HMF Update

Hyden, Miron & Foster, PLLC

Cash Balance Plans: The New Retirement Kid on the Block

by Lyle D. Foster

Qualified retirement plans (i.e. 401(k), profit sharing, defined benefit, etc.) are an extremely important planning tool for businesses. These plans are becoming even more significant with rising incomes tax rates. Qualified retirement plans have many attractive features including: (1) contributions are income tax deductible, (2) contributions grow tax-deferred and therefore compound much faster, (3) contributions are protected from creditors and (4) employee retention. Qualified retirement plans typically come in two broad varieties: defined contribution plans and defined benefit plans.

Defined contribution plans. These types of plans may encompass deferrals based on an employees own contributions, (i.e. 401(k) plans) as well as employer contributions (i.e. employer matching contributions on deferrals, or employer profit sharing contributions or both) put in on behalf of an employee. Defined contribution plans are widespread. However, there are limitations for people who want to defer larger amounts of money. Defined contribution plans have a total limit, per participant, with deferrals and employer money, of $51,000 for the year 2013. For those owners that would like to defer a greater amount of money, there is a type of plan that has recently gained attention due to the Pension Protection Act of 2006 called the "cash balance plan."

Defined benefit plans. Traditional defined benefit plans promise to pay a pre-set formula of benefits to its participants at retirement. The formulas are difficult to grasp and funding can be less predictable. Traditional defined benefit plans have somewhat fallen out of favor in the last few years. However, with the enactment of the Pension Protection Act of 2006, a new variety of a defined benefit plan has gained noted popularity.

What is a cash balance plan? The cash balance variety of a defined plan is known as a "hybrid" plan because it operates like a defined benefit plan but has characteristics similar to a defined contribution plan. The draw to cash balance plans is primarily based upon the amount of deductible taxable income.

While defined contribution plans have a limit of $51,000 per year, it

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A View From the Cliff

by Lori L. Holzwarth

In last minute fashion, Congress and the President reached an agreement to avoid the taxation side of the "fiscal cliff" and passed sweeping tax reform legislation entitled the American Taxpayer Reform Act of 2012 (ATRA12). The tax reform was only half of the problem facing our government, as they still must tackle the budget cuts. This article is a summary of the income and estate/gift tax changes made by ATRA12.

For individual taxpayers, ATRA12 made permanent the Bush-era tax rates for all taxpayers except individuals with $400,000 taxable income, $450,000 for married taxpayers, and $425,000 for heads of households. A new top income tax rate of 39.6% was added for those individuals.

Capital gains and dividend tax rates were also increased to 20% (up from 15%) for these same taxpayers. Taxpayers below these thresholds will continue the capital gains and dividend tax rates of 0 to 15% previously in place. Qualified dividends continue to be taxed at the capital gains rate instead of as ordinary income.

ATRA12 permanently extends the marriage penalty relief by giving married couples double the standard deduction for a single person. A permanent patch to the Alternative Minimum Tax (AMT) was also included, with thresholds indexed for inflation so that middle-class taxpayers should not be at risk of AMT in the future.

A phase out of personal exemptions is new for 2013, starting at $300,000 for married couples, $275,000 for heads of households, $250,000 for single, and $150,000 for married filing separate. Under the phase out, the total personal exemption is reduced 2% for each $2,500 of the taxpayer's income over the threshold level.

The new law extended through December 31, 2013, the provisions allowing for a tax-free distribution from an IRA to public charities by individuals who are age 70½ or older, up to a maximum of $100,000 per year. This distribution may also be used to meet the taxpayers minimum required distributions for the year.

For businesses, ATRA12 extended through 2013 Section 179 small business expensing, bonus depreciation (some categories extended through 2014), Section 41 research tax credits, and Work Opportunity Tax Credits.

There were several estate and gift tax changes as well. The $5 million exclusion for taxable gifts and estates was made permanent and indexed for inflation starting in 2012. That means the exemption this year is $5.25 million. The maximum estate tax rate has been set at 40%. Portability, which allows surviving spouses to utilize a deceased spouse's unused exemption amount, has also been made permanent. ARTA12 extended provisions concerning qualified family owned business interests, installment payments for estate tax for closely-held businesses, and a repeal of the 5% surtax on estates larger than $10 million. ATRA12 extended the deduction for state estate taxes on the federal estate tax return. The amount that individuals may give as gifts per donee tax free each year is $14,000 for 2013.

So what should you do? Everyone should take out their estate planning documents and review them. For married couples with estates of less than $5 million, we may want to reconsider division of assets upon the first spouse's death. For larger estates, if the surviving spouse is planning on utilizing portability of the deceased spouse's unused estate tax exclusion amount, a timely estate tax return electing portability is required at the first spouse's death. It is vital to remember to return to your attorney upon your spouse's death. For older clients facing RMD's from their retirement plans, you should speak with your attorney about how a direct payment from your IRA to your charity could be more tax efficient than writing the check yourself.

If you have any questions about any of these changes, please give one of the attorneys at HYDEN, MIRON & FOSTER, PLLC a call.

Identity Theft and the IRS

by Jane F. Strike

Each year, the IRS reports increasing instances of identity theft in tax reporting. The filing of false returns has become a common criminal enterprise. Several of our clients at Hyden, Miron & Foster have reported having their identities stolen and false returns filed.

How does identity theft affect your taxes?

- Thieves use the stolen social security number to file a fraudulent return and receive a refund before the true taxpayer files a return.
- The identity thief uses the stolen social security number to apply for employment.

How do you know that your taxes have been affected by identity theft?

- You receive an IRS notice that more than one return has been filed for you.
- You did not file a return, but you receive notice of balance due from the IRS.
- The IRS sends you a notice of receiving wages from an employer that you do not know.

How should you respond to identity theft with the IRS? If you receive any notices from the IRS, respond quickly.

If you know you are a victim of identity theft and have not received any notices from the IRS, report the identity theft by calling the IRS Identity Protection Specialized Unit at 800-908-4490. After consulting with the IRS, complete an IRS Identity Theft Affidavit, Form 14039.

How is the IRS working to protect taxpayers from identity theft?

1. The IRS has developed filters to catch questionable returns.
2. The IRS has instituted a special review process when multiple refunds are sent to the same address or account.
3. The IRS issues an Identity Protection PIN to past victims of identity theft. This six-digit number allows legitimate returns to bypass filters and prevents processing delays.

How can I protect myself from becoming a victim of identity theft?

- Don't carry your social security card with you.
- Don't give out your social security number unless required.
- Check your credit report annually.
- Secure your personal and financial information at home.
- Secure your personal computers with anti-virus programs, firewalls, and updated passwords.
- Do not divulge personal information over the telephone, fax, mail, or internet unless you have confirmed the identity and legitimacy of the recipient.

If you are a victim of identity theft, please give of the attorneys at Hyden, Miron & Foster, PLLC a call to discuss your particular situation.

IRS Identity Protection Specialized Unit
(800) 908-4490

Internal Revenue Service Updates

by Laura G. Wiltshire

The Internal Revenue Service recently announced the annual adjustments to dollar limitations on benefits and contributions to retirement plans. The following is a summary of some of these changes:

- **Contributions to Qualified Retirement Plans**: The 2013 contribution limit is $17,500 for employees who participate in 401(k), 403(b), most 457 plans and the federal government's Thrift Savings Plan. The 2013 catch-up contribution limit for those employees who are aged 50 and over remains the same at $5,500.
- **Contributions to Traditional and Roth IRAs**: The 2013 contribution limit for traditional and Roth IRAs was increased to $5,500. The 2013 catch-up contribution limit remains the same at $1,000.
- **Contribution Phase-Out Limit Increase for Traditional IRAs**: The deduction for taxpayers making contributions to a traditional IRA is phased out for singles and heads of household who are covered by a workplace retirement plan and have modified adjusted gross income (AGI) between $59,000 and $69,000. For married couples filing jointly, in which the spouse who makes the IRA contribution is covered by a workplace retirement plan, the income phase-out range is $95,000 to $115,000. For an IRA contributor who is not covered by a workplace retirement plan and is married to someone who is covered by a workplace retirement plan, the deduction is phased out if the couple's income is between $178,000 and $188,000.
- **Contribution Phase-Out Limit Increase for Roth IRAs**: The AGI phase-out range for taxpayers making contributions to a Roth IRA is $178,000 to $188,000 for married couples filing jointly. For singles and heads of households, the income phase-out range is $112,000 to $127,000.
- **Increase in AGI Limit for Saver's Credit**: The AGI limit for the saver's credit (also known as the retirement savings contribution credit) for the low and moderate income worker is $59,000 for married couples filing jointly; $44,250 for heads of household; and $29,500 for married individuals filing separate and for singles.

The Internal Revenue Service also announced annual inflation adjustments for 2013, including tax rate schedules. Some of the highlights of these changes are:

- **Foreign Earned Income Exclusion:** The foreign earned income exclusion $97,600.
- **Standard Deduction**: The standard deduction is $6,100 ($12,200 for married couples filing jointly).
- **Itemized Deduction Limit**: The American Taxpayer Relief Act of 2012 added a limitation for itemized deductions for individuals with income greater than $250,000 ($300,000 for married couples filing jointly).
- **Earned Income Credit:** The maximum earned income credit amount is $6,044 for taxpayers filing jointly who have 3 or more qualifying children.

Optional Standard Mileage Rates for 2013:

- 56.5 cents per mile for business miles driven;
- 24 cents per mile driven for medical or moving purposes; and
- 14 cents per mile driven in gratuitous service of charitable organizations.

As an alternative to using the standard mileage rates, taxpayers may choose to calculate the actual cost of using their vehicle.

For more information regarding tax changes from the recently passed American Taxpayer Relief Act of 2012, contact one of the attorneys at HYDEN, MIRON & FOSTER, PLLC.

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is not uncommon for individuals to be able to deduct as much as $200,000 a year if placed into a cash balance plan. Coupled with a defined contribution plan, the deduction amount can approach $250,000 or more per year.

In general, defined benefit plans provide a specific benefit at retirement for each eligible employee; while defined contribution plan benefits provided to an employee depend on the amount of the employee and/or employer contributions, as well as the gains or losses of the account.

A cash balance plan on the other hand is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance rather than the amount of monthly benefit to be received at a set age. A cash balance plan defines benefits payable to the participants as either a percentage of pay or a flat dollar amount or a combination of both.

It is also possible to differentiate between different classes of employees in the cash balance plan. Some employees can have a higher contribution amount or percentage than others, if required tests are satisfied. Because of the way benefits are calculated, there is a "hypothetical account balance" that is generated for each participant. At the end of each year, the participant can see this hypothetical account balance.

How much can be saved? Age and salary determine the outcome. But, it is not uncommon for these deduction amounts to get as high as $250,000 per year for the owner. The deduction amount can be scaled back to meet the goals of the owner. Lastly, if the company has multiple owners, each owner can target a differing amount, making a cash balance plan customizable.

Why is a cash balance more beneficial than a traditional defined benefit plan? A cash balance plan is generally better received by plan sponsors and participants alike. Under a traditional defined benefit plan, the benefits payable are determined by a fixed calculable formula at normal retirement age. Because of the complex formula, employees, especially younger ones, have a difficult time equating the benefit amount being contributed annually on their behalf by their employer. However, in a cash balance plan, the formula is based on a percentage of pay or a flat dollar amount and the participant can actually see an "account balance." This is much easier to understand in the workforce than a traditional defined benefit plan. Cash balance plans are also easier to understand and therefore more predictable by the employer.

Are you a candidate for a cash balance plan? Generally speaking, cash balance plans are attractive for

high income earners and professional services. More specifically, the following characteristics are important:

- Owners who would like to contribute more than $51,000 per year into a retirement account;
- Companies that are relatively stable in their business plan model and have certain expected profits;
- Owners who are older than 40 years old;
- Companies that are already making a substantial contribution to a qualified retirement plan for participants.

Hyden, Miron & Foster, PLLC has been drafting qualified retirement plans, including cash balance plans for over 20 years. Give us a call today to discuss your retirement plan options.

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