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With four specific services, The Center provides complete unbiased planning. The Center does not sell any products; its main purpose is to provide advice. Local experts are retained to implement the plans developed by the Center. The Center for Financial, Legal & Tax Planning is located at 4501 W. DeYoung Street, Suite 200, Marion, Illinois 62959. Phone 618-997-3436; Fax 618-997-8370.

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Defined Contribution Plans Summary and Limits

There are many types of retirement plans available for taxpayers. In fact, there are so many, the President and Congress have considered reducing retirement accounts from the many types that exist today into one simplified retirement savings program. Various plans can only be set up by an employer (The 401(K)s and 403(B)s), while others can be set up by anyone simply by setting up an account at a bank (typically an Individual Retirement Account).

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With the new rounds of tax legislation, the concept of the Roth retirement accounts has been expanded so that it applies to a much larger group of people. Roth accounts are known to be "no tax deduction now, and no taxes paid later" accounts. Traditional accounts, on the other hand, are exactly the opposite. Owners of traditional plans can take a tax deduction or deferral as applicable for contributions made to the plan, however taxpayers must pay taxes when the amounts are distributed. Most, if not all plans allow the taxpayer to enjoy gains while not having to pay capital gains tax or ordinary income until distributed.

Additionally, the amounts that can be contributed to the plans have changed radically. For a long time, many IRA annual contribution amounts were limited to $2,000. The amounts which can be contributed have gone up substantially and now new features, such as catch up amounts, have been added for those turning 50 and over this year. The following article discusses in summary the types of defined contribution retirement plans and contribution amounts.

The Employer Plans

Traditional 401(K)

The 401(K) is a retirement plan which arises from Section 401(K) of the Internal Revenue Code. 401(K)s are generally retirement plans sponsored by employers for their employees. 401(K) contributions are excludible from income. Tax deferrals occur when money is contributed to the plan. The annual deferred contribution limit to a 401(K) is $15,000. For those turning 50 and older this year, a "catch-up" or additional contribution of $5,000 annually, is allowed. When distributed, the distribution is taxable as ordinary income. A 401(K) account can be rolled over into an IRA.

Unlike the IRA, participants in 401(K)s enjoy the privilege of borrowing money from their plans without the penalties that IRA holders pay when they borrow or withdraw from their plans in given circumstances. Many employers also match contributions to employee plans up to a certain level. Typically the employee enjoys the greatest benefit when the employee contributes the maximum amount and receives the maximum amount of employer matching contributions to the plan.

The Solo(K)

The term "Solo(K)" is not found anywhere in the Internal Revenue Code. The term Solo(K) is a term coined by the retirement planning industry to denote a retirement plan which is advantageous for self employed individuals to use. Various and specific, newly enacted sections of the code make it advantageous for self employed people to use 401(K)s. These self employed 401(K)s are typically referred to as Solo(K)s, The Self Employed(K) or even the baby(K).

Solo(K)s are generally only available to or advantageous to 1) those who are self employed AND have no other employees or 2) those who are self employed AND their only other employee is their spouse. As of yet, domestic partnerships and same sex couples are not eligible for participation in Solo(K)s.

As with the other 401(K)s, the deferred limit from income is $15,000 while allowing $5,000 catch up contributions. Participants of the plan can contribute up to $44,000 per year to the plan. The difference between $15,000 and $44,000 however will not be deferred from current income.

Roth 401(K)

The Roth 401(K) is similar in all respects to the traditional 401(K), however, instead of contributions being deferred, contributions are taxed presently, but not taxed upon distribution. Roth 401(K) contribution limits remain the same as traditional 401(K) limits. Income must generally be below $150,000 annually to take full advantage of the Roth 401(K). Taxpayers making about $150,000 will experience phase-out between $150,000 and $160,000 of Adjusted Gross Income.

The Roth 401(K) was only in effect until December 31, 2006. Many people bypassed this opportunity to take advantage of the Roth provisions of the 401(K) because of this uncertainty. Given the past trends and most likely case scenario, contributions to the Roth 401(K)s will be allowed to rollover to some form of traditional 401(K) or Roth IRA to achieve equity after December 31, 2006.

Simple 401(K)

The Simple 401(K) is also an employer plan, but they tend to be easier to administer. The contribution limits are $10,000 annually, while allowing $2,500 catch-up contributions for those over 50 years of age annually.

Traditional 403(B)

This is generally a government employee retirement plan which is equivalent to the private sector 401(K) plans. The 403(B) is often referred to as the cousin of the 401(K) retirement plan because they are so similar. The annual contribution limit is $15,000, while allowing a $5,000 annual "catch-up" contribution for those 50 and older.

Roth 403(B)

This retirement plan is the same as the traditional 403(B) (above); however, it allows no deferral for contributions currently as it does not tax distributions when made, just the same as the Roth 401(K).

The Individual Plans

Traditional IRA

The traditional IRA is an individual retirement account. These can be set up by an individual at a bank. The annual contribution limit for 2006 is $4,000 and the law allows $1,000 annual "catch-up" contribution limits for those turning 50 years of age and older in 2006. If you are contributing to both a traditional and Roth IRA, the combined limit is $5,000. Under the traditional IRA, contributions are deductible, but distributions are taxed when received by the taxpayer. Furthermore, if a taxpayer takes a distribution from an IRA before the age of 59½, the taxpayer is subject to a 10% penalty unless an exception applies. The exceptions include distributions upon death, separation from service, a divorce and medical expenses. IRA holders can convert their IRA into a special IRA known as the "Self Directed IRA." Self Directed IRAs can invest in many different sorts of items including real estate, businesses, even gold and collectibles.

Comment: Since gold and silver are hot investments now (up 50% in the last year), it is worth mentioning that gold, silver and platinum purchased and sold under a Self Directed IRA is taxable at the standard 5%/15% rates. If you own gold, this is an excellent vehicle to avoid the collectible capital gains rate of 28% upon sale!

An IRA can also be rolled over from one IRA account to another. As mentioned above, a 401(K) can be rolled over into an IRA to avoid early taxes. However, an IRA cannot be rolled over into a 401(K) plan.

Roth IRA

This is also an individual account. The contribution limits are the same as the traditional IRA, however contributions are not deductible. Staying true to "Roth" form, the contributions are not deductible, but the distributions do not get taxed. Roth eligibility is phased out once again between $150,000 and $160,000 for joint filers.

Normally it is advisable, no matter what plan you subscribe to, to only choose the Roth if you believe your income tax rate will be higher in the future as opposed to your current rate. For most people, this will not be the case. Most people entering retirement see a lower rate in retirement than in the beginning years of their retirement savings. It is my recommendation that you discuss this possibility with your investment advisor before blindly going with one plan or another.

Simplified Employee Plan (SEP)

A SEP is a retirement plan where the employer contributes directly to an IRA of an employee. The employer contributions are excluded from the employee's gross income and an annual contribution of up to $44,000 is allowed. The employee is also allowed to contribute to the plan. SEPs are set up by completing IRS form 5305-SEP and retaining the form as evidence of the plan. The form 5305-SEP is not submitted to the IRS.

Simple IRA

This plan is established by an employer by completing forms 5405-SIMPLE (when the employee can choose the financial institution) or 5305-SIMPLE when the employer chooses the financial institution that will receive the contributions. The annual limit of contributions is $10,000 annually, while allowing $2,500 in annual catch-up contributions.

Conclusion

Currently there are nine retirement plans to choose from. Knowing the basics and amounts that can be contributed to the respective plan is always valuable knowledge to have when you are planning for your retirement. If you have further questions about retirement plans, feel free to call Marcus at The Center for further details.