SEP IRA Plans

“Individual” Simplified Employee Pension Plan

A Simplified Employee Pension Plan, commonly known as a SEP-IRA, is a retirement plan specifically designed for self-employed people and small-business owners. It can be installed and benefit a sole proprietor significantly beyond what an individual IRA can do for the individual who owns a business with NO employees. We focus on that scenario here. We will also discuss SEP-IRAs for employers WITH employees later on in Section 2 of your course.

Many employers find it hard to fund their retirement to the extent that larger employers with employees can do. The problem might be that they do not have a good retirement plan in place or that the one they have in not able to accept the level of deposits to provide an adequate retirement for the sole employer.

SEP IRAs were introduced in 1978 (effective 1/1/79) and they have proven to be a popular program. SEP stands for Simplified Employee Pension, and the emphasis here is on "simplified."

SEPs are as easy to use as individual IRAs and almost identical as well. But they offer one major advantage over IRAs: Instead of being limited to a $5,500 annual deductible contribution (2018), one can put away 25% of their self-employment income, with their contribution capped at $55,000 (2018). They are permitted to do this even if they or their spouse participate in another pension or retirement plan.

Contributions into a SEP IRA are generally tax deductable and investment earnings in a SEP grow tax deferred. Withdrawals after age 59½ are taxed as ordinary income. Withdrawals prior to age 59½ may incur a 10% IRS penalty as well as income taxes. With a SEP, each eligible employee has their own separate SEP IRA which is then funded by the employer.
SEPs involve minimal disclosure and reporting requirements. One can contribute different amounts from year to year, and they can wait until April 15 to contribute for the previous year (or later if they file an extension). Other plans must be established by December 31.

A SEP IRA may be a good option for employers who want to make high contributions to their own accounts. A self-employed individual with no employees other than a spouse may also want to consider an Individual 401k as well as a SEP IRA.

If they have just a spouse as an employee and are looking for a plan that is truly low cost and low maintenance, then they should consider a SEP IRA.

**Simplified Employee Pension Plan (SEP IRA)**

A Simplified Employee Pension (SEP) is a written arrangement (a Plan) that allows an employer to make contributions toward his or her own (if a self-employed individual) retirement plan without becoming involved in more complex arrangements. As in an IRA, the plan's earnings aren't taxed until they are withdrawn at retirement. All of the money contributed to a participant's account immediately belongs to that person. This means there is no mandatory minimum vesting period. In addition, the participant "guides" the investment. For example, if the contributions are invested in mutual funds, he can choose the fund(s) in which to invest his contribution.

SEP, much like SIMPLE, was designed for the small employer with no employees. Hence, it is easy to establish and maintain with no federal filings required. When establishing a SEP-IRA plan for their business, they establish their own separate SEP-IRA account. Then, the owner contributions are then made into an eligible SEP-IRA account. The plan is funded with tax-deductible contributions, and they do not have eligible employees to cover. Its key features are highlighted below.

**Features**

Indeed, the only requirement is that the employer indicate that SEP contributions are being made on his W-2. In addition, the employer can decide from year to year whether or not to make a contribution. In this way, SEPs are similar to profit sharing plans.

Unlike SIMPLE IRA plans, the employer is not required to give 60 days’ notice that a contribution will be made. As the underlying account is an IRA, the owner may have a self-directed IRA as his or her SEP-IRA. This is in addition to any other IRAs one has.

With a SEP there is no "plan document," and they don't need to file annual reports with the IRS. Contributions can vary from year to year. So, if they hit a lean spell, they aren't locked in.
Contributions are limited to 25% of compensation to a maximum of $55,000, indexed for 2018. They are not required to be made each year. If a contribution is made, it must be made in accordance with set rules that may be different for each situation.

**Establishment**

For prior year deductibility, SEPs need not be established until the owner has filed his/her tax return (including extensions). This is a tremendous advantage over any other qualified plan. The norm is that plans must be established by plan year end.

The deadline for making contributions, as well as setting up the plan, is the owner’s tax return filing deadline, including extensions. This is a critical difference from the deadline for IRA contributions, which is fixed at April 15.

They can take advantage of the extended deadline to receive their tax refund before their contribution is due and use their refund to fund their SEP. Suppose they wish to fund their SEP for 2018 but are experiencing cash flow problems. They know that they will receive a refund on their 2018 taxes. They file an extension for their 2018 taxes so that they have until Aug. 15, 2019, to file.

Filing an extension also means they have until Aug. 15, 2019, to fund their SEP for 2018. They file their tax return on April 16, or as soon as possible after April 15. Unless a major snafu occurs with their return at the IRS processing center, they will receive their refund well before Aug. 15 and have this additional cash to fund their SEP.

**Eligibility**

If he or she adds employees in the future, the owner must cover virtually all employees. Only those who are not age 21 and who have not earned at least $600 (indexed 2018) are not eligible for a contribution.

**Basics**

*High Contribution Limits*

Contributions to a SEP can be made between 0% to 25% of compensation up to $55,000 for 2018. For incorporated businesses, compensation is based on W-2 income and a SEP contribution can be made up to 25% of W-2 wages. For sole proprietors compensation is based on “adjusted earned income.” Adjusted earned income is determined by completing an IRS worksheet. Contributions of up to 20% of adjusted gross income can be made to a SEP IRA. Annual compensation of more than $275,000 in 2018 cannot be taken into consideration for determining contributions.

Some plans allow the employer to contribute a flat dollar amount for each plan.
Contributions are 100% vested.

**Tax Deductible Contributions**
Within IRS limits, contributions into a SEP IRA are generally 100% tax deductible to the owner. SEP IRA contributions are made by the employer into their own SEP.

**Tax Deferred Growth**
Interest earned in a SEP IRA grows tax-deferred. Dividends and investment earnings continue to grow without being taxed until you withdraw the assets. Withdrawals after age 59½ are taxed as ordinary income. Withdrawals prior to age 59½ may incur a 10% IRS penalty as well as income taxes. At age 70½ Mandatory Required Distributions are required.

**Contribution Flexibility**
Contributions into a SEP are completely discretionary. The percentage of contribution can vary year to year depending on profitability.

**Low Cost and Easy Administration**
SEP IRA accounts are inexpensive, easy to setup and maintain and do not require annual IRS filings.

**Retirement Plan Consolidation**
Retirement plans can be rolled over and consolidated into a SEP. This includes Traditional IRAs, 401k Plans, Money Purchase Plans, Profit Sharing Plans, Defined Benefit Plans, 403b Plans and Rollover IRAs. A Roth IRA or retirement accounts that have after tax contributions cannot be rolled over into a SEP IRA.

**SEP IRAs are Subject to the IRA Distribution Rules**
Neither loans nor hardship distributions are permitted.

Penalty free distributions are allowed after attainment of age 59½; permanent disability; education expenses; first time home purchase (up to $10,000 lifetime cap); payment of medical expenses and payment of health insurance if unemployed.

Other distributions generally are subject to a 10% penalty tax if made prior to attainment of age 59½.

**Who May Want to Establish**
What's the lure of these plans? They cost nothing but time to set up, and the owners is not required to contribute. Moreover, SEP-IRAs are easier to set up and maintain than most retirement plans. The sole requirement is to fill out an adoption agreement, which is a far simpler agreement than those found with other plans.
The SEP is the easiest retirement plan for the self-employed taxpayer to maintain. It should especially appeal to small businesses that don't have staffs to handle the extra paperwork and record keeping required by other more complex retirement plans. SEP IRAs are used by smaller employers who want a plan with no paperwork and which offers maximum contribution flexibility.

Owners who are looking for a prior year tax deduction may **ONLY** use a SEP.

Sole proprietors with no common law employees are typical users of SEPs.

To establish a SEP-IRA, they can obtain adoption agreement kits free of charge from the IRS, mutual fund companies, brokerage firms or banks. There is usually a section in the back of each kit called the SEP Plan Document that covers the “nitty gritty” of the decisions that need to be made. It's worth noting that the adoption agreement must be executed by the owner's tax filing deadline, plus extensions.

The only cost involved in establishing a SEP-IRA is the annual trustee fee of about $10 to $15 per year. There are plenty of companies that do this for free.

SEP-IRAs are excellent for the self-employed business owner. The business owner becomes fully vested immediately -- once a contribution has been made to their account, it belongs to them.

**SEP IRA with NO Employees**

**SEP IRA contributions for a self-employed individual with no employees**

Contributions between 0% and 25% of compensation up to a maximum of $55,000 in 2018 can be made into a SEP IRA. For incorporated businesses, compensation is based on W-2 income and there is a 25% maximum contribution. For sole proprietors compensation is based on adjusted earned income. Adjusted earned income is determined by completing an IRS worksheet. Contributions of up to 20% of adjusted gross income can be made to a SEP IRA. Annual compensation of more than $275,000 in 2018 cannot be taken into consideration for determining contributions.

**SEP IRA Eligibility**

Incorporated and unincorporated businesses. Sole proprietors, qualify. Also, individuals with self-employed income may be able to contribute to a SEP even if they contribute the maximum into a 401k or 403b retirement plan through their full-time employer.

Self-employed individuals could also consider an Individual 401k as an alternative to a SEP IRA. When compared to a SEP IRA, an Individual 401k may allow a greater contribution at the same income level due to the way the contribution is calculated.
Who is considered to be an eligible owner?
Generally, when a SEP is established IRS Form 5305 is completed. This short form sets the eligibility requirements for determining who is eligible.

Is the SEP IRA a good retirement plan option for a family business employing their children?
Yes. The SEP IRA is very egalitarian and requires that contributions for employees be at the same percentage of income as for the business owner. SEP IRA contributions are made by the employer and the contributions are vested immediately. Therefore, it is a generous retirement plan and employee benefit, but expensive for employers. However, when the employees are the children the money stays in the family and the parents are helping their children prepare for retirement and the contribution is a tax-deductible business expense.
Chapter 7 Objectives

Upon completion of this section, you will:

- Understand what retirement need analysis tools are, what’s unique, and how they work.
- Know key attributes about planning for and reaching retirement goals.

Chapter Seven: Retirement Need Analysis

A Simple Calculation To Get Started

Planning Ahead

There are certainly quite a number of needs analysis tools and calculators available. The following is just one sample of a simple one to explore as it addresses the basics many consider in going about getting their arms around retirement income needs and planning. Feel free to substitute your own assumptions. Your preferences may differ based on your experience and each client’s unique situation.

A Simple Calculation to get Started

1. How much annual income will you want in retirement? (Figure at least 70% of your current annual income just to maintain your current standard of living.)

2. Subtract the income you expect to receive annually from:
   - Social Security
     If you make under $25,000, enter $8,000; between $25,000 - $40,000, enter $12,000; over $40,000, enter $14,500 (For married couples - the lower earning spouse should enter either their own benefit based on their income or 50% of the higher earning spouse’s benefit, whichever is higher.)
     It is assumed you will begin receiving Social Security Benefits at age 65, however the age for full benefits is rising to 67. Your Social Security statement will provide a personalized benefit estimate based on your actual earning history.
   - Traditional Employer Pension -- a plan that pays a set dollar amount for life, where the dollar amount depends on salary and
years of service (in today's dollars)
• Part-time income
• Other

This is how much you need to make up for each retirement year:

Now you want a rough estimate of how much money you'll need in the bank the day you retire. So, the accountants went to work and devised this simple formula. For the record, they figure you'll realize a constant real rate of return of 3% after inflation, you'll live to age 87, and you'll begin to receive income from Social Security at age 65. If you anticipate living longer than age 87 or earning less than a 3% real rate of return on your savings, you'll want to consider using a higher percentage of your current annual gross income as a goal on line 1.

3. To determine the amount you'll need to save, multiply the amount you need to make up by the factor below.

<table>
<thead>
<tr>
<th>Age you expect to retire:</th>
<th>55</th>
<th>60</th>
<th>65</th>
<th>70</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Your factor is:</td>
<td>21.0</td>
<td>18.9</td>
<td>16.4</td>
<td>13.6</td>
</tr>
</tbody>
</table>

4. If you expect to retire before age 65, multiply your Social Security benefit from line 2 by the factor below.

<table>
<thead>
<tr>
<th>Age you expect to retire:</th>
<th>55</th>
<th>60</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Your factor is:</td>
<td>8.8</td>
<td>4.7</td>
</tr>
</tbody>
</table>

5. Multiply your savings to date by the factor below (include money accumulated in a 401(K), IRA, or similar retirement plan):

<table>
<thead>
<tr>
<th>If you want to retire in:</th>
<th>10 years</th>
<th>15 years</th>
<th>20 years</th>
<th>25 years</th>
<th>30 years</th>
<th>35 years</th>
<th>40 years</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Your factor is:</td>
<td>1.3</td>
<td>1.6</td>
<td>1.8</td>
<td>2.1</td>
<td>2.4</td>
<td>2.8</td>
<td>3.3</td>
</tr>
</tbody>
</table>

Total additional savings needed at retirement:

Don't panic. Those same accountants devised another formula to show you how much to save each year in order to reach your goal amount. They factor in
compounding. That's where your money not only makes interest, your interest starts making interest as well, creating a snowball effect.

6. To determine the ANNUAL amount you'll need to save, multiply the TOTAL amount by the factor below.

<table>
<thead>
<tr>
<th>If you want to retire in:</th>
<th>Your factor is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 yrs.</td>
<td>.085</td>
</tr>
<tr>
<td>15 yrs.</td>
<td>.052</td>
</tr>
<tr>
<td>20 yrs.</td>
<td>.036</td>
</tr>
<tr>
<td>25 yrs.</td>
<td>.027</td>
</tr>
<tr>
<td>30 yrs.</td>
<td>.020</td>
</tr>
<tr>
<td>35 yrs.</td>
<td>.016</td>
</tr>
<tr>
<td>40 yrs.</td>
<td>.013</td>
</tr>
</tbody>
</table>

See? It's not impossible or even particularly painful. It just takes planning. And the sooner you start, the better off you'll be.

More on Reaching Financial Goals

Reaching financial goals requires a considerable amount of thought, planning and discipline. The following outlines how you might benefit and excel in reaching yours and helping others to reach their goals:

- gather the appropriate information;
- formulate a realistic savings and investment plan; and
- implement the plan with a program of disciplined saving and wise investment.

Get the Facts, Learn the Basics

The first step in reaching a financial goal is getting the right information. Making well considered savings and investment decisions depends on knowing your own financial situation and needs. The following list serves as a useful example of some of the primary areas that you and Americans need to address in retirement planning:

- Cash reserves for emergencies
- Social Security benefits
- Employer-sponsored pensions or profit sharing plans
- Tax-sheltered savings plans such as 401(k)s
- Individual Retirement Accounts
- Savings

Individuals must then set financial goals and formulate a plan to achieve them.
Making a Plan

Once an individual has gathered the basic information and has reasonably sound knowledge of the saving and investment options available, he or she is ready to formulate a plan, or road map, to serve as a financial guide in the coming years. Here is a suggested a five-step approach to help people get started on developing a financial plan.

- **Set Goals.** Figure out what your major goals are, how much it will cost to reach them and the number of years that you have to build up your savings.

- **Start Saving.** Your savings should not depend on what happens to be left over at the end of the month. Based on your goals and how much you need to save to reach them, start setting aside something toward each goal every month ... and put it in separate accounts. The best way to make sure that you have money to save is to put yourself on a budget based on your income and expenses.

- **Match Investments to Goals.** Take the time to learn about the best types of savings and investment products for each of your goals. An important point: Choosing the right type of investment is more important than choosing the very “best” product of that type. Never buy an investment that you do not understand. Always make sure that any investment you buy makes sense as part of your overall financial plan.

- **Do Annual Check-Up.** Have your goals changed? How are your investments doing? Could you save even more? These are the questions that you should ask at least once every year.

- **Choose Help Wisely.** You may be able to put together and carry out a financial plan on your own. Public libraries, book stores, and the Internet are good sources of information about financial planning strategies, as well as the savings and investment products used to carry them out. If you decide that you need the help of a financial professional, determine in advance what services you want to get and then interview two or three properly licensed professionals who specialize in your needed services, are experienced, and have clean disciplinary records. Make sure you know how your financial adviser is going to be compensated and the total cost of getting his or her advice and putting it into action.
Saving and Investing Wisely

More than half of all current investors rely on professional financial advisers for their investment advice. Nevertheless, almost four-fifths of investors feel it is difficult to know how to go about choosing a good professional investment advisor. Worse still, the vast majority of investors fail to investigate the backgrounds of financial planners and stockbrokers they hire to advise them. Individuals should investigate before they invest. Here are some tips individuals should follow to protect their hard-earned money:

Ask Questions
- Is the investment registered?
- Are the broker and the firm licensed to do business in my state?

Know Your Broker
- Ask your state’s securities regulators if they’ve received complaints against the broker and the broker’s firm.

Know the Investment
- How long has the company been in business? What are its products or services? Has the company made money for investors before?

Get the Facts in Writing
- Don’t get swept away by a sales pitch. Always ask for and read carefully the company’s prospectus or latest annual report.

Watch Out for Fraud
- Think twice if you see any of these tell-tale signs of trouble:
  - Pressure to invest before you’ve had an opportunity to investigate
  - Sales people offering “inside” or “confidential” information
  - Claims of a “once-in-a-lifetime opportunity” or a “limited time offer”
  - Promises of spectacular profits or “guaranteed” returns
  - Assurances that the investment is “risk-free” or “as safe as a certificate of deposit”
  - Reluctance or outright refusal to send you written information about the investment

Complain Promptly
- If you have problems, get help right away. Contact the broker’s supervisor or the firm’s compliance officer.
Final Words

The retirement issue is one of the most important aspects for you and Americans in the years and decades to come. How we go about the challenges of planning for it and putting aside enough funds to make it financially possible and pleasurable is key. In a world of uncertainty and change, the planning process and funding solutions will have to be flexible and adaptable to those changes. It will require that we stay focused on the goals and dreams of our clients and prospects. It will require us to frequently review, update, and adjust the amount of money being set aside to stay on track as inflation and earnings rates fluctuate.

We will need to continually study and keep up with all the current legislation and government/private sector sponsored programs. We must do this to make sure we are good sources of information and wise counsel for ourselves and for those we help in finding their way to a financially sound future and retirement.

More now than ever before, our clients and prospects need your assistance and encouragement in helping them to become more knowledgeable for their own benefit as well as their capacity to be able to work confidently with you. As we all know, the success of financial planning and providing for a rewarding retirement is a proactive partnership between you and your clients.
EMPLOYER SPONSORED PLANS

Overview and Objectives

This course was designed to provide you with information for financial professionals in the area of Small Business Retirement Plans with special attention to the various types and issues specific to the world of accumulation for retirement through worksite and small business retirement Plans.

Informing you about plan details and broadening your competency in these plans is the objective for each student.

It acknowledges and includes detailed examination of Payroll Deduction IRA's, Simple IRAs, and SEP IRAs, SARSEP IRAs, 401(k)s, 403(b)s, Profit Sharing, and Defined Benefit and other specialty categories sponsored and available throughout the worksite marketplace. It also highlights distribution opportunities and tax consequences for withdrawals that are fundamental components of retirement accumulation programs.

Our objective is also that you will acquire a new level of competency and insight into this highly critical area of people’s financial future...saving and accumulating dollars for use in the future through plans offered through small businesses.

As time goes by, individuals’ situations change with respect to their available discretionary income, tax brackets, and family situations. In addition, tax law changes, program availability, and feature modifications are constantly being reviewed, updated, and changed. Some save specifically for retirement and education. Some save for the future (retirement) exclusively and take care of education as best they can when it occurs prior to their retirement...or some combination of both!

Yet some things are fundamental and seldom, if ever, change. Accumulating funds for the future depends on money, time, a vehicle, and consistency. With so many plans and places to save or invest in, the real key is for clients to start putting aside funds today so that a retirement nest egg is available down the road. The more one puts away today, the more it grows. The higher yield or growth each dollar earns makes it compound faster and greater. The less taxes we pay when we put it away, as it grows, and when we take it out allows for each dollar to work harder, grow larger, and provide for more of its intended usage. And, to the extent we have planned ahead for certain amounts to be available at specific times in the future, the more motivated clients are to put aside on a regular basis an amount that will grow to what is needed in the future (consistency).

Whether you are a newer or a veteran in helping others, we’re confident that you will gain new insight into this critical area for Americans as well as brush up on current info and regulations pertinent to this area of your expertise.
Chapter 8 Objectives

Upon completion of this section, you will:

- Gain increased awareness of advantages of saving for retirement at the workplace.
- Learn about the basic categories and characteristics of business retirement plans.

Chapter Eight: Employer-Sponsored Retirement Plan

What is It?

Employer-sponsored plans do not substitute for personal savings but, rather, enhance it. Employers offer the means for disciplined savings over the course of an employee's working life, dramatically increasing the likelihood that savings will accrue for the purpose of retirement.

Employer-sponsored retirement plans generally involve more complex requirements than individual retirement plans. For income tax purposes, employer-sponsored retirement plans are classified as either qualified or nonqualified plans. Qualified plans receive favorable tax treatment, both for the employer and the employee, because they comply with nondiscrimination and fiduciary responsibility requirements.

Qualified plans offer significant advantages to employers and employees. The tax-deferred status of qualified plan investment earnings is beneficial to both the employer and employees because investment earnings are not taxed to either while the funds remain in the plan.

The tax-favored treatment of qualified plans generally is an important consideration for the employer who is installing a qualified plan. This is because the employer is allowed to deduct contributions to a qualified plan in the year the contributions are made. This deduction is especially valuable to the business owner, since, in many small businesses, it will offset the cost of including the rank-and-file employees in the qualified plan.

The following represent some of the advantages of the employer sponsored retirement system - to employees, to employers, and to our nation as a whole:
Advantages to Employees

- Allow employees to prepare financially for their retirement years;
- Allow employees to engage in disciplined long-term savings;
- Provide security for workers who would otherwise not save;
- Provide investment education opportunities for employees;
- Help alleviate some financial risks to employees and/or family members from sudden and unexpected tragedies such as disability or death.
- Provide employees with a financial stake in their employer (ESOP; stock bonus, stock options);
- Provide professional investment/management of accumulated retirement savings

Advantages to Employers

- Allow employers to attract and retain a quality workforce;
- Increase worker productivity;
- Builds employee ownership of and financial commitment to their employers;

Advantages to our Nation

- Provide investment funds that spur economic growth and boost national savings;
- Reduce the strain on government entitlement programs;
- Engage workers in systematic long-term savings;
- Provide for broad-based participation by employees allowing more individuals to save for retirement.

Today small business owners have a number of retirement plan options to choose from, including the most common SEP-IRA, SIMPLE-IRA and 401(k) Plans. To help compare these plan options, the chart below outlines features that may be helpful to determine which is most appropriate for a business.

Plans Fall into Two Categories

- Plans generally funded by employer contributions (such as SEP-IRAs) – where the business contributes the same percentage of compensation for them and any eligible employees they may have; and

- Plans generally funded by employee elective deferrals and employer contributions (such as SIMPLE-IRA and 401(k) Plans) – where employees have an opportunity to defer part of their salary to fund their retirement plans - on a tax-advantaged basis.
In determining which of these retirement plans is most appropriate for a business, one will want to consider a few key questions, including:

- How much, if any, responsibility do they want to have for contributing to their employees’ retirement plans?
- What percentage of compensation do they and their employees want to be able to contribute each year?
- How much does each plan require them to contribute to the plan on behalf of their employees?
- Are they willing to assume some additional administrative responsibilities and costs for their retirement plan in exchange for more flexibility?

To help compare the answers to these questions for plan options, check out the following chart. See which plan combines the features that may be most appropriate for a particular business.

<table>
<thead>
<tr>
<th>Features</th>
<th>SEP-IRA</th>
<th>SIMPLE-IRA</th>
<th>401(k)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Eligibility</td>
<td>Any self-employed individual, business owner, or individual who earns any self-employed income</td>
<td>Businesses with 100 or fewer eligible employees and who do not currently maintain any other retirement plan</td>
<td>Any type of public or private company; typical for companies with 25 or more employees</td>
</tr>
<tr>
<td>Key Advantage</td>
<td>Easy to set up and maintain</td>
<td>Salary reduction plan with less administration</td>
<td>Features such as vesting schedules and loans</td>
</tr>
<tr>
<td>Funding Responsibility</td>
<td>Employer contributions only</td>
<td>Funded by employee salary reduction contributions and employer contributions</td>
<td>Funded by employee salary reduction contributions and employer contributions</td>
</tr>
<tr>
<td>Annual Contribution Per Participant</td>
<td>Up to 25% for 2018 of up to $275,000 considered compensation, up</td>
<td>Employee: Up to 100% of compensation, maximum of $12,500 for the</td>
<td>Employee: Depending on plan design, could be up to 100% of compensation, up</td>
</tr>
</tbody>
</table>
to a maximum of $55,000 for the 2018 plan year. Employer: Either match employee contributions dollar for dollar up to 3% of compensation (maximum $12,500 for the 2018 plan year); can be reduced to as low as 1% in any 2 out of 5 yrs. Or contribute 2% of each eligible employee's compensation, up to $12,500 for 2018.

Access to Assets
Withdrawals at any time. Withdrawals are subject to current federal income taxes and a possible 10% penalty (if the participant is under age 59½).

Vesting of Contributions
Immediate
Employee and employer contributions vested 100% immediately

Cannot take withdrawals from plan until a "trigger event" occurs. May offer loan provisions and allow withdrawals in certain hardship situations. (Hardship withdrawals may be subject to a possible 10% penalty if participant is under age 59½.)
Notes:
The maximum compensation on which contributions and SIMPLE-IRA employer 2% non-elective contributions can be based is $275,000 for the 2018 plan year. For self-employed people, compensation means earned income.

Employees age 50 and older in 2018 may be able to make an additional annual $3000 catch-up elective deferral contribution to their SIMPLE-IRA and $6000 to their 401(k).

Employees age 50 and older in 2018 may be eligible to receive an additional annual $3000 catch-up employer match to their SIMPLE-IRA

Self-Directed Plans

Self-direction of retirement plan investments means that one decides on the investments they wish to make in their retirement plan. This means every kind of IRA, and every kind of Keogh or Qualified Plan. IRA and Keogh plans all have an investment section in their respective trust and plan and trust documents. The investment section specifies what types of investments are permitted and under what circumstances. Truly self-directed plans have investment language which permits them to direct the trustee or custodian of their IRA or Keogh plan to make any investment permitted by law, and/or the trustee or custodian is able to make on behalf of their plan. The trust and plan documents will also indicate that there are transactions which are prohibited and in the case of IRAs, those collectibles which are not permitted.

The tax laws affecting retirement plans can be confusing and complicated. Depending upon their financial situation, their future goals, and whether they might have an employee-sponsored plan available, they will need to choose between several alternatives. Our recommendation is that they study their position carefully and confer with their tax advisor or financial planner on the best course for them.
Chapter 9 Objectives

Upon completion of this section, you will:

- Gain increased knowledge and awareness of key attribute of all 401(k) retirement plans
- Discover how the unique “carve outs” that are Roth and “Solo” 401(k)s work.

Chapter Nine: 401(K) Plans

What is a 401(k)?

A 401(k) is a type of retirement plan that allows employees to save and invest for their own retirement. Through a 401(k), they can authorize their employer to deduct a certain amount of money from their paycheck before taxes are calculated, and to invest it in the 401(k) plan. Their money is invested in investment options that they choose from the ones offered through their company’s plan. The federal government established the 401(k) in 1981 with special tax advantages, to encourage people to prepare for retirement. They get their name from the section of the Internal Revenue Code which established them.

How Does a 401(k) Plan Work?

One decides how much money they want deducted from their paycheck and how it is to be invested during each pay period, up to the legal maximum set by the IRS sets each year. They also decide how to invest that money, choosing from their plan's different investment options. The money they contribute to their 401(k) accounts is deducted from their pay before income taxes are taken out. This means that by contributing to a 401(k), they can actually lower the amount they pay each pay period in current taxes. For example, if they earn $1,000 each paycheck, and they contribute, say 5% ($50), they are only taxed on $950. They don't owe income taxes on the money until they withdraw it from the plan, when they could be in a lower tax bracket.

Many business owners think their business is too small for a 401(k). It may not be as they think and they should think it over again. If they have more than 25 employees, then they might be surprised to find that a 401(k) is not as expensive to create and maintain as they may have thought. Due to the competitiveness amongst 401(k) providers, the price point continues to drop. For example, a well-known 401(k) provider company now offers a 401(k) package for businesses with 25 employees or less that costs $1,400 per year in annual fees, plus $28 per employee. As you might guess, these
plans have limited flexibility. Employers are going to pay more for the more flexible robust fancy plans.

**How Much One Can Contribute to a 401(k) Plan at Work**

They can have their employer deduct a percentage of their pay (before taxes are calculated) and invest that money into their retirement plan account, up to the amount allowed by their plan. That amount cannot exceed the annual IRS dollar limit which was $17,500 in 2014. In 2018, the maximum pre-tax contribution changed to $18,500. It’s important to remember that their employer-sponsored retirement plan(s) may have additional limits. Some plans allow them to contribute on an after-tax basis as well. After-tax contributions also have a maximum limit determined by the IRS.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>If under age 50</th>
<th>If age 50 and 0ver</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$15,000</td>
<td>+$5,000 = $20,000</td>
</tr>
<tr>
<td>2007</td>
<td>$15,500</td>
<td>+$5,000 = $20,500</td>
</tr>
<tr>
<td>2008</td>
<td>$15,500</td>
<td>+$5,000 = $20,500</td>
</tr>
<tr>
<td>2009</td>
<td>$16,500</td>
<td>+$5,500 = $22,000</td>
</tr>
<tr>
<td>2010</td>
<td>$16,500</td>
<td>+$5,500 = $22,000</td>
</tr>
<tr>
<td>2014</td>
<td>$17,500</td>
<td>+$5,500 = $23,000</td>
</tr>
<tr>
<td>2015</td>
<td>$18,000</td>
<td>+$6,000 = $24,000</td>
</tr>
<tr>
<td>2016-2017</td>
<td>$18,000</td>
<td>+$6,000 = $24,000</td>
</tr>
<tr>
<td>2018</td>
<td>$18,500</td>
<td>+$6,000 = $24,500</td>
</tr>
</tbody>
</table>

**Total Contributions**

The IRS has also set limits on the total amount that may be contributed to their 401(k) account from all sources combined, including any employer matching or profit-sharing contributions, and any employee after-tax contributions. For 2018, the maximum is the lesser of 100% of compensation or $55,000. The $55,000 limit will increase in $1,000 increments based on cost of living adjustments.

**Catch up Provision**

To encourage people to put aside more funds to shore up their retirement accounts by contributing more than the current limits with additional amounts that they might have not have put aside earlier, additional amounts can now be contributed.

If they are expected to reach age 50 or older during the calendar year January 1-December 31 and are making the maximum Plan or IRS pretax contribution, they may make an additional "catch-up" contribution each pay period. Starting in 2018, the maximum annual catch-up contribution is $6,000. Please note that they must make a
separate election to take advantage of the catch-up contribution. This $6,000 catch-up contribution will increase subject to cost of living adjustments (COLAs) in $500 increments.

If, at the end of the calendar year, their regular pre-tax contributions have not exceeded the Plan contribution limit or the IRS annual dollar limit, some or all of their catch-up contributions will be recharacterized as regular pre-tax contributions.

The welcome addition of these “catch up” contributions to the tax law can give those who are nearing retirement the opportunity to defer extra dollars each year, potentially making a big difference when retirement arrives.

**Retirement Savings Contributions Credit**

An individual may be able to take a tax credit of up to $1,000 (up to $2,000 if filing jointly) if he or she makes eligible contributions to an employer sponsored retirement plan or an IRA. This credit could reduce the individual’s federal income tax paid dollar for dollar.

If the individual makes eligible contributions to a qualified retirement plan, an eligible deferred compensation plan, or an IRA, he or she can claim the credit if all of the following apply.

- He or she is age 18 or older.
- He or she is not a full-time student.
- No one else, such as his or her parent(s), claims an exemption for him or her on their tax return.

His or her adjusted gross income (2018) is not more than:

- $63,000 if your filing status is married filing jointly,
- $47,250 if your filing status is head of household, or
- $31,500 if your filing status is single, married filing separately, or qualifying widow(er).

The individual is a full-time student if, during some part of each of 5 calendar months (not necessarily consecutive) during the calendar year, he or she is either:

- A full-time student at a school that has a regular teaching staff, course of study and regularly enrolled body of students in attendance, or
- A student taking a full-time, on-farm training course given by either a school that has a regular teaching staff, course of study, and regularly enrolled body of students in attendance or a state, county or local government.
Eligible contributions include:

- Contributions to a traditional or Roth IRA,

Salary reduction contributions (elective deferrals, including amounts designated as after-tax Roth contributions) to:

- A 401(k) plan (including a SIMPLE 401(k)),
- A §403(b) annuity,
- An eligible deferred compensation plan of a state or local government (a governmental 457(b) plan) (Roth contributions are not permitted in these plans),
- A SIMPLE IRA plan (Roth contributions are not permitted in these plans), or
- A salary reduction SEP (Roth contributions are not permitted in these plans), and
- Contributions to a §501(c)(18) plan.

They also include voluntary after-tax employee contributions to a qualified retirement plan or §403(b) annuity. For purposes of the credit, an employee contribution will be voluntary as long as it is not required as a condition of employment.

The amount of the credit you can get is based on the contributions you make and your credit rate. Your credit rate can be as low as 10% or as high as 50%. Your credit rate depends on your income and your filing status. See Form 8880 to determine your credit rate.

In 2018 this table below shows the tax credit available based on the following table on the first $2,000 of contributions made into a workplace retirement savings plan and IRAs.

<table>
<thead>
<tr>
<th>Extra Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Joint filers</td>
</tr>
<tr>
<td>Adjusted Gross Income (AGI)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Company Match

Some companies offer a "match" or "matching contribution" as an incentive to join the company retirement plan. It means that the company will contribute a certain amount
to their account (usually between $0.25 and $1.00) for every dollar that they contribute, up to a certain limit. The match formula can vary. To receive the matching contribution, the plan may require that they work a specified number of years. It makes good sense to take advantage of a company match by setting aside the maximum amount required to qualify for a matching contribution. If their employer offers a matching contribution, their savings can grow that much faster.

**Employer Contributions Included in the Annual Limit on 401(k) Contributions?**

Employer contributions are subject to different limits than employee contributions. The federal annual limit on pre-tax contributions applies only to their own contributions. In addition to plan limits, they may also be subject to additional contribution limits if they are considered a "highly compensated employee." The Internal Revenue Code limits the amount of money employees and employers may collectively contribute to each employee's plan account. In 2018, according to IRS the maximum is the lesser of 100% of compensation or $55,000. The $55,000 limit increases in $1,000 increments adjusted for inflation.

**Can an employee write a check to add more money to their account?**

No. By law, the only way they can contribute money to their 401(k) plan account is by automatic payroll deduction. They cannot write a check to add money to their account. If they want to contribute more money to their account, they should increase the deferral percentage through the Deductions area under the Accounts tab. Be aware that all 401(k) contributions are subject to certain limits.

**Government limits how much one can contribute to a 401(k)**

Congress limits the amount that an employee can contribute to their 401(k) to ensure that it still receives revenue from them in the form of federal income tax. Every dollar that they contribute to their 401(k) is a dollar that the government does not immediately receive federal taxes on. (It receives taxes later, when they withdraw their money.) By limiting how much income they can protect from current taxes, Congress ensures that it'll have a steady revenue flow.

**How Earnings in a 401(k) Account are Taxed**

Dividends, interest, and capital gains reinvested in their company's retirement plan account will not be taxed until they withdraw them (which is ideally at retirement, when they could be in a lower tax bracket). They are taxed as ordinary income if they withdraw them before age 59½ and they may owe a 10 percent early withdrawal penalty.
Withdrawals in a Financial Emergency

Depending on their plan, one may be eligible for a "hardship withdrawal," for those unexpected circumstances when they may need their money before retirement. According to IRS regulations, their "hardship" must represent an "immediate and heavy financial need" and there must not be "any other resources reasonably available to them to handle that financial need." The IRS generally recognizes four reasons for a hardship withdrawal:

- Certain non-reimbursable medical expenses for them, their spouse or their dependents
- Purchase of a primary residence (excluding mortgage payment)
- Payments of certain post-secondary education expenses for the next year for them, their spouse or their dependents
- To prevent eviction from or foreclosure on their primary home

Some plans also allow hardship withdrawals for other reasons. If so, they may need to show their employer proof of how they intend to use the money, and proof that the amount they requested isn't more than enough to satisfy their need. Certain hardship withdrawals will no longer be eligible for rollover. Therefore, there will no longer be 20 percent automatically withheld from their hardship amount, although it will still be subject to ordinary income taxes and a possible 10 percent early withdrawal penalty if they are under 59½.

As a result of the Economic Growth and Tax Relief Reconciliation Act of 2001, hardship withdrawals are not eligible to be rolled over, and are not subject to a federal income tax withholding. They may still owe income taxes and a possible 10% early withdrawal penalty if they are under 59½ when they file their annual income tax return. State and local taxes may also apply.

How Withdrawals Affect Taxes
It depends on whether they withdraw pre-tax or after-tax contributions:

Pre-Tax Contributions

In a nutshell, they must eventually pay ordinary income tax on all money in their account that has not yet been taxed. Therefore, they must pay income tax on any money that they withdraw from their pre-tax account, as well as any earnings on their pre-tax and after-tax contributions. (Remember, even though they have paid taxes on the contributions to their after-tax account, they have not yet paid taxes on the earnings.)
After-Tax Contributions (some plans do not allow after-tax contributions)

Since they have already paid income tax on the money that they contribute to their after-tax account, they do not pay income tax on this money when they withdraw it. However, when they withdraw from this portion of their account, tax regulations may require that they also withdraw a proportional percentage of any earnings on this money. This means that they will have to pay income tax on those earnings.

If You are Under Age 59½

Because company retirement plans are designed to help them save for retirement, tax laws require that they pay an early withdrawal penalty for most withdrawals made before age 59½. This penalty is intended to discourage early withdrawals and to help them save for their retirement. So, in addition to the ordinary income tax that they would pay on any pre-tax contributions and earnings, or after-tax earnings, they may also owe a 10 percent penalty on an early withdrawal.

Penalty for Withdrawing from a 401(k) Plan Account?

There can be, depending on one’s age and retirement status when they withdraw. Generally speaking, they will be assessed a penalty equal to 10 percent of the taxable amount of their withdrawal if they withdraw money before they reach age 59½. There are some instances when they may not have to pay a penalty. Keep in mind that they must pay income taxes on all withdrawals of taxable money, which affects the amount of the check they receive. Unless they request a "direct rollover" to roll the eligible money to another employer-sponsored plan or to an IRA, 20 percent of the taxable portion of their withdrawal will be withheld. (They may owe more or less than this amount when they file their income taxes, depending on their tax bracket.)

As a result of the Economic Growth and Tax Relief Reconciliation Act of 2001, hardship withdrawals are not eligible to be rolled over, and are not subject to a federal income tax withholding. They may still owe income taxes and a possible 10% early withdrawal penalty if they are under age 59½ when they file their annual income tax return. State and local taxes may also apply.

When the 10 Percent Early Withdrawal Penalty Not Apply

If one withdraws pre-tax money that is subject to taxation before age 59½ and they do not roll it over into another employer's plan or into an individual retirement account (IRA), they may owe a 10 percent early withdrawal penalty. (Of course, they will also have to pay income tax whenever they withdraw money that is subject to taxation from the plan.) There are a few instances when they may not have to pay this penalty. Some exceptions include:

- If they leave their company in the year they attain age 55 or older;
• If they withdraw money in substantially equal payments, made at least annually over their life expectancy or the joint life expectancy of them and their designated beneficiary;
• If they become disabled (as the Internal Revenue Code defines it);
• They may request a hardship withdrawal for certain medical expenses as long as they do not exceed the amount allowed as a deduction on their income tax return. Not all plans allow for such withdrawals

**What Happens if They Should Die?**

If they die during their working years, their plan account is payable to a beneficiary designated by them. Their beneficiary would receive rights to their account balance, and could decide what to do with it, within plan guidelines. It is vital that they have designated their account beneficiaries. If they are married, their spouse is automatically designated as their beneficiary. If they wish to have someone other than their spouse deemed as beneficiary, their spouse must sign (in the presence of a Notary Public or a plan representative) a waiver acknowledging this decision.

**What Happens to the Account if Disabled**

If their disability meets the criteria set forth in the Internal Revenue Code, most plans provide that they become 100 percent vested in any money their employer may have contributed to their account, as well as any earnings, (if they’re not already 100 percent vested). They may also be eligible to withdraw money from the plan.

**Can my 401(k) account balance be levied to pay child support?...Alimony?**

Possibly…under the terms of a Qualified Domestic Relations Order (sometimes called a "QDRO"), the court may order that they set aside a portion of their 401(k) balance for child support, alimony, marital property rights of a spouse, etc. If a court issues such an order, they can be required to pay child support and alimony from their 401(k) account balance. They may want to discuss such an issue with your attorney.

**402(f) Special Tax Notice**

The 402(f) notice describes the tax consequences, including the right to roll over all or a portion of one’s plan account, if they take a distribution from their retirement plan. IRS regulations require that they read the special tax notice prior to taking a withdrawal of any type from their 401(k) plan account. This document reviews the following:

• Tax withholdings
• Early withdrawal penalties
• Special tax treatments
• Rollover options
Spousal and non-spousal tax options

Borrowing From a 401(k) and How Does it Work

It depends on the provisions of their employer's retirement plan. Not all plans allow for loans. If their plan allows for loans, the most they can borrow is the lesser of 50 percent of their vested balance or $50,000. Any loan balances over the previous 12 months may reduce the amount they have to borrow. Some plans may have more restrictions.

When one takes a loan from their account, they actually take money out of their account, with a promise to repay it. They pay their account back the amount they borrowed plus interest (a fixed rate determined at the time of the loan), through automatic deductions from their pay or bank account, or through coupon payments (as allowed by their plan). The interest they pay their account is not tax-deductible and is paid with after-tax dollars. As long as they repay their loan on time, they won't be subject to withholding taxes or penalties, as they would if they withdraw from their account before retirement. There are some additional things to keep in mind when considering taking a loan.

First, they must check with their employer to find out what the rules are for repayment if they leave the company before repaying their loan in full. Many plans require prompt, full repayment. Not repaying their loan within the provisions of the plan can cause it to be in default, triggering tax consequences.

Second, they should note that while it may seem like a loan is tax-free, it isn't. Over time, they will pay taxes on the money twice. First, loan repayments are deducted from their paycheck after income taxes have been withheld, then as repayments are reinvested in their account, they are characterized as pre-tax money. So, when they withdraw from their account, they will pay taxes on the money again.

Lastly, they should consider the possible long-term effects a loan can have on their account balance. Although a loan may be a practical option when they need financial assistance, they could miss out on the full growth potential of their principal over the long term. In other words, the money they take out of their account immediately loses its earning potential. And while they're paying interest on the loan, it's important to remember that the interest is coming out of their own pocket.

Taxes or Penalties Involved with a Loan

There aren't taxes or penalties when they initially take a loan. Taxes or penalties only come into play if they leave their employer without repaying their loan and/or if they don't repay their loan on time while they are still employed. If they decide to leave their employer, they must repay their loan in full immediately or within a certain amount of time (depending on the provisions of their plan). If they are under age 59½ and they do
not repay their loan within this certain time frame, the pre-tax portion of their loan is then considered an "offset distribution." This distribution is subject to a 10 percent early withdrawal penalty as well as current income taxes unless they rollover the outstanding balance to an IRA or another employer-sponsored retirement plan within 60 days. Some employers treat loan defaults differently, and some charge fees for taking loans.

**Starting to Take Money from Their 401(k) Plan**

Generally, they must begin to take distributions no later than April 1 of the year following the year in which they turn age 70½ or following the year in which they retire, whichever is later.

**What is an MRD?**

MRD stands for "minimum required distribution." The Internal Revenue Code established these minimums to ensure that people actually use their Employer Sponsored Retirement Plan account balance for retirement (and not, for instance, to pass onto their heirs). Unless an earlier date is specified by their plan, they must take their first withdrawal (MRD) from their account by April 1 of the year following the year in which they reach age 70½, or April 1 of the year following the year in which they retire, whichever is later.

However, if they are a five percent owner of their employer, they must begin taking MRDs by April 1 following the year they reach age 70½. If they defer their first MRD payment until April 1, they must take their second MRD payment by December 31 of that same year. In each subsequent year, the minimum required distribution must be made on or before December 31. If they do not take an MRD from their retirement account each year, the Internal Revenue Code imposes a 50% penalty tax on the amount that should have been withdrawn in each calendar year. This tax is in addition to regular income taxes. A few Employer Sponsored Retirement Plan accounts may require that distributions always begin at age 70½ and in some situations employees may defer the start date to age 75 for value accumulated in a 403(b) plan as of December 31, 1986.

**IRS Rules Regarding MRDs**

On April 17, 2002, the IRS issued final regulations relating to MRDs from retirement accounts (including 401(k) plan accounts, IRAs, and 403(b) plans). Those rules were effective January 1, 2003. Under the rules, life expectancy tables were available with longer expectancy factors that would generally result in smaller required distribution amounts.
Other Features

The 2002 rules also simplified calculations of the year-end account balance that is the basis for the MRD amount, and:

- Retained features that allow flexible designation of beneficiaries
- Became effective for all Employer Sponsored plans and IRAs in 2003 and after

Revised MRD Rules

The IRS initially proposed regulations governing MRDs in 1987. In January 2001, the IRS proposed revised MRD rules. These rules (finalized in April 2002) eliminated the need to make elections for life expectancy or calculation method as under the old rules. Under the final regulations, participants can designate a beneficiary or change a designation after they reach age 70½ without affecting their MRD calculation in most cases. However, it is always a good idea to keep beneficiaries up to date. These rule changes may also help their beneficiaries to reduce their MRDs.

Can a MRD be Withdrawn and Rolled into Another Tax-deferred Account, Like an IRA?

No. MRDs are not eligible rollover distributions and may not be rolled over into an IRA or employer-sponsored retirement plan.

How MRDs are Calculated

Generally, MRD is determined by dividing the adjusted market value of the tax-deferred retirement account as of December 31 of the prior year by an applicable life expectancy factor taken from the Uniform Lifetime Table.

If a Spouse is More Than 10 Years Younger than the Participant

If a spouse is more than 10 years younger than the participant, and she will be the sole primary beneficiary for the entire distribution calendar year, they should use the Joint Life Expectancy Table to calculate their MRD. This will result in a smaller MRD than with the Uniform Lifetime Table.

Taking More than their MRD in a Given Year

Yes. They can take more than their MRD from their retirement plan in a given year, subject to their plan's withdrawal provisions. If they take more than their MRD in a given year, they may not apply the amount in excess of their MRD toward their MRD for the subsequent year.
Taking MRDs If Still Working

If they continue to work beyond age 70½, and do not own more than 5% of the business they work for, they may be able to defer taking distributions from their employer sponsored retirement plan until April 1 of the calendar year after the year in which they retire. They should consult with their Plan Administrator to determine their Required Beginning Date. If they are still working and have other tax-deferred retirement accounts in addition to their current employer's workplace savings plan, they must satisfy their MRD for those other accounts each year after they reach age 70½.

Does Federal Income Tax Withholding Apply to these Distributions?

Federal income tax withholding does apply to their MRD, unless they elect otherwise. They must include the taxable amount of their MRD in their taxable income when they file their annual income tax return. MRDs may also be subject to state and local taxes.

Options if One Leaves Their Job

One of the reasons why company retirement plans like 401(k)s are so popular is because they are portable: generally speaking, one can take their vested account balance with them from job to job. If they decide to change jobs, they generally have three options for their retirement plan savings, listed below.

1. Leave their savings in their employer-sponsored retirement savings plan.

If a participant has more than $5,000 invested in their account they may be able to leave their money in the plan if they leave the company. It depends on their company's specific retirement savings plan rules, but many plans allow them to keep their money invested until the later of:

- the April 1st following the year in which they retire, OR
- the April 1st following the year in which they turn age 70½.

2. Directly roll over all or a portion of their money to another employer-sponsored retirement plan or to a traditional individual retirement account (IRA).

Yes…if their new employer plan will accept a rollover from their previous retirement savings plan. They can also roll over their eligible retirement savings plan account balance to another financial institution and open a traditional "Rollover IRA." The easiest way to do either of these is to request a "direct rollover," which means that they have their current employer make the withdrawal check payable to their new employer's plan trustee or to their IRA's custodian on their behalf. Perhaps the biggest benefit to having the check made payable to one of these institutions instead of having
it made payable to them is the fact that they avoid the mandatory federal income tax withholding. If the check is made payable to them personally, the federal government requires that 20 percent automatically be withheld up front on the taxable portion of their withdrawal.

3. *Take a full or partial withdrawal with the check payable to them.*

If they withdraw money from their retirement savings plan account they will owe current income taxes on the eligible portion of their withdrawal. In addition, if they take the withdrawal before age 59½, they may also owe an additional 10 percent early withdrawal penalty.

If they request that their employer make the check payable to them, instead of to another employer's qualified plan or to an IRA, 20 percent of their withdrawal will automatically be withheld as prepayment of their federal income taxes.

If they have the check made payable to themselves, and then decide to roll it over into an IRA or another employer's qualified plan, they have 60 days from the date of receiving the distribution check to invest the money. They will have to add the missing 20 percent from other money sources at this time if they want to roll over the entire amount of the withdrawal. They may claim the 20 percent federal income taxes withheld on their income tax return. Depending on their total tax situation, they may or may not receive a refund. In most cases if they are under age 59½, they will also owe the 10 percent early withdrawal penalty on any portion of their withdrawal that they do not roll over.

**If One Leaves an Employer**

If they have an outstanding balance on their loan and do not make arrangements to pay it back when they terminate employment, their loan will be considered in default and the outstanding balance would be treated as a taxable withdrawal. The provisions of their plan will outline the circumstances under which default occurs.

**Partial Rollovers**

One can leave some money in their previous employer's plan and roll some of it over to their new employer's retirement plan...or into an IRA. In most cases this is possible. This is known as a "partial rollover." They should check with their previous and new employers to see if it's possible for their situation.

Generally speaking, most companies allow departing employees no matter what the reason (retirement, job change, laid-off, fired, etc.) to keep money invested in its retirement plan as long as their balance exceeds $5,000 and they are younger than age 70½. Some people choose partial rollovers because they like the investment choices in...
their previous employer's plan, but they also like the choices in their new employer's plan.

Or, they may have an investment in their previous employer's plan that they're not quite ready to sell.

On the other hand, investing in two different plans means that they'll have to maintain paperwork for both plans, which can be cumbersome.

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<thead>
<tr>
<th>401(k) - 2018</th>
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<tbody>
<tr>
<td><strong>Eligibility</strong></td>
</tr>
<tr>
<td>Employer: Any business.</td>
</tr>
<tr>
<td>Employee: Employees who worked at least 1,000 hours in the past year; two years, if no vesting period.</td>
</tr>
<tr>
<td><strong>Contribution Limits</strong></td>
</tr>
<tr>
<td>Employer contribution cannot exceed $55,000 or 100% of salary below $55,000.</td>
</tr>
<tr>
<td>Employee: $18,500 ($24,500 if you will be age 50 or older as of 12/31/18).</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
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<tr>
<td>Determined by employer.</td>
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<tr>
<td><strong>Pros</strong></td>
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<tr>
<td>Employee/employer contributions. Match not required.</td>
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<tr>
<td><strong>Cons</strong></td>
</tr>
<tr>
<td>Administration can be expensive.</td>
</tr>
<tr>
<td>Employer contributions usually take years to vest</td>
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“Solo 401(k)”...the One-Person 401(k)

The Individual 401k is a self-employed retirement plan that is sometimes referred to as an "Individual(k)", "Solo 401k", "Single(k)" and "Self Employed 401k".

**What is an Individual 401k?**

The Individual 401k is the newest and most exciting retirement plan to benefit the self-employed, thanks to the tax law created by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). This tax law became effective beginning January 1, 2002 and provides significant advantages to small businesses whose only employee is the owner or the owner and their spouse. These self-employed business owners can...
establish an Individual 401k plan and take advantage of this powerful retirement savings tool.

What makes the Individual 401k unique is that compared to other self-employed retirement plans greater contributions may be made at identical income levels, therefore maximizing retirement contributions and valuable tax deductions. 2018 Individual 401k contribution limits are $18,500 a year ($24,500 if age 50+). Also, an Individual 401k allows the flexibility to borrow against the value of your 401k. Tax free loans (up to 50% of the total 401k value with a $50,000 maximum) are permitted in an Individual 401k plan.

Self-employed business owners may be well suited for an Individual 401k if their objective is to maximize their retirement contributions or if they would like to borrow from their retirement plan using their 401k balance as collateral via a tax free Individual 401k loan.

**Individual 401k Plan Benefits**

The Individual 401k plan has several benefits for small business owners and the self-employed.

- Higher Contribution Limits
- Tax Deductible Contributions
- Tax Deferred Growth
- Contribution Flexibility
- Access to Tax Free Loans
- Cost Effective Administration
- Retirement Plan Consolidation

The Solo 401k takes advantage of the existing laws found under section 401(k) of the Internal Revenue Code as well as the new laws created by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) that went into effect on January 1, 2002. The Solo 401k is an under publicized gem in the tax law with a number of interesting features that make the Solo 401k unique relative to other popular self-employed retirement plans like a Keogh or SEP IRA.

**Solo 401k Eligibility**

The Solo 401k is available to self-employed individuals and business owners with no full time W-2 employees other than themselves or a spouse. Businesses employing independent contractors (1099 employees) would not disqualify you from a Solo 401k. Sole proprietorships, partnerships, LLCs and corporations (including both subchapter S and C corporations) would qualify.
A business that employs part time W-2 employees may be able to exclude them from plan participation. Generally, under federal law you are permitted to exclude the following types of employees:

- Employees under age 21.
- Employees with less than one year of service.
- W-2 employees who work less than 1000 hours per year
- Certain union employees
- Certain nonresident alien employees.

**Solo 401k Contribution Limits**

In 2018 the maximum Solo 401k contribution limit 100% up to is $55,000 or $61,000 if age 50+. Given sufficient income, a husband and wife working for the same business may contribute up to $110,000 combined or $122,000 if age 50+. Because of the way the contribution is calculated a larger contribution usually can be made into a Solo 401k than to a Keogh or SEP IRA at the same income level. Therefore, the Solo 401k is usually the best option for maximizing retirement contributions and valuable tax deductions while reducing income taxes.

**Solo 401k Loan**

Another important distinction between the Solo 401k versus other self-employed retirement plans is the ability to receive a Solo 401k loan. Loans are permitted up to ½ of the total value of the Solo 401k up to a maximum of $50,000. Solo 401k loans generally have a 5-year term. Principal and interest is repaid back to yourself into your Solo 401k. A Solo 401k loan can be provided tax free, penalty free and without credit checks or income qualifications and the money can be used for any purpose. A Solo 401k loan is a key benefit and may be considered a valuable feature for many self-employed business owners.

**Individual 401k Contribution Limits**

Compared to other retirement plans you may be able to make greater contributions at identical income levels, therefore maximizing retirement contributions and valuable tax deductions.

In 2018, the Individual 401k contribution limit is $55,000 or $61,000 if age 50 or older. The annual Individual 401k contribution consists of 2 parts a salary deferral contribution and a profit sharing contribution. The total allowable contribution adds these 2 parts together to get to the maximum Individual 401k contribution limit.
Individual 401k Contribution Calculation - for a S or C corporation or an LLC taxed as a corporation

Salary Deferral Contribution

- In 2018, 100% of W-2 earnings up to the maximum of $18,500 or $24,500 if age 50 or older can be contributed to an Individual 401k.

Profit Sharing Contribution

- A profit sharing contribution up to 25% of W-2 earnings can be contributed into an Individual 401k.

Individual 401k Contribution Calculation - for a sole proprietorship, partnership or a LLC taxed as a sole proprietorship

Salary Deferral Contribution

- Although the term salary deferral is used, these businesses do not provide a W-2 salary to the business owner. For businesses of this type, the salary deferral contribution is based on net adjusted business profit. Net adjusted business profit is calculated by taking gross self-employment income and then subtracting business expenses and then subtracting ½ of the self-employment tax. In 2018, 100% of net adjusted business profits income up to the maximum of $18,500 or $24,000 if age 50 or older can be contributed in salary deferrals into an Individual 401k.

Profit Sharing Contribution

- A profit sharing contribution can be made up to 20% of net adjusted businesses profits. Net adjusted business profit is calculated by taking gross self-employment income and then subtracting business expenses and then subtracting ½ of the self-employment tax. You will want to ask your tax professional for assistance with this calculation.

Roth Individual 401k

The Roth Individual 401k is a retirement plan for the self-employed that allows non-tax-deductible salary deferral contributions that grow tax free and are withdrawn tax free at retirement. Starting January 1, 2006, the Roth 401k salary deferral option became available in an Individual 401k. This plan known as a "Roth Individual 401k" combines features of Roth IRAs, but with higher contribution limits.
Pre-tax Versus After-tax (Roth) Contributions in the Individual 401k

Individual 401k salary deferral contributions can be made as Roth 401k (after tax) or Traditional 401k (pre-tax).

The basic difference between a Roth 401k and a Traditional 401k is that the Roth 401k is funded with after-tax contributions while the Traditional 401k is funded with pre-tax contributions. In other words, with a Roth 401k you pay taxes today in return for a tax-free withdrawal in retirement. Traditional 401k contributions are tax deductible and are made pre-tax, so you save taxes today, but withdrawals are taxed in retirement. As a result, the choice between the two 401k options comes down to whether you believe your income taxes rates will be higher or lower in retirement. If you believe your income tax rates will be higher at retirement, then making Roth 401k contributions may be more advantageous. Also, there may be some estate tax benefits of a Roth 401k because in the case of death, the Roth 401k assets are tax free to your heirs.

Roth Individual 401k Differs from a Roth IRA

A Roth Individual 401k is similar to a Roth IRA because it allows after-tax contributions to grow tax-free until retirement when they are withdrawn tax free. However, a Roth Individual 401k allows much higher annual contribution amounts than a Roth IRA. Roth IRAs have a $5,500 limit in 2018. The new higher limit for the Roth Individual 401k is $18,500 ($24,500 if age 50 or older) for the 2018 tax year.

Advantages of the Roth Individual 401k over the Roth IRA

- Regardless of income, everyone qualifies for a Roth Individual 401k. In 2018, you can’t contribute fully to a Roth IRA if your adjusted gross income exceeds $199,000 if you file a joint tax return with your spouse and $135,000 if you are single.

- Higher contribution limits are permitted with a Roth Individual 401k than a Roth IRA. For 2018, participants can contribute up to $18,500 to a Roth 401k ($24,500 if age 50 or older). But they can only contribute $5,500 in 2018 ($6,500 if age 50+) in a Roth IRA.

How Much to Contribute to a Roth Individual 401k Annually

In 2018 the limit is $18,500. If age 50 or older an additional $6,000 catch up contribution is also allowed for a total of $24,500.
Can the profit sharing portion of an Individual 401k also be made with after-tax (Roth) contributions?

No. The profit sharing contribution cannot be made as a Roth contribution.

A profit sharing contribution of up to 25% of compensation can also be made into an Individual 401k. The profit sharing portion of the Individual 401k contribution is not eligible to be made as a Roth contribution. Profit sharing contributions are made pre-tax and are tax deductible.

In 2018 the combined salary deferral and profit sharing contributions in a Individual 401k cannot exceed $55,000 ($61,000 if age 50 or older).

Withdrawals from a Designated Roth 401k Account

At age 59½, or later provided the 5-year rule is satisfied. An exception to the age 59½ rule occurs in the event of disability or death (in which case the proceeds are tax free to your heirs).

“Five-Year Rule”

Assets may be withdrawn tax-free from a Roth Individual 401k provided the account has been established for five or more years and you are age 59½ or older. An exception is made in case of disability or death.

Best Suited for a Roth Individual 401k

The Roth Individual 401k is a new salary deferral option which is useful for a wide variety of people. See if any of the scenarios below apply to you.

You anticipate being in a higher income tax bracket in retirement than your current income tax bracket

If this is the case, then it may make sense to make after tax Roth 401k contributions and pay income taxes now while in a lower tax bracket. Then while in retirement the assets can be withdrawn tax free when you are in a higher tax bracket.

You are relatively young and earn a lower income now, but expect to earn a much higher income and expect to be in a higher tax bracket in the future

If you expect your income to increase dramatically over your career, you may find contributing to the Roth feature today to be very advantageous, as you are in a lower tax bracket now than you will be in the future. Also, if you are many years from retirement, you could choose a Roth 401k as your best option as you expect your
retirement plan to grow tax-free to a significant nest egg that can be withdrawn tax-free, more than compensating for the taxes paid when young and lower paid.

You had an usual year and your income decreased considerably and as a result you are in a lower tax bracket this year than your expected tax bracket in retirement.

You may want to take this opportunity to make Roth 401k contributions since you are in an usually low tax bracket this year.

Retirement investors who feel federal income tax rates will increase in the future

If you believe the government will increase tax rates in the future, then you may be better off making Roth 401k contributions and paying income taxes now. That way you would be paying taxes now at a lower tax rate and receiving the distributions federal tax free in the future at retirement when income tax rates are higher.

You already have considerable assets in traditional pre-tax retirement accounts

In that case you may want to diversify your future tax liability and invest salary deferral contributions into the Roth 401k. That way some of your retirement nest egg can be withdrawn tax free at retirement. That is especially beneficial if tax rates rise in the future.

You earn a high income and would like to make Roth IRA contributions, but can’t based on the Roth IRA income limits

- Roth IRAs have income limits, but Roth Individual 401k plans have no income limits.

- Everyone qualifies for a Roth Individual 401k. You cannot contribute fully to a Roth IRA if your adjusted gross income exceeds $183,000 if you file a joint tax return with your spouse ($116,000 if you are single) in 2015.

- Higher contribution limits are permitted with a Roth Individual 401(k) than a Roth IRA regardless of income.

- In 2015, participants can contribute up to $18,000 to a Roth 401k ($24,000 if age 50 or older). Roth IRA contribution limits are $5,500 ($6,500 if age 50+) in 2015.

You wish to reduce future taxes on social security benefits

Qualified withdrawals from a Roth Individual 401k are excluded from taxable income when calculating taxes on Social Security benefits.
Currently, in 2018, half of Social Security benefits are taxable if AGI (adjusted gross income) plus one half of social security benefits exceeds $32,000 if married filing jointly or $25,000 if single. Note that the $32000 / $25000 threshold has never been adjusted since 1993. However, up to 85% of your benefits can be taxable if your MAGI is more than $34,000 ($44,000 if you are married filing jointly) or if you are married filing separately and lived with your spouse at any time during 2018. No one will pay federal income tax on more than 85% of their Social Security benefits. As a result, the value of tax savings via Roth accounts increases over time. Distributions from a Traditional 401k are included in AGI for determining Social Security benefit taxes, but distributions from a Roth Individual 401k are excluded, therefore saving taxes on Social Security benefits. Consult your tax advisor to verify your tax savings.

You want to avoid taking Mandatory Required Distributions (MRDs) at 70½ and you like the idea of passing assets tax free to your heirs

You can roll over a Roth Individual 401k to a Roth IRA and avoid the legal requirement to take withdrawals at age 70½. This can save significant taxes and be useful for estate planning because the taxes saved will increase your estate and your heir's distributions will be tax free in the future as well.

**Important Considerations**

- Roth contributions are irrevocable. Once the money goes into a Roth 401k account, it can't be switched over to a regular 401k.

- Also, Roth contributions are subject to federal state and payroll taxes in the year the Roth contribution is made (but are withdrawn tax free at retirement and grow tax free during working years).

- You can roll over Roth Individual 401k contributions to a Roth IRA when retired or if terminated.

- There is never a requirement to take a distribution from any Roth type retirement plan.

- This can help with tax planning to minimize taxes on Social Security benefits.

**Roth Individual 401k Basics**

Individual 401(k) salary deferral contributions can be made as Roth 401(k) (after tax) or Traditional 401(k) (pre-tax). The basic difference between a Roth 401(k) and a Traditional 401(k) is that the Roth 401k is funded with after-tax contributions while the Traditional 401(k) is funded with pre-tax contributions. In other words, with a Roth
401(k) you pay taxes today in return for tax-free withdrawals in retirement. Traditional 401(k) contributions are tax deductible and are made pre-tax, so you save taxes today, but withdrawals are taxed in retirement.

The Individual 401k contribution limit in 2018 is $18,500 or $24,500 if age 50 or older. The annual contributions into an Individual 401k consists of 2 parts a salary deferral contribution and a profit sharing contribution.

**Roth 401(k) Salary Deferral**

Participants in a Individual 401(k) have the option to make Roth 401(k) contributions only with the salary deferral portion of the Individual 401k. In 2018 the Roth 401(k) salary deferral contribution limit is $18,500 and $24,500 if age 50 or older. Individual Roth 401k salary deferral contributions are not tax deductible, but withdrawals are tax free after age 59½ provided the 5-year rule is satisfied.

**Profit Sharing**

A profit sharing contribution of up to 25% of compensation can also be made into a Individual 401(k). The profit sharing portion of the Individual 401(k) contribution is not eligible to be made as a Roth contribution. Profit sharing contributions are made pre-tax and are tax deductible.

Note: The combined 2018 salary deferral and profit sharing contributions in a Individual 401k cannot exceed $55,000 or $61,000 if age 50 or older.

**Roth 401k versus Traditional 401k Comparison**

<table>
<thead>
<tr>
<th></th>
<th>Roth 401(k) (after tax contributions)</th>
<th>Traditional 401(k) (pre-tax contributions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum annual contribution (under age 50)</td>
<td>$18,500 - 2018</td>
<td>$18,500 - 2018</td>
</tr>
<tr>
<td>Maximum annual contribution (age 50 or older)</td>
<td>$24,500 - 2018</td>
<td>$24,500 - 2018</td>
</tr>
<tr>
<td>Tax treatment of contributions</td>
<td>After tax (not tax deductible)</td>
<td>Pre-tax (tax deductible)</td>
</tr>
<tr>
<td>Tax treatment of distributions</td>
<td>Distributions are tax free if five years have passed since the first contribution AND there is a qualifying event (attainment of age 59½, death or disability)</td>
<td>Distributions are taxed as ordinary income and can be withdrawn after age 59½ without IRS penalty.</td>
</tr>
<tr>
<td>Required minimum distributions (RMDs)</td>
<td>Must begin at age 70½ unless rolled to a Roth IRA. If rolled over to a Roth IRA then the money is not subject to RMD</td>
<td>Must begin at age 70½</td>
</tr>
</tbody>
</table>
rules until the death of IRA owner

| Rollovers | Can rollover to another Roth 401k or a Roth IRA | Can rollover to another traditional 401k or a Traditional IRA or Rollover IRA |

**Tax Deductible Contributions**

Individual 401(k) retirement plans may provide significant tax savings because in general, you can deduct 100% of contributions made into an individual 401(k) from your taxable income. Incorporated businesses can generally deduct the salary deferral contribution from W-2 earnings and the profit sharing contribution as a business expense. Unincorporated businesses such as sole proprietors can generally deduct contributions made to an individual 401(k) from personal income.

**Tax Deferred Growth of Investment Earnings**

Assets in an Individual 401(k) grow tax-deferred, meaning you won't pay taxes on the dividends and investment earnings until you withdraw the assets. Tax deferred earnings growth can have a powerful effect over time. Money can be withdrawn after age 59½ without penalty. When money is withdrawn after age 59½ income taxes will be paid only on the amount that is withdrawn and the remaining balance in the Individual 401k continues to go tax deferred. If you should withdraw money prior to age 59½, you will pay income taxes and it's likely that you will incur an additional 10% IRS penalty for a premature withdrawal.

For some self-employed investors, saving in a tax advantaged retirement plan such as an Individual 401(k) provides a significant benefit. Investors are able to make tax deductible contributions during their working years and are able to earn many years of tax deferred growth on the dividends and investment earnings. Once retired and potentially in a lower tax bracket, you can withdraw the money as needed from your Individual 401(k).

**Contribution Flexibility**

Each year the funding of your individual 401k retirement plan is completely discretionary. You can increase or decrease your salary deferral and/or profit sharing contributions depending on the profitability of your business.

**Individual 401k Loan - Access to Tax Free Loans**

An Individual 401k loan is permitted at any time using the accumulated balance of the 401k as collateral for the loan. Individual loans are permitted up to 1/2 of the total
balance of the 401k up to a maximum of $50,000. A loan from an Individual 401k is received tax free and penalty free. There are no penalties or taxes due provided loan payments are paid on time.

Generally, Individual 401k loans have a 5-year maximum repayment term. Individual 401k loans used for the purchase of a primary residence may extend the loan repayment term up to 10-15 years. Loans must be repaid according to the terms of the loan amortization schedule which is provided when a loan is initiated. Failure to repay the loan according to these terms may result in a loan default causing taxes as well as IRS penalties. Loans are not permitted with Traditional or Roth IRAs, SEP IRAs, or Keogh (Money Purchase/Profit Sharing Plans).

Loan payments are made monthly or quarterly. Loan payments of principal and interest are repaid back into your own Individual 401k. Because of this an Individual 401k loan may be a favorable option compared to other loans where interest is paid to the bank or lending institution.

The proceeds from an Individual 401k loan can be used for any purpose and there are no income or credit qualifications to receive the loan. The ease of an Individual 401k loan is attractive because startup businesses and self-employed business owners often run into difficulties with qualifying for a self-employed loan through banks and lending institutions.

Cost Effective Administration

Compared to traditional 401k's, the Individual 401k plan is easy, flexible and inexpensive to maintain because administration is minimal, and complex discrimination tests are not required. Fees vary depending on the level of administrative services provided by the Individual 401k administrator. Loans may have an additional administrative fee. If an Individual 401k is greater than $250,000 IRS form 5500 needs to be filed and the administrator may charge a fee for its completion or you could elect to complete the form yourself.

Retirement Plan Consolidation

An important feature of the Individual 401k plan is the opportunity to consolidate retirement assets into one account. This includes Traditional IRAs, SEP IRA Plans, 401k Plans, Money Purchase Plans, SIMPLE IRAs, Profit Sharing Plans, Defined Benefit Plans, 403b Plans and IRA Rollovers. Consolidating retirement accounts is important if you use the loan provision. Other advantages of rolling over and consolidating your retirement plans into your individual 401k are improved financial organization and ease of monitoring a retirement portfolio.
Maximize Contributions for Sole Proprietors

One can now contribute a higher percentage of their income to a 401(k) plan as a sole proprietor, making the one-person 401(k) a more viable retirement plan option. Being able to make tax-deferred contributions as both employee and employer maximizes their contribution to their retirement plan.

Compliance

One-person 401(k) plans are exempt from most compliance tests, which ensure that 401(k) plans don’t discriminate in favor of highly compensated employees.

Their spouse or any other equal partner in a partnership and that partner’s spouse can participate in a one-person 401(k) without being subject to compliance testing. Otherwise, rules governing 401(k) plans are the same for one-person plans as they are for large corporations.

Keep in mind if they decide to hire other employees in the future, they must let them participate in the plan. Any future employees must be treated equally under the plan provisions. When they add employees, they will be subject to compliance testing and potentially additional costs for plan administration.
Chapter Ten: SIMPLE IRA Plans

Savings Incentive Match Plan for Employees (SIMPLE IRA)

SIMPLE IRAs are good for employees. They allow employee contributions. And, they mandate an employer match. For 2018, annual contributions are generally limited to $12,500 ($15,500 if they are 50 or older as of 12/31/18) plus an employer matching contribution (up to 3% of their salary).

If a business has less than 100 people, then a SIMPLE IRA is a great way to get started in providing retirement savings for employees, don't get the SIMPLE IRA confused with its similar cousin, the SIMPLE 401(k). This retirement option is like a traditional 401(k) except it typically has higher fees and less flexibility.

What Is a SIMPLE Plan?

The SIMPLE IRA is an employer sponsored retirement plan available to small businesses with less than 100 employees including sole proprietorships, partnerships, S corporations and C corporations.

SIMPLE IRA's consist of 2 parts

SIMPLE IRA's consist of 2 parts: an optional employee salary deferral and a mandatory employer match. SIMPLE IRA's are easy to administer, and IRS filings are not required. SIMPLE IRAs must be established by October 1st in order to contribute to a plan for the current year.

A SIMPLE plan is a tax-favored retirement plan that certain small employers (including self-employed individuals) can set up for the benefit of their employees.
Which employers can establish a SIMPLE-IRA plan?

Generally, any small business that employs 100 or fewer employees who earned at least $5,000 in the preceding year can establish a SIMPLE-IRA plan, provided the employer does not concurrently maintain any other employer-sponsored retirement plan.

A SIMPLE plan is a written agreement (salary reduction agreement) between an employee and their employer that allows them, if they are an eligible employee (including a self-employed individual), to choose to:

Reduce their compensation by a certain percentage each pay period, and
Have their employer contribute the salary reductions to a SIMPLE IRA on their behalf. These contributions are called salary reduction contributions.

All contributions under a SIMPLE IRA plan must be made to SIMPLE IRAs, not to any other type of IRA. The SIMPLE IRA can be an individual retirement account or an individual retirement annuity. Contributions are made on behalf of eligible employees. Contributions are also subject to various limits.

In addition to salary reduction contributions, their employer must make either matching contributions or non-elective contributions.

Once they know that their company can establish a SIMPLE-IRA plan, they need to determine employee eligibility.

Eligible Employees

They must be allowed to participate in their employer's SIMPLE plan if they:

- Received at least $5,000 in compensation from their employer during any 2 years prior to the current year, and
- Are reasonably expected to receive at least $5,000 in compensation during the calendar year for which contributions are made.

While employers cannot make these eligibility requirements more restrictive, they can generally liberalize them to include more employees.

Self-Employed Individual

For SIMPLE plan purposes, the term employee includes a self-employed individual who received earned income.

Excludable Employees

Their employer can exclude the following employees from participating in the SIMPLE plan.
Employees whose retirement benefits are covered by a collective bargaining agreement (union contract).

Employees who are nonresident aliens and received no earned income from sources within the United States.

Employees who would not have been eligible employees if an acquisition, disposition, or similar transaction had not occurred during the year.

**Compensation**

For purposes of the SIMPLE plan rules, their compensation for a year generally includes the following amounts.

- Wages, tips, and other pay from their employer that is subject to income tax withholding.
- Deferred amounts elected under any 401(k) plans, 403(b) plans, government (section 457(b)) plans, SEP plans, and SIMPLE plans.

**Self-employed Individual Compensation**

For purposes of the SIMPLE plan rules, if they are self-employed, their compensation for a year is their net earnings from self-employment before subtracting any contributions made to a SIMPLE IRA on their behalf.

Beginning after 2001, for purposes of the limit on deductions for contributions to a self-employed person's SEP-IRA, net earnings from self-employment include services performed while claiming exemption from self-employment tax as a member of a group conscientiously opposed to social security benefits.

**Significant Tax Advantages**

Contributing to a SIMPLE-IRA plan can help small business owners save on their business taxes as well as their personal income taxes.

**As an Employer**

As an employer, they can generally deduct any contributions they make on behalf of their plan participants from their business expenses. Beginning January 1, 2002, the new law grants a special non-refundable tax credit for 50% of certain plan expenses up to a maximum of $500 a year for the first three plan years.

**As a Participant**

As a participant, they and any eligible employees can elect to defer part of their salary and direct that money into an individual SIMPLE-IRA. Because these contributions are deferred before certain taxes are withheld, they actually reduce contributing participant’s current taxable income.
For 2018, a non-refundable **tax credit** may be available to individuals who make pre-tax contributions to a SIMPLE-IRA. The credit applies to the first $2,000 in contributions. There are certain eligibility requirements that must be met, and the rate of credit depends on the individuals adjusted gross-income. (See below)

**Extra Tax Credit**

As in 401(k)s and 403(b)s with all these contribution increases and catch up provisions recently, there is also a tax credit for lower and middle-income earners to make retirement saving more attractive. For 2018, there is a tax credit available based on the following table on the first $2,000 of contributions made into a workplace retirement savings plan and IRAs.

In 2018 this table below shows the tax credit available on the first $2,000 of contributions made into a workplace retirement savings plan and IRAs.

<table>
<thead>
<tr>
<th>Adjusted Gross Income (AGI)</th>
<th>Joint filers</th>
<th>Other filers</th>
<th>Credit</th>
<th>Maximum Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0-38,000</td>
<td>$0-28,500</td>
<td>$0-19,000</td>
<td>50%</td>
<td>$1,000</td>
</tr>
<tr>
<td>$38,001-41,000</td>
<td>$28,501-30,750</td>
<td>$19,000-20,500</td>
<td>20%</td>
<td>$400</td>
</tr>
<tr>
<td>$41,001-63,000</td>
<td>$30,751-47,250</td>
<td>$20,501-31,500</td>
<td>10%</td>
<td>$200</td>
</tr>
<tr>
<td>Over $63,000</td>
<td>Over $47,250</td>
<td>Over $31,500</td>
<td>0%</td>
<td>$0</td>
</tr>
</tbody>
</table>

Any earnings within a SIMPLE-IRA enjoy tax-deferred growth until withdrawn. When earnings aren't eroded by taxes each year, they can compound faster.

**Flexible Contribution Requirements**

**Employee Contributions**

Eligible employees can elect to contribute by salary deferral up to 100% of compensation up to a maximum of $12,500 for the 2018 plan through salary reduction. (The amount elected by the employee may be expressed as a percentage of compensation or as a specific dollar amount.) Additionally, participants age 50 and older in 2018 may be able to make an additional annual catch-up elective deferral contribution to their SIMPLE-IRA as well.
**Catch-Up Contributions**

For the year 2018, 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 2018 is $3000. The limit is subject to cost-of-living increases in $500 increments.

**Employer Contributions**

Employers can choose from two different contribution methods – and can even switch between these options each year, provided certain notification requirements are met:

*Matching Option*
Requires a 3% employer match is made only for those employees electing to defer a portion of their salary. Employers match employee salary deferrals dollar for dollar up to 3% of employee compensation (up to a maximum of $12,500 or $15,500 if age 50+ in 2018). An employer can reduce the employer's match to 1% of each participating employee's compensation for any two years in a five-year period.

*Non-Elective Contribution Option*
Requires a 2% match of employee compensation (up to $5,300 in 2018) or all eligible employees regardless of whether the employee is electing to defer a portion of their salary or not.

SIMPLE IRA's are very inexpensive to maintain and their costs vary but may cost approximately $25-$50 annually per employee account.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>If under age 50</th>
<th>If age 50 and 0ver</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$10,000</td>
<td>+$1,500 = $11,500</td>
</tr>
<tr>
<td>2007</td>
<td>$10,500</td>
<td>+$2,000 = $12,500</td>
</tr>
<tr>
<td>2008</td>
<td>$10,500</td>
<td>+$2,000 = $12,500</td>
</tr>
<tr>
<td>2009</td>
<td>$11,500</td>
<td>+$2,500 = $14,000</td>
</tr>
<tr>
<td>2010</td>
<td>$11,500</td>
<td>+$2,500 = $14,000</td>
</tr>
<tr>
<td>2011</td>
<td>$11,500</td>
<td>+$2,500 = $14,000</td>
</tr>
<tr>
<td>2014</td>
<td>$12,000</td>
<td>+$2,500 = $14,500</td>
</tr>
<tr>
<td>2015</td>
<td>$12,500</td>
<td>+$3,000 = $15,500</td>
</tr>
<tr>
<td>2016 - 2018</td>
<td>$12,500</td>
<td>+$3,000 = $15,500</td>
</tr>
</tbody>
</table>

**Access to Assets**

Like a Traditional IRA, a SIMPLE-IRA plan does allow participants to withdraw their money at any time. However, to encourage long term saving for retirement, distributions from a SIMPLE-IRA in the first two years of participation are subject to a...
higher early withdrawal penalty than nonqualified distributions made from Traditional IRAs or Roth IRAs.

**If a participant is under age 59½:**

- Withdrawals taken within the first two years of plan participation will generally be subject to a 25% early withdrawal penalty
- Withdrawals taken after the first two years will generally be subject to a 10% early withdrawal penalty

Withdrawals taken within the first two years of plan participation are not permitted for purposes of conversion to a Roth IRA or rollover by transfer to an IRA other than a SIMPLE-IRA.

These early withdrawal penalties do not apply to those participants who have attained age 59½ or are taking distributions for death, disability, substantially equal periodic payments, medical expenses in excess of 10.0% of AGI, health insurance premiums by certain unemployed individuals, first-time home purchases, qualified higher education expenses, or on account of an IRS levy.
# SIMPLE IRA

<table>
<thead>
<tr>
<th><strong>Eligibility</strong></th>
<th><strong>Employers</strong></th>
<th><strong>Employee</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Employers with 100 employees or less who do not maintain any other retirement plan.</td>
<td>All employees who have ever earned more than $5,000 in any two years prior and who will earn at least $5,000 this year.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Contribution Limits</strong></th>
<th><strong>Employers</strong></th>
<th><strong>Employee</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>3% employer match (in certain situations, the match can be 1% to 2%) or 2% non-elective contribution for all employees up to $5,500 per employee. (2018)</td>
<td>$12,500 plus employer match up to 3%. (Employer can contribute $12,500 plus match to her own account.) Additional $3,000 if you are age 50 or older as of 12/31/18.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th><strong>Vesting</strong></th>
<th><strong>Immediate</strong></th>
<th><strong>Immediate</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pros</strong></td>
<td>Employees can make contributions. If you have lower salary (or self-employment income), you can make larger contributions than under other types of plans.</td>
<td>Employees can make contributions</td>
</tr>
</tbody>
</table>

| **Cons** | Employer most likely cannot contribute as much as she can to a SEP IRA. Match is mandatory. Vesting is immediate. | None really, unless you have a high salary that would permit larger contributions under other types of plans. |
Chapter Eleven: SEP IRA Plans

Simplified Employee Pension Plan

A Simplified Employee Pension Plan, commonly known as a SEP-IRA, is a retirement plan specifically designed for self-employed people and small-business owners.

Many employers find it hard to hire employees for their small businesses? The problem might be that they do not have a good retirement plan in place or that the one they have in not attractive enough. If it doesn’t compete or if there is none at all, then savvy employees are unlikely to want to work for them.

SEP IRAs were introduced in 1978 (effective 1/1/79) and they have proven to be a popular program. SEP stands for Simplified Employer Pension, and the emphasis here is on "simplified."

SEPs are as easy to use as IRAs and almost identical as well. But they offer one major advantage over IRAs: Instead of being limited to a $5,500 annual deductible contribution (2018), one can put away 25% of their self-employment income, with their contribution capped at $55,000 (2018). They are permitted to do this even if they or their spouse participate in another pension or retirement plan.

Contributions into a SEP IRA are generally tax deductible and investment earnings in a SEP grow tax deferred. Withdrawals after age 59½ are taxed as ordinary income. Withdrawals prior to age 59½ may incur a 10% IRS penalty as well as income taxes. With a SEP, each eligible employee has their own separate SEP IRA which is then funded by the employer.

SEPs involve minimal disclosure and reporting requirements. One can contribute different amounts from year to year, and they can wait until April 15 to contribute for the previous year (or later if they file an extension). Other plans must be established by December 31.
A SEP IRA may be a good option for employers who want to make high contributions to their own accounts and the accounts of partners or employees. A self-employed individual with no employees other than a spouse may also want to consider an Individual 401k as well as a SEP IRA.

If they have just a handful of employees and are looking for a plan that is truly low cost and low maintenance, then they should consider a SEP IRA.

**Simplified Employee Pension Plan (SEP IRA)**

A Simplified Employee Pension (SEP) is a written arrangement (a Plan) that allows an employer to make contributions toward his or her own (if a self-employed individual) and employees' retirement plans without becoming involved in more complex arrangements. As in an IRA, the plan's earnings aren't taxed until they are withdrawn at retirement. All of the money contributed to a participant's account immediately belongs to that person. This means there is no mandatory minimum vesting period. In addition, the participant "guides" the investment. For example, if the contributions are invested in mutual funds, he can choose the fund(s) in which to invest his contribution.

SEP, much like SIMPLE, was designed for the small employer. Hence, it is easy to establish and maintain with no federal filings required. When establishing a SEP-IRA plan for their business, they and any eligible employees establish their own separate SEP-IRA accounts. Then, the employer contributions are then made into each eligible employee’s SEP-IRA account. The plan is funded with tax-deductible employer contributions, and they must cover all eligible employees. Its key features are highlighted below.

**Features**

Indeed, the only requirement is that the employer indicate that SEP contributions are being made on any W-2 given to employees. In addition, the employer can decide from year to year whether or not to make a contribution. In this way, SEPs are similar to profit sharing plans.

Unlike SIMPLE IRA plans, the employer is not required to give 60 days’ notice to employees that a contribution will be made. Employers are required to make the contribution into an IRA of the employee’s designation. Each participant under the SEP may establish his or her own IRA account at the institution of his or her choice. As the underlying account is an IRA, any covered employee may have a self-directed IRA as his or her SEP-IRA. This is in addition to any other IRAs one has.

Such a contribution makes an employee an active participant in a qualified plan. Employers may also integrate their contributions with Social Security so that allocations to highly paid employees will be increased. Employee contributions are not allowed.
With a SEP there is no "plan document," and they don't need to file annual reports with the IRS. Contributions can vary from year to year. So if they hit a lean spell, they aren't locked in.

Contributions are limited to 25% of compensation to a maximum of $55,000, indexed for 2018. They are not required to be made each year. If contributions are made, they must be made in accordance with set rules that may be different for each situation.

**Establishment**

For prior year deductibility, SEPs need not be established until the employer has filed his/her tax return (including extensions). This is a tremendous advantage over any other qualified plan. The norm is that plans must be established by plan year end.

The deadline for making contributions, as well as setting up the plan, is the employer’s tax return filing deadline, including extensions. This is a critical difference from the deadline for IRA contributions, which is fixed at April 15.

They can take advantage of the extended deadline to receive their tax refund before their contribution is due and use their refund to fund their SEP. Suppose they wish to fund their SEP for 2018 but are experiencing cash flow problems. They know that they will receive a refund on their 2018 taxes. They file an extension for their 2018 taxes so that they have until Aug. 15, 2019, to file.

Filing an extension also means they have until Aug. 15, 2019, to fund their SEP for 2018. They file their tax return on April 16, or as soon as possible after April 15. Unless a major snafu occurs with their return at the IRS processing center, they will receive their refund well before Aug. 15 and have this additional cash to fund their SEP.

**Eligibility**

Employers must cover virtually all employees. Only those who are not age 21 and who have not earned at least $600 (indexed 2018) are not eligible for a contribution.

All plans may exclude union employees whose retirement benefits are the subject of collective bargaining agreements and certain non-resident aliens.

**Basics**

*High Contribution Limits*

Contributions to a SEP can be made between 0% to 25% of compensation up to $55,000 for 2018. For incorporated businesses, compensation is based on W-2 income and a SEP contribution can be made up to 25% of W-2 wages. For sole proprietors, compensation
is based on “adjusted earned income.” Adjusted earned income is determined by completing an IRS worksheet. Contributions of up to 20% of adjusted gross income can be made to a SEP IRA. Annual compensation of more than $275,000 in 2018 cannot be taken into consideration for determining contributions.

In a SEP, the employer must contribute the same percentage of compensation for employees as he does for himself. To determine the annual retirement contribution, you could make based on your income use the SEP IRA calculator.

Some plans allow the employer to contribute a flat dollar amount for each plan.

Some employers choose to integrate the plan with Social Security enabling a higher allocation of the contribution for certain employees.

Employee contributions are not allowed.

Contributions are 100% vested.

**Tax Deductible Contributions**
Within IRS limits, contributions into a SEP IRA are generally 100% tax deductible to the employer. SEP IRA contributions are made by the employer into their own SEP as well as to the individual SEP account of each eligible employee.

**Tax Deferred Growth**
Interest earned in a SEP IRA grows tax-deferred. Dividends and investment earnings continue to grow without being taxed until you withdraw the assets. Withdrawals after age 59½ are taxed as ordinary income. Withdrawals prior to age 59½ may incur a 10% IRS penalty as well as income taxes. At age 70½ Mandatory Required Distributions are required.

**Contribution Flexibility**
Contributions into a SEP are completely discretionary. The percentage of contribution can vary year to year depending on profitability.

**Low Cost and Easy Administration**
SEP IRA accounts are inexpensive, easy to setup and maintain and do not require annual IRS filings.

**Retirement Plan Consolidation**
Retirement plans can be rolled over and consolidated into a SEP. This includes Traditional IRAs, 401k Plans, Money Purchase Plans, Profit Sharing Plans, Defined Benefit Plans, 403b Plans and Rollover IRAs. A Roth IRA or retirement accounts that have after tax contributions can not be rolled over into a SEP IRA.
SEP IRAs are Subject to the IRA Distribution Rules

Neither loans nor hardship distributions are permitted.

Penalty free distributions are allowed after attainment of age 59½; permanent disability; education expenses; first time home purchase (up to $10,000 lifetime cap); payment of medical expenses and payment of health insurance if unemployed.

Other distributions generally are subject to a 10% penalty tax if made prior to attainment of age 59½.

Who May Want to Establish

What's the lure of these plans? They cost nothing but time to set up, and employers are not required to contribute. Moreover, SEP-IRAs are easier to set up and maintain than most retirement plans. The sole requirement is to fill out an adoption agreement, which is a far simpler agreement than those found with other plans.

Employers need to make only two decisions: who will be eligible to participate, and what formula will be used to allocate the funds they choose to contribute ($100 per month, for example, or a percentage of salary).

The SEP is the easiest retirement plan for the self-employed taxpayer to maintain. It should especially appeal to small businesses that don't have staffs to handle the extra paperwork and record keeping required by other more complex retirement plans. SEP IRAs are used by smaller employers who want a plan with no paperwork and which offers maximum contribution flexibility.

Employers who are looking for a prior year tax deduction may ONLY use a SEP.

Sole proprietors with no common law employees and members of Boards of Directors are also typical users of SEPs.

To establish a SEP-IRA, you can obtain adoption agreement kits free of charge from the IRS, mutual fund companies, brokerage firms or banks. There is usually a section in the back of each kit called the SEP Plan Document that covers the “nitty gritty” of the decisions that need to be made. It's worth noting that the adoption agreement must be executed by the employer's tax filing deadline, plus extensions.

The only cost involved in establishing a SEP-IRA is the annual trustee fee of about $10 to $15 per year, which can be paid by the employee; employers might want to pick up this cost as a gesture of goodwill. If the company one approaches asks for an additional fee on top of the trustee fee, find someone else -- there are plenty of companies that do this for free.
SEP-IRAs are not perfect, though. From the employee's perspective, SEP-IRAs omit a key advantage of the more complex retirement plans: the ability to contribute pre-tax income to their account. Instead, employees must rely only on the generosity of their employer, who can contribute on a pre-tax basis.

From the employer's point of view, the plan doesn't necessarily encourage employees to save for the future as features like matching contributions don't exist. In addition, participants become fully vested immediately -- once a contribution has been made to the participant's account, it belongs to them. This just means that they'll need to find other ways to ensure that employees will stick around.

**SEP IRA with NO Employees**

**SEP IRA contributions for a self-employed individual with no employees**
Contributions between 0% and 25% of compensation up to a maximum of $55,000 in 2018 can be made into a SEP IRA. For incorporated businesses, compensation is based on W-2 income and there is a 25% maximum contribution. For sole proprietors, compensation is based on adjusted earned income. Adjusted earned income is determined by completing an IRS worksheet. Contributions of up to 20% of adjusted gross income can be made to a SEP IRA. Annual compensation of more than $275,000 in 2018 cannot be taken into consideration for determining contributions.

**SEP IRA Eligibility**
Incorporated and unincorporated businesses. Sole proprietors, partnerships, LLCs, Subchapter S and C corporations qualify. Also, individuals with self-employed income may be able to contribute to a SEP even if they contribute the maximum into a 401k or 403b retirement plan through their full-time employer.

Self-employed individuals should also consider an Individual 401k as an alternative to a SEP IRA. When compared to a SEP IRA, an Individual 401k may allow a greater contribution at the same income level due to the way the contribution is calculated.

**SEP IRA with Employees**

A SEP IRA plan can be established by a business owner with employees. A SEP IRA is funded 100% by the employer, employees do not contribute. In special situations, a SEP IRA may be an ideal retirement plan for a business owner with employees.

When a SEP IRA is established each eligible employee would open their own separate SEP IRA account. Annually the employer would make a contribution to their own SEP IRA account and to each eligible employee's SEP IRA account. The percentage contributed into each SEP IRA account is the same percentage for the employer and
each eligible employee. The annual contribution percentage made by the employer is flexible and can be changed from year to year depending on profitability.

In general, contributions to the owner's SEP IRA account and the contributions made to each eligible employee's SEP IRA account are 100% tax deductible as a business expense. A SEP IRA allows generous contribution limits but also requires generous contributions from the employer on behalf of all eligible employees.

**SEP IRA for Small Business Owners with Employees**

With a SEP, contributions are made by the employer (employees do not contribute). All eligible employees have their own individual SEP account. Contributions are made by the employer to the employer’s SEP as well as to any eligible employee's SEP accounts. The employer can elect to contribute between 0% to 25% of compensation and the percentage of contribution can vary annually at the employer's discretion. The employer and all eligible employees must receive the same fixed percentage. The annual contribution made by the employer is tax deductible.

**Who is considered to be an eligible employee?**

Generally, when a SEP is established IRS Form 5305 is completed. This short form sets the eligibility requirements for determining who is eligible such as age and length of employment. This form should be kept on file by the employer. When the employer and employees meet the eligibility requirements stated on the completed 5305 form then the employer must make contributions on their behalf. Employers must satisfy the same requirements as the employees. Employers can make the eligibility requirements less strict, but must make contributions to employees if they meet the following 3 requirements:

- 21+ years old
- Have at least 3 years of service in last 5 years
- Have earned at least $450 in compensation from the employer for the year.

**SEP IRA Eligibility**

Incorporated and unincorporated businesses. Sole proprietors, partnerships, LLCs, Subchapter S and C corporations qualify.

**SEP IRA Eligibility**

Incorporated and unincorporated businesses. Sole proprietors, partnerships, LLCs, Subchapter S and C corporations qualify.

**Must part time and seasonal employees be included in the SEP IRA?**

Yes, if they earned $600 (2018) or more in the current year and worked for the business in 3 of the past 5 years and they are age 21 or older. Nonresident aliens may be excluded. When a SEP IRA is established a short form called IRS Form 5305 is completed which states the eligibility requirements. The requirements can be less restrictive than the above stipulations but can't be more restrictive.
In what situations might a SEP IRA be appropriate?
A SEP IRA may be a good option for employers who want to make high contributions to their own SEP account and the SEP accounts of partners or employees.

Why would an employer with employees choose the SEP IRA?
An employer might choose the SEP IRA to be generous to employees and create loyalty and lower turnover. It also might serve as a motivating factor for employees because annual contributions are flexible at the employer’s option. For example, an employer might elect to contribute to a SEP IRA only if a certain threshold of sales or profits is reached. Because the employer contribution can be from 0 to 25% of employees’ wages, the employer can adjust that percentage annually depending on company sales or profits at their discretion.

Is the SEP IRA a good retirement plan option for a family business employing their children?
Yes. The SEP IRA is very egalitarian and requires that contributions for employees be at the same percentage of income as for the business owner. SEP IRA contributions are made by the employer and the contributions are vested immediately. Therefore, it is a generous retirement plan and employee benefit, but expensive for employers. However, when the employees are the children the money stays in the family and the parents are helping their children prepare for retirement and the contribution is a tax-deductible business expense.
## SEP IRA

<table>
<thead>
<tr>
<th></th>
<th><strong>Employers</strong></th>
<th><strong>Employee</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eligibility</strong></td>
<td>Any business owner or self-employed individual</td>
<td>All employees who have worked for you for three of the past five years and who earned at least $600 from you last year.</td>
</tr>
<tr>
<td><strong>Contribution Limits</strong></td>
<td>25% (if you're an employee of the corporation) up to $55,000; 20% (if self-employed) up to $55,000. (2018)</td>
<td>Employees cannot contribute. But the employer must contribute to eligible employee accounts the same salary percentage she contributes to her own.</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>Immediate.</td>
<td>Immediate.</td>
</tr>
<tr>
<td><strong>Pros</strong></td>
<td>Contributions do not have to be made every year. Very easy and cheap to set up and administer.</td>
<td>Vesting is immediate.</td>
</tr>
<tr>
<td><strong>Cons</strong></td>
<td>Must cover all qualifying employees. Employees cannot contribute. Vesting is immediate.</td>
<td>Employees cannot contribute.</td>
</tr>
</tbody>
</table>
Chapter Twelve: 403(b) Plans

Tax Sheltered Annuities (TSAs)

If a person works for a public school or certain tax-exempt organizations such as religious, charitable, educational, scientific and literary organizations described in IRC Sec. 501(c)(3), they may be eligible to participate in a TSA retirement plan offered by their employer. TSA plans are commonly referred to as 403(b) plans. TSA participants can invest funds in annuity contracts, custodial accounts holding mutual fund shares, or retirement income accounts (for certain plans maintained by churches). Special rules apply to figure the cost of the life insurance premiums paid to cover any incidental life insurance protection.

Three Benefits

There are three benefits to contributing to a TSA.

First, one does not pay tax on the contributions they make in the year that they are made. There are either excludable or deductible from one’s income. They do not pay taxes on these amounts contributed until they retire when is the time most people plan to begin distributions to supplement their income after retirement.

Second, earnings and gains within their TSA are not taxed until they are withdrawn. They are tax deferred.

Thirdly, in the years after 2001 they may be eligible to take credit for elective deferrals that they contribute to their TSA.

Employers Make Contributions for Employees

A person cannot set up his or her own TSA. Only their employer can. But typically, the employee agrees to have his or her salary reduced by the amount to be contributed. If
the employer contributes its own funds, the arrangement is subject to many of the same rules that govern regular qualified plans.

**How Contributions Can be Made**

Generally, only one’s employer can make contributions to their 403(b) account. However, some plans will allow them to make after-tax contributions (defined later). The following types of contributions can be made to 403(b) accounts.

**Elective Deferrals**
These are contributions made under a salary reduction agreement. This agreement allows their employer to withhold money from their paycheck to be contributed directly into a 403(b) account for their benefit. They do not pay tax on these contributions until they withdraw them from the account.

**Non-elective Contributions**
These are employer contributions that are not made under a salary reduction agreement. One cannot pay tax on these contributions until they withdraw them from the account. Non-elective contributions include matching contributions, discretionary contributions, and mandatory contributions from their employer.

**After-tax Contributions**
These are contributions they make with funds that they must include in income on their tax return. A salary payment on which income tax has been withheld is a source of these contributions. If their plan allows them to make after-tax contributions, these are not excluded from income and they cannot deduct them on their tax return.

**Combination**
A combination of any of the three contribution types listed above.

**How Much Can Be Contributed**

Known as one of the best lines of defense in planning for a comfortable retirement, 403(b) plans have become an even better way to save. The Economic Growth and Tax Relief Reconciliation Act of 2001 (the Act) made some changes to 403(b)s that can allow you to save more, consolidate eligible retirement plan accounts, and make up for lost time with extra contributions.

**Contribute More**

Thanks to this tax law, now participants can contribute more through their 403(b) plans. Before the tax law, all employees with fewer than 15 years of service were limited to $10,500 in annual pre-tax contributions (called "elective salary deferral" contributions). In 2018, the pre-tax contribution limit is $18,500.
With the new law, employees of tax exempt and governmental organizations who participate in 403(b) plans will no longer be subject to the Maximum Exclusion Amount (MEA) Rules which were repealed beginning in 2002. This eliminated the need for participants to complete complex calculations each year, and increased contribution limits for many 403(b) participants.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>If under age 50</th>
<th>If age 50 and 0ver</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>$15,500</td>
<td>$5,000 = $20,500</td>
</tr>
<tr>
<td>2008</td>
<td>$15,500</td>
<td>$5,000 = $20,500</td>
</tr>
<tr>
<td>2009</td>
<td>$16,500</td>
<td>$5,500 = $22,000</td>
</tr>
<tr>
<td>2010</td>
<td>$16,500</td>
<td>$5,500 = $22,000</td>
</tr>
<tr>
<td>2011</td>
<td>$16,500</td>
<td>$5,500 = $22,000</td>
</tr>
<tr>
<td>2014</td>
<td>$17,500</td>
<td>$5,500 = $23,000</td>
</tr>
<tr>
<td>2015</td>
<td>$18,000</td>
<td>$6,000 = $24,000</td>
</tr>
<tr>
<td>2015 - 2017</td>
<td>$18,000</td>
<td>$6,000 = $24,000</td>
</tr>
<tr>
<td>2018</td>
<td>$18,500</td>
<td>$5,000 = $24,500</td>
</tr>
</tbody>
</table>

(Amounts are for 2007-2018)

In addition, 403(b) participants can take advantage of both the new age 50+ catch up provisions and the existing 403(b) lifetime catch-up provisions.

### Catch-up Contributions

If they're nearing retirement and feel like they're "behind the eight-ball" with their savings, there's some good news. There are now two ways for 403(b) participants to catch up. In fact, once they have contributed the maximum to their 403(b), based on plan or IRS limits, they could potentially put away up to $24,500 in 2018 if they qualify for both of the catch-up provisions summarized below.

**Age 50+ Catch-up**

If their plan allows, they may be able to make additional annual "Age 50+ Catch-up" contributions to their 403(b) plan beginning in the year they turn age 50. If they're already contributing the maximum to their 403(b) based on plan or IRS limits, they may be able to use these pre-tax, catch-up contributions to save even more for retirement. In 2018, the Age 50+ catch-up contribution limit is $6,000.

**403(b) Lifetime Catch-up**

This is available to employees who work for an educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches and have completed 15 or more years of service. This catch-up provision allows participants to contribute up to $3,000 in 2018 in addition to the
regular contribution limit. To qualify, they must be a long-term employee who has contributed on average less than $5,000 a year to their 403(b) plan. The maximum lifetime limit for this catch-up provision is $15,000.

### 403(b) and Catch-up Contribution Limits

<table>
<thead>
<tr>
<th>Year</th>
<th>Age 50+ Catch-up</th>
<th>403(b) Lifetime Catch-up</th>
</tr>
</thead>
<tbody>
<tr>
<td>2008</td>
<td>$20,500</td>
<td>$3,000</td>
</tr>
<tr>
<td>2009</td>
<td>$22,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>2010</td>
<td>$22,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>2011</td>
<td>$22,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>2015</td>
<td>$24,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>2017</td>
<td>$24,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>2018</td>
<td>$24,500</td>
<td>$3,000</td>
</tr>
</tbody>
</table>

### Extra Tax Credit

Similar to 401(k)s, 403(b) participants enjoy all these contribution increases and catch up provisions as well as there is also a tax credit for lower and middle income earners to make retirement saving more attractive. For 2018 there is a tax credit available based on the following table on the first $2,000 of contributions made into a workplace retirement savings plan and IRAs.

### Extra Credit - 2018

<table>
<thead>
<tr>
<th>Adjusted Gross Income (AGI)</th>
<th>Joint filers</th>
<th>Head of Household</th>
<th>Other filers</th>
<th>Credit</th>
<th>Maximum Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$0-38,000</td>
<td>$0-28,500</td>
<td>$0-19,000</td>
<td>50%</td>
<td>$1,000</td>
<td></td>
</tr>
<tr>
<td>$38,001-41,000</td>
<td>$28,501-30,750</td>
<td>$19,000-20,500</td>
<td>20%</td>
<td>$400</td>
<td></td>
</tr>
<tr>
<td>$41,001-63,000</td>
<td>$30,751-47,250</td>
<td>$20,501-31,500</td>
<td>10%</td>
<td>$200</td>
<td></td>
</tr>
<tr>
<td>Over $63,000</td>
<td>Over $47,250</td>
<td>Over $31,500</td>
<td>0%</td>
<td>$0</td>
<td></td>
</tr>
</tbody>
</table>

### When a TSA Can Be Set Up

A TSA can be set up at any time during the year; however, an employee’s salary reduction agreement must be entered into before the reduced amounts are available to the employee. An employee can later modify their deferral amount, but only with respect to future income.
What TSA Funds Can Be Invested In

There are three choices:

- Annuities (fixed or variable and individual or group)
- Custodial accounts invested in mutual funds
- Combination of whole life insurance and annuities

Custodian of the Assets

Annuities and insurance are with an insurance company. Mutual funds are placed with a corporate trustee.

When a Distribution Is Required

Generally, a person withdraws their funds at their retirement. In order for them to avoid penalties, their withdrawals must begin in the calendar year during which they became 70½ or, if later, the calendar year during which the employee actually retires. At a minimum, the funds must be taken out over the life expectancy of the person and, if desired, his or her spouse.

Penalty for Early Withdrawals

There is a 10% penalty for withdrawals prior to age 59½, and all withdrawals are taxed currently as ordinary income unless the distribution is rolled over; transferred to another TSA; or the annuitant is totally disabled, separates from service (after age 55), or dies. Also, a person’s salary reduction amounts (but not the earnings) are available for financial hardship; e.g., an immediate and heavy financial need which cannot be met with other assets.

Can TSA Funds Be Borrowed?

Yes. Participants can borrow funds from their TSA and then later restore them without incurring a tax, if established conditions are met regarding maximum loan amount, amortization requirements, time period for repayments, etc.

Death of a TSA Participant

If a participant with a TSA dies, the proceeds become a part of their taxable estate for Federal Estate Tax purposes, and they are considered as ordinary income to the beneficiary, except for any “pure” insurance proceeds that might be a part of the death benefits.
Changing From One TSA to Another

A participant is allowed to transfer their funds from one 403(b) investment to another and it will not be considered a taxable distribution if the funds remain subject to the distribution restrictions on the prior investment. If a TSA is rolled directly into an IRA, it will defer taxation. If it is paid to the participant first, it will be subject to the mandatory 20% income tax withholding rule.

Deferred Amounts Counted as Current Compensation

Yes, deferred amounts can be counted as current compensation in computing benefits under a separate qualified pension plan, if the qualified plan so provides.
Chapter 13 Objectives

Upon completion of this section, you will:

- Understand what Profit Sharing and Defined benefit plans are and how they work.
- Know how the PBGC relates to defined contribution plans and protects consumers.

Chapter Thirteen: Other Plans, Distribution, & Taxation

Profit Sharing and Defined Contribution

While this study course is designed to inform and educate you in the employer-sponsored retirement plans that allow participants to contribute and direct investments for their own retirement benefits, it is helpful to also be reminded of, be made aware of, and have a basic review of 2 other available employer sponsored plans to round out overall awareness.

Some companies will have either or both of these plans available as well as offer the previously covered contributory plans in addition. Others will have the contributory plans for the benefit of their employees and not have any other formal pension plans such as these two plans in this chapter.

We have included a brief overview and a grid to outline the basics of each plan for your benefit. Other courses available go into depth on these and other corporate pension plans. If you are working actively in this retirement marketplace it is recommended that you search out further study opportunities in this area.

Difference Between a 401(k) Plan and Profit Sharing Plan

A "profit sharing plan" is a type of retirement plan. It allows an employer to share profits of the company with employees by contributing a percentage of the company’s annual profits to the plan. The amount of the contribution can change each year, or may not be made at all, depending on the company's circumstances.

A 401(k) plan is a feature of a profit sharing plan or a stock bonus plan. Unlike a profit sharing plan, however, employees can contribute a percentage of their own salaries (up to certain limits) to the plan for retirement savings. 401(k)s also allow employers to
contribute money to its employees' accounts in the form of "company match" contributions, usually as an incentive to get employees to participate in the plan. Current income taxes are deferred on both employer and employee contributions and all investment earnings, until the money is withdrawn from the plan.

**Profit Sharing Plans**

As you might imagine, a profit sharing plan gives an employee a slice of their company's profits. Annual contributions are made to their account, but because they are based on their company's performance, they'll likely vary from year to year.

Among the many plan types, the profit sharing plan stands out because it is uniquely both employer and employee friendly. It allows for considerable employer flexibility with regard to contributions and minimum employer liability with regard to benefits. It also allows for the maximum accessibility to account dollars by the participant. The stock bonus plan and the ESOP are offshoots of the profit sharing concept, with their own unique advantages.

Employees are motivated by participation in their company’s profits. Larger employers, better able to manage the administrative expenses, frequently offer a profit sharing plan in addition to a defined benefit plan; smaller employers may offer a profit sharing plan alone. While a profit sharing plan must specify how employer contributions will be allocated, the employer is not required to make contributions of any specified amount on an annual basis. To retain the plan’s qualified status, the employer must make “substantial and recurring” contributions to the plan.

Profit sharing plans can provide the employer with protection by making contributions contingent upon the employer having profit. At one end, a profit sharing plan’s contribution formula may specify that a certain percentage of each participant’s salary will be contributed each year, regardless of whether the business realized a profit during a specific year. (The Tax Reform Act of 1986 allows for profit sharing contributions in years in which there is no profit.) The plan may specify that contributions will be made only if the profits exceed a certain level. The plan also could set a limit on the amount of profit that would be available for contributions and also could specify that the board of directors has the discretion to determine what, if any, contribution is made each year regardless of the firm’s profit. Under such plan designs, the employer would have discretion on whether to use the profits for other purposes, such as expansion.

Another important aspect of profit sharing plans is the freedom to invest all of the plan’s assets into the employer’s stock. Although that may be very rare, profit sharing plans are not restricted from purchasing the employer’s stock. Pension plans, in contrast, can invest no more than 10% of the plan’s assets in the employer’s stock.
Another distinction between profit sharing plans and pension plans pertains to the ability of employees, including owner-employees, to make withdrawals while still in service. Profit sharing plans can be designed to allow for in-service withdrawals as long as the funds were in the participant’s account for a minimum of two years.

### Profit Sharing

<table>
<thead>
<tr>
<th>Employers</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eligibility</strong></td>
<td>Any business owner or self-employed individual.</td>
</tr>
<tr>
<td><strong>Contribution Limits</strong></td>
<td>25% of salary (20% of self-employment income) up to $55,000. (2018)</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>Determined by employer.</td>
</tr>
<tr>
<td><strong>Pros</strong></td>
<td>Contributions can vary from year to year.</td>
</tr>
<tr>
<td><strong>Cons</strong></td>
<td>Administration usually requires hiring a pro.</td>
</tr>
</tbody>
</table>

### Defined Benefit Plan

Defined benefit plans are considered the opposite of the contribution-oriented plans. In a contribution-oriented plan, the formula for the contribution is specified in the qualified plan document, and the funding is fixed or variable within certain limits. The ultimate retirement benefit in a contribution-oriented plan is not specified prior to retirement: the benefit will be determined by the value of the participant’s account balance at retirement.

Defined benefit plans promise to pay an employee a specific pension at retirement. By law, the amount of annual retirement benefit cannot be in excess of $220,000 (2018) if retirement is at normal retirement age. Actuarial determinations are required annually to ensure that the plan is adequately funded to provide the promised benefits.
As pension plans, defined benefit plans fulfill the definitely determinable benefits requirement by providing a specific annual retirement benefit to participants. However, the various types of defined benefit plans provide this specific benefit in different ways.

The cash balance plan has the appearance of a defined contribution plan; however, the employer’s guarantee on the investment return sets the cash balance plan apart from a defined contribution plan. That is, in a defined contribution plan, the retirement benefit is largely determined by the investment performance of the funds; the amount of a participant’s retirement benefit cannot be projected with any certainty. However, in a defined benefit plan—whether it is a pension plan or a cash balance plan—the employer takes the responsibility for guaranteeing investment results.

The amount of the defined benefit plan participant’s retirement benefit can be projected with certainty. It is guaranteed by the employer sponsor and backed by the Pension Benefit Guaranty Corporation, a federal agency set up to supervise and insure this guarantee (within certain limits).

Some may have thought that defined benefit plans had gone out with shag carpet? For many they have and for others it may be just what the doctor ordered. Maybe not. A defined benefit plan just might make sense for some owners and their employees as a part of an overall strategy to maximize retirement income potential by combining several plans with varying pros and cons depending on age, income, retirement plans, and cash flow.

These plans can be administered through a Keogh. If one is in their 50s, looking to retire in the next 10 years or so and haven't built up their nest egg yet, then a defined benefit plan is a good opportunity to save. They can contribute as much as is needed to give them an annual retirement payout of $220,000 (2018) or 100% of the average of their three highest consecutive pay years. (They’ll need an actuary to help them with the calculations.) Unfortunately, what’s good for them is bad for younger employees. Because they have more years until retirement, their contribution limit will be lower than the owners and older employees.

And, there are additional drawbacks. For starters, a defined benefit plan can be expensive and it's not very flexible. For example, contributions are not optional. If they can't fund their plan, then they'll have to change their plan document. And, the IRS does not look kindly on companies that change their plan frequently. Below are a few characteristics and provisions to gain a brief overview.
Defined Benefit Plan

<table>
<thead>
<tr>
<th>Employers</th>
<th>Employee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Eligibility</strong></td>
<td>Any business owner or self-employed individual.</td>
</tr>
<tr>
<td><strong>Contribution Limits</strong></td>
<td>No set limit. Contributions are based on actuarial assumption. Maximum annual retirement benefit is $220,000 (2018) or 100% of the participant's average compensation for his highest three consecutive earning years.</td>
</tr>
<tr>
<td><strong>Vesting</strong></td>
<td>Determined by employer.</td>
</tr>
<tr>
<td><strong>Pros</strong></td>
<td>Older employers looking to put away a lot of money over short time period can do so.</td>
</tr>
<tr>
<td><strong>Cons</strong></td>
<td>Can be expensive. Actuary required to determine contribution/deduction limit. Inflexible.</td>
</tr>
</tbody>
</table>

Employer-Sponsored Retirement Plans Differ by Tax Treatment

Think of a retirement plan account as an umbrella. When money is placed under the umbrella or plan, it is treated differently as far as taxes go.

The money that is put into a retirement plan is referred to as a contribution; it's one’s original contribution or principal contribution. Since they have not paid taxes on it, it will eventually all subject to taxation.
The money that they put into a plan will earn interest or receive dividend income or capital gain distributions. These "earnings", unlike money in a savings account, mutual fund, certificate of deposit are not taxed in the year in which they are earned. Thus the "earnings" will continue to grow and compound tax free until withdrawn.

The IRS eventually collects taxes on the “contributions” and "earnings" of their retirement plan.

When they withdraw money from their plan, the entire account, according to the IRS, are subject to "ordinary income taxes" in the year in which they are withdrawn. Keep in mind that capital gain distributions in a mutual fund are taxed at capital gains rates.

The IRS also has what it calls "Premature Distributions" if they withdraw their account assets and they’re under the age of 59½. Not only are their assets taxed at ordinary income tax rates, the IRS makes them pay a penalty of an additional 10% on entire amount of the account.

However, there are no penalties on distributions:

- Made after they are 59½.
- Made on or after the death of the owner of the retirement plan.
- If the taxpayer becomes disabled.
- A part of a series of substantially equal periodic payments (not less than annually) for the life (or life expectancy) of the taxpayer or joints lives (or joint expectancies) of the taxpayer and his or her designated beneficiary.

**Avoid Probate**

If a premature death should occur, the accumulated funds within their retirement plan may be transferred to their named beneficiaries, avoiding the expense, delay, frustration and publicity of the probate process. Like most assets, the retirement plan is part of their taxable estate. Their heirs can generally choose to receive a lump sum payment, or a guaranteed monthly income.

**Minimum Required Distributions**

Once they have retired they can postpone withdrawing their money from their retirement plan until they have reached the age of 70½. In the calendar year in which they turn age 70½ they must make their first withdrawal by the time they reach age 70½. In future years they are required to make a withdrawal by the end of the calendar year.
Retirement Plans Covered

If they have an IRA, 401(k), SEP-IRA, TSA or SIMPLE Plan they are required to begin minimum distributions by age 70½. Roth IRA’s are NOT covered by the MRD rule.

Multiple Retirement Plans

If they have more than one retirement plan from which minimum required distributions must be made, they must calculate the amount required for each plan. The actual minimum distribution may be taken from one plan to satisfy the MRD. The value used to calculate the MRD is the total value of each plan as of December 31st of the preceding year.

IRA Penalty

Failure to make the required distribution by the end of the calendar year results in a penalty equal to 50% of the amount of the distribution. In addition, ordinary income taxes are due on the entire amount, as well.

Calculating the MRD

*Minimum Required Distribution*

Calculating the MRD is easy. Take their account balance as of December 31 of the preceding year and divide by their life expectancy.

Account Balance

Contributions - Includes all contribution made in the immediate preceding year for which the calculation is being made.

Distributions - When calculating the distribution for the second year only, it is reduced by any distribution made in that year to satisfy the minimum distribution requirement for the first year. The first-year distribution year is the year in which they reach age 70½.

Life Expectancy

- Single Life Expectancy - The owner’s life expectancy as set forth by IRS
- Joint Life Expectancy - The owner & designated beneficiary set by IRS
- Death of Owner - If the owner dies before distributions have begun, the remaining life expectancy of the beneficiary.
Distributions Prior to Age $59\frac{1}{2}$

If they make a withdrawal prior to age $59\frac{1}{2}$ from their retirement plan they must pay an additional tax of 10%. This tax is 10% of the part of the distribution that they have to include in gross income. It is in addition to any regular income tax on the amount they have to include in gross income.

Exceptions to the Premature Distribution Penalty Tax

The are exceptions to the premature distribution penalty tax for distributions made from IRAs and retirement plans;

**Unreimbursed Medical Expenses**
- Even if they are under age $59\frac{1}{2}$, they do not have to pay the 10% tax on amounts they withdraw that are not more than:
  - The amount they paid for unreimbursed medical expenses during the year of the withdrawal, minus 10.0% of their adjusted gross income for the year of the withdrawal.
  - They can only take into account unreimbursed medical expenses that they would be able to include in figuring a deduction for medical expenses on Schedule A, Form 1040. They do not have to itemize their deductions to take advantage of this exception to the 10% additional tax.

**Medical Insurance**
- Even if they are under age $59\frac{1}{2}$, they may not have to pay the 10% tax on amounts they withdraw from their traditional IRA during the year that are not more than the amount they paid during the year for medical insurance for themselves, their spouse, and their dependents. They will not have to pay the tax on these amounts if all four of the following conditions apply.
  - They lost their job
  - They received unemployment compensation paid under any federal or state law for 12 consecutive weeks.
  - They make the withdrawals during either the year they received the unemployment compensation or the following year.
  - They make the withdrawals no later than 60 days after they have been re-employed.

**Disability**

If they become disabled before they reach age $59\frac{1}{2}$, any amounts they withdraw from their traditional IRA or retirement plans because of their disability are not subject to the
10% additional tax. They are considered disabled if they can furnish proof that they cannot do any substantial gainful activity because of their physical or mental condition. A physician must determine that their condition can be expected to result in death or to be of long continued and indefinite duration.

**Death**

If one dies before reaching 59½, the assets in their IRAs and retirement plans can be distributed to their beneficiary or to their estate without either having to pay the 10% additional tax. However, if they inherit a retirement account or plan from their deceased spouse and elect to treat it as their own, any distribution they later receive before they reach age 59½ may be subject to the 10% additional tax.

**Higher Education Expenses**

Even if they are under age 59½, if they paid expenses for higher education during the year, part (or all) of any withdrawal may not be subject to the 10% tax on early withdrawals. The part not subject to the tax is generally the amount that is not more than the qualified higher education expenses for the year for education furnished at an eligible educational institution. The education must be for them, their spouse, or the children or grandchildren of them or their spouse.

When determining the amount of the withdrawal that is not subject to the 10% tax, include qualified higher education expenses paid with any of the following funds.

- An individual's earnings.
- A loan.
- A gift.

An inheritance given to either the student or the individual making the withdrawal. Personal savings (including savings from a qualified state tuition program).

**Do not include expenses paid with any of the following funds.**

- Tax-free distributions from an education IRA.
- Tax-free scholarships, such as a Pell grant.
- Tax-free employer-provided educational assistance.
- Any tax-free payment (other than a gift, bequest, or devise) due to enrollment at an eligible educational institution.
- Qualified higher education expenses. Qualified higher education expenses are tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a student at an eligible educational institution. In addition, if the individual is at least a half-time student, room and board expenses are qualified higher education expenses.
**Eligible Educational Institution**

This is any college, university, vocational school, or other postsecondary educational institution eligible to participate in the student aid programs administered by the Department of Education. It includes virtually all accredited, public, nonprofit, and proprietary (privately owned profit-making) postsecondary institutions. The educational institution should be able to tell them if it is an eligible educational institution.

**First Home**

To qualify for penalty-free withdrawal treatment as a first-time homebuyer distribution, a distribution must meet the following requirements.

It must be used to pay qualified acquisition costs before the close of the 120th day after the day they received it.

It must be used to pay qualified acquisition costs for the main home of a first-time homebuyer who is any of the following.

- Themselves.
- Their spouse.
- Them or their spouse's child
- Them or their spouse's grandchild
- Them or their spouse's parent or other ancestor

When added to all their prior qualified first-time homebuyer distributions, if any, the total distributions cannot be more than $10,000. If both husband and wife are first-time homebuyers they each can withdraw up to $10,000 penalty-free for a first home.

**Qualified Acquisition Costs**

Qualified acquisition costs include the following items.

- Costs of buying, building, or rebuilding a home.
- Any usual or reasonable settlement, financing, or other closing costs

**First-time Homebuyer**

A first-time homebuyer is, generally, any individual (and his or her spouse, if married) who had no present ownership interest in a main home during the 2-year period ending on the date the individual acquires the main home to which these rules apply.
Date of Acquisition

The date of acquisition is the date that:

- The first-time homebuyer enters into a binding contract to buy the main home to which these rules apply, or
- The building or rebuilding of the main home to which these rules apply begins.

Avoidance of the Pre 59½ Distribution Penalty

If they make a withdrawal prior to age 59½ from their traditional IRA and retirement plan they must pay an additional tax of 10%. This tax is 10% of the part of the distribution that they have to include in gross income. It is in addition to any regular income tax on the amount they have to include in their gross income.

However, if they stringently adhere to one of three withdrawal methods that the IRS approves of, they may make withdrawals prior to age 59½ and avoid the Premature Distribution Penalty Tax.

An Annuity Payout Option

They can receive distributions from their traditional IRA and retirement plans that are part of a series of substantially equal payments over their life (or their life expectancy), or over the lives (or joint life expectancies) of them and their beneficiary, without having to pay the 10% additional tax, even if they receive such distributions before they are age 59½.

They must use an IRS-approved distribution method and they must take at least one distribution annually for this exception to apply. One IRA-approved method is known as the "life expectancy method". For minimum distribution purposes, this method, when used for this purpose, results in the exact amount required, not the minimum amount.

The payments under this exception must continue for at least 5 years, or until they reach age 59½, whichever is the longer period. This 5-year rule does not apply if a change from an approved distribution method is made because of the death or disability of the IRA/retirement plan owner.

The payment must be calculated on the life or life expectancy of the recipient of the retirement plan and payments be made no less frequently than annually. If the payments under this exception are changed before the end of the above required periods for any reason other than the death or disability of the retirement account owner, he or she will be subject to the 10% additional tax.
For example, if they received a lump-sum distribution of the balance in their retirement plan account/traditional IRA before the end of the required period for their annuity distributions and they did not receive it because they were disabled, they would be subject to the 10% additional tax. The tax would apply to the lump-sum distribution and all previous distributions made under the exception rule.

There are two other IRS-approved distribution methods that they can use. They are generally referred to as the "amortization method" and the "annuity factor method." These two methods are complex and require the assistance of a tax professional. For more information about these methods see IRS Notice 89-25 in Internal Revenue Cumulative Bulletin 1989-1.

**Pension Benefit Guaranty Corporation (PBGC)**

**Protecting Private-Sector Defined Benefit Pension Plans**

The Pension Benefit Guaranty Corporation (PBGC) protects the retirement incomes of more than 40 million American workers in nearly 24,000 private-sector defined benefit pension plans. A defined benefit plan provides a specified monthly benefit at retirement, often based on a combination of salary and years of service. PBGC was created by the Employee Retirement Income Security Act of 1974 to encourage the continuation and maintenance of private-sector defined benefit pension plans, provide timely and uninterrupted payment of pension benefits, and keep pension insurance premiums at a minimum.

PBGC is not funded by general tax revenues. PBGC collects insurance premiums from employers that sponsor insured pension plans, earns money from investments and receives funds from pension plans it takes over.

In 2017, PBGC paid out about $5.6 billion for monthly retirement benefits, up to a guaranteed maximum, for nearly 868,000 retirees in 4,800 single-employer and multiemployer pension plans that cannot pay promised benefits. Including those who have not yet retired and participants in multiemployer plans receiving financial assistance, PBGC is responsible for the current and future pensions of about 1.5 million people.

The maximum pension benefit guaranteed by PBGC is set by law and adjusted yearly. For plans that end in 2016, the maximum guarantee for workers who retire at age 65 is $60,136 yearly ($5,011.36 monthly). The guarantee is lower for those who retire early or when there is a benefit for a survivor. The guarantee is increased for those who retire after age 65.
Governance

PBGC is headed by a Director who is appointed by the President and confirmed by the Senate. The Board of Directors consists of the Secretaries of Labor, Commerce and Treasury, with the Secretary of Labor as Chair.

The Corporation is aided by a seven-member Advisory Committee appointed by the President of the United States to represent the interests of labor, employers, and the general public. ERISA outlines several specific responsibilities for PBGC's Advisory Committee, including advising on policies and procedures for PBGC's investments, the trusteeship of terminated plans, and on other matters as determined by PBGC.

How PBGC Operates

The Pension Benefit Guaranty Corporation (PBGC) protects the retirement benefits of more than 40 million workers and retirees.

Where the Money Comes From

PBGC revenue does not come from the use of general fund tax dollars. It is derived from:

- Insurance premiums paid by nearly 24,000 insured defined benefit pension plans
- Assets from terminated trusteed plans
- Investment income
- Recoveries from companies that sponsored failed plans
- Net premium revenue totaled about $7.0 billion in fiscal year 2017

Two Pension Insurance Programs

- The single-employer program protects about 30 million workers and retirees in over 22,000 pension plans
- The multiemployer program protects over 10 million workers and retirees in about 1,400 pension plans. Multiemployer plans are set up pursuant to collective bargaining agreements involving more than one unrelated employer, generally in one industry.
- If a single-employer plan fails and PBGC becomes responsible for it, the agency directly pays benefits due to retirees (and future retirees) up to legal limits.
- PBGC does not directly pay the benefits of people in failed multiemployer plans. Instead, the agency provides financial assistance to the plans themselves, which continue to pay retirees.
What Happens When PBGC Takes Over a Plan

PBGC reviews a plan’s records to determine what benefits a participant will receive. To ensure PBGC has the correct information, they ask the participant to complete an information form.

- If one is already receiving a pension, PBGC will continue paying them without interruption during their review.
- These payments will be an estimate of the benefits that PBGC can pay under the insurance program.
- It may be less than one was receiving from their plan, but it will be paid in the annuity form they chose at retirement.
- If a participant has not yet retired: Four months before they want their benefits to begin, they will need to request an estimate from PBGC.
- Three months before they want their benefits to begin, start their application by using PBGC online service. Or, they can call the PBGC Customer Contact Center toll-free at 1-800-400-7242.
- PBGC pays most benefits by electronic direct deposit, but a recipient may still receive their benefit by paper check if they prefer.
Chapter Fourteen: Important Facts & Figures

Traditional and Roth IRA Contribution Limits
Here’s are the Traditional and Roth IRA contribution limits for 2018, and for years past.

<table>
<thead>
<tr>
<th>Year</th>
<th>Age 49 and Below</th>
<th>Age 50 and Above</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002-04</td>
<td>$3,000</td>
<td>$3,500</td>
</tr>
<tr>
<td>2005</td>
<td>$4,000</td>
<td>$4,500</td>
</tr>
<tr>
<td>2006-07</td>
<td>$4,000</td>
<td>$5,000</td>
</tr>
<tr>
<td>2008</td>
<td>$5,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>2009</td>
<td>$5,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>2010</td>
<td>$5,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>2013</td>
<td>$5,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>2014</td>
<td>$5,500</td>
<td>$6,500</td>
</tr>
<tr>
<td>2015</td>
<td>$5,500</td>
<td>$6,500</td>
</tr>
<tr>
<td>2016-18</td>
<td>$5,500</td>
<td>$6,500</td>
</tr>
</tbody>
</table>

IRA/Roth Contribution Levels 2018

<table>
<thead>
<tr>
<th>Year</th>
<th>Under age 50</th>
<th>Age 50+</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$5,500</td>
<td>$6,500</td>
</tr>
</tbody>
</table>

Roth IRA Eligibility 2018

<table>
<thead>
<tr>
<th>Year</th>
<th>If your tax status is...</th>
<th>...you can contribute to a Roth IRA if your modified adjusted gross income is less than...</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>Married, filing jointly</td>
<td>$189,000</td>
</tr>
<tr>
<td>2018</td>
<td>Single</td>
<td>$135,000</td>
</tr>
</tbody>
</table>
Traditional IRA Deductions 2018

If you are covered by a retirement plan at work, use this IRS table to determine if you can deduct your 2018 Traditional IRA contribution:

<table>
<thead>
<tr>
<th>If Your Filing Status Is...</th>
<th>And Your Modified AGI Is...</th>
<th>Then You Can Take...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, head of household</td>
<td>$63,000 or less</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td></td>
<td>more than $63,000 but less than $73,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$72,000 or more</td>
<td>no deduction.</td>
</tr>
<tr>
<td>Married filing jointly or qualifying widow(er)</td>
<td>$101,000 or less</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td></td>
<td>more than $101,000 but less than $121,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$121,001 or more</td>
<td>no deduction.</td>
</tr>
<tr>
<td>Married filing separately</td>
<td>less than $10,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$10,000 or more</td>
<td>no deduction.</td>
</tr>
</tbody>
</table>

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.
If you are not covered by a retirement plan at work or one isn’t offered, use this IRS table to determine if you can deduct your 2018 Traditional IRA contribution:

<table>
<thead>
<tr>
<th>If Your Filing Status Is...</th>
<th>And Your Modified AGI Is...</th>
<th>Then You Can Take...</th>
</tr>
</thead>
<tbody>
<tr>
<td>Single, head of household, or qualifying widow(er)</td>
<td>any amount</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td>Married filing jointly or separately with a spouse who is not covered by a plan at work</td>
<td>any amount</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td>Married filing jointly with a spouse who is covered by a plan at work</td>
<td>$189,000 or less</td>
<td>a full deduction up to the amount of your contribution limit.</td>
</tr>
<tr>
<td></td>
<td>more than $189,000 but less than $199,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$199,000 or more</td>
<td>no deduction.</td>
</tr>
<tr>
<td>Married filing separately with a spouse who is covered by a plan at work</td>
<td>less than $10,000</td>
<td>a partial deduction.</td>
</tr>
<tr>
<td></td>
<td>$10,000 or more</td>
<td>no deduction.</td>
</tr>
</tbody>
</table>

If you file separately and did not live with your spouse at any time during the year, your IRA deduction is determined under the "Single" filing status.

### Roth IRA Conversion Eligibility

<table>
<thead>
<tr>
<th>Year</th>
<th>Eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>2009</td>
<td>Only if your modified adjusted gross income is $100,000 or less</td>
</tr>
<tr>
<td>2010 on</td>
<td>Anyone can</td>
</tr>
</tbody>
</table>
SEP IRA Contribution Levels 2018

Here’s what you can contribute to a SEP IRA:

<table>
<thead>
<tr>
<th>Year</th>
<th>Status</th>
<th>Maximum Contribution</th>
<th>Deductible</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>W-2 Income</td>
<td>Up to 25% of compensation, but no more than $55,000.</td>
<td>Yes (100%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>($220K)</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>Self Employed</td>
<td>Up to 20% of compensation, but no more than $55,000.</td>
<td>Yes (100%)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>($275K)</td>
<td></td>
</tr>
</tbody>
</table>

2018 Federal Tax Brackets

<table>
<thead>
<tr>
<th>Rate</th>
<th>For Unmarried Individuals, Taxable Income Over</th>
<th>For Married Individuals Filing Joint Returns, Taxable Income Over</th>
<th>For Heads of Households, Taxable Income Over</th>
</tr>
</thead>
<tbody>
<tr>
<td>10%</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>12%</td>
<td>$9,525</td>
<td>$19,050</td>
<td>$13,600</td>
</tr>
<tr>
<td>22%</td>
<td>$38,700</td>
<td>$77,400</td>
<td>$51,800</td>
</tr>
<tr>
<td>24%</td>
<td>$82,500</td>
<td>$165,000</td>
<td>$82,500</td>
</tr>
<tr>
<td>32%</td>
<td>$157,500</td>
<td>$315,000</td>
<td>$157,500</td>
</tr>
<tr>
<td>35%</td>
<td>$200,000</td>
<td>$400,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>37%</td>
<td>$500,000</td>
<td>$600,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

Federal Estate Tax Levels

At death, a surviving spouse’s estate will owe estate taxes on the net value that exceeds the annual exemption:

<table>
<thead>
<tr>
<th>Year</th>
<th>Exempt from Tax</th>
<th>Estate-Tax Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Unlimited</td>
<td>0%</td>
</tr>
<tr>
<td>2018</td>
<td>Single $5,600,000</td>
<td>Married $11,200,000</td>
</tr>
</tbody>
</table>
State Estate-Tax Levels 2018

While the net value of a surviving spouse’s estate may fall below the federal exemption level, it still may wind up owing state estate tax if it exceeds the following exemption level:

<table>
<thead>
<tr>
<th>State</th>
<th>Exemption Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connecticut</td>
<td>$2,600,000</td>
</tr>
<tr>
<td>Delaware</td>
<td>$5,549,000 2017 or prior (2018 Estate Tax repealed)</td>
</tr>
<tr>
<td>District of Columbia</td>
<td>$5,600,000 $11,200,000</td>
</tr>
<tr>
<td>Hawaii</td>
<td>$5,600,000 $11,200,000</td>
</tr>
<tr>
<td>Illinois</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Maine</td>
<td>$5,600,000 $11,200,000</td>
</tr>
<tr>
<td>Maryland</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Minnesota</td>
<td>$1,800,000</td>
</tr>
<tr>
<td>New Jersey</td>
<td>$2,000,000 (2018 Estate Tax repealed)</td>
</tr>
<tr>
<td>New York</td>
<td>$5,250,000</td>
</tr>
<tr>
<td>Oregon</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Rhode Island</td>
<td>$1,515,516</td>
</tr>
<tr>
<td>Vermont</td>
<td>$2,750,000</td>
</tr>
<tr>
<td>Washington</td>
<td>$2,129,000</td>
</tr>
</tbody>
</table>

Annual Gift Tax Exclusion 2018

You may give the following amount to an individual, free of gift tax:

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Exclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$15,000</td>
</tr>
</tbody>
</table>
Single Life Expectancy Table for Inherited IRAs

(to be used for calculating post-death required distributions to beneficiaries)

Designated beneficiaries use this single life expectancy table based on their age in the year after the IRA owner's death. That factor is reduced by one for each succeeding distribution year. Spouse beneficiaries who do not elect to roll the IRA over or treat it as their own, also use the single life table, but they can recalculate each year.

<table>
<thead>
<tr>
<th>0</th>
<th>82.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>81.6</td>
</tr>
<tr>
<td>2</td>
<td>80.6</td>
</tr>
<tr>
<td>3</td>
<td>79.7</td>
</tr>
<tr>
<td>4</td>
<td>78.7</td>
</tr>
<tr>
<td>5</td>
<td>77.7</td>
</tr>
<tr>
<td>6</td>
<td>76.7</td>
</tr>
<tr>
<td>7</td>
<td>75.8</td>
</tr>
<tr>
<td>8</td>
<td>74.8</td>
</tr>
<tr>
<td>9</td>
<td>73.8</td>
</tr>
<tr>
<td>10</td>
<td>72.8</td>
</tr>
<tr>
<td>11</td>
<td>71.8</td>
</tr>
<tr>
<td>12</td>
<td>70.8</td>
</tr>
<tr>
<td>13</td>
<td>69.9</td>
</tr>
<tr>
<td>14</td>
<td>68.9</td>
</tr>
<tr>
<td>15</td>
<td>67.9</td>
</tr>
<tr>
<td>16</td>
<td>66.9</td>
</tr>
<tr>
<td>17</td>
<td>66.0</td>
</tr>
<tr>
<td>18</td>
<td>65.0</td>
</tr>
<tr>
<td>19</td>
<td>64.0</td>
</tr>
<tr>
<td>20</td>
<td>63.0</td>
</tr>
<tr>
<td>21</td>
<td>62.1</td>
</tr>
<tr>
<td>22</td>
<td>61.1</td>
</tr>
<tr>
<td>23</td>
<td>60.1</td>
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This table is the new life expectancy table to be used by all IRA owners to calculate lifetime distributions (unless your beneficiary is your spouse who is more than 10 years younger than you). In that case, you would not use this table, you would use the actual joint life expectancy of you and your spouse based on the regular joint life expectancy table. The Uniform Distribution Table is never used by IRA beneficiaries to compute required distributions on their inherited IRAs.

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