



Defined Contribution Plans- Summary and Limits

Introduction

There are many types of retirement plans available for taxpayers. In fact, there are so many, the President has considered reducing retirement accounts from the many types that exist today into one simplified retirement savings program. Additionally, the amounts that can be contributed to the plans have changed radically. The following Tax Advisory discusses in summary the types of defined contribution retirement plans and contribution amounts.

The **Traditional 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. However, specific sections of the code also make it advantageous for self allowed annually. When distributed, the distribution is taxable as ordinary income.

The **Roth 401(K)** is similar in all respects to the traditional 401(K); however, instead of contributions being deductible, contributions are taxed presently, but not taxed upon distribution. Roth 401(K) contribution limits remains are the same as traditional 401(K) limits. Income must generally be below \$160,000 annual to take advantage the Roth 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 (as of 2005, indexed in 2006 for inflation), while allowing \$2500 catch-up contributions for those over 50 years of age annually.

The **Traditional 403(B)** is generally a government employee retirement plan which is equivalent to the private sector 401(K) plans. The annual contribution limit is \$15,000, while allowing a \$5000 annual "catch-up" contribution for those 50 and older.

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Dr. Bart A. Basi is an attorney, CPA, and the President of The Center for Financial, Legal & Tax Planning, Inc, a full service company specializing in financial, legal & tax matters. Basi is a nationally recognized author, lecturer, and advisor on how to structure deals to minimize taxes.

Tax structure makes the difference between getting the deal done and watching the deal fall apart. Many of you may be familiar with Basi and the topics he covers in the *Financial, Legal & Tax Advisory* which may be read in various industry-specific trade publications.

A CASE STUDY

The Tax Court has held that a buy-sell agreement was irrelevant in the valuing of closely held stock. In the case, the owner / decedent held a controlling interest in the business. His brother-in-law was also a part owner in the company. Together the two had buy-sell agreements restricting lifetime transfers and at death. The agreement required THE COMPANY to buy the shares upon

death. This is known as a redemption agreement.

The IRS refused to acknowledge the buy-sell as the proper avenue to value the estate of the deceased. The agreement was originally executed long before the decedent's death calling for merely book value. After the decedent's death, the buy-sell was modified and the buy-sell lowered the value to a substantially lower value. This agreement was not allowed for valuation purposes.



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

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 \$4000 and the law allows \$1000 annual “catch-up” contribution limits for those turning 50 years of age and older this year. Under the traditional IRA, contributions are deductible, but distributions are taxed when made.

The **Roth IRA** is also an individual account. The contribution limits are the same as the traditional IRA, however they are not deductible. Staying true to “Roth” form, the contributions are not deductible, but the distributions do not get taxed.

A **Simplified Employee Plan (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.

The **SIMPLE IRA** plan is established by an employer by completing forms 5304-SIMPLE (when the employee can choose the financial institution) or 5305-SIMPLE when the employer chooses the financial institution which 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.



Points of Interest

1. **There are many types of retirement plans available for taxpayers. In fact, there are so many, the President has considered reducing retirement accounts from the many types that exist today into one simplified retirement savings program.**
2. **Under the traditional IRA, contributions are deductible, but distributions are taxed when made.**
3. **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.**

The Bradway Group—Tampa
1101 Channelside Drive, Suite 290
Tampa, FL 33602-3611

The Center For Financial, Legal & Tax Planning, Inc.
4501 W. DeYoung St., Suite 200
Marion, Illinois 62959

Editor's Comment:

Buy-Sell agreements are critical for people who are involved in partnerships and mixed entities. Here, the IRS rejected the claim for the lower estate value 1) because the agreement was not the original agreement and 2) the decedent was the controlling shareholder with the ability to modify the agreement at any time. Had this decedent had a cross purchase agreement (an agreement allowing others to purchase the shares) the buy-sell would have stood.

I encourage everyone to have a buy-sell arrangement. Under the buy-sell, businesses have better longevity and estate taxes can be limited in appropriate circumstances. If you are interested in a buy-sell agreement, contact the Center for help.



Determining the Fair Market Value of Your Business

One of the most frequently asked questions in my business is “How can I determine/improve the Fair Market Value of my business?” When we talk about the Fair Market Value, we’re referring to the value of your business *as seen through the eyes of a qualified buyer*.

Depending upon the business, there may be industry rules of thumb, such as X times the annual sales for a professional practice, or \$Y per seat for a restaurant, or \$Z per bay for a self-service car wash, which may be helpful; but there are many factors to consider, such as customer concentration, industry trends, regional economic trends, strength of the balance sheet, strength of the management team, age & condition of the equipment, just to name a few.

From experience, however, I advise my clients that 70% - 80% of the selling price of an ongoing business is determined by its *proven ability to generate cash*. All of these other factors play a role in determining the final selling price, but if you’re looking for the most important way to directly improve the fair market value of your business, work on improving its profitability and its cash flow.

If you know of a business owner who’s thinking of selling and who might benefit from a free consultation with us, have them contact me, or any of the M&A professionals at www.bradwaygroup.com

Mike Ertel, CBI, M&AMI
The Bradway Group
813.299.7862 Direct

The Bradway Group—Palm Beach
824 US Highway 1, Suite 270
North Palm Beach, FL 33408

The Center For Financial, Legal & Tax Planning, Inc.
4501 W. DeYoung St., Suite 200
Marion, Illinois 62959

The Bradway Group—Palm Beach
824 US Highway 1, Suite 270
North Palm Beach, FL 33408
Phone: 561-776-8085
Fax: 561-776-1844

The Bradway Group—Tampa
1101 Channelside Drive, Suite 290
Tampa, FL 33602-3611
Phone: 813-864-6600
Fax: 813-864-6601

The Center For Financial, Legal & Tax Planning, Inc.
4501 W. DeYoung St., Suite 200
Marion, Illinois 62959
Phone: 618-997-3436
Fax: 618-997-8370

Satellite Office:
Longboat Key, FL 34228
Phone and Fax: 941-383-3338



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www.taxplanning.com

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▶▶▶ Frequently Asked Questions...

Q. I am exchanging property in a 1031 "like-kind-exchange". Can I exchange my one property for more than one property?

A. Yes. As long as the property being exchanged is within the same class, you may exchange the property for more than one property. When dealing with real estate, you can exchange one property for up to 3 properties.

Q. I am thinking about setting up an Individual Retirement Account (IRA). What are the contribution limits for 2006?

A. The 2006 IRA contribution limits are \$4000 and allow an additional \$1000 "catch up" annual contribution from those turning 50 or more this year.

Q. I would like to value my business so I can sell it. Is there a multiple I could use as a rule of thumb which would be accurate?

A. No. Multiples are not recognized by the IRS as a valid valuation device. When valuing a business for sale, it is wise to invest in a valuation. Valuations of businesses are complex and require expertise. Simply using a multiple ignores too many contingencies and the like to be effective as a valuation device.

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