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2015 ASPPA ANNUAL CONFERENCE
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ASPPA
MAKING RETIREMENT PLANS WORK

Workshop 55: Fun Times with Self-Employment Compensation Calculations

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Workshop 55: Fun Times with Self-Employment Compensation Calculations

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Eligible Employers

1. Sole Proprietor
2. Partnership
3. Corporation
4. "S" Corporation
5. Limited Liability Partnership (LLP)
6. Limited Liability Company (LLC)
7. Non-profit Organizations

Eligible Employers

1. Sole Proprietors include:
   a. Independent Contractors
   b. Qualified Joint Ventures –Both Spouses carrying on the Trade or Business
   c. Single member LLC - Treated as a disregarded entity and taxed as a Sole Proprietor
2. Partnership – Owners referred to as Partners
3. Corporation
4. "S" Corporation – Owners referred to as Shareholders
5. Limited Liability Company (LLC) – Owners referred to as Members; States have the rules as to how they can be structured. Taxed as Partnership unless a Form 8832 is filed.

Partnerships

- *Individual partners* in a partnership or owners of an LLC electing to be treated as a partnership may not adopt a SEP plan (or any plan) as an individual
- The "employer" must adopt the plan
- In this case, the employer is the partnership or the LLC
- Contributions of employees are deducted on the partnership return, Form 1065 Line 18
- Contributions on behalf of the partners are reported in Box 13, using Code R, on the Schedule K-1 and then deducted on the partner's Form 1040, Line 28

Qualified Joint Venture

- Small Business and Work Opportunity Tax Act of 2007 added *qualified joint ventures of married couples* not treated as partnerships as a form of sole proprietorship. The provision was effective for taxable years beginning after December 31, 2006.
- This provision generally permitted a qualified joint venture whose only members are a married spouses filing a joint return not to be treated as a partnership for Federal tax purposes.

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Qualified Joint Venture

A *qualified joint venture* is a joint venture involving the conduct of a trade or business, if:

- the only members of the joint venture are the 2 spouses;
- both spouses materially participate in the trade or business; and
- both spouses elect to have the provision apply.
- Election made by filing 1040 jointly and separate Schedule C's and Schedule SE's and use this to determine individual Eis.
- The spouses decide what the percentage of interests will be and then all items of income, gain, loss, deduction and credit are divided between the spouses

Why a Qualified Joint Venture and not a Partnership?

- A business ***jointly owned and operated*** by a married couple is treated as a partnership for tax purposes, spouses must comply with filing and record keeping requirements imposed on partnerships and their partners.
- Married co-owners failing to file properly as a partnership may have been reporting on a Schedule C in the name of one spouse…one spouse received credit for social security and Medicare coverage
- Under the Qualified Joint Venture election, both spouses will receive credit for social security and Medicare coverage purposes.

"Plan" Compensation

Maximum Plan Compensation			
1998	$160,000	2008	$230,000
1999	$160,000	2009	$245,000
2000	$170,000	2010	$245,000
2001	$170,000	2011	$245,000
2002	$200,000	2012	$250,000
2003	$200,000	2013	$255,000
2004	$205,000	2014	$260,000
2005	$210,000	2015	$265,000
2006	$220,000	2016	?
2007	$225,000		

Fiscal Year Plans

Applying the Various Limits:

- **Plan Year Begins:** Compensation Limit; taxable wage base for permitted disparity; comp for HC.
- **Plan Year Ends:** 415 Dollar Limit.
- **Calendar Year:** Deferral Limit, regardless of Plan Year.

Compensation

In General:

Common-Law-Employees	W-2 (Generally Box 1)
Owners of Corporations	W-2 (Generally Box 1)
Owners of S Corporations	W-2 (Generally Box 1)
Sole Proprietor / Partners	Earned Income
Owners of L.L.P.s	Earned Income
Owners of L.L.C.s	Depends on Structure

Partnership/SP	Corporation
⇩	⇩
Earned Income	W-2

Owners of S Corporations

- Compensation for plan purposes must be determined using the individual's Form W-2, just like any other employee.
- The 'pass through' corporate profits (indicated on a Schedule K-1 of Form 1120S) that are brought over to the S Corp. owner's tax return, Form 1040, is NOT compensation, but rather passive income!

Owners of S Corporations

- For Example – Jane is one of the shareholders of an S Corporation. She receives no W-2 but has profits on her K-1 for the Corporation of $100,000. If the company has a profit-sharing plan with a 20% rate of contribution, what is Jane's contribution to the Plan?

Earned Income for Self-Employed

- "Compensation" for a self-employed individual (sole proprietor or partner) is "earned income".
- The starting point to determine a self-employed's earned income is his or her net profit amount from the Schedule C (or Schedule K-1 in the case of a partnership).

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Earned Income for Self-Employed

- Self-employed deducts the contribution on his or her own behalf and also deducts 1/2 of the self-employment taxes in the "Adjustments to Income" section of their Form 1040.
- Therefore, beginning with contributions made **for** 1990 and beyond (with the exception of 2011 and 2012), the earned income formula looks like this:

Net Profit = Earned Income + the Self-Employed's Contribution + ½ Self Employment Tax (164(f) deduction)

OR

NP=EI + C +1/2 SET

OR

EI = NP- C- 1/2SET

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Self Employment Tax (SET)

	Employee	Employer	Total
Health Insurance	1.45%	+ 1.45%	= 2.9%

Taxable Wage Base

2015 $118,500

Employee		Employer	Total
7.65%	+	7.65%	= 15.3%

6.2% FICA SS

1.45% Medicare

Schedule SE: NP X .9235 = Adjusted NP Subject to SET

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Law Changed for 2013 – Additional Medicare Tax for Higher Wage Earners

When are individuals liable for Additional Medicare Tax?

If the individual's wages, compensation, or self-employment income…

…together with that of his or her spouse if filing a joint return

exceed the threshold amount for the individual's filing status.

Threshold - Additional Medicare Tax of 0.9% for Individuals

2015	
Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying widow(er) with dependent child	$200,000

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How do Self-Employeds Calculate this new tax?

Individuals who are subject to FICA and SECA calculate this in 3 steps:

- Step 1. Calculate Additional Medicare Tax on any wages in excess of the applicable threshold for the filing status, without regard to whether any tax was withheld.
- Step 2. Reduce the applicable threshold for the filing status by the total amount of Medicare wages received, but not below zero.
- Step 3. Calculate Additional Medicare Tax on any self-employment income in excess of the reduced threshold.

How do Self-Employeds Calculate this new tax?

Example 1:

- Chuck, a single filer, has $130,000 in wages and $145,000 in self-employment income.
- Chuck's wages are not in excess of the $200,000 threshold for single filers, so Chuck is not liable for Additional Medicare Tax on these wages.
- Before calculating the Additional Medicare Tax on self-employment income, the $200,000 threshold for single filers is reduced by Chuck's $130,000 in wages, resulting in a reduced self-employment income threshold of $70,000.
- Chuck is liable to pay Additional Medicare Tax on $75,000 of self-employment income ($145,000 in self-employment income minus the reduced threshold of $70,000).

How do Self-Employeds Calculate this new tax?

Example 2:

- Dave and Eve are married and file jointly. Dave has $150,000 in wages and Eve has $175,000 in self-employment income.
- Dave's wages are not in excess of the $250,000 threshold for joint filers, so Dave and Eve are not liable for Additional Medicare Tax on Dave's wages.
- Before calculating the Additional Medicare Tax on Eve's self-employment income, the $250,000 threshold for joint filers is reduced by Dave's $150,000 in wages resulting in a reduced self-employment income threshold of $100,000.
- Dave and Eve are liable to pay Additional Medicare Tax on $75,000 of self-employment income ($175,000 in self-employment income minus the reduced threshold of $100,000).

COMPENSATION "EARNED INCOME" FOR SELF- EMPLOYED INDIVIDUAL

2015 Net Profit of $135,000

Total Self Employment Tax of $18,309.50
Plan Rate: 25%
Plan Type: PS

IRC FORMULA

NP = EI + C + ½ SET
135,000.00 = EI + .25 EI + 9,154.75
125,845.25 = 1.25 EI
100,676.20 = EARNED INCOME
X .25

$25,169.05 SEP Contribution

FIGURING SET
Self Employment Tax

1.	NP	135,000.00
2.	Adjustment	x .9235
3.	Result	124,672.50

Multiply TWB for the year by 15.3% and add 2.9% times the difference between Line 3 and the TWB

'15 TWB = 118,500.00
x .153
18,130.50
+ 179.00
TOTAL SET 18,309.50

IRS EQUIVALENCY METHOD

NP - ½ SET x Equivalent %
135,000 – 9,154.75 x 20% = **$25,169.05 Contribution**

Equivalent percentage: $\frac{.25}{1.25}$ = .20 or 20%

124,672.50
- 118,500.00
6,172.50
X .029
179.00

COMPENSATION "EARNED INCOME" FOR SELF- EMPLOYED INDIVIDUAL

2015 Net Profit of $135,000

Total Self Employment Tax of $18,309.50

Plan Rate: 25%

Plan Type: PS

Step 1

FIGURING SET
Self Employment Tax

1. NP	135,000.00
2. Adjustment	x .9235
3. Result	124,672.50

Step 2

1) Multiply TWB for the year by 15.3%

'15 TWB = 118,500.00
x .153
18,130.50
\+ 179.00
18,309.50
TOTAL SET

2) add 2.9% times the difference between Line 3 and the TWB

124,672.50
\- 118,500.00
6,172.50
X .029
179.00

IRC FORMULA

NP = EI + C + ½ SET
135,000.00 = EI + .25 EI + **9,154.75**
125,845.25 = 1.25 EI
100,676.20 = EARNED INCOME
X .25
$25,169.05 Contribution

Step 3

IRS EQUIVALENCY METHOD

NP - ½ SET x Equivalent %
135,000 – **9,154.75** x 20% = **$25,169.05 Contribution**

Equivalent percentage: $\frac{.25}{1.25}$ = .20 or 20%

Net Profit Needed to Equal Earned Income

For Year 2014

$323,587 NP = $260,000 EI

For Year 2015

$329,763 NP =$265,000

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Increases for 2016

	2015	2016
Compensation	$265,000	$?
415(c)	$ 53,000	$?
415(b)	$210,000	$?
Key-Employee	$170,000	$?
Taxable Wage Base	$118,500	$?

All Savers Credits Amounts and Compensation Thresholds for traditional and Roth IRAs have increased. See IRS Information Release

Equivalency Method for Determining Earned Income

- If only one plan, the following equivalency method may be used to compute the plan contribution. Whenever the plan calls for a certain percentage of "earned income" to be contributed on behalf of a self-employed individual, the equivalent percentage of "adjusted" net profit can be used to compute the contribution.
- However, to determine the "adjusted net profit", the net profit (from Schedule C) must first be reduced by the §164(f) deduction (from Schedule SE).

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Equivalency Method for Determining Earned Income

- As in the case in the 2015 earned income example above, instead of using the formula to determine the self-employed's plan contribution, one could simply multiply the "adjusted" net profit from the Schedule C by the equivalency percentage which corresponds to the 25% of earned income.

- $135,000.00 (net profit from Schedule C)
- - 9,154.75 (the §164(f) deduction)
- $125,845.25 ("adjusted" net profit)
- X .20 **(% from chart that corresponds to 25%)**
- $ 25,169.05 (2015 plan contribution)

EI for 2015 Using $135,000 Net Profit

First, compute the total self-employment tax on Schedule SE.

Step 1: Enter Net Profit from Schedule C	$135,000.00
Step 2: Enter .9235	.9235
Step 3: Multiply Step 1 by Step 2, enter result	$124,672.50
Step 4: Figure total SET Tax:	
Amount subject to 12.4% Old-Age portion of FICA:	$118,500.00
SET tax for Old-Age portion: 12.4% X $118,500 =	$ 14,694.00
Amount subject to 2.9% Medicare portion of FICA:	$124,672.50
SET tax for Medicare portion: 2.9% X $124,672.50 =	$ 3,615.50
Total SET tax ($14,694.00 + $3,615.50) =	$ 18,309.50
Reported on Line 56 of Form 1040	

EI for 2015 using $135,000 Net Profit

Step 5: Figure ½ SET deduction:

50% of the amount determined in Step 4 $ 9,157.75

****Deducted on Line 27 of Form 1040****

EI for 2015 using $135,000 Net Profit

<u>Second</u>, apply the normal earned income formula by using the ½ SET deduction amount determined in Step 5 above.

Net Profit = Earned Income + the Contribution + ½ SET deduction
(Fill in known information)

$135,000 = EI + .25(EI) + $9,154.75
(Subtract $9,154.75 from both sides)

$125,845.25 = 1.25(EI)
(Divide both sides by 1.25)

$100,676.20 = EI;

25% X $100,676.20 = $25,169.05 = Contribution

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Taking the Deductions

The self-employed would take a deduction for the $25,169.05 contribution on his Federal income tax return in the adjustments to income section as a deduction for a profit sharing contribution on his own behalf.

He would also take a deduction of $9,154.75 that is the SET deduction for his self-employment taxes in that same section.

If there were employees, the contribution made on behalf of each employee is determined by multiplying each employee's W-2 compensation by 25%. The Employer would take a deduction for contributions made on behalf of the employees on his Schedule C.

(Any contributions made on behalf of regular employees are deducted from the Schedule C <u>before</u> the self-employeds net profit is determined.)

Partnership Calculation of Earned Income

Generally done the same way, only Earned Income calculated for each Partner!

		2015 Allocation - Partnership Example				
	Comp	**Elective**	**Safe Harbor NE**	**10.2075% NE**	**Total Employer**	**Totals**
Don	$252,919.93	$18,000.00	$7,587.60	$25,816.92	$33,404.52	$51,404.52
David	$252,919.93	$18,000.00	$7,587.60	$25,816.92	$33,404.52	$51,404.52
Robert	<u>$35,000.00</u>	<u>$500.00</u>	<u>$1,050.00</u>	<u>$3,572.64</u>	<u>$4,622.64</u>	<u>$5,122.64</u>
	$540,839.86	$36,500.00	$16,225.20	$55,206.48	$71,431.68	$107,931.68
25% of Comp=	$135,209.97					

Don	**NP**	**1/2 SET**	**C**	**EI**
50% Partner	$300,000.00	$11,364.23	$35,715.84	**$252,919.94**
	1/2SET =	$11,364.23		
David	**NP**	**1/2 SET**	**C**	**EI**
50% Partner	$300,000.00	$11,364.23	$35,715.84	**$252,919.94**
	1/2SET =	$11,364.23		

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Surface Transportation and Veterans Health Care Choice Improvement Act of 2015

- HR 3236 was enacted 7/31/2015
- Affects the due dates for certain tax returns
- Generally effective for tax years beginning after 12/31/2015
  - Exception for C corporations with a June 30 fiscal year – this change will be effective for years beginning after 12/31/2025
- As a result IRS must amend relevant regulations to affect the change in dues dates for
  - Form 1065
  - Form 5500
  - Form 990

Comparison of Previous Due Dates to New Due Dates

For calendar year 2015 | For calendar year 2016

Type of Entity	Due Date	Extension	Due Date	Extension
C Corp	3/15	9/15	4/15	10/15
Partnership	4/15	9/15	3/15	9/15
Sole Prop	4/15	10/15	4/15	10/15
Qualified Joint Venture	4/15	10/15	4/15	10/15
S Corp	3/15	9/15	3/15	9/15
Form 5500	7/31	10/15	7/31	11/15
Form 990 Series	4/15	1^{st} -7/15 2^{nd}-10/15	4/15	11/15
FBAR Return	6/30	None	4/15	10/15

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Taking the Deductions

Deduction Worksheet for Self-Employed

Step 1
Enter your net profit from line 31, Schedule C (Form 1040); line 3, Schedule C-EZ (Form 1040); line 34, Schedule F (Form 1040)*; or box 14, code A**, Schedule K-1 (Form 1065)*. For information on other income included in net profit from self-employment, see the Instructions for Schedule SE, Form 1040. . . . . ______
*Reduce this amount by any amount reported on Schedule SE (Form 1040), line 1b.
**General partners should reduce this amount by the same additional expenses subtracted from box 14, code A to determine the amount on line 1 or 2 of Schedule SE.

Step 2
Enter your deduction for self-employment tax from Form 1040, line 27 . . . . ______

Step 3
Net earnings from self-employment. Subtract step 2 from step 1 . . . . ______

Step 4
Enter your rate from the *Rate Table for Self-Employed* **or** *Rate Worksheet for Self-Employed* . . . . ______

Step 5
Multiply step 3 by step 4 . . . . ______

Step 6
Multiply $260,000 by your plan contribution rate (not the reduced rate) . . . . ______

Step 7
Enter the **smaller** of step 5 or step 6 . . . . ______

Step 8
Contribution dollar limit $52,000

- **If you made any elective deferrals to your self-employed plan, go to step 9.**
- **Otherwise, skip steps 9 through 20 and enter the smaller of step 7 or step 8 on step 21.**

Taking the Deductions

Step 9
Enter your allowable elective deferrals (including designated Roth contributions) made to your self-employed plan during 2014. Do not enter more than $17,500 . . . . ______

Step 10
Subtract step 9 from step 8 . . . . ______

Step 11
Subtract step 9 from step 3 . . . . ______

Step 12
Enter one-half of step 11 . . . . ______

Step 13
Enter the **smallest** of step 7, 10, or 12 . . . . ______

Step 14
Subtract step 13 from step 3 . . . . ______

Step 15
Enter the **smaller** of step 9 or step 14 . . . . ______

- **If you made catch-up contributions, go to step 16.**
- **Otherwise, skip steps 16 through 18 and go to step 19.**

Step 16
Subtract step 15 from step 14 . . . . ______

Step 17
Enter your catch-up contributions (including designated Roth contributions), if any. Do not enter more than $5,500 . . . . ______

Step 18
Enter the **smaller** of step 16 or step 17 . . . . ______

Step 19
Add steps 13, 15, and 18. . . . . ______

Step 20
Enter the amount of designated Roth contributions included on lines 9 and 17. . . . . . . ______

Step 21
Subtract step 20 from step 19. This is your **maximum deductible contribution**. . . . . . ______

Next: Enter your actual contribution, not to exceed your maximum deductible contribution, on Form 1040, line 28.

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Taking the Deductions

(2014 Schedule SE)

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

1a	Net farm profit or (loss) from Schedule F, line 34, and farm partnerships, Schedule K-1 (Form 1065), box 14, code A	**1a**	
b	If you received social security retirement or disability benefits, enter the amount of Conservation Reserve Program payments included on Schedule F, line 4b, or listed on Schedule K-1 (Form 1065), box 20, code Z	**1b**	( )
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; Schedule K-1 (Form 1065), box 14, code A (other than farming); and Schedule K-1 (Form 1065-B), box 9, code J1. Ministers and members of religious orders, see instructions for types of income to report on this line. See instructions for other income to report	**2**	200,000
3	Combine lines 1a, 1b, and 2	**3**	200,000
4	Multiply line 3 by 92.35% (.9235). If less than $400, you do not owe self-employment tax; **do not** file this schedule unless you have an amount on line 1b ▶	**4**	184,700
	Note. If line 4 is less than $400 due to Conservation Reserve Program payments on line 1b, see instructions.		
5	**Self-employment tax.** If the amount on line 4 is: • $117,000 or less, multiply line 4 by 15.3% (.153). Enter the result here and on **Form 1040, line 57,** or **Form 1040NR, line 55** • More than $117,000, multiply line 4 by 2.9% (.029). Then, add $14,508 to the result. Enter the total here and on **Form 1040, line 57,** or **Form 1040NR, line 55**	**5**	19,864
6	**Deduction for one-half of self-employment tax.** Multiply line 5 by 50% (.50). Enter the result here and on **Form 1040, line 27,** or **Form 1040NR, line 27** — **6** 9,932		

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 11358Z **Schedule SE (Form 1040) 2014**

Taking the Deductions

Adjusted Gross Income

23	Educator expenses	23		
24	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106 or 2106-EZ	24		
25	Health savings account deduction. Attach Form 8889	25		
26	Moving expenses. Attach Form 3903	26		
27	Deductible part of self-employment tax. Attach Schedule SE	27	9,932	
28	Self-employed SEP, SIMPLE, and qualified plans	28	14,825	
29	Self-employed health insurance deduction	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid **b** Recipient's SSN ▶	31a		
32	IRA deduction	32		
33	Student loan interest deduction	33		
34	Tuition and fees. Attach Form 8917	34		
35	Domestic production activities deduction. Attach Form 8903	35		
36	Add lines 23 through 35			36
37	Subtract line 36 from line 22. This is your **adjusted gross income** ▶			37

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2014)

Taking the Deductions

Schedule C – line 19

4 Cost of goods sold (from line 42) . . . 4
5 **Gross profit.** Subtract line 4 from line 3 . . . 5
6 Other income, including federal and state gasoline or fuel tax credit or refund (see instructions) . . . 6
7 **Gross income.** Add lines 5 and 6 . . . ▶ 7

Part II Expenses **Enter expenses for business use of your home only on line 30.**

8	Advertising	8	18	Office expense (see instructions)	18
9	Car and truck expenses (see instructions)	9	19	Pension and profit-sharing plans	19
			20	Rent or lease (see instructions):	
10	Commissions and fees	10	a	Vehicles, machinery, and equipment	20a
11	Contract labor (see instructions)	11	b	Other business property	20b
12	Depletion	12	21	Repairs and maintenance	21
13	Depreciation and section 179 expense deduction (not included in Part III) (see instructions)	13	22	Supplies (not included in Part III)	22
			23	Taxes and licenses	23
			24	Travel, meals, and entertainment:	
14	Employee benefit programs (other than on line 19)	14	a	Travel	24a
15	Insurance (other than health)	15	b	Deductible meals and entertainment (see instructions)	24b
16	Interest:		25	Utilities	25
a	Mortgage (paid to banks, etc.)	16a	26	Wages (less employment credits)	26
b	Other	16b	27a	Other expenses (from line 48)	27a
17	Legal and professional services	17	b	**Reserved for future use**	27b

28 **Total expenses** before expenses for business use of home. Add lines 8 through 27a . . . ▶ 28
29 Tentative profit or (loss). Subtract line 28 from line 7 . . . 29
30 Expenses for business use of your home. Do not report these expenses elsewhere. Attach Form 8829 unless using the simplified method (see instructions).

Equivalency Chart for Determining Contribution

Equivalency Chart

% of earned income	= % of adjusted net profit	% of earned income	= % of adjusted net profit
25%	20%	12%	10.714%
24%	19.355%	11%	9.910%
23%	18.699%	10%	9.091%
22%	18.033%	9%	8.257%
21%	17.355%	8%	7.407%
20%	16.667%	7%	6.542%
19%	15.966%	6%	5.660%
18%	15.254%	5%	4.762%
17%	14.530%	4%	3.846%
16%	13.793%	3%	2.913%
15%	13.043%	2%	1.961%
14%	12.281%	1%	.990%
13%	11.504%		

Permitted Disparity Examples

- Mike Magic is a self-employed individual with one common-law employee. We will assume that Mike's net profit after making contributions for Marge is $200,000.
- The Plan is a Profit-Sharing Plan.
- Marge's annual salary is $20,000.
- Mike wishes to contribute the maximum for himself under an integrated formula. The integration level for the year is the taxable wage base of $117,000 for 2014. The maximum integrated contribution for Mike's 2014 Profit Sharing plan is (C = Total Contribution to plan):

Permitted Disparity Examples

- Contribution = .25 (total compensation)
- C = .25 (Marge's Salary + Mike's net profit - C - 1/2 SET)
- C = .25 (220,000 - C – 9,868)
- C = .25 (210,132 - C)
- C = 52,533 - .25C
- 1.25C = 52,533
- C = 42026

$42,026 is the total amount that must be allocated under the integration formula. Therefore Mike's earned income is $200,000 – 42,026 – 9,868 or $148,105

Permitted Disparity Examples

The allocation is as follows:

EE	Comp.	3% Total	3% Excess	2.7% TC + Excess	RA = 30,671.36
Mike	148,105	4,443.17	933.17	4,838.70	27,022.30
Marge	20,000	600.00	.00	540.00	3,649.06
Totals	168,105	5,043.17	933.17	5,378.70	30,671.36

Total Contributions: Mike = $37,237.34 (25.14% of compensation)
Marge= $ 4,789.06 (23.95% of compensation)
Total $ 42,026.40**

$168,105.58 x 25% = 42,026.40 maximum deductible contribution

Permitted Disparity Examples

Money Purchase Example - The integration level is $117,000 using Mike's earned income figure from Example 1 ($148,105) and the total plan contribution of $42,026, we can compute the BCP and ECP as follows:

Total Contrib = BCP (all Base Comps) + (BCP + .057)(all Excess Comps)
42,026.00 = BCP (117,000 + 20,000) + (BCP + .057)(31,105)
42,026 = BCP (137,000) + (BCP)(31,105) + 1772.98
42,026 = BCP (168,105) + 1772.98
40,253 = BCP (168,105)
.239451533 = BCP

The ECP is the BCP + .057
ECP = .239451533 + .057
ECP = .296451533

Permitted Disparity Tables

Quick Reference Table for 2014

If the Integration Level is:	Then the rate for Money Purchase and Non Top-Heavy Profit Sharing Plans is:	Or the rate for Step 3 Top-Heavy Profit Sharing Plans is:
Over 0 up to $23,400	5.7%	2.7%
Over $23,400 Up to $93,600	4.3%	1.3%
Over $93,600 But less than $117,000	5.4%	2.4%
Equal to $117,000	5.7%	2.7%

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Permitted Disparity Tables

Quick Reference Table for 2015

If the Integration Level is:	Then the rate for Money Purchase and Non Top-Heavy Profit Sharing Plans is:	Or the rate for Step 3 Top-Heavy Profit Sharing Plans is:
Over 0 up to $23,700	5.7%	2.7%
Over $23,700 Up to $93,600	4.3%	1.3%
Over $94,800 But less than $118,500	5.4%	2.4%
Equal to $118,500	5.7%	2.7%

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"Deemed" Control Group

- Has been referred to as "the Keogh Pitfall" by the WSJ
- If a participant in a §403(b) also owns another trade or business that adopts a plan, that individual has one overall limit under §415 between the §403(b) and the other plan.
- If the other business plan is a cash or deferred arrangement, the individual has one deferral limit between the §403(b) and the other plan.

"Deemed" Control

- Employee deemed to "control" their 403(b) account.
- Only applies if they own > 50% of another business.
- Excess will ALWAYS be in the 403(b)!
- Preamble to 415 regs require 403(b) employer to know whether employee controls another business.
- Must maintain record of excess back to the date the excess occurred, otherwise the 403(b) becomes a nonqualified annuity or plan.

403(b) Excesses

If there are 2 plans maintained and a 415 Excess occurs – the excess will always be in the 403(b) Plan! (Final 415 regs. –issued 4/07, effective 2008)

The preamble states that the "employer" should know that another plan is being "controlled" by the employee.

For example a teacher who has a consulting business and has a plan for that business. Or a Doctor who maintains a private practice separate from their 403(b) at the Hospital

Doctor's Plans

Hospital 403(b) Plan

- Deferrals Only
- Doctor, age 52 with 20 years of service participates and contributes:
  - $18,000 plus
  - $ 6,000 plus
  - $ 3,000

Dr. has his own private practice

- Adopts a SEP
- No employees
- Contributes a total of $53,000

The Doctor has a 415 excess which ***must be removed*** from the 403(b) Plan. Common error for Doctors, Professors, and Teachers!

401(k) for the Self-Employed

Caution: Self-employed or partner cannot "pre-fund" deferrals:

Although a self-employed or partner can make deferral contributions throughout the year based on their anticipated final earned income, front loading the contribution is not permitted. Consequently, a self-employed or partner needs to make sure that services have already been performed that generate the income before making their deferral contribution.

Deferrals May Not Precede Election or Services

- A contribution can be treated as a deferral (either pre-tax or Roth) only after an election is made to defer receipt of the compensation that would have otherwise been paid to the employee.
- Also, a contribution can be treated as a deferral only after the employee has performed service with respect to which the contributions are made (or when the cash would be currently available, if earlier).

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Deferrals May Not Precede Election or Services

- This rule presents an interesting scenario for a self-employed individual or partner in a partnership.
- These individuals typically and periodically take "draws" from the business.
- Such draws are not yet considered "compensation" earned by the individual. At the end of the year, the self-employed or partner must determine, with respect to the entire years' gross receipts and deductible expenses, the actual amount of net profit with respect to the business.

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Deferrals May Not Precede Election or Services

- A partner's/sole proprietor's compensation is deemed currently available on the last day of their taxable year (usually December 31st)
- Accordingly, a self-employed or partner may not make a cash or deferred ***election*** with respect to compensation for a taxable year after the last day of that year.
- In other words, a self-employed must make a ***valid election*** to defer for a year by December 31st, although the deadline to contribute the amount is up to his or her tax filing deadline including extensions.

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Deferrals May Not Precede Election or Services

- Also, the regulations make clear that the earned income of a self-employed or partner constitutes payment for services during that year.
- This means that a self-employed or partner must have provided the service in connection with the receipt of payment for such services before a deferral contribution can be made.
- However, a deferral contribution can be made before the final earned income is determined for the taxable year.

Deferrals Deadlines and Corrections

- 15 day Plan Asset Rule for ERISA Plans/7 day safe harbor
- State law for NonERISA Plans
- Excess deferrals: In the case of an employee receiving a Form W-2 the deferrals have actually come from a paycheck. The deferrals reduce Box 1 compensation on Form W-2 and the deferrals are reported in Box 12a even if the deferral is in excess of the limit.
- A self-employed, determining an excess deferral is more complicated since the individual does not actually receive a paycheck and does not receive a Form W-2

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Self-Employed and Partner Issues

- IRS was considering additional guidance in determining how a self-employed identifies an excess, how corrective distributions, if any, are reported by the payer, and how the individual reports the correction on his or her Form 1040.
- In the Participant's Instructions on Form 1099-R, the IRS states where corrections of excess deferrals, etc. are reported on the employee's Form 1040. It states: . . ."Also report on that line [referring to the wage line] permissible withdrawals from eligible automatic contribution arrangements and corrective distributions of excess deferrals, excess contributions, or excess aggregate contributions ***except if you are self-employed***."

Other Contribution Deadlines

Matching, nonelective and/or regular profit sharing contributions - no later than the employer's tax filing deadline, including extensions.

Compensation Defined for SIMPLE Plans

For employees, compensation is gross wages before subtracting the employee's salary reduction contributions.

For self-employed individuals, compensation means net earnings prior to subtracting any contributions made under the SIMPLE plan on behalf of the self-employed individual.

The formula for determining Compensation for a self-employed individual *only* in a SIMPLE Plan is:

Net Profit (from Schedule C) X .9235 = Compensation

Compensation

- Compensation for the 3% matching contribution or the 2% nonelective contribution from the Employer is based on the Employee's entire calendar year compensation.
- IRS Notice 98-4 Q & A D-4 for Matching Employer Contributions.
- IRS Notice 98-4 Q & A D-6 for Nonelective Employer Contributions.

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Example

Shannon owns Travel Dreams, an unincorporated travel agency.

Shannon has 2 employees:

Frank earns $30,000 and defers $4,000

Delilah earns $25,000 and defers $1,000

Shannon's net profit before any contribution is made and before the wage deduction is $130,000.

Shannon has elected to make a matching contribution at the rate of 3%. All employees are under age 50.

Example

Employee	Gross Compensation	Reduced Compensation	Deferral	Total Match	Contribution
Frank	$30,000	$26,000	$4,000	$900	$4,900
Delilah	$25,000	$24,000	$1,000	$750	$1,750
Totals	$55,000	$50,000	$5,000	$1,650	$6,650

Shannon would deduct the $6,650 total contributions for her employees on her Schedule C.

Shannon's wage deduction on her Schedule C is $50,000.

Shannon's profit of $130,000 minus the wage deduction and the total contributions for employees:

$130,000 - $50,000 - $6,650 = $73,350

Example

Shannon's "compensation" would be:

$73,350 X .9235 = $67,738.73

Shannon decides to defer the maximum of $12,000 for 2014. Her matching contribution would be:

$67,738.73 X .03 = $2,032.16

Shannon's total contribution for herself is $14,032.16 ($12,000 plus $2,032.16) She would deduct the $14,032.16 on her Form 1040 in the adjustment to income section.

Post Severance Compensation

- Post-Severance Compensation:
  - Amounts received by the later of 2½ months after separation or the end of the limitation year may be used as compensation.
  - Only includes amounts that the employee was entitled to had they not separated from service – i.e., accumulated Sick pay, vacation pay, or other salary. Does not include Severance Pay.
  - For 403(b) Plans where the Employer's Plan include post-severance Employer Contributions, compensation is the compensation earned within the immediate prior "year of service" which could span a period of years.

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Miscellaneous Issues to Consider…

- Controlled Groups
- Affiliated Service Groups
- W-2 Compensation and Earned income in the same year
- Multiple businesses, same owner(s), one business has a loss
- Multiple businesses, same owner(s), one business with employees
- Simplified Plans or EZ-K start-up no employees and then starts hiring…

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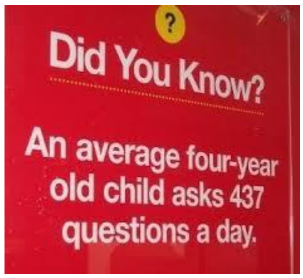
Questions



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