

# retirement plans

Contributing to retirement plans can provide you with financial security as well as reducing and/or deferring your taxes. However, there are complex rules that govern the type of plans available to you, the amount you can contribute, whether contributions need to benefit your employees, and the requirements for taking funds out of the plan. Failure to adhere to these rules can have severe adverse tax consequences.



## RETIREMENT PLAN BENEFITS

Retirement plans (other than Roth IRAs and plans offering Roth 401(k) plans) offer these tax saving advantages:

- Your contributions grow tax-deferred until withdrawn.
- Your contributions are tax deductible, thereby reducing your current year's taxes.

Roth IRAs and Roth 401(k) plans offer different tax savings opportunities by providing for tax-free growth and withdrawals in the future, but there is no current-year tax deduction for your contributions.

### chart

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## RETIREMENT PLANS

### Retirement plans available to self-employed individuals include:

- Simplified Employee Pension (SEP) Plans
- SIMPLE IRA or SIMPLE 401(k) Plans
- Defined Contribution Plans including 401(k) Plans
- Defined Benefit Plans

### Employer-sponsored salary deferral plans available to employees include:

- 401(k) Plans
- 403(b) Plans for Employees of Public Schools or Tax-Exempt Educational, Charitable and Religious Organizations
- 457(b) Plans for Employees of Government Organizations
- SIMPLE Plans for Companies with 100 or Fewer Employees

### Individual Retirement Accounts (IRAs) available to all individuals, subject to income limitations:

- Roth
- Traditional
- Education

## AVAILABLE RETIREMENT PLANS

There are many different types of retirement plans available with different contribution and distribution rules. The specific plan(s) you can contribute to depends on a variety of factors, including your income, whether you are an employee or self-employed, and whether or not you contribute to or participate in other retirement plans.

Self-employed individuals have more flexibility to choose plans to maximize contributions. Employees are more limited since they will have to make contributions based on the type of plan their employer offers, but may gain the advantage of having their employer match some or all of their contributions. Employees may also be eligible to make contributions to other plans in addition to the ones offered by their employer, if they have earned income from a self-employment activity (such as consulting or directors' fees). Employees or self-employed individuals and their spouses may also be eligible to contribute to a traditional or Roth IRA.

Chart 8 shows the different types of retirement plans that you may be eligible to participate in. Chart 9 shows the maximum annual contributions that you can make for 2015 and 2016.

### Special Note — IRS Uniform Policy Regarding Same-Sex Spouses — Impact on Retirement Plans

On June 26, 2015 the U.S. Supreme Court ruled in *Obergefell v. Hodges* that states cannot ban same-sex marriages in the U.S. On October 21, 2015, the IRS released proposed regulations under IRC section 7701.

The proposed regulations clarify and strengthen the guidance the IRS provided under Revenue Ruling 2013-17. As a result of the decisions in *Windsor* and *Obergefell*, the IRS has determined that for federal tax purposes marriages of same-sex couples should be treated the same as marriages of opposite-sex couples. The proposed regulations would amend the terms 'husband,' 'wife,' and 'spouse' under IRC section 7701 to be interpreted in a neutral manner meaning an individual lawfully married to another individual and 'husband and wife' mean two individuals lawfully married to each other. These definitions apply regardless of the individual's sex.

Similar to Revenue Ruling 2013-7, the proposed regulations provide that the marriage of two individuals will be recognized for federal tax purposes, which includes qualified retirement plans, SEPs, SIMPLEs, and IRAs, if their marriage is recognized by any state, possession, or territory of the U.S. A marriage performed in a foreign jurisdiction will be recognized for federal tax purposes if it is recognized by at least one state, possession or territory of the

U.S. The proposed regulations do not treat registered domestic partnerships, civil unions, or similar arrangements not considered marriages under state law as a marriage for federal tax purposes.

## SIMPLIFIED EMPLOYEE PENSION PLAN

A SEP plan allows you, in your capacity as employer, to make contributions to your own IRA and to eligible employees' IRAs. If you do not have employees, the plan is a single participant plan for your benefit. If you have eligible employees, you must also make contributions on their behalf. The maximum allowable annual contribution to a SEP is \$53,000 for 2015 and 2016. However, the contribution on behalf of a self-employed individual cannot exceed 25% of his or her eligible compensation (net of the deduction for the contribution). The contribution limit for common law employees covered by a SEP is the lesser of 100% of their eligible compensation or \$53,000 for 2015 and 2016.

There are several advantages of a SEP compared to a qualified defined contribution plan (e.g., a profit-sharing plan). Unlike a

defined contribution plan, which must be established by December 31, a SEP plan can be set up any time prior to the due date of the tax return for the current year of the sponsoring entity (including extensions as late as October 15) and you can still deduct contributions on your prior year's tax return, even though made in the next year. Another advantage is that SEPs do not require the same documentation as defined contribution plans, nor is Form 5500 required to be filed annually.

## QUALIFIED DEFINED CONTRIBUTION AND BENEFIT PLANS

A qualified defined contribution plan can be a profit-sharing plan, a money purchase pension plan, or a target benefit pension plan.

The maximum contribution to a defined contribution plan for each employee is the lesser of \$53,000 in 2015 and 2016 or 100% of his or her compensation. For self-employed individuals, the maximum contribution will generally be limited in the same manner as for SEPs unless 401(k) provisions are included in the plan.

chart

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## RETIREMENT PLAN MAXIMUM ANNUAL CONTRIBUTION LIMITS

Type of Plan	Maximum Annual Contribution	
	2015	2016
401(k), 403(b), salary deferrals	\$ 18,000	\$ 18,000
Defined-contribution plan including salary deferral amounts above	53,000	53,000
Defined-benefit plan*	210,000	210,000
Traditional and Roth IRAs	5,500	5,500
SEP Plans	53,000	53,000
457(b) salary deferrals to state and local government and tax-exempt organization plans	18,000	18,000
SIMPLE plans (Savings incentive match plan for employees)	12,500	12,500
Catch-up contributions for individuals age 50 or older		
<ul style="list-style-type: none"> <li>• 401(k), 403(b) and 457(b) plans</li> <li>• Traditional and Roth IRAs</li> <li>• SIMPLEs</li> </ul>	6,000 1,000 3,000	6,000 1,000 3,000

\* This is the maximum annual benefit that can be provided for by the plan, based on actuarial computations.

A qualified defined benefit plan sets a future annual pension benefit and then actuarially calculates the contributions needed to attain that benefit. Because the plan is actuarially driven, the annual contribution may exceed those allowable for other types of plans, and is based on the employee's age, average annual income and annual desired benefit (limited to the maximum allowable annual benefit). The maximum allowable annual benefit is the lesser of \$210,000 in 2015 and 2016 or 100% of earned income.

Whether you choose a defined contribution or a defined benefit plan, your plan must be in place by December 31 of the year for which you want to make tax deductible contributions to the plan. As long as the plan is in existence on that date, you can make tax deductible plan contributions to a defined contribution plan as late as the due date of that year's income tax return, including extensions (as late as October 15, or September 15 for sole proprietors, partnerships, LLCs or corporations). For calendar year-defined benefit plans, contributions must be made by September 15, regardless of an extension to file until October 15.

#### **In-Plan Roth conversions**

The Small Business Jobs Tax Relief Act of 2010 included two retirement plan provisions. The first provides a special Roth conversion opportunity that a plan sponsor may (but is not required to) offer to plan participants under its 401(k) or 403(b) plan. The second provision allows governmental 457(b) plans to offer a Roth feature and the Roth conversion feature.

Employees can elect under certain conditions to convert some or all of certain amounts that were contributed to a plan on a pre-tax basis into a Roth after-tax account inside of the plan. This is known as an "in-plan" Roth conversion. Both 401(k) plans and 403(b) plans may permit such a conversion, but the plan documents must provide for the in-plan conversion.

ATRA further expanded this provision by lifting conditions which essentially allow an in-plan conversion for all plan participants.

There is no recharacterization option for an in-plan Roth conversion, so once a conversion is made it is irrevocable.

#### **Application to plans and participants**

Any current or former plan participant who has an account balance in the plan and who is eligible to receive an eligible rollover distribution ("ERD") can make the Roth conversion election. The election is available to surviving spouses, but not non-spouse beneficiaries. There is no income limit or filing status restriction for this election. The conversion may be applied to any type of vested contributions (and earnings thereon) that are currently distributable and would be treated as an ERD. Contribution types that would be eligible for conversion are: pre-tax 401(k), 403(b), and 457(b) deferrals, matching contributions, and profit sharing

chart

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### UNIFORM LIFE TABLE

If you are either unmarried, or married, but your spouse is either not the sole beneficiary or is not more than 10 years younger than yourself, you can compute your required minimum distribution by using this table. Assuming you are 73 years old and your qualified retirement plans, in the aggregate, were valued at \$2,000,000 at the end of 2015, you would be required to take a minimum distribution of \$80,972 in 2016 (\$2,000,000 divided by a distribution period of 24.7).

Age	Distribution Period	Age	Distribution Period
70	27.4	85	14.8
71	26.5	86	14.1
72	25.6	87	13.4
73	24.7	88	12.7
74	23.8	89	12.0
75	22.9	90	11.4
76	22.0	91	10.8
77	21.2	92	10.2
78	20.3	93	9.6
79	19.5	94	9.1
80	18.7	95	8.6
81	17.9	96	8.1
82	17.1	97	7.6
83	16.3	98	7.1
84	15.5	99	6.7

contributions. In addition, certain after-tax contributions may be rolled over to an in-plan Roth account.

## SALARY DEFERRAL PLANS (401(K), 403(B) AND 457(B) PLANS)

A 401(k) plan is a profit sharing plan that allows participants to elect to have a portion of their compensation contributed to the plan. The maximum employee elective contribution that can be made for 2015 and 2016 is \$18,000 (\$24,000 for taxpayers age 50 and over). This annual limit applies to your total contributions even if you have more than one employer or salary deferral plan.

Similar provisions apply for 403(b) and 457(b) plans.

## SIMPLE PLANS

An employer that had no more than 100 employees who earned \$5,000 or more of compensation in the preceding year, can establish a SIMPLE plan as long as the employer doesn't maintain any other employer-sponsored retirement plan. A SIMPLE plan can take the form of an IRA or a 401(k) plan. Both plans allow employees to contribute up to \$12,500 for 2015 and 2016 (\$15,500 for taxpayers age 50 and over) with the employer generally required to match employee contributions at a maximum of 3% of the employee's compensation. For a SIMPLE IRA, the employer may choose to reduce the matching contribution to less than 3% but no less than 1% in 2 out of every 5 years.

**Caveat:** *The benefit of a SIMPLE plan is that it is not subject to non-discrimination and other qualification rules, including the top-heavy rules, which are generally applicable to qualified plans. The downside is that you cannot contribute to any other employer-sponsored retirement plan and the elective contribution limit is lower than for other types of plans. For the employee, the mandatory employer matching requirement can be attractive, though limited. For the employer, the contributions are not discretionary.*

**New for 2016:** PATH allows a taxpayer to roll over amounts from an employer-sponsored retirement plan (e.g., a 401(k) plan) to a SIMPLE plan, provided that the plan has existed for at least 2 years.

## INDIVIDUAL RETIREMENT ACCOUNTS (IRAs)

Reminder: Beginning in 2015, you can make only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs you own. The one-rollover-per-year limitation is applied by aggregating all of an individual's IRAs, including SEP and SIMPLE IRAs, as well as traditional and Roth IRAs, effectively treating them as one IRA for purposes of the limit. Please note that the following rollovers are exempted from this rule:

- Trustee-to-trustee transfers between IRAs are not limited because you do not receive a physical check from the originating IRA to deposit to the new IRA. Therefore, the transfer is not considered a rollover by the IRS. The assets and/or cash are electronically transferred from the old IRA trustee to the new IRA trustee.
- Rollovers from traditional to Roth IRAs ("conversions") are not limited (because they generate tax revenue).

**Example:** *If you have three traditional IRAs, (IRA-1, IRA-2 and IRA-3), and you took a distribution from IRA-1 on January 1, 2016 (received a check) and rolled it over into IRA-2 the same day (must be within 60 days), you could not roll over any other 2016 IRA distribution unless the rollover meets one of the above exceptions or the transition rule discussed below.*

The 2 most common types of IRAs are Roth IRAs and traditional IRAs. While there are significant differences between these IRAs, there are also common rules that apply to both of them. You can contribute up to \$5,500 for 2015 and 2016 (\$6,500 if at least age 50) to either IRA account, or both combined. To be deductible as a contribution for a traditional IRA (Roth contributions are not tax deductible) in the current year, you must make the contribution on or before April 15 of the following year. An extension to file your tax return does not extend this date. To be eligible to contribute to either IRA, you must have earned income equal to or greater than the IRA contribution amount. Taxable alimony is considered earned income for IRA purposes.

## TRADITIONAL IRA: CURRENT TAX DEDUCTION

A traditional IRA allows a current tax deduction for your contributions and the earnings grow tax-deferred. The contributions lower your current year's taxes, but future distributions will be fully taxable as ordinary income, subject to ordinary income tax rates at the time of distribution. Also, once you reach age 70½, you can no longer make contributions in that year or future years. You can only make tax deductible contributions to a traditional IRA if you (or your spouse, if married) do not actively participate in an employer-sponsored retirement plan for any part of the

year. However, you can still make contributions to an employer-sponsored plan and deduct your own IRA contributions if you meet one of these exceptions:

- You are single and your MAGI does not exceed \$61,000 in 2015 and 2016. A partially deductible IRA contribution is allowed until your MAGI reaches \$71,000 in 2015 and 2016.
- You are married, but only one of you actively participates in an employer-sponsored plan and your combined MAGI doesn't exceed \$183,000 in 2015 (\$184,000 in 2016). Only the non-active participant can make a deductible IRA contribution. A partially deductible contribution can be made until the combined MAGI reaches \$193,000 in 2015 (\$194,000 in 2016).
- Both you and your spouse (if filing jointly) participate in employer-sponsored plans, but your combined MAGI does not exceed \$98,000 in 2015 and in 2016. You can make a partially deductible IRA contribution until your MAGI reaches \$118,000 in 2015 and in 2016.
- You can always make a nondeductible contribution irrespective of the income limitations or participation in an employer-sponsored plan up until the year you attain age 70½.

## ROTH IRA: NO TAXES ON DISTRIBUTIONS

A Roth IRA differs from a traditional IRA primarily because your contributions are made on an after-tax basis, but your withdrawals are generally tax free. A Roth IRA offers these advantages over a traditional IRA:

- You never pay any income tax on the earnings if you take only qualified distributions. To qualify as a tax-free distribution, the Roth IRA must have been opened more than 5 years ago and the distribution must be made after age 59½ (with a few exceptions).
- Distributions before reaching age 59½ (and other nonqualified distributions) are first treated as a nontaxable return of your contributions. To the extent these distributions do not exceed your contributions, they are not taxed. This gives you more flexibility to withdraw funds to cover financial emergencies. However, amounts that exceed your accumulated contributions are subject to regular income tax, plus an additional 10% penalty as nonqualified distributions.
- Original account owners and their spouses who are designated beneficiaries are not required to take distributions beginning at age 70½ — or ever.

- Your contributions can continue to be made to the plan after you reach age 70½, as long as you have sufficient earned income and/or alimony.
- Contributions to a Roth IRA can be made even if your MAGI is too high for a traditional IRA or you are covered by an employer-sponsored plan. The AGI limits for making Roth IRA contributions are \$183,000 in 2015 (\$184,000 in 2016) if you are married filing jointly, or \$116,000 in 2015 (\$117,000 in 2016) if you are single or head of household (with partial contributions permitted until your AGI reaches \$193,000 in 2015 (\$194,000 in 2016), if married filing jointly and \$131,000 in 2015 (\$132,000 in 2016) if single or head of household).

If you already have a traditional IRA in place, you may want to consider rolling part or all of the balance into a Roth IRA. The advantage of this rollover is that you convert tax-deferred future growth into tax-free growth. The disadvantage is that the amount of the rollover from the traditional IRA is taxable, as if you received the distribution. Before you roll over anything, evaluate the potential benefit of the tax-free growth compared to the lost earnings on the tax you pay because of the rollover.

- **Who should make a conversion to a Roth IRA?** Those individuals who have many years to go before retirement and who should be able to recover the tax dollars lost on the conversion may benefit from a conversion. Others who may benefit are those who anticipate being in a higher tax bracket in the future and those able to pay the tax on the conversion from non-retirement account assets.
- **What are some planning ideas for high-income taxpayers?** High-income individuals can make nondeductible contributions to a traditional IRA this year and in future years so that the amounts can be converted to Roth IRAs. However, to the extent an individual also has a traditional IRA funded with pre-tax contributions, the conversion is deemed to be made pro rata from each IRA.

High income individuals whose spouses are much younger and who do not anticipate the need to take distributions should consider a conversion to a Roth since the spouse may take the Roth IRA as her own and distributions will not be required until the second spouse passes.

## REQUIRED MINIMUM DISTRIBUTION (“RMD”) RULES

You must generally start taking RMDs from your qualified retirement plan or traditional IRA by April 1 of the year following the year in which you reach age 70½. For each year thereafter, the RMD amount must be taken by December 31 of that year. If you are a participant in a qualified retirement plan of your current employer, you should refer to the plan document or consult with your employer regarding when you must begin receiving RMDs from the plan as some plans do not require you to take RMDs until you terminate your employment even if you have already reached age 70½ before leaving your employer. For example, if you own 5% or less of the employer and are still employed by the employer at 70½, the plan document may allow you to defer taking distributions from the plan until you actually retire. This exception does not apply to SEPs or SIMPLE IRAs.

**Note:** *If you turned or will turn 70½ during the year, you can either take a distribution in that year or defer the distribution until the following year. If you elect to defer, you must take 2 distributions the following year (the first by April 1 and the second by December 31).*

Generally, if you fail to take an RMD from your qualified retirement plan or traditional IRA after you reach 70½, you are subject to a 50% penalty on the shortfall. If you are subject to the penalty, you do not have to take a catch-up distribution since the penalty effectively covers the income tax that you would have had to pay on the distribution, as well as a penalty. The RMD is computed by taking the aggregate value of all your qualified retirement plans at December 31 of the prior year and dividing that sum by a distribution period determined by the IRS. There are two tables for determining the distribution period. One is called the Uniform Lifetime Table and is used by unmarried individuals, or a married individual if the individual's spouse is either not the sole beneficiary or is not more than 10 years younger than the individual. The other table is the Joint Life and Last Survivor Expectancy Table and is used when the spouse is the sole beneficiary and is more than ten years younger than the individual. The Uniform Lifetime Table, the more commonly used table, is reproduced in Chart 10 with an example of how to compute your RMD.

## AVOID EARLY WITHDRAWAL PENALTIES

Generally, withdrawals from employer-sponsored qualified plans and IRA accounts are taxed at your ordinary income tax rate. If taken before reaching age 59½, you are also subject to a 10% early withdrawal penalty unless you meet one of the following exceptions:

- You take distributions because of job separation (such as early retirement) and you are at least 55 years old at the time you terminate your employment with the employer. These distributions must be made as part of a series of substantially equal periodic payments (made at least annually) for the individual's life (or life expectancy) or the joint lives (or joint life expectancies) of the individual and the designated beneficiary(ies). If early distributions are from an employee plan, payments must begin after separation of service.

**Note:** *This exception does not apply to IRA accounts.*

- You receive distributions under a qualified domestic relations order (pertaining to a court-ordered separation or divorce).
- You have a qualifying disability.
- You are the beneficiary on the account of a deceased participant.
- You use distributions for medical expenses, limited to the amount not otherwise deductible.
- You take distributions in the form of substantially equal periodic or annuity payments for a period of at least 5 years and the last payment is received in a year after you reach age 59½.
- You use the distribution to make a first-time home purchase (limited to \$10,000).
- You use the distribution to pay for qualified higher education expenses for you, your spouse, your children or your grandchildren.

## DISTRIBUTIONS BETWEEN AGE 59½ AND 70½

Even though you are not required to take distributions between the ages of 59½ and 70½, you may need to take them to meet expenses or you may want to take them if your tax bracket is low. Though you are not subject to the early withdrawal penalties, the distributions are taxable in the year withdrawn. If you take distributions to take advantage of a low tax bracket, make sure you compare the benefit of the reduced rate against the loss of the tax-deferred growth had the funds been left in the retirement account.

## LUMP-SUM (OR OTHER ELIGIBLE) DISTRIBUTIONS

Amounts distributed from a qualified retirement plan can be rolled over tax-free into an IRA or another qualified plan as long as the

transfer is done directly from trustee to trustee. If you personally receive the funds, 20% of the distribution is required to be withheld for federal income taxes (some states also require state income tax withholding). If you fail to roll over the full amount of the distribution (before any withholding tax) within 60 days to another IRA or qualified retirement plan, you will also be subject to income tax and possibly early withdrawal penalties on the distribution if you are under age 59½.

**Special Planning Note:** *Distributions from qualified plans that are not made from a designated Roth account may be rolled over directly to a Roth IRA. Under these rules, you will be required to pay income taxes in the year of the distribution, but will not be subject to the mandatory 20% tax withholding or the 10% early distribution penalty if you are younger than age 59½. Previously, only distributions from designated Roth accounts of qualified plans could be directly rolled over to a Roth IRA without being subject to the income limitation.*

## SURVIVING SPOUSE DISTRIBUTION RULES

Upon the death of a participant/owner of a qualified retirement plan or IRA, a surviving spouse can make an eligible rollover distribution into his or her own plan or IRA. Distributions from the surviving spouse's plan or IRA would not be required until he or she reached age 70½. At that time, the RMD rules discussed above would apply.

## NONSPOUSE BENEFICIARIES

If allowed under the terms of the plan document, distributions from a deceased participant's qualified retirement plan are permitted to be rolled over into an IRA for a beneficiary who is not the decedent's spouse, such as a child of the deceased. The rollover must be in the form of a direct trustee-to-trustee transfer to an IRA for the benefit of the beneficiary. The IRA is treated as an inherited IRA so the beneficiary will not have the ability to roll over the IRA to another IRA in the future. However, the beneficiary will now be allowed to take funds out of the inherited IRA over his or her life expectancy, beginning in the year after the decedent's death, rather than fully within 5 years (as noted below).

If the plan document governing your plan does not provide for non-spouse rollovers to an inherited IRA, then non-spouse beneficiaries such as children of the deceased are not eligible to roll over a decedent's qualified plan balance into their own plan or IRA. They must take distributions based on the minimum distribution method used by the decedent if he or she had already reached 70½, or within 5 years after the decedent's death if the decedent had not yet begun taking required minimum distributions.

A non-spouse beneficiary of a decedent's IRA will have to commence taking RMDs beginning in the year following the year of the IRA account holder's death based on the life expectancy of the oldest beneficiary (if more than one primary beneficiary is named). This is true whether the IRA account holder was already taking RMDs or died before his or her required beginning date. Alternatively, if the IRA account holder died before his or her required beginning date, the beneficiary(ies) have the option of still using the 5-year rule, which does not require any distributions from the account until the year containing the fifth anniversary of the IRA account holder's death. However, in that year, the entire account must be distributed.