

A Reprint from *Tierra Grande*

The 2001 Tax Act made retirement plans for self-employed workers significantly more attractive. Additional enhancements went into effect in 2002. This is good news for real estate brokers and sales associates operating as independent contractors because they are considered self-employed for tax purposes.

Self-employed individuals can choose from several retirement plans. They differ in complexity and in the amount of contribution allowed.

Traditional IRAs. The least complicated plans are traditional IRAs and Roth IRAs. Contributions to traditional IRAs provide a tax deduction in the year they are made, and all qualified withdrawals are taxable as ordinary income.

Contributions can be made to traditional IRAs until age 70½; withdrawals must begin after age 70½. Limits on contribution amounts are listed in the table. Qualified withdrawals may begin at age 59½ as well as under various other conditions. A 10 percent penalty plus regular income tax applies to unqualified withdrawals.

Roth IRAs. Contributions to Roth IRAs are nondeductible, but all qualified withdrawals are tax free. There is no age limit for contributions (contributions beyond age 70½ are allowed) and no mandatory withdrawals.

Traditional IRA and Roth IRA contribution limits. Contribution limits

on traditional and Roth IRAs will rise over time, as shown in the table. IRAs can be established for both the worker and a nonincome-earning spouse. Workers over age 50 are allowed to make additional contributions, called “catch-up contributions.”

For Roth IRAs (but not traditional IRAs), the maximum annual contribution is phased out for single individuals with adjusted gross income between \$95,000 and \$110,000 and for joint filers with adjusted gross income between \$150,000 and \$160,000. Various phase-out limits

Traditional IRA and Roth IRA Contribution Limits

Tax Year	Normal Contribution Limit	“Catch-up” Contribution Limit
2001	\$2,000	\$ 0
2002–2004	3,000	500
2005	4,000	500
2006–2007	4,000	1,000
2009+	Inflation-indexed	1,000

exist for traditional IRAs if brokers or their spouses participate in an employer-sponsored pension plan.

For example, assume a self-employed broker has \$100,000 net income from commissions in 2002 (\$110,000 total commissions less \$10,000 expenses), and the broker’s spouse does not earn income. Both are over age 50. The broker and the spouse each may deposit \$3,500 (\$3,000 plus a catch-up contribution of \$500) into either their traditional or Roth IRAs in 2002, for a total annual contribution of \$7,000.

SEP-IRA. Self-employed workers can establish a Simplified Employee Pension (SEP) IRA for themselves. The contributions are deductible and are made to the taxpayer’s traditional IRA account. The annual contribution limit is 13.0435 percent of net self-employed earnings. Contributions cannot exceed \$30,000 for 2002 (up from \$25,500 in 2001). Roth IRA contribution limits are not affected by SEP-IRA contributions. Thus, the self-employed broker from the previous example can deposit a deductible \$13,044 in a SEP-IRA (13.0435 percent of \$100,000) plus a total of \$7,000 in Roth IRAs.

SIMPLE-IRA. Starting in 2002, a self-employed person can make a deductible deposit of \$7,000 plus a matching deductible contribution of up to 3 percent of self-employment net income. For example, the self-employed broker discussed previously could contribute \$10,000 to a SIMPLE-IRA (\$7,000 plus 3 percent of \$100,000 net self-employment income, which equals \$3,000). Roth IRA contributions would still be available with the limits shown in the table (\$3,500 each for the broker and the spouse).

The \$7,000 SIMPLE-IRA contribution limit will rise by \$1,000 per year until it reaches \$10,000 in 2005. After 2005, the limit will rise with inflation.

Keogh. The deductible contribution limit for Keogh accounts in 2002 is the smaller of \$40,000 or 20 percent of taxable compensation. The \$40,000 limit will rise with inflation starting in 2003. While the contribution level is higher than the other plans described, Keogh plans are more complicated to establish and maintain over time.

A future column will address how individuals can self-direct IRA investments in real estate and other assets.

The optimal retirement strategy for one person may not be appropriate for another. Because of the complexity of retirement planning, consultation with an accountant or attorney is recommended. ♣

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