30. Retirement 4: Understanding Individual and Small-Business Plans

Introduction

Whether you work for a large or a small company or are self-employed, you need to plan for retirement. This chapter will discuss your third priority regarding money when saving for retirement: individual retirement accounts. I will explain how you can plan for retirement if you work for a small company or are self-employed. Even if you already have a qualified retirement plan with your company, you may still be eligible to contribute to an individual retirement plan and save even more for your retirement goals. The key is to understand the retirement vehicles available to you and how you can utilize these vehicles to help you achieve your goals.

Objectives

When you have completed this chapter, you should be able to do the following:

A. Understand individual retirement accounts
B. Explain when it is beneficial to convert a traditional IRA to a Roth IRA
C. Describe retirement plans designed for small businesses and individuals who are self-employed
D. Understand plans and strategies for individual and small business plans.

Understanding individual and small-business retirement plans is an important part of retirement planning.

Describe Individual Retirement Accounts

Because of the Taxpayer Relief Act of 1997, there are now three main types of individual retirement accounts (IRAs): the traditional IRA, the Roth IRA, and the education IRA. In addition to these three main types of IRAs, there are many other types of IRAs you should learn about as you prepare for retirement.

Traditional IRAs

A traditional IRA is a retirement account in which you can contribute up to $6,000 in 2019 if you are under age 50; if you are over age 50, you can contribute $7,000 (see Table 1). This account may or may not be tax-deferred, depending on your income level and whether or not you are a participant in another employer-sponsored retirement plan (ESRP). To contribute to a

traditional IRA, you must be younger than 70½ years, and you or your spouse must have earned income the year you contribute.

Contributions to a traditional IRA are tax-deductible if you meet certain conditions. If you are single and are not an active participant in an ESRP, or if you are married and neither spouse is an active participant in an ESRP, your traditional IRA contributions are tax-deductible regardless of your income level. If you or your spouse is an active participant in an ESRP, you can deduct contributions only if your income is below a certain level (see Table 3). For example, in 2018, if you are below age 50, you can deduct the full $6,000 contribution on your income tax return if you do not have an ESRP. You can also deduct the full $6,000 if you have an ESRP but your modified adjusted gross income (AGI) is $101,000 or less for a joint return or $63,000 or less for a single return (see Table 3).

Table 1. Traditional and Roth IRA Annual Contribution Limits

Year	Contribution Limit	Catch-Up Contributions*
2015	$5,500	$1,000
2016	$5,500	$1,000
2017	$5,500	$1,000
2018	$5,500	$1,000
2019	$6,000	$1,000

* The catch-up contribution is for individuals over age 50.

You can take withdrawals from a traditional IRA after you reach age 59½ and you can use the money for any purpose. Before you reach this age, your withdrawals are subject to federal penalties of 10 percent unless you use the withdrawals to pay for your first home (limit $10,000), death or disability expenses, annuity payments, or medical expenses greater than 7.5 percent of your AGI.

Traditional IRA plans that defer taxes require that you begin taking minimum distributions by April 1 of the year after you turn age 70½. You can always take out more. This required minimum distribution amount is calculated by dividing the total account balances of all tax-deferred IRA retirement plans on December 31 of the previous year by the individual's current life expectancy (see Table 2). Note that there is a 50 percent penalty on minimum distributions that are not taken.

Table 2. Life Expectancy and Age

Age	Life Expectancy (LE)	Age	LE
70	27.4	75	22.9
71	26.5	76	22.0
72	25.6	77	21.2
73	24.7	78	20.3
74	23.8	79	19.5

Roth IRAs

A Roth IRA : is a type of individual retirement plan in which contributions are made with after-tax dollars. Because you make contributions with after-tax dollars, your contributions are not tax-deductible. However, this plan provides a unique benefit that is not available with any other retirement plan: all earnings and capital gains are tax-free when you or your beneficiaries make withdrawals at retirement.

You can contribute to a Roth IRA even if you have an ESRP and even if you are over age 70½. In 2019, each individual can contribute up to $6,000 (see Table 1).

A big advantage of a Roth IRA is that you can withdraw your initial contributions at any time without incurring taxes or penalties (check your state's tax rules for more information); however, this benefit does not apply to earnings. Earnings are tax-free if your Roth IRA has been in place for at least five years and if you are at least 59½ when you make withdrawals. You can contribute to both a traditional IRA and a Roth IRA in a single year, but you cannot exceed the yearly contribution limits for the combined contributions to your traditional and Roth IRAs. With Roth IRAs, you are not required to receive distributions by age 70½.

The disadvantages of a Roth IRA include that there are income limits above which you cannot invest in a Roth IRA (see Table 3), and you must hold your account for at least five years before you can make earnings withdrawals without penalty.

If you make withdrawals before age 59½ and you have had the account for fewer than five years, earnings are subject to ordinary income taxes. Earnings are also subject to an early withdrawal penalty of 10 percent unless you use the money to purchase your first home or to pay for death or disability costs.

If you make withdrawals after age 59½ but you have had the account for fewer than five years, earnings are subject to ordinary income taxes but not to early withdrawal penalties.

If you make withdrawals after age 59½ and you have had the account for five years or more, all contributions and earnings can be withdrawn tax-free. There are no minimum withdrawal requirements.

Education IRAs or Coverdell Education Savings (ESA) Accounts

An education IRA : is an investment tool you can use to prepare for the cost of your children's education. You can set up a separate IRA for each child and make contributions to these accounts until the child reaches age 18. The annual contribution limit for education IRAs in 2018 is $2,000 per child; your total contributions into different ESA accounts can equal no more than $2,000 per child. These contributions and their earnings can be withdrawn tax-free if they are used to pay for qualified educational expenses related to enrollment at eligible elementary, secondary, post-secondary, and higher-education facilities. All savings must be withdrawn by the time the child reaches age 30, but any amount left over after you pay for one child's education can be rolled into another child's account. You also cannot take a Hope education credit on your

tax return the same year in which you withdraw money from your education IRA. One disadvantage of an Education IRA is that there are income limits above which you cannot invest in an education IRA (see Table 3).

Other IRAs

The spousal IRA is funded by a married taxpayer in the name of his or her spouse. Normally, participants in IRAs must have earned income. However, it is not necessary for the spouse to have earned income with the spousal IRA.

In a nondeductible IRA, contributions are made with after-tax dollars, and earnings grow tax-deferred; taxes are paid on the earnings when they are withdrawn at retirement. Even if your modified adjusted gross income (MAGI) is greater than allowable limits, you may still find it useful to look into this type of IRA.

An individual retirement annuity is set up with a life insurance company through the purchase of an annuity contract. This annuity ensures a certain dollar amount of funds will be paid to the owner each period of the contract after retirement.

The employer and employee association trust account IRA is set up by employers, unions, and associations.

The rollover IRA is a traditional IRA that is set up specifically to receive distributions from a qualified retirement plan, such as another 401(k), IRA, or other plan.

An inherited IRA is acquired by the non-spousal beneficiary of a deceased IRA owner.

The simplified employee pension IRA (SEP IRA) is a traditional IRA set up by a small-business owner for the company's employees. This type of IRA will be discussed later in this chapter.

The savings incentive match plan for employees IRA (SIMPLE-IRA) is a traditional IRA set up by a small-business employer for the company's employees. This type of IRA will be discussed later in this chapter.

Deductibility and Contribution Limits

Individuals whose modified adjusted gross income (MAGI) is below the ranges listed in Table 3 can take the full deduction for contributing to a traditional IRAs or make a full contribution to a Roth IRA or education IRA. Your MAGI is calculated by taking your adjusted gross income and adding certain items such as deductions for foreign income, foreign-housing, student-loans, IRA-contributions, and for higher-education costs. If your MAGI is between the ranges indicated, you can take only a partial tax deduction on your contribution or make only a partial contribution to the indicated IRA account.

Which Is Better: The Traditional IRA or the Roth IRA?

The decision of whether you should invest in the traditional IRA or the Roth IRA should be based mainly on these five factors: (1) your need to reduce current taxes through tax deductions, (2) your anticipation of tax rates when you retire, (3) your availability of money to pay the necessary taxes on the money contributed to a Roth IRA, (4) your need for investment flexibility, and (5) your need for estate planning to transfer assets to your heirs.

If you need tax deductions now, the traditional IRA is the best choice. Note, however, that since you are taking a deduction now, you will have to pay taxes on your entire traditional IRA balance (principal and earnings) when you retire. Remember that tax-deferred vehicles have the disadvantage of converting capital gains income (which is taxed at a lower rate, generally 15 percent) into ordinary income (which is taxed at your higher marginal tax rate).

Table 3. IRA Deductibility and Contribution Limits

	Modified Adjusted Gross Income (MAGI) Range	
Traditional IRA- Deductibility Limits		
Year	Single Range	Married Range
2015	$61,000–$71,000	$98,000–$118,000
2016	$61,000–$71,000	$98,000–$118,000
2017	$62,000–$72,000	$99,000–$119,000
2018	$63,000–$73,000	$101,000–$121,000
2019	$64,000–$74,000	$103,000–$123,000
Roth IRA- Contribution Limits		
2015	$116,000–$131,000	$183,000–$193,000
2016	$117,000–$132,000	$184,000–$194,000
2017	$118,000–$133,000	$186,000–$196,000
2018	$120,000–$135,000	$189,000–$199,000
2019	$122,000–$137,000	$193,000–$203,000
Coverdell (Education IRA)- Contribution Limits		
2015	$95,000–$110,000	$190,000–$220,000
2016	$95,000–$110,000	$190,000–$220,000
2017	$95,000–$110,000	$190,000–$220,000
2018	$95,000–$110,000	$190,000–$220,000
2019	$95,000–$110,000	$190,000–$220,000

If you expect your tax rates to be lower in the future, the traditional IRA is usually the best choice. If you expect tax rates to be higher in the future, the Roth IRA is usually the better choice. To see the impact of tax rates on retirement savings, see Roth versus Traditional: Which Is Better for You (LT28).

If you currently have the money available to pay taxes on your retirement plan contributions, your best choice is likely the Roth IRA. If you pay taxes now on the principal, you will never have to pay taxes on any of the earnings again if you withdraw funds after age 59½ and have

held the fund for at least five years. In addition, you can theoretically contribute more to the Roth IRA than to the traditional IRA. Remember that the Roth is an after-tax contribution fund—this means that to make the $6,000 contribution in 2019, you must earn $6,000 plus any taxes you must pay on your income. If your average tax rate is 15 percent, you would, in essence, be contributing $6,471 in earnings ($6,000 / (1 – .15)) before taxes.

If you need investment flexibility, which in this case means that you think you may need to withdraw some of your retirement funds before retirement (and you would like to withdraw funds without a penalty), the Roth IRA is the better choice. Since you have already paid taxes on the principal you contribute to the Roth IRA, you are allowed to withdraw the principal at any time without having to pay any penalties or taxes.

Finally, if you want to leave your retirement money to your heirs, the Roth IRA is usually the better choice. Since taxes are paid up front on the Roth IRA, the money can be left to heirs without the imposition of additional estate or inheritance taxes on distribution. Assets from a traditional IRA require the payment of taxes before distribution to your heirs.

Explain When It Is Beneficial to Convert a Traditional IRA to a Roth IRA

Converting : your traditional IRA into a Roth IRA may be a smart choice under the following circumstances: (1) you think your tax bracket will stay the same or go up after you retire, (2) you plan to wait at least five years before withdrawing money, (3) you have sufficient funds from other savings or investments to pay the taxes on the conversion; (4) you won't move into a higher tax bracket during the year by converting, or (5) you want to avoid a minimum-distribution requirement from your retirement savings at age 70½.

To convert to a Roth IRA, you take the money from your traditional IRA, 401(k), 403(b), or 457 plan and pay the taxes on these accounts before moving the funds to a Roth IRA. For the money to accumulate tax-free in the Roth account, both the 5-year rule and the 59½-year rule still apply.

Transfers are allowed in three ways: (1) by accepting a payment from your traditional IRA and re-depositing it within 60 days, (2) by requesting a trustee-to-trustee direct transfer, or (3) by changing the account designation to a Roth with the account's trustee. The direct transfer is the simplest and safest way to convert. If you use the 60-day rollover option, remember that a 10 percent penalty tax will be withheld at distribution, and you will have to replace the withheld taxes with other funds when the money is deposited into the Roth account. Moreover, the 10 percent early withdrawal penalty applies if you use IRA funds to pay income taxes at conversion. Direct transfer is the simplest and safest way to convert funds from one type of account to another.

Describe Retirement Plans Designed for Small Businesses and Self-Employed

Just as there are: retirement plans available to employees of large businesses, there are also retirement plans available to employees of small businesses and to individuals who are self-

employed. These plans have some of the same tax advantages as the plans available to larger businesses, and some are even more generous. Some of these plans allow you to invest even if you already have another retirement plan through another employer. If you are self-employed (either full- or part-time), or if you work for a small business, you can invest money in a simplified employee pension plan (SEP IRA), a Keogh plan, or a new savings incentive match plan for employees (SIMPLE IRA).

There are two categories of small-business retirement plans. The first category includes plans funded by the small-business employer, for example, SEP IRAs and Keogh plans. The second category includes plans funded by both the small-business employer and the employee: mainly the SIMPLE IRA and SIMPLE 401(k) plans.

Plans Funded by Your Employer

The **SEP IRA** (simplified employee pension individual retirement account) allows a small-business employer to contribute to employees' retirement funds. The employer usually contributes the same percentage of income for each eligible employee. In 2018, employers could contribute a maximum of either 25 percent of an employee's salary or $56,000, whichever was less. The limits on the amount of money that can be contributed to this defined-contribution account are set in Code 415 of the Internal Revenue Code (see Table 4). There are no minimum contribution requirements on the amount the employer can contribute to these plans, and they are generally best for companies with few employees. If you have one of these accounts, you can still have other qualified individual retirement accounts. Contributions are tax-deductible for the employer, earnings grow tax-deferred for the employee, and the individual employees own the plans.

Table 4. Section 415 Funding Limits

Year	$ Amount
2015	53,000
2016	53,000
2017	54,000
2018	55,000
2019	56,000

SEP IRAs are easiest to set up and maintain, and they do not require annual filings. They allow larger contributions than traditional IRAs ($56,000 versus $6,000 in 2019). This is the best type of retirement plan for businesses with no or only a few employees.

The major disadvantages of a SEP IRA include that you cannot borrow against the retirement plan and that early withdrawals (withdrawals made before age 59½) incur a 10 percent penalty in addition to ordinary income taxes.

Keogh Plans (also called HR 10 plans) are set up by a sole proprietor or partnership. These plans allow small businesses to make tax-deductible contributions to employees' retirement plans.

Plans can either be defined-benefit plans or defined-contribution plans, but most Keogh plans are defined-contribution profit-sharing plans or defined-contribution money-purchase plans.

Employers usually contribute the same percentage of income for each eligible employee. As an employee, you can also contribute up to 20 percent of your income (to a maximum of $56,000 in 2019) into your Keogh plan. As with many other retirement plans, Keogh investments grow tax-deferred.

There are three unique options that make Keogh plans flexible: two are defined-contribution plans and one is a defined-benefit plan. These options make Keogh plans somewhat similar to the defined-benefit plans and defined-contribution plans offered by larger companies. (For more complete details on these plans, see Internal Revenue Service, Publication 560: Retirement Plans for Small Businesses: SEP, SIMPLE, and Qualified Plans at http://www.irs.gov/pub/irs-pdf/p560.pdf.)

There are two types of Keogh defined-contribution plans: profit-sharing plans and money-purchase plans. Profit-sharing plans allow employers to share company profits with employees by contributing to employee retirement plans. Contribution limits for profit-sharing plans are more flexible than limits on other plans. Money-purchase plans have a fixed contribution limit that is not based on company profitability. A Keogh defined-benefit plan is any plan that is not a defined-contribution plan.

In a defined-contribution plan, the maximum amount an employer can contribute in 2018 is either 100 percent of an employee's average salary for the past three years or $56,000, whichever is less. In a defined-benefit plan, the maximum amount an employer can contribute in 2018 is either the employee's average salary for the past three years or $225,000, whichever is less. Because of these higher contribution maximums, Keogh plans are especially helpful for those trying to catch up on retirement savings.

Possible disadvantages of Keogh plans include that they require more administrative work than SEP IRAs, they cannot be borrowed against, and they must be established by December 31 of each year.

Plans Funded by Both You and Your Employer

The most popular plans that are funded by both the employer and employee are the SIMPLE plans. SIMPLE plans, or savings incentive match plans for employees, are tax-sheltered retirement plans for small businesses (businesses with fewer than 100 employees) or for individuals that are self-employed. In SIMPLE plans, an employer matches some employee contributions; SIMPLE plans are similar to company-matching 401(k) plans. There are two different types of SIMPLE plans: SIMPLE IRAs and SIMPLE 401(k) plans.

In a SIMPLE IRA, both you and your employer take part in funding your retirement. To be eligible for a SIMPLE IRA, you cannot have another qualified plan at the same time. In 2019,

you can contribute up to 100 percent of your annual income, up to a maximum of $13,000, in tax-deferred funds (see Table 5). Since contributions are tax-deferred, there is a penalty for early withdrawals. Money withdrawn within two years of establishing the account incurs a 25 percent penalty, and money withdrawn before you reach age 59½ incurs a 10 percent penalty and is taxed as ordinary income.

With a SIMPLE IRA, your employer must match your contributions (usually up to two to three percent of your annual income) unless you make non-elective or optional contributions. The employer is required to make a minimum contribution of two percent of your annual income to your SIMPLE IRA each year. Any contributions you or your employer makes to your SIMPLE IRA are tax-deductible. Compared with other small-business plans, SIMPLE IRA plans are easy to set up and administer.

Table 5. SIMPLE IRA/401(k) Plan Contribution Limits

Year	Contribution Limit	Catch-up*
2015	$12,500	$3,000
2016	$12,500	$3,000
2017	$12,500	$3,000
2018	$12,500	$3,000
2019	$13,000	$3,000

* Catch-up contributions are available for those over age 50.

A SIMPLE 401(k) plan is very similar to a SIMPLE IRA and has the same contribution limits and matching requirements. However, a SIMPLE 401(k) plan requires more time and resources to establish. If you are making contributions to a SIMPLE 401(k) plan, your employer must match one to three percent of your elective annual contributions or contribute at least two percent of your annual income as a non-elective contribution.

Understand Plans and Strategies for Small Business and Individual Plans

As you put your Retirement Plan together, it is important to think through some plans and strategies. Examples include:

Plans and Strategies

Accumulation

- Live on a budget, save 20%, always get the company match
- Save 20% of every dollar, 15% into your Roth 401k or Roth IRA for both you and your spouse (if you don't have a Roth 401k), 3% for other goals, and 2% for children's mission and education
- Invest in Roth accounts while young and when rates are low. Use these to target your tax rate in retirement (to a low level)
- Even though you don't know future tax rates, maximize investments in Roth accounts as you are saving more for retirement.

Retirement

- Calculate a minimum level of retirement income, and annuitize that amount (if you have sufficient assets). The process is:
  - a. Calculate Social Security and defined benefit plan(s)
  - b. Determine your minimum amount needed to live on
  - c. Take a percentage of retirement assets (including 401k/403b/Roth and traditional IRAs/SEP/Simple Plans) at retirement to purchase an immediate annuity to give you the minimum amount needed for an acceptable level of income
- Have both Roth and traditional retirement assets so you can target your tax rates in retirement
- Donate assets from your traditional IRA/SEP/Simple plans to pay tithes and offerings to eliminate your capital gains.

Distribution

- Have taxable (tax now), Roth (rarely taxed) and traditional (taxes later) vehicles to target your tax rate in retirement
- Set a target tax rate, then pull traditional assets up to that specific amount, then Roth assets afterwards to reduce taxes
- Make sure to pay your Required Minimum Distributions if over 69.5
- During your later years which your income is less, i.e., during missions, transfer money from your tax-deferred to tax-eliminated accounts. Use this time to move assets into Roth accounts with as little tax consequences as possible
- After age 69.5, donate assets from your traditional IRA/SEP/Simple/401k/403b plans to pay tithes and offerings, to eliminate your capital gains, and to fulfill your required Minimum Distribution amounts.

Summary

It is important to plan for retirement. Because of the Taxpayer Relief Act of 1997, there are now three main types of individual retirement accounts (IRAs): the traditional, the Roth, and the education. There are also many other types of IRAs that you should learn about as you plan for retirement. Individuals who are self-employed or employed by small businesses have access to unique retirement plans that can help them reach their retirement goals. It is important for you to understand and use the investment vehicles available to you.

A traditional IRA is a retirement account in which you can contribute up to $6,000 each year (in 2019) if you are under age 50 or up to $7,000 if you are over age 50 (see Table 1). This account may or may not be tax-deferred, depending on your income level and whether you or your spouse are participating in an employer-sponsored retirement plan (ESRP). To contribute to a traditional IRA, you must be younger than 70½ and you or your spouse must have earned income. Contributions to a traditional IRA are tax-deductible if you meet certain conditions.

A Roth IRA is a type of individual retirement plan in which your contributions are made with after-tax dollars. Your contributions are not tax-deductible, but all earnings and capital gains are tax-free when you or your beneficiaries make withdrawals at retirement.

A Coverdell Education Savings Account, or education IRA, is an investment tool you can use to prepare for the cost of your children's education. You can set up a separate IRA for each child and make contributions into these accounts until the children reach age 18. The annual contribution limit for Education IRAs in 2019 is $2,000 per child. These contributions and their earnings can be withdrawn tax-free if they are used to pay for qualified educational expenses related to enrollment at eligible elementary, secondary, post-secondary, and higher-education facilities.

In addition to the traditional IRA, Roth IRA, and education IRA, there are a number of other IRAs you should learn about. These IRAS include the spousal, nondeductible, individual retirement annuity, employer and employee association trust account, rollover, inherited, simplified employee pension (SEP IRA), and savings incentive match plan for employees IRAs (SIMPLE IRA).

The decision of whether to invest in the traditional IRA or the Roth IRA should be based mainly on five factors: (1) your need to reduce current taxes with tax deductions, (2) your anticipation of tax rates when you retire, (3) your availability of money to pay the necessary taxes on the Roth IRA, (4) your need for investment flexibility, and (5) your need for estate planning to transfer assets to your heirs.

There are special retirement plans available to employees of small businesses and individuals who are self-employed. These plans have some of the same tax advantages as the plans available to larger businesses and may be even more generous. Some of these plans allow you to invest even if you already have another retirement plan through another employer. For example, if you are self-employed, either full- or part-time, or if you work for a small business, you can invest money in a simplified employee pension plan (SEP IRA), a Keogh plan, or a new savings incentive match plan for employees (SIMPLE IRA).

There are two categories of small-business retirement plans. The first category includes plans funded by the small-business employer, such as SEP IRAs and Keogh plans. The second category includes plans funded by both the small-business employer and the employee, mainly the SIMPLE IRA and SIMPLE 401(k) plans.

Assignments

Financial Plan Assignments

Your Retirement Plan has many different sections, including individual and small business plans. How will you utilize individual IRAs in your retirement Plan? Do you have a small-business retirement account or an individual retirement account? If so, who do you have the plan with?

What are your annual fees for the account? Is there a way to minimize those fees?

Where are your assets invested? Are they invested in a manner that is consistent with the asset-allocation targets detailed in your financial plan and the fact that they are longer-term assets? What are your plans and strategies for these accounts?

Learning Tools

The following Learning Tools may be helpful as you prepare your Personal Financial Plan:

Retirement Planning Needs Spreadsheet (LT06)
This Excel spreadsheet helps you determine how much you must save each month to achieve a specific lifestyle at retirement based on the following estimates: years until retirement, expected return, inflation, and tax rates.

Retirement Planning Ratio Forecasts (LT25)
This spreadsheet is an Excel template that will help you determine where you are in your progress toward achieving your retirement goals. By inputting the relevant information, you can estimate whether you are on track for reaching your retirement goals, based on your age and income.

Roth versus Traditional: Which Is Better for You (LT28)
This spreadsheet includes an Excel template to help you determine whether the traditional or the Roth IRA is a better investment vehicle to help you save for retirement. Note that this spreadsheet considers only the factor of future taxes when making this decision.

Review Materials

Terminology Review

Education IRA. An Education IRA, also called a Coverdell ESA, is an investment vehicle for planning for the future cost of a child's education. The plan allows after-tax contributions each year for each child until age 18. Contributions and their subsequent earnings are tax-free when withdrawn to pay for qualified secondary and post-secondary education expenses.
Individual Retirement Accounts. These are retirement account created with the Taxpayer Relief act of 1997. While there are over a dozen different individual retirement accounts, the three major types of Individual Retirement Accounts are Traditional IRA, Roth IRA, and Education IRA, which is also called a Coverdell Education Savings Account (ESA).
Individual Retirement Annuity: An IRA set up with a life insurance company through purchase of annuity contract.
Inherited IRA: An IRA acquired by the non-spousal beneficiary of a deceased IRA owner.
Keogh Plan. This is a small business retirement plan set up by a sole proprietor or partnership (not incorporated) which allows employers to make tax-deductible payments to retirement plans, similar to pension or profit-sharing plans. Plans can be either a defined benefit or defined contribution, but most commonly are DC profit sharing or money purchase plans. Contributions

are tax deductible, earnings grow tax-deferred, and employers may borrow from the Plan
Non-deductible IRA. Individuals may contribute to a non-deductible IRA. The benefits are that money is contributed after-tax, and investment earnings grow tax-deferred. No taxes are paid on the investment earnings until the earning are withdrawn at retirement. Accurate record keeping is required to pro-rate the nondeductible portion of any subsequent distribution.
Non-deductible IRA: An IRA with contributions made after-tax, and earnings grow tax-deferred, with taxes paid when withdrawn at retirement.
Required Minimum Distributions. This is a legal requirement of many tax-deferred retirement vehicles which require savers to distribute a specific amount each year after age 69 of total plan assets. It is calculated by dividing the total amount in accounts by a specified number given.
Rollover IRA: A traditional IRA set up to receive a distribution from a qualified retirement plan.
Roth Conversion. This is the process of converting a traditional individual retirement account to a Roth account.
Roth IRA. This is an individual retirement account which provides no deduction for contributions but provides that all earnings and capital gains are tax free upon withdrawal after retirement. You are actually investing more with a Roth, since your investments are after-tax, and contributions can be withdrawn tax/penalty free. Earnings grow tax-free if the Roth IRA is in place for at least 5 years, and you are 59½ years old.
SEP-IRA. The Simplified Employee Pension (SEP-IRA) is an Individual Retirement Account which allows a small business employer to contribute to the retirement of the employees. Employer contributes the same percentage to all employees, and no required annual contribution. Contributions are tax deductible, earnings grow tax-deferred, and employees own the plans.
SIMPLE 401k. This is a small business qualified retirement plan that provides some matching funds by the employer. Employees can have no other qualified plan, and may contribute up to the specific amount each year. Contributions are tax deferred and grow tax-free, and there is a penalty for early withdrawal. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%
SIMPLE IRA. This is one of the SIMPLE retirement plans where Employees can participate. Contributions are tax deductible, it is easy to set up and administer (compared with a traditional 401(k)). A small business qualified retirement plan that provides some matching funds by the employer.
SIMPLE Plans. These are Savings Incentive Match Plans (SIMPLE) that provides matching funds by the employer. It can be established as an IRA or as part of a 401k plan. Employees can have no other qualified plan, and can contribute up to 100% of compensation to a maximum limit each year. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%.
Spousal IRA. A Spousal IRA is an IRA contribution for a non-earning spouse. If one spouse is an active participant, the non-earning spouse can contribute to a Spousal IRA. Limits are the same as the traditional and Roth IRA.
Traditional IRA. An individual retirement account in which an individual can contribute up to a specific amount annually which is tax-deferred. Eligibility and amounts depend on the contributor's income level and whether they have other retirement plans. The contribution is tax deductible and earnings grow tax-deferred.

Review Questions

1. What are the three main types of individual retirement accounts?

2. If your marginal tax rate is low now and you believe it will continue get larger as you grow older, which type of IRA should you most likely make contributions into?
3. What is the 2019 annual contribution limit per individual for a traditional IRA? Roth IRA? Education IRA?
4. If you currently need a tax deduction, which type of IRA is preferable to contribute to?
5. What are two types of small business/self-employment retirement plans that are funded by the employer?

Case Studies

Case Study 1

Data:

Steve is considering a traditional IRA. He is married and he and his wife both have an Employer Sponsored 401k retirement plan at work. His modified adjusted gross income is $115,000 this year.

Application:

a. Can Steve fully contribute to a traditional IRA and get the tax deduction? Why or why not?

b. Can he contribute to any other IRAs?

c. If neither Steve nor his wife have an employer sponsored retirement plan at work, could he still contribute to a traditional IRA and get the tax deduction?

Case Study 1 Answers

a. Can Steve contribute to a traditional IRA?

- Steve cannot contribute to a traditional IRA and get the full tax deduction as his income is beyond the MAGI phase-out limits of $103-123,000 in 2019

b. Can he contribute to other IRAs?

- He could contribute to a Roth or a non-contributory IRA which is a traditional IRA with no initial tax benefits

c. Neither have an employer plan, so what can they do?

- If neither Steve nor his wife are covered by an employer sponsored retirement plan at work, they can both contribute to a traditional IRA regardless of MAGI limits. If only one spouse is covered by a retirement plan at work, the traditional IRA limits are expanded to the limits of the Roth IRA

Case Study 2

Data

Bill has money in a traditional and a rollover IRA. He retired on his 60th birthday and did not use any of his traditional IRA balances. On December 31 of his 69th year, he had $150,000 in his traditional IRA.

Calculations:

How much is he required to take out of his account the next year?

Age	Life Expectancy
70	27.4
71	26.5

Case Study 2 Answer

Bill will be required to take a distribution of $150,000 / 27.4 (from the life expectancy table), or $5,474.45, the next year.

Case Study 3

Data

Steve is considering a traditional IRA. He is married, and his modified adjusted gross income is $121,000 per year.

Application

Can Steve contribute to a traditional IRA? Why or why not?
Can he contribute to any other IRAs?
If neither Steve nor his wife have an employer sponsored retirement plan at work, could he still contribute to a traditional IRA and get the tax deduction?

Case Study 3 Answers

a. Steve will not be able to contribute to a traditional IRA because his income is beyond the MAGI phase-out limits of $101-121,000 in 2019.
b. He could, however, contribute to a Roth IRA as he is below the phase out limits, or a non-contributory IRA which is a traditional IRA with no initial tax benefits.
c. If neither Steve nor his wife are covered by an employer sponsored retirement plan at work, they can both contribute to a traditional IRA regardless of MAGI limits. If only one spouse is covered by a retirement plan at work, the traditional IRA limits are expanded to the limits of the Roth IRA.

Case Study 4

Data

Sam and his wife just turned 60, and they are very concerned about retirement. All their kids are grown, and they have additional money they want to contribute toward retirement in 2018. Their modified adjusted gross income is $120,000 this year, and they feel they can save 30 percent for retirement this year. Their company has a 401(k) plan without a match.

Application

Which vehicles can they use, and how much can they save for retirement?

Case Study 4 Answers

Sam is eligible for not only the 401(k) (limit of $19,000 in 2019), but also the $6,000 catch up contribution.
Both he and his wife are also eligible for the $6,000 Roth IRA contribution, as well as the

$1,000 catch up limit, as they are not beyond the phase-out limits for the Roth IRAs ($14,000 total). They are, however, beyond the limits for the traditional IRA to get the deduction.
Overall, they could invest $25,000 in their 401(k) and $14,000 in their IRAs for a total of $39,000 saved in 2019.