

# THE Pension Digest

## ALSO IN THIS ISSUE –

IRA Contributions for 2019  
Page 1

IRA Contribution Deductibility  
Charts for 2018 and 2019  
Page 2

Roth IRA Contribution Charts for  
2018 and 2019  
Page 3

SEP and Simple Limits and Saver's  
Credit Limits for 2019  
Page 3

E-mail Consulting Guidance -  
Inheriting IRAs  
Page 4

Cannot Aggregate RMDs for IRAs  
with RMDs for 401(k) Plans  
Page 4

IRS Issues Draft Version Of the  
2019 Form 1099-R  
Page 5

Inherited IRAs - To Accept Trans-  
fers or Not  
Page 6

Sponsoring a SEP Allows A Small  
Business To Reduce Its FICA Tax  
Expense  
Pages 7 and 8

**Collin W. Fritz and  
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“The Pension Specialists”



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## IRA Contribution Limits for 2019 – \$6,000 and \$7,000

The 2019 maximum limits for annual tradi-  
tional IRA and Roth IRA contributions are  
being increased to \$6,000 (if under age 50)  
and \$7,000 (if age 50 or older). For 2018 the  
limits are \$5,500 and \$6,500. Federal tax law  
provides for a change in the contribution limit  
once the cost of living adjustment equals or  
exceeds \$500. These contribution limits were  
changed from \$5,000 to \$5,500 for 2013. The  
annual contribution limit for individuals age  
50 or older remains at \$1,000. Note on page  
2 that the compensation limits used to deter-  
mine the amount an IRA owner who is an  
active participant is able to claim as a tax  
deduction for their traditional IRA contribu-  
tion have also increased.

The 2019 maximum contribution limit for SEP-  
IRAs is increased to \$56,000 (or, 25% of com-  
pensation, if lesser) up from \$55,000. The mini-  
mum SEP contribution limit used to determine if  
an employer must make a contribution for a part-  
time employee remains the same at \$600.

The 2019 maximum contribution limits for  
SIMPLE-IRAs is increased to \$13,000 if the indi-  
vidual is under age 50 and \$16,000 if age 50 or  
older. The catch-up amount of \$3,000 did not  
change.

The 2019 maximum elective deferral limit for  
401(k) participants is changed to \$19,000 for  
participants under age 50 and \$25,000 for par-  
ticipants age 50 and older. The catch-up amount  
of \$6,000 did not change.

### Contribution limits for a person who is not age 50 or older.

<u>Tax Year</u>	<u>Amount</u>
2008-12	\$5,000
2013-18	\$5,500
2019	\$6,000

### Contribution Limits for a person who is age 50 or older.

<u>Tax Year</u>	<u>Amount</u>
2008-12	\$6,000
2013-18	\$6,500
2019	\$7,000

## IRS Issues 2019 IRA/Pension Limits

### IRS Announces Cost-of-Living Adjustments for 2019

The IRS in Notice 2018-83 Released its 2019 Adjustments as Follows:

	2017	2018	2019
Taxable Wage Base — OASDI Only	\$127,500	\$128,700	\$132,900
SEP and Qualified Plan			
Maximum Compensation Cap — 401(a)(17) & 404(e)	\$270,000	\$275,000	\$280,000
Elective (Salary) Deferral Limit — 401(k) & SAR-SEP	\$18,000	\$18,500	\$19,000
Elective Deferral Catch-up Limit for 401(k)	\$6,000	\$6,000	\$6,000
SIMPLE Deferral Limit — 408(p)(2)(A)	\$12,500	\$12,500	\$13,000
SIMPLE Catch-up Limit	\$3,000	\$3,000	\$3,000
Highly-Compensated Employees (Compensation as Indexed)	\$120,000	\$120,000	\$125,000
Defined Benefit Limit — Section 415(b)(1)(A)	\$215,000	\$220,000	\$225,000
Defined Contribution Limit — Section 415(c)(1)(A)	\$54,000	\$55,000	\$56,000
SEP Minimum Compensation Threshold — 408(k)(2)(c)	\$600	\$600	\$600
Key Employee Top Heavy — 41(i)(ii)(a)(i)	\$175,000	\$175,000	\$180,000

## IRA Contribution Deductibility Chart for 2018

(for participants and/or spouses in  
employer-sponsored retirement plans.)

### Amount of Modified AGI - (Combined modified AGI if married)

#### Single or Head of Household

Below \$63,000 or less	Entitled to full deduction
\$63,001-\$72,999.99	Entitled to prorated deduction amount - use special formula**
\$73,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$63,000/\$10,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married - joint return, both are covered or qualifying widower

Below \$101,000 or less	Entitled to full deduction
\$101,001 - \$120,999.99	Entitled to prorated deduction amount - use special formula**
\$121,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$101,000/\$20,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married -

##### joint return, but only you are covered or qualifying widower

Below \$101,000 or less	Fully Deductible
\$101,001-\$120,999.99	Entitled to prorated deduction amount - use special formula*
\$121,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$101,000/\$20,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married - joint return, but only your spouse is covered

Below \$189,000 or less	Fully Deductible
\$189,001-\$198,999.99	Entitled to prorated deduction amount - use special formula**
\$199,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$189,000/\$10,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married Filing Separately

Below \$10,000	Entitled to prorated deduction amount - use special formula**
\$10,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$0/\$10,000. This will give you a ratio that determines the amount you cannot deduct.\*

\*Any amount determined under this formula which is not a multiple of \$10 shall be rounded to the next lowest \$10.

However, an IRA accountholder will be able to deduct a minimum of \$200 as long as his or her AGI is not above the phase-out range (base amount plus \$10,000).

## IRA Contribution Deductibility Chart for 2019

(for participants and/or spouses in  
employer-sponsored retirement plans.)

### Amount of Modified AGI - (Combined modified AGI if married)

#### Single or Head of Household

Below \$64,000 or less	Entitled to full deduction
\$64,001-\$73,999.99	Entitled to prorated deduction amount - use special formula**
\$74,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$64,000/\$10,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married - joint return, both are covered or qualifying widower

Below \$103,000 or less	Entitled to full deduction
\$103,001 - \$122,999.99	Entitled to prorated deduction amount - use special formula**
\$123,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$103,000/\$20,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married -

##### joint return, but only you are covered or qualifying widower

Below \$103,000 or less	Fully Deductible
\$101,003-\$122,999.99	Entitled to prorated deduction amount - use special formula**
\$123,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$103,000/\$20,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married - joint return, but only your spouse is covered

Below \$193,000 or less	Fully Deductible
\$193,001-\$202,999.99	Entitled to prorated deduction amount - use special formula**
\$203,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$193,000/\$10,000. This will give you a ratio that determines the amount you cannot deduct.\*

#### Married Filing Separately

Below \$10,000	Entitled to prorated deduction amount - use special formula**
\$10,000 or more	No deduction permissible

\*\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$0/\$10,000. This will give you a ratio that determines the amount you cannot deduct.\*

\*Any amount determined under this formula which is not a multiple of \$10 shall be rounded to the next lowest \$10.

However, an IRA accountholder will be able to deduct a minimum of \$200 as long as his or her AGI is not above the phase-out range (base amount plus \$10,000).

### Roth IRA Contribution Chart for 2018

Amount of AGI and Filing Status

#### Single, Head of Household or Qualifying Widow(er)

Below \$120,000	Entitled to full contribution amount
\$120,000-\$134,999.99	Entitled to prorated contribution amount - use special formula*
\$135,000 or more	No contribution permissible

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$120,000/\$15,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

#### Married Filing Jointly

Below \$189,000	Entitled to full contribution amount.
\$189,000-198,999.99	Entitled to prorated contribution amount - use special formula*
\$199,000 or more	No contribution permissible.

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$189,000/\$10,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

#### Married Filing Separate Returns

\$0-\$9,999.99	Entitled to prorated contribution amount - use special formula*
\$10,000 or more	No contribution permissible

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$0/\$10,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

### Roth IRA Contribution Chart for 2019

Amount of AGI and Filing Status

#### Single, Head of Household or Qualifying Widow(er)

Below \$122,000	Entitled to full contribution amount
\$122,000-\$136,999.99	Entitled to prorated contribution amount - use special formula*
\$137,000 or more	No contribution permissible

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$122,000/\$15,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

#### Married Filing Jointly

Below \$193,000	Entitled to full contribution amount.
\$193,000-202,999.99	Entitled to prorated contribution amount - use special formula*
\$203,000 or more	No contribution permissible.

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$193,000/\$10,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

#### Married Filing Separate Returns

\$0-\$9,999.99	Entitled to prorated contribution amount - use special formula*
\$10,000 or more	No contribution permissible

\*Explanation of special formula. Multiply the permissible contribution by the following ratio: amount of adjusted gross income in excess of \$0/\$10,000. This will give you a ratio that determines the amount you cannot contribute. Round to the lowest \$10.00.

### SEP and SIMPLE Limits

	2016	2017	2018	2019
Maximum SEP Contribution	\$53,000	\$54,000	\$55,000	\$56,000
Maximum SIMPLE Deferral (Under age 50)	\$12,500	\$12,500	\$12,500	\$13,000
Maximum SIMPLE Deferral (Age 50 & older)	\$15,500	\$15,500	\$15,500	\$16,000

### Saver's Credit Limits for 2018

The applicable percentage for 2018 is based on modified adjusted gross income (AGI) and your tax-filing status, and is determined by the following table:

Joint Return		
AGI Over	AGI Not Over	Percentage
\$0	\$38,000	50%
\$38,000	\$41,000	20%
\$41,000	\$63,000	10%
\$63,000	N/A	0%

#### Head of Household

AGI Over	AGI Not Over	Percentage
\$0	\$28,500	50%
\$28,500	\$30,750	20%
\$30,000	\$47,250	10%
\$47,250	N/A	0%

#### Other Filers Including Married, Filing Separately

AGI Over	AGI Not Over	Percentage
\$0	\$19,000	50%
\$19,000	\$20,500	20%
\$20,500	\$31,500	10%
\$31,500	N/A	0%

### Saver's Credit Limits for 2019

The applicable percentage for 2019 is based on modified adjusted gross income (AGI) and your tax-filing status, and is determined by the following table:

Joint Return		
AGI Over	AGI Not Over	Percentage
\$0	\$38,500	50%
\$38,500	\$41,500	20%
\$41,500	\$64,000	10%
\$64,000	N/A	0%

#### Head of Household

AGI Over	AGI Not Over	Percentage
\$0	\$28,875	50%
\$28,875	\$31,125	20%
\$31,125	\$48,000	10%
\$48,000	N/A	0%

#### Other Filers Including Married, Filing Separately

AGI Over	AGI Not Over	Percentage
\$0	\$19,250	50%
\$19,250	\$20,750	20%
\$20,750	\$32,000	10%
\$32,000	N/A	0%

## Email Consulting Guidance - Inheriting IRAs

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**Q-1** The bank has the following Inherited IRA on its books:

1. Account owner died naming non-spouse beneficiary 1.
2. Non Spouse beneficiary establishes an IRA and names spouse as beneficiary 2.
3. Beneficiary 2 has been taking RMDs based on the life expectancy of the original account owner since she was younger than beneficiary 1.

Beneficiary 2 just died; her four children are named as beneficiaries. I am assuming that the four can take a lump sum or continue taking distributions based on the original account owner's life expectancy. Is this correct?

**A-2** You are correct. The RMD method applying to the first beneficiary will continue to be used to calculate the RMD for any subsequent beneficiary after the first beneficiary dies.

You indicate the second beneficiary had continued such schedule and that this second beneficiary has recently died. There are 4 beneficiaries of the second beneficiary. The same schedule will apply for their RMD purposes.

**Q-2** A customer passes away in April of this year and was in RMD status, their children were in this morning and I opened three inherited IRAs. I did the father's RMD for 2018 and split it between the three children and set them up in 2019 for an auto-distribution of their RMD. I just want to make sure I informed them correctly. The 2019 RMD will be figured on their ages, they were asking, and I wanted to make sure I gave them the correct information.

One more question – When determining the formula, do I use the single lifetime table or the uniform lifetime table? And I am unclear on the one year reduction rule.

**A-2** You are correct. Because you have established an inherited IRA in 2018 for each beneficiary there will be a separate RMD calculation for each beneficiary using each beneficiary's age for the following year. The one year reduction rule will be used to determine the divisor for subsequent years (2020 and later).

The bank will prepare a 2018 Form 1099-R for each

child to report the RMD distribution made to each child in 2018. A child beneficiary has the duty to withdraw the decedent's RMD to the extent it was not distributed prior to his or her passing.

A beneficiary calculation requires use of the single life table. The initial divisor for a beneficiary is determined for the year after the year the IRA owner died. The divisor for that first year is that initial divisor.

If the holder died in 2017 and the beneficiary is or will be age 42 by 12/31/18, then the divisor is 41.7 for 2018, it will be 40.7 for 2019 (41.7-1.0), it will be 39.7 for 2020 (41.7-2.0) etc.

## Cannot Aggregate RMDs for IRAs with RMDs for 401(k) Plans

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**Q-3** Is it permissible for a participant of the bank's 401(k) to take her RMD from IRAs which she has?

**A-3** No. A participant of a 401(k) plan and who is subject to the RMD requirement must withdraw his or her RMD from the 401(k) plan. The person is not allowed to withdraw the 401(k) RMD from an IRA or vice versa.

The statutory law sets forth a special taxation distribution rule for traditional IRAs, SEP IRAs and SIMPLE IRAs. A person who has multiple IRAs is required when applying the standard traditional IRA distribution/taxation rules to aggregate all IRAs so that he or she is considered to only have one IRA.

The IRS in 2002 when it rewrote the regulation setting forth the RMD rules for 401(k) plans and IRAs adopted the special IRA rule that a person who has multiple IRAs is to have determined the RMD for each IRA, but the person is permitted to aggregate such amounts and take the combined RMD amount from just one IRA.

This IRS regulation expressly states a person who has multiple 401(k) plans or other QP plans must take the respective RMD from each plan. The law does not require or allow QP balances from multiple plans to be aggregated. There must be a calculation and an RMD from each 401(k) plan.

In addition, the regulation clearly states a person cannot satisfy their RMD with respect to a 401(k) plan by withdrawing such amount from an IRA. This is true even if the QP plan only has one participant.



## IRS Issues Draft Version Of the 2019 Form 1099-R

See the proposed version of the 2019 Form 1099-R.

The proposed changes to the 2019 Form 1099-R are minimal. A "Date of payment" box is being added.

The Tax Cuts and Jobs Act of 2017 as enacted on December 18, 2017, created new IRS reporting requirements relating to the sale and purchase of life insurance policies. There are now reporting requirements for individuals and entities other than the issuing insurance company.

In years prior to 2019 Form 1099-R was used to report certain distributions from annuity insurance contracts in addition to distributions from IRAs and employer sponsored retirement plans. A new box is being added to report the date of payment for reportable death benefits under Code section 6050Y.

This new box, a "Date of payment" box is being created just to the left of box 15, Local Tax Withheld. The account number box in the lower left-hand corner is becoming smaller, but it will still be sufficiently large to report the account number when required to do so.

This box will never be completed with respect to an IRA. Current law does not permit an IRA to own a life

insurance policy. However, it is permissible for a 401(k) or other employer sponsored plan to purchase as a plan investment a life insurance policy as long as certain requirements are met.

Thus, there may situations when this box must be completed with respect to an insurance policy bought or sold by a 401(k) plan or other employer sponsored qualified plan.

There are now reporting requirements with respect to the sale/purchase of a life insurance policy. The person who acquires the policy must prepare a reporting form setting forth their name and address, the name and address of the person who sold the policy, the date of such sale, the names of the issuer of the life insurance contract and the policy number and the amount of each payment.

There are also now reporting requirements with respect to reportable death benefits. The person who makes a payment of reportable death benefits must prepare a reporting form setting forth their name and address, the name and address of the person who is paid the death benefit, the date of such payment, the gross amount of such payment and such person's estimate of the investment in the contract with respect to the buyer.

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and phone no.		1 Gross distribution \$		OMB No. 1545-0119 <b>2019</b> Form 1099-R		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2a Taxable amount \$				
PAYER'S TIN		2b Taxable amount not determined <input type="checkbox"/>		Total distribution <input type="checkbox"/>		Copy 1 For State, City, or Local Tax Department
RECIPIENT'S TIN		3 Capital gain (included in box 2a) \$		4 Federal income tax withheld \$		
RECIPIENT'S name		5 Employee contributions/ Designated Roth contributions or insurance premiums \$		6 Net unrealized appreciation on employer's securities \$		
Street address (including apt. no.)		7 Distribution code(s) IR/ SEP/ SIMPLE		8 Other \$		
City or town, state or province, country, and ZIP or foreign postal code		9 Your percentage of total distribution %		9b Total employee contributions \$		
10 Amount allocated to R within 5 years		11 First year of desig. Roth contrib.		12 State tax withheld \$		14 State distribution \$
Account number (see instructions)		Date of payment <input type="checkbox"/>		15 Local tax withheld \$		16 Name of locality \$
				13 State "Other" tax \$		17 Local distribution \$

Form 1099-R [www.irs.gov/Form1099R](http://www.irs.gov/Form1099R) Department of the Treasury - Internal Revenue Service

DRAFT AS OF  
September 7, 2018  
DO NOT FILE

## Inherited IRAs - To Accept Transfers or Not

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Most financial institutions with the authority to be an IRA custodian will decide to accept the transfer of inherited IRA funds. Why? These inherited or beneficiary accounts tend to be long term accounts. There is usually just one distribution per year. Each institution must decide what fees, if any, will be charged with respect to the inherited IRA.

The following email guidance was recently furnished to a financial institution after it had merged with another financial institution. Prior to the merger one institution had accepted the transfer of inherited IRAs and the other had not. A decision was to be made as to what the policy would be after the merger.

Subject: Deciding Whether To Accept Transfers of Inherited IRAs Not Originating at xxx Banking and Trust Company

I understand that some IRA custodians/trustees have adopted the approach that they will not accept transfers of inherited IRAs originating at another IRA trustee. However, the IRA trustee will administer the inherited IRA if the IRA owner had their IRA with xxx Banking and Trust at the time of their death.

You did not send me any written explanation why the other institution had adopted its policy that it was unwilling to accept the transfer of an inherited IRA. Does such a writing exist so that one can understand the rationale for not wanting to service inherited IRAs?

For the reasons discussed below I believe a bank should be willing and want to accept the transfer of inherited IRA funds especially if the inheriting beneficiary is already a bank client or wants to be a new bank client. I don't believe an IRA trustee is subjecting itself to increased liability as long as it services the inherited IRA as it should.

Inherited IRA funds will generally be long term accounts as current law allows a non-spouse beneficiary to withdraw required minimum distributions over their life expectancy. This is true whether the IRA funds are invested in time deposits or trust investments. Advisory and management fee income can be earned by the

IRA trustee as long as the IRA trustee's fees are reasonable.

An IRA trustee must perform special administrative duties for inherited IRAs. There must be special titling of the IRA for Form 5498 reporting purposes. In general, no additional contributions can be made except for transfers from another like-kind inherited IRA and direct rollovers of 401(k) or other pension funds. The inheriting beneficiary must comply with the required distribution rules.

The IRS has provided conflicted guidance regarding the tasks an IRA custodian is to provide with respect to inherited IRAs. See the attached pages from the IRS instructions for Forms 5498 and 1099-R. Regardless of these instructions, we at CWF believe the IRA trustee should assist a beneficiary with complying with the RMD rules because Article IV of the IRA plan agreement does require that RMDs occur after the IRA owner has died. At a minimum assist means furnishing an RMD notice and reminding the beneficiary he or she will owe the 50% tax if an RMD is not timely withdrawn. I would suggest adopting the policy that the IRA trustee will force the distribution by a certain date if the inheriting beneficiary has not furnished written instruction why such distribution is not required.

Under current law an inheriting IRA beneficiary cannot take or receive a distribution and then make a rollover contribution as the statutory law expressly prohibits this. This means the only way an inheriting beneficiary may move the inherited IRA funds away from the current IRA trustee is by a transfer.

The transfer of an inherited IRA is not identical to the transfer of a regular IRA because with respect to the inherited IRA there are special beneficiary RMD considerations. In general, is the beneficiary's RMD to be determined using the life distribution rule or the 5 year rule, if applicable?

The basic transfer rule is - whatever rule the beneficiary is using at IRA trustee #1 must continue to apply at IRA trustee #2. This is a tax subject so there are times when there are exceptions.

As long as the IRA owner designates individuals or a non-trust entity such as a university, church or charity as

his or her IRA beneficiaries, the administration of an inherited IRA is relatively easy.

There will be times when the IRA owner designates a trust as his or her IRA beneficiary and then dies. An inherited IRA will need to be established - the Jane Doe Trust as beneficiary of Jane Doe's IRA. Admittedly the administration - of such inherited IRAs can be complicated because trusts can be complicated, the tax rules are complicated and IRS guidance is very limited. I believe the IRA trustee should assist the trustee of the trust. As with many tax situations, the IRA trustee and trustee of trust may need to jointly discuss the situation and then settle on a course of action. There may be times when the financial institution serving as the IRA trustee is also serving as the trustee of the trust. There should be comprehensive written explanations for the IRA transactions and what fees are being earned for serving as the IRA trustee versus serving as the trustee of the trust.

It is also possible for a person to establish a trustee IRA. In this case, the individual and the IRA trustee will establish trust distribution provisions at the time the trustee IRA is established. Such an IRA can also be transferred.

In summary, I believe the policy of never accepting the transfer of an inheriting originating with another IRA trustee is imprudent. XXX Banking and Trust Company is a trust entity and it should generally want to accept transfers of inherited IRAs. Of course, there may be some inherited IRAs which have issues which would influence a financial institution to decline a request to serve as the IRAQ custodian/trustee.

## Sponsoring a SEP Allows A Small Business To Reduce Its FICA Tax Expense

A small business owner understands the FICA expense associated with its employees. The business pays a tax equal to 7.65% of each employee's compensation and so does the employee. For discussion purposes it is assumed that ABC Corporation has 6 employees with compensation as set forth on the next page.

The general federal tax rule is - all income is subject to the FICA taxes. There were two major exceptions. SEP-IRA contributions are not subject to the FICA tax. Cafeteria plan contributions are also not subject to the FICA tax. Employer contributions to pay health insurance premiums and employer contributions to HSAs are not subject to the FICA tax.

The purpose of this article is to illustrate savings of \$13,770 will be realized if the employer can convince its employees to take a compensation package of wages and a SEP-IRA contribution equal to 25% of compensation versus only wages. See the discussion below - ABC Corporation has 6 employees.

Under compensation approach #1, the employees are paid only wage compensation totaling \$450,000. The total FICA tax is \$68,850 ( $\$450,000 \times .153$ ). 50% is paid by the corporation (\$34,425) and the other 50% (\$34,425) by the employees.

Under compensation approach #2, the employees are paid wage compensation of \$360,000 and the employer makes SEP-IRA contributions totaling \$90,000. The combined employer expense is still \$450,000. However, the combined FICA tax is reduced to \$55,080 from \$68,850. The \$55,080 is determined by multiplying compensation of \$360,000 by 15.3%. The FICA tax of 15.3% does not apply to the \$90,000 SEP-IRA contribution.

A person who is age 59 1/2 or older will generally have the same tax result even when the employer makes the SEP-IRA contribution because he or she is able to withdraw SEP-IRA funds at any time. The person must include this amount in income which is what would have happened if the funds had been paid directly as wages.

A person who is under age 59 1/2 will not have the same tax result. The situation is a different because a person who is under age 59 1/2 will owe the 10% additional tax if he or she withdraws the SEP-IRA funds before age 59 1/2.

	No. SEP Wage Expense	No. SEP Wage Expense Including FICA	Net Amount Paid to Employee
Sara	\$150,000	\$161,475	\$138,350
Tom	\$100,000	\$107,650	\$92,350
Mary	\$80,000	\$86,120	\$73,880
Sam	\$50,000	\$53,825	\$46,175
Alicia	\$40,000	\$43,060	\$36,940
Mark	\$30,000	\$32,295	\$27,705
<b>Total</b>	<b>\$450,000</b>	<b>\$484,000</b>	<b>\$415,400</b>

Total FICA Expense  $\$450,000 \times .153 = \$68,850$

1/2 borne by employer = \$34,425

1/2 borne by employees = \$34,425

25% SEP	25% SEP Wage Expense	SEP Contribution	EE Exp Incl. FICA	Ee's Net Amt	Ees Total Amt Incl. SEP
Sara	\$120,000	\$30,000	\$129,180	\$110,820	\$140,820
Tom	\$80,000	\$20,000	\$86,120	\$73,880	\$93,880
Mary	\$64,000	\$16,000	\$68,896	\$59,104	\$75,104
Sam	\$40,000	\$10,000	\$43,060	\$36,940	\$46,940
Alicia	\$32,000	\$8,000	\$34,448	\$29,552	\$37,552
Mark	\$24,000	\$6,000	\$25,836	\$22,164	\$26,164
<b>Total</b>	<b>\$360,000</b>	<b>\$90,000</b>	<b>\$387,540</b>	<b>\$332,460</b>	<b>\$422,400</b>
Change	-\$90,000	+\$90,000	-\$96,885	-\$93,115	+\$7,000

Total FICA Exp.  $\$360,000 \times .153 = \$55,080$

1/2 borne by employer = \$27,540      \$6,885 saved by employer

1/2 borne by employee = \$27,540      \$6,885 saved by employee

The FICA expense decreases by \$13,770 (\$68,850 (\$450,000 x .153) versus \$55,080 (\$350,000 x .153).

The net amount paid to the employees increases by \$7,060 (\$415,400 vs. \$422,460).

The net amount by the employer decreases by \$6,885 (\$484,525 - \$387,540 - \$90,000).