

Compensation Techniques for Owners and Employees of Closely Held Businesses

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➤ **KEY PLANNING
OPPORTUNITIES**

➤ **INCENTIVES FOR SMALL
BUSINESSES**

➤ **NEW LEGISLATION**

IRS and DOL Awareness

- IRS Publication 560 - Retirement Plans for Small Business
- Newsletters and booklets
- Checklists
- Increased audit activity
- IRS and DOL Websites

Using the Web for Employee Benefits and Retirement Information

- Source documents
- Keeping current
- Free on-line publications
- Pay to access publications
- www.benefitslink.com

Qualified Plan Incentives

- Increased contribution, deductions and compensation limits
- 401(k) plan flexibility
 - Traditional 401(k) plan
 - Safe harbor plan
 - Simple plan
 - Solo 401(k) plans
 - Beware of fees
 - Delinquent contribution issues

Profit Sharing Plan

- Increased contribution limits
- Merging of money purchase plans or terminating
- Design – i.e. age weighted comparability plans

Defined Benefit Plans

- ↳ Recent increasing interest
- ↳ Contributions in excess of DC limit
- ↳ 412(i) plans

Other Incentives

- ↳ Top heavy rules
- ↳ User fee waived
- ↳ Tax credits for contributions

Distribution Enhancements

- Increased portability between plans
- 60 day rollover rule eased
- 72 (t) payments revised

Executive Compensation and Supplemental Nonqualified Plans

- New rules affecting nonqualified deferred compensation
- Executive compensation audit program
- Effects of Sarbanes-Oxley

Shift in Retirement Savings Strategies

- Taxable accounts vs. nontaxable accounts
- Roth IRA conversions

Your Retirement

- Retirement plan changes
- Small business provisions
- IRA changes
- IRS publications and tools
- Proposed legislation

Retirement Plans

Plan Limit Increases:

- ↳ Contribution limits
- ↳ Compensation limits
- ↳ Deduction limits for employers

Retirement Plans

Contribution limits - 401(k) plans

<u>Year</u>	<u>Maximum Contribution</u>
2002	\$11,000
2003	\$12,000
2004	\$13,000
2005	\$14,000
2006 & later	\$15,000

Retirement Plans

Contribution limits - SIMPLEs

<u>Year</u>	<u>Maximum Contribution</u>
2002	\$ 7,000
2003	\$ 8,000
2004	\$ 9,000
2005	\$10,000

Retirement Plans

Catch-up contributions

<u>Year</u>	<u>Qualified Plan</u>	<u>SIMPLE</u>
2002	\$ 1,000	\$ 500
2003	\$ 2,000	\$ 1,000
2004	\$ 3,000	\$ 1,500
2005	\$ 4,000	\$ 2,000
2006 & later	\$ 5,000	\$ 2,500

Retirement Plans

New Roth 401(k)

- ↳ Contributions with after-tax dollars
- ↳ Distributions are tax-free
- ↳ No minimum required distribution

Retirement Plans

Compensation limit for
setting benefits

2003 - \$200,000 2004 - \$205,000
2005 - \$210,000

Increased Deduction Limits for Employers

Retirement Plans

Defined benefit plans –
Annual benefits limit

2003 - \$160,000 2004 - \$165,000

2005 - \$170,000

Retirement Plans

Defined contribution plans

**25% annual addition
limit eliminated**

Dollar limit increased

Retirement Plans

Defined contribution plans –
Annual contribution limit

2003 - \$40,000

2004 - \$41,000

2005 - \$42,000

Retirement Plans

Portability

**Rollovers between all types
of plans now allowed**

**Automatic Rollovers for
Involuntary Distributions**

Retirement Plans

↳ Changes to top-heavy rules

↳ Faster vesting

Effective date: Plan years beginning in 2002 or later

Uniform Loan Rules for All Business Owners

Small Business Retirement Plans

New Tax Credit

- ↪ Annual maximum \$500
- ↪ Applied to start-up costs
- ↪ 3 years
- ↪ Cannot claim deduction for same expenses

Effective date: New plans set up in 2002 or later

IRS User Fee Relief

Small employers exempt from fee

Determination letter request in first 5 years

New Tax Credit for Savers

- ↳ Targets low and middle-income savers
- ↳ 18 and older
- ↳ No full-time students
- ↳ Cannot be a dependent

Effective date: 2002

New Tax Credit for Savers

Credit	AGI (Single)	AGI (MFJ)
50%	\$ 0 - \$15,000	\$ 0 - \$30,000
20%	\$ 15,001 - \$16,250	\$ 30,001 - \$32,500
10%	\$ 16,251 - \$25,000	\$ 32,501 - \$50,000

Recent Developments and Planning

- ↳ Plan amendments
- ↳ One person 401(k) plans
- ↳ Merging money purchase and profit sharing plans
 - Rev Rule 2002-42: 100% vesting is not triggered upon merger

Recent Developments and Planning (Cont'd)

- ↳ New rules for avoiding annual audit
 - Bonding requirements
 - Qualifying plan assets
 - Additional SAR information

Recent Developments and Planning (Cont'd)

- DOL guidelines on 401(k) deposits
- Recent IRS 5500 filing guidance
- Orphan plans
- 412 (i) plans
- Abusive – listed transactions
- ESOP planning
- Plan investments

Recent Developments and Planning (Cont'd)

- DOL DFVC Program
 - Delinquent filer voluntary compliance program
- IRS EPCRS Program Revisions
 - Employee plans compliance resolution system

Recent Developments and Planning (Cont'd)

- Executive compensation audit program
- Fringe benefits planning
- Health reimbursement accounts
 - Revenue ruling 2002-41
 - Notice 2002-45
- Health savings accounts
- 419 welfare plans

Sarbanes-Oxley Act

- Overview of provisions
- Blackout provisions
- DOL interim regulations
- Investment advice
- Plan loans
- Effect on executive compensation

Retirement Savings Strategies Under the New Tax Law

Reaching Retirement Goals

↳ Recent Surveys

- 42% - Improved Job Market
- 31% - Upswing in Stock Market
- 8% - New Tax Law

New Tax Laws

- ↳ New tax laws can affect retirement planning and retirement savings allocations

New Strategies

- ↳ General Rule
 - Put your most highly taxed investments in tax-favored accounts and most tax-favored investments in taxable accounts.

New Strategies (Cont'd)

- ↳ How investments are taxed now
 - Interest from investments
 - Distributions from REITs
 - Distributions from mutual funds
 - Treasury bond interest
 - Index and tax-managed mutual funds
 - Municipal bond interest
 - Stocks

New Strategies (Cont'd)

- ↳ Traps with stocks
 - Distributions from retirement plans
 - Tax treatment of distributions

When Tax Deferral Pays

- ↳ Reasons it can still pay to own stocks in a 401 (k), Keogh, or IRA retirement plans even though lower rates do not apply to gains in plans.
 - You may be in a low tax bracket at retirement
 - 10-15%
 - The up-front deduction lets you save more
 - Tax-free compounding is still valuable
 - Security against creditors
 - Benefit of NUA – net unrealized appreciation

Time Left Until Retirement

- ↳ When young, buying stock through tax-deferred accounts instead of a taxable account may maximize future wealth, in spite of the higher tax rate that will be due on gains at the end. This is because of the power of compound earnings over a long period.

Time Left Until Retirement (Cont'd)

Taxable Account	1,000	$7,600 \times 15\% = 6,460$
401 (k) Account	1,500	$11,400 \times 33\% = 7,600$

(30 years, 7%)

Nearing Retirement

↪ Adjust your portfolio so the highest taxed investments are in nontaxable accounts and lowest taxed are in taxable accounts.

– Tactics

- Use NUA distributions to remove stock shares from 401 (k) plans.

Nearing Retirement (Cont'd)

– Tactics (cont'd)

- If stocks held in an IRA have been beaten down in value during the stock market slump, but you expect them to recover, consider withdrawing them in kind and holding them in a taxable accounts.
- Use future contributions to tax deferred plans to buy interest-paying investments.

Nonqualified Deferred Compensation Plans

- ↳ Distributions taxed as ordinary income
- ↳ Review implementation and participation in such plans

Options → Restricted Stock

- ↳ Restricted stocks vs. options
- ↳ Microsoft mix of restricted stock
- ↳ Vesting issues

Taxation of Restricted Stock

- ↳ 83 (b) election for restricted stock
- ↳ Future appreciation taxed at 15% rather than 35% at vesting
- ↳ Dividends paid on restricted stock taxed at 15% rate with election

Latest Regulatory and Legislative Developments

THANK YOU.