



SIMPLE IRA

The SIMPLE (Savings Incentive Match Plan for Employees) IRA is a simplified, tax-favored retirement plan for small employers that provides for elective contributions by employees and meets certain vesting, participation and administrative requirements. This plan permits contributions only under a qualified salary reduction arrangement. A qualified salary reduction arrangement is defined as a written arrangement of an "eligible employer" under which:

- 1. Employees eligible to participate may elect to receive payments in cash or contribute them to the SIMPLE IRA account.*
- 2. The amount to which such an election applies must be expressed as a percentage, or dollar amount, of compensation and may not exceed \$10,500 per year (2007).*
- 3. The employer must also make matching contributions or non-elective contributions to the account.*
- 4. No other contributions may be made to the account.*

The maximum elective deferral amount is \$10,500 for 2007 and catch-up contributions of \$2,500 in 2007.

An individual who defers \$10,000 to a SIMPLE IRA of one employer and participates in a 401(k) plan of another employer would be limited to an elective deferral of \$5,500 in 2007 (\$15,500 - \$10,000) to the 401(k) plan.

The requirements for the employer's matching contributions or non-elective contributions are as follows:

MATCHING FORMULA

Under this formula, the employer is generally required to match employee elective contributions dollar-for-dollar up to an amount not exceeding 3% of the employee's compensation. However, a special rule permits the employer to elect a lower percentage matching contribution for all eligible employees (not less than 1% of each employee's compensation). To get the lower percentage, the employer has to notify the employees of the election within a reasonable period of time before the 60-day election period for electing to participate in the plan.

The employer may not use the lower percentage if the election would result in the percentage being lower than 3% in more than two out of the five years ending with the current year. If the employer (or a predecessor employer) has maintained the plan for less than five years, the employer will be treated as if the percentage was 3% in the prior years during which the arrangement was not in effect. If the employer made non-elective contributions for a year (instead of matching contributions) under the formula described below, it will be treated as having a percentage of 3% in that year.

The compensation limit under IRC Section 401(a)(17) does not apply for purposes of the matching formula; therefore, the 3% match could reach the maximum of \$10,500 (2007) for an employee with compensation of \$350,000 in a year.

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A matching contribution made under this provision on behalf of a self-employed individual is not treated as an elective employer contribution for purposes of the limit on such contributions. The purpose of this provision is to treat self-employed individuals in the same manner as employees for purposes of the limit on elective contributions.

NON-ELECTIVE CONTRIBUTION FORMULA

Instead of making matching contributions, an employer can elect to make a non-elective contribution of 2% of compensation on behalf of each eligible employee with at least \$5,000 in compensation from the employer for the year.

If the employer makes this election, it must notify the employees within a reasonable time before the 60-day election period for electing to participate in the plan. The compensation limit under Section 401(a)(17) applies for purposes of this formula. Thus, the maximum amount that could be contributed in non-elective contributions for an employee would be \$4,500 (i.e., 2% of \$225,000 in 2007).

An arrangement will not be treated as a qualified salary reduction arrangement if the employer or a predecessor employer maintained another qualified plan (including a 403(a) annuity, a 403(b) tax-sheltered annuity, a SEP, or a governmental plan other than a Section 457 plan) under which contributions were made or benefits accrued for service during any year in which the Simple IRA plan was in effect.

However, if only employees other than those covered under a collectively bargained agreement are eligible to participate in the SIMPLE IRA plan, this rule will be applied without regard to a collectively bargained plan. In addition, for purposes of this rule, transfers, rollovers or forfeitures are disregarded except to the extent that forfeitures replace otherwise required contributions.

ELIGIBLE EMPLOYER

Only an eligible employer may adopt a SIMPLE IRA plan. An "eligible employer" is defined as an employer who employed no more than 100 employees earning at least \$5,000 from the employer during the preceding year.

For purposes of this limitation, all employees employed at any time during the calendar year are taken into account, even those who are excludable or are ineligible to participate. Furthermore, certain self-employed individuals who receive earned income from the employer during the year must be counted for purposes of the 100-employee limitation. An employer who maintains a plan in which only collectively bargained employees may participate is not precluded from offering a SIMPLE IRA to its non-collectively bargained employees.

Generally, an eligible employer who ceases to be eligible after having established and maintained a SIMPLE IRA plan for at least one year will, nonetheless, continue to be treated as eligible for the following two years. However, special rules apply where a failure to remain eligible (or to meet any other requirement of Section 408(p)) was due to an acquisition, disposition or similar transaction involving another eligible employer.

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CHOOSING THE RIGHT PLAN

The tax laws allowing the Roth IRA, and later the Roth 401(k), have caused certain dilemmas over which retirement plan to choose. Of course deciding to use a Roth is not as simple as it seems. You probably have at least two retirement plans to choose from, maybe more. There is more than one way of calculating which plan will yield the most, and you may need the help of a financial advisor.

The basic rules for the Roth IRA are clear. Individuals can contribute up to \$5,000 a year and \$10,000 for married couples in 2010. The money is not tax deductible, so funding this plan is based on after tax dollars. The full contribution is available to single individuals with adjusted gross incomes under \$105,000 and couples under \$167,000. Single individuals can make partial contributions on incomes up to \$120,000 and couples can make partial contributes if their income does not exceed \$177,000.

You can take out your own contribution, tax-free, anytime you want. You also get the earnings tax-free if you hold the IRA at least five years and withdraw the money under one of the following circumstances:

- You are 59½, or older.
- You withdraw up to \$10,000 to buy a first home
- You become disabled
- Your heirs receive proceeds upon your death

Should you use the Roth IRA instead of some other retirement plan? The following considerations may help.

SELF-EMPLOYED

1. There is a variety of tax-deductible plans available for the self-employed. A simplified plan (SEP), a Keogh plan and a Simple IRA. All of them allow larger contributions than you are allowed with a Roth IRA.

2. If you can afford to, you should consider putting the maximum into a deductible plan and funding a Roth.

3. If you cannot fund two plans in full, it may be to your benefit to set aside the first \$4,000 in a Roth account.

4. If you are in the same tax bracket when you retire, the Roth IRA is generally more advantageous than the tax-deductible plan.

5. As in all retirement plans, the younger you are and the sooner you start investing - the better.

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EMPLOYEES WITH A 401(K) PLAN

1. If the company matches the money you put in, invest enough to get the maximum match.
2. If you can afford to, put the maximum match in your 401(k) and fully fund the Roth.
3. If you do not get an employer match, consider putting up to \$4,000 of your retirement contribution into a Roth IRA and the rest into your 401(k).

ROTH 401(k)

Your Roth choices have expanded since changes that took effect for plan years beginning on or after January 1, 2006. Employers may now offer a Roth 401(k) feature, which combines certain advantages of the Roth IRA with the convenience of 401(k) plan elective deferral-style contributions.

A qualified Roth contribution program means a program under which an employee may elect to make designated Roth contributions in lieu of all or a portion of elective deferrals that the employee is otherwise eligible to make. Regulations set forth the following requirements for designated Roth contributions: (1) the contribution must be designated irrevocably by the employee at the time of the cash or deferred election as a designated Roth contribution, (2) the contribution must be treated by the employer as includable in the employee's income at the time the employee would have received the amount in cash, were it not for the election (i.e., it must be treated as subject to applicable withholding requirements), and (3) the contribution must be maintained by the plan in a separate account.

The requirements for Roth 401(k) plans were enacted by EGTRRA 2001, but took effect January 1, 2006. The Pension Protection Act of 2006 made the provision of Roth 401(k) permanent, effectively removing the sunset scheduled for 2010 in EGTRRA.

THE BEST CHOICE

Those who favor Roth accounts tend to believe that their income and tax rate upon retirement will not be significantly lower than at present and are willing to prepay tax on income they invest to gain the tax free status on withdrawals and earnings in later years. Additionally, they recognize the advantage of allowing the investment to grow without any required distribution.

Conversely, those who usually favor traditional IRA accounts believe that they can contribute more because of the immediate deferment of the income tax and believe that their income and tax rate may be lower upon retirement or age 70 ½ when they will be required to take distributions.

So, which is really the better choice? You need to make sure you have the discipline to start saving today for your retirement. Take advantage of every opportunity you can to contribute to that retirement nest egg.

Source: Tax Facts 2010, National Underwriter Company
Financial Planning Consultants, Inc.

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SELF-EMPLOYED PENSION PLAN

KEOGH OR HR-10 PLAN

Self employed proprietors or partners may establish a tax sheltered retirement plan under the provision of HR-10, the Keogh Act. The result is a tax deferral of the top dollars earned, plus a shelter of all earnings on these deposits until retirement.

The fund can grow substantially by the "magic" of compound interest and the interest on dollars that would have been paid in taxes during the accumulation years. If you're self employed and the Keogh account is your only retirement plan, then your contribution limit is \$49,000 or 100% of eligible compensation, whichever is less for the tax year 2010. The maximum deductible contribution is limited to 25% of your eligible compensation.

For purposes of the deduction limit, "earned income" of a self-employed individual does not include the contribution on behalf of the self-employed person. In determining his adjusted gross income, a self-employed person deducts his plan contributions directly from gross income – the deduction is allowable whether or not he itemizes deductions.

Execution of a Keogh plan requires guidance by a financial planner since there are traps one may fall into unknowingly. There are several options.

DEFINED CONTRIBUTION PENSION

Option 1 - The contribution formula you initially establish locks a person in at that percentage. In other words, no flexibility exists. The formula might be a fixed percentage of all employees' wages, such as 10 percent.

Option 2 - Each year an individual determines what percent of wages is desired to contribute, retaining total flexibility. This is referred to as a profit sharing type of Keogh plan.

The combination of both options provides for flexible planning. For example under Option 1, five percent (5%) could be committed and then under Option 2, a percentage may be determined not exceeding the maximums for defined contribution plans.

DEFINED BENEFIT PENSION

Option 3 - A plan may also be established that will allow larger contributions, based on funding a specific retirement benefit. If there were only a few years until retirement, this would produce a very large payment, which may be very desirable for some individuals. This type of plan calls for a large fixed contribution and is normally suitable for older owner(s).

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INVESTING PENSION PROCEEDS

Funding may occur through a variety of investment vehicles including bank accounts, money market funds, annuities, mutual funds, real estate and bonds. There are advantages to each.

The situation, time until retirement and other investment holdings will dictate the most effective funding method.

RECEIVING THE BENEFITS

Funds may be withdrawn in a lump sum and taxes paid on the entire amount. A series of payments can also be taken such as an annuity guaranteed for a lifetime and perhaps the spouse's lifetime too.

A tax penalty of 10% is required for withdrawals made by plan participants prior to age 59 ½, unless disabled; withdrawal used for higher education expenses; up to \$10,000 for a new home purchase; or self-employed health care expenditures.

Keogh funds are includible in the gross estate for Federal estate tax purposes. The funds may be paid to a non-marital trust in order to escape taxation at the death of the surviving spouse.

Accumulated funds may also be converted to an annuity, using a variety of the funding products offered by life insurance companies.

REPORTING REQUIREMENTS

In 1982, the Tax Equity and Fiscal Responsibility Act (TEFRA) was signed into law by the President. The effect on Keogh plans is described in the following paragraphs.

On or before July 31, 1985, individuals who have established Keogh plans must have filed IRS form 5500-C. Form 5500-C covers investments, income and expenses from the previous year and is five pages long with questions related to plan administrators, funding arrangements and vesting.

Form 5500-C must be filed in the first year of reporting and every third year thereafter.

Form 5500-R, a two-page form, can be filed in intervening years, or Form 5500-C can be filed for each and every year.

Failure to file could result in IRS penalties of \$25 per day per Keogh account up to a maximum of \$15,000 unless reasonable cause is established.

For taxpayers on a calendar year basis, IRS extension Form 5558 must be filed on or before July 31 of the current reporting year for a two and one-half month extension. For taxpayers on a fiscal year, the deadline is the last day of the seventh month following the end of their fiscal year.

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