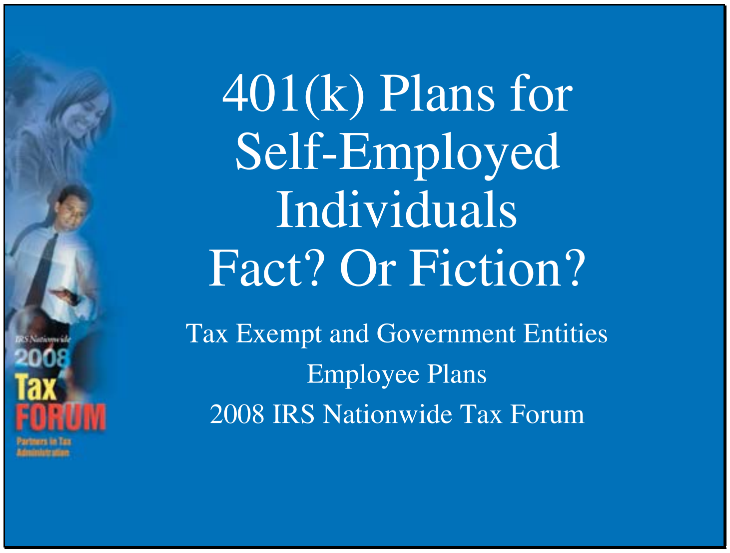
Slide 1



Good afternoon.

Introduce yourself and provide your qualifications for speaking.

This presentation, along with the notes, will be posted to our web site, www.irs.gov/ep, in September after the final Tax Forum in San Diego. So if you miss anything during my chat, please visit our web site to view this presentation, along with our other EP Tax Forum presentations.

Today I am going to talk to you about 401(k) plans for self-employed individuals. You may have heard these referred to as “Solo-ks” or “Uni-ks” or “one participant ks.” They are all different names for the same thing. They are all regular, plain-old, vanilla 401(k) plans that have one participant, who is a self-employed individual, or that person and his or her spouse. We have heard a lot of misinformation being disseminated about these plans and we would like to set the record straight. We want to let you know what is fact and what is fiction.

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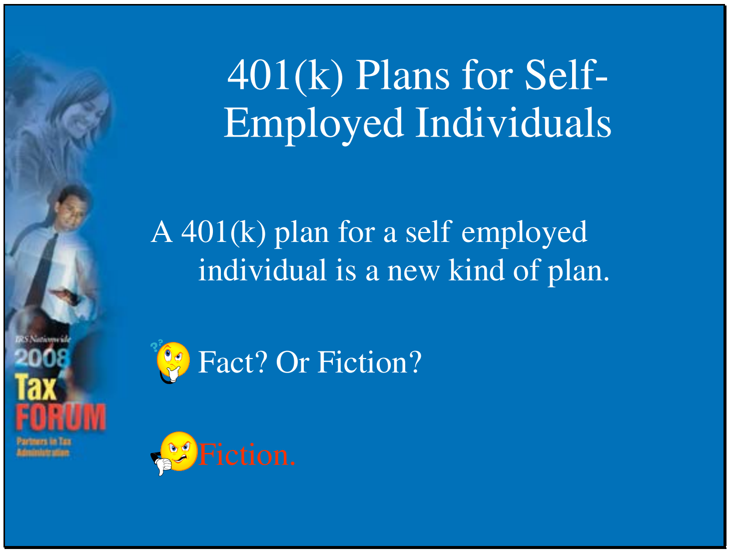


The "one-participant 401(k) plan" is not a new type of plan. It is a traditional 401(k) plan covering only one employee. The plans have the same rules and requirements as any other 401(k) plan. The surging interest in these plans is a result of the EGTRRA tax law change that became effective in 2002. The law changed how salary deferral contributions are treated when calculating the maximum deduction limits for contributions to a 401(k) plan. This change created an opportunity for some people to put away additional amounts toward their retirement. The marketing for this type of plan is aimed at business owners who do not have any employees, other than themselves and perhaps their spouse. Many of the advantages stressed by marketers of these plans vanish if the employer expands the business and hires more employees. No matter what the plan is called, it must meet the rules of the Internal Revenue Code. If employees are hired and they meet the eligibility requirements of the plan and the Code, they must be included.

Under prior law, the employer profit-sharing and matching contributions were combined with the employee deferral when determining the maximum deduction limit of 25% of employees' compensation. Now, since the tax law change, the employee deferrals are removed from the deduction limit calculation. Only the employer contributions are limited to less than or equal to 25% of the employees' compensation. The employee deferrals can be made in addition to the employer contributions.

In 2008, the employee deferral for a 401(k) plan is limited to the lesser of earned income or $15,500. This is called the 402(g) limit. If the employee is age 50 or older, an extra $5,000 may be deferred. This extra amount is called a "catch-up contribution." These deferrals can be either pre-tax or, if the plan allows, after-tax contributions. The after-tax deferrals are known as designated Roth contributions. We've been asked if a participant can defer $15,500 in pre-tax deferrals and an additional $15,500 in Roth contributions. The answer is "No." There is one limit per person for all types of elective deferrals. However, the $15,500 can be split in any ratio between the Roth and the pre-tax elective deferrals.

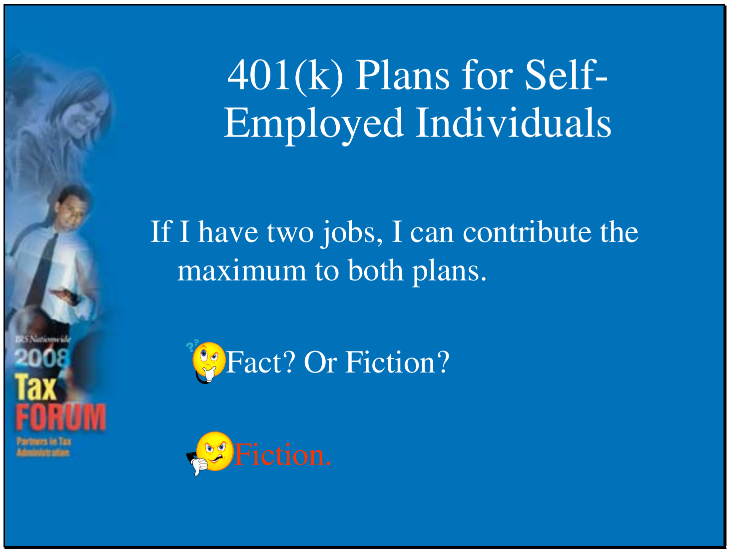
Another question that we often hear is how salary deferrals are made when a person is self-employed or involved in a partnership. The person doesn't usually know for certain what their income will be until the end of the year, or later. The final 401(k) regulations address this issue. The regulations state that a partner's or self-employed person's income is deemed available to them on the last day of their taxable year. And since an employee must have a deferral election in place before compensation is available, a self-employed person may not make a cash or deferred election with respect to compensation for a partnership or sole proprietorship taxable year after the last day of that year. If a partnership provides for cash advance payments paid to the partner during the taxable year that is based on the value of the partner's services prior to the date of payment (and which do not exceed a reasonable estimate of the partner's earned income for the taxable year), the individual can defer a portion of these advances even though their final compensation has not yet been determined. Obviously, if the self-employed person wants to maximize their contribution, they can't do so until their final compensation has been determined. That is o.k. as long as the election was in place as of the last day of the taxable year. Bottom line, self-employed participants may defer against “advances” or “draws.”

Keep in mind that at the end of the plan year, the deferrals still must be tested as an annual addition for the §415 limits. If the test fails then the excess amounts deferred would have to be corrected.

Lastly, employer contributions are not required to be made until the due date of the employer’s tax return, plus extensions. So, in the case of a sole proprietor, this is when the 1040 is due – October 15, if an extension was filed.

The IRS is not promoting these plans, nor are we saying these plans are bad. We simply suggest that employers use care when looking into any retirement arrangement to be sure the plan they decide on is right for them and that they look not only at the limits that apply to the plan but also at the limits that apply to themselves.

Slide 3



We have seen practitioners marketing these plans to self-employed persons who are also employed by a second company and participating in its plan offering elective deferrals. The 402(g) limits we just discussed in the prior slide ($15,500 and age-50-or-older catch-up of $5,000) are by person, not by plan. For example, Joe, aged 40, is employed by Company X, and participates in Company X's 401(k) plan. Joe defers the most allowed by Code section 402(g) for 2008, $15,500. He also has his own business with a 401(k). He will not be able to defer anything in the self-employed 401(k) for 2008. This is because the Code section 402(g) limit applies to the individual and he has already deferred the maximum allowed for the year.

It is also vital to keep in mind that the Code limits total contributions made to a defined contribution plan, including elective deferrals, to no more than $46,000 in 2008. (Note: the additional $5,000 catch-up contribution is not taken into account in determining this limit). An example of this will be shown later on in the presentation.

However, if the person is not a controlling shareholder of Company X, he can make non-elective employer contributions to his own plan up to the limits of that plan. Basically, non-elective employer contributions are all contributions to a plan other than matching contributions and the employee's elective deferrals. These employer contributions would be capped by the deduction and overall 415 limits – the lesser of 100% of compensation or $46,000 in 2008.

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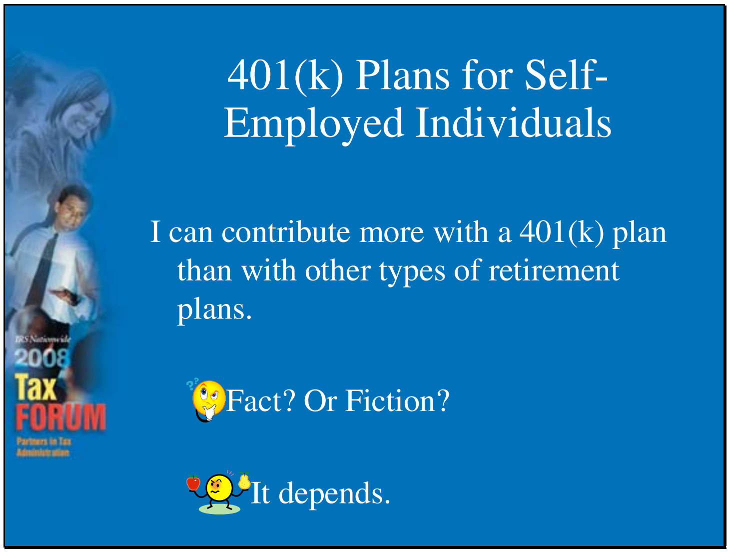

There are two basic types of retirement plans: defined contribution plans and defined benefit plans.

The first group is defined contribution plans. Defined contribution plans are the most common plans today. The ultimate retirement benefit in these plans depends on the amount of contributions that are made to the plan - either employer contributions or employee elective deferrals, or both - and the investment returns of the individual accounts in the retirement trust. In this type of plan, each year's contribution is defined either by dollar amount or by description. For example, a stated percentage of profits. The investment risk lies with the employees. One type of defined contribution plan is IRA-based plans, which include SEPs and SIMPLE IRA plans. SEPs have only employer contributions while SIMPLE IRA plans have both employer and employee contributions. These plans all use individual retirement arrangements to hold contributions made under the plan. They are fairly easy to set up and have few administrative requirements. Other common types of defined contribution plans are profit-sharing plans, including those with a 401(k) feature. These plans can be more flexible and, thus, more complex to administer than the IRA-based plans.

The final group is defined benefit plans, which provide an annual stated benefit commencing at retirement age. For example, the plan could provide a benefit formula of 75% of the average annual compensation earned in the 3 final years of employment. Another example might be 2% of final compensation times years of service. The annual contribution that the employer must make depends upon the make up of the workforce and investment returns. In this type of plan, the investment risk lies with the employer. An enrolled actuary must determine the amount of the required contribution each year. The contribution that is needed to fund the benefit of the plan must be made, regardless of employer profits. If the contribution is not made, there is an excise tax. If the self-employed individual doesn't have any money set aside for retirement and waits to set up a defined benefit plan until a few years from retirement, the required contribution into this type of plan can be much larger than with a 401(k). DB plans are more complex than defined contribution plans

My guess is that not too many of you in the audience are involved in defined benefit plans, so let's take them out of the mix and compare the maximum amount that a self-employed individual could put into a 401(k), SEP, or SIMPLE IRA plan in a year.

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401(k) Plans for Self-Employed Individuals

Example 1: Maximum contribution based on $50,000 W-2 comp, owner/employee age 50				
Plan Type	Contribution			
	EE	Catch-up	ER	Total
401(k)	$15,500	$5,000	$12,500	$33,000
SEP	$ 0	$ 0	$12,500	$12,500
SIMPLE	$10,500	$2,500	$1,500	$14,500

The following two examples will show how plan choice depends on the individual facts and circumstances of each employer – including compensation amounts. They will also show how the three separate, yet interrelated, contribution limits interact – the 402(g) deferral limit, the 404 deduction limit and the 415(c) individual limit. They also highlight that age 50 catch-ups can only be made through a plan that permits elective deferrals. SEPs are not eligible. Also, that the amount of the catch-up differs for a SIMPLE IRA plan than for a 401(k) plan.

To make things clearer, this example is based on a W-2 self-employed person, rather than a Schedule C individual. I know that this isn't exactly real world. Not many self-employed folks get a W-2. Bear with me here. Our point is to show the differences between these three types of plans using the same compensation. Schedule C sole-proprietors must do an added calculation starting with earned income to determine their maximum contribution, which, in effect, brings the maximum 25% of compensation limit down to 20% of earned income. We don't have the time during this presentation to walk you through the steps of the added calculation. A step-by-step worksheet for this calculation can be found in Pub 560 and many tax software products do the calculation automatically.

The individual in our example is age 50. So, the employee is eligible to make a catch-up contribution.

Note that the driving limit in this example is the 404 deduction limit on the employer contributions. The biggest difference is the fact that the 401(k) permits a $15,500 employee elective deferral and $5,000 catch-up in addition to the employer contributions, for a total contribution of $33,000. This is $20,500 more than the same person could contribute to a SEP.

Note that the SIMPLE IRA contribution is greater than the SEP contribution with these facts.

The SIMPLE IRA calculation for 2008 is the maximum employee elective deferral of $10,500 plus the maximum employee catch-up contribution of $2,500 plus the employer match of 3% of $50,000, or $1,500, for a total contribution to the SIMPLE IRA of $14,500.

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401(k) Plans for Self-Employed Individuals

Example 2: Maximum contribution based on $184,000 W-2 comp, owner/employee age 50				
Plan Type	Contribution			
	EE	Catch-up	ER	Total
401(k)	$15,500	$5,000	$30,500	$51,000
SEP	$ 0	$ 0	$46,000	$46,000
SIMPLE	$10,500	$2,500	$5,520	$18,520

Now, let's compare that with an example of a person, still over age 50, with W-2 compensation in the amount of $184,000. Even though, for 2008, compensation is limited to $230,000, the section 415 limit of $46,000 means that the maximum plan contribution is achieved with compensation of $184,000 ($46,000/25%).

At compensation above this amount, the results between a 401(k) and a SEP plan will not change – for an individual UNDER age 50. There is no difference between the two plans at and above the $184,000 compensation amount. In this example, the contribution is made up of the employee deferral ($15,500 plus the $5,000 catch-up contribution) and the employer contribution, which is limited to the individual section 415 limitation of $46,000 minus the non-catch-up employee deferral of $15,500, or $30,500. Note that the employer contribution could have been $46,000 and catch-up $5,000 for the same maximum.

The key point is that the only difference between the 401(k) and the SEP is the age 50 catch-up. If the individual was under age 50, there would be no difference between the maximum under the two plans.

Again, note the disparity between the SIMPLE IRA and both the 401(k) and SEP plans.

The $18,520 SIMPLE calculation is based on its maximum elective deferral of $10,500 plus the maximum age 50 catch-up of $2,500 and the required employer contribution of 3% of $184,000, or $5,520. (There is a difference, however, in the SIMPLE plan in that as compensation increases beyond $184,000, the 3% employer contribution will also increase as it is based on total compensation and is not limited by the Code section 401(a)(17) limits.)

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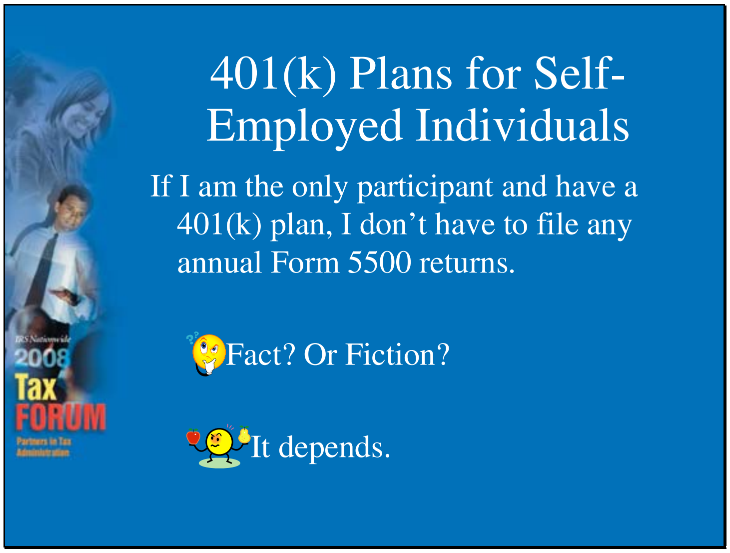

Again, this is not a yes/no answer. A Form 5500-EZ (or Form 5500) does not have to be filed for a plan year (other than the final plan year) that begins on or after January 1, 2007, if you have one or more one-participant plans that separately or together had total assets of $250,000 or less at the end of that plan year. In other words, if the assets of the plan or plans exceed $250,000, a Form 5500-EZ is required for a one-participant plan. The IRA-based plans almost never have an annual Form 5500 filing requirement, regardless of the value of the IRA assets.

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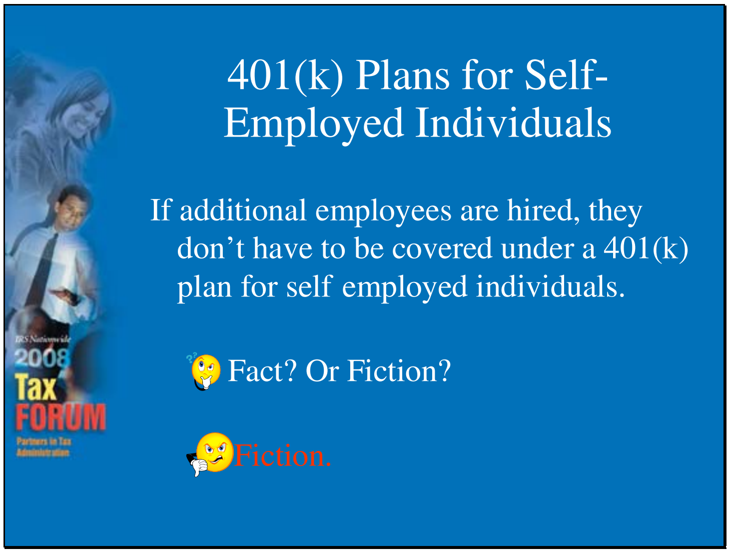

Just because the plan is called a Uni-k, or Solo-K, or whatever, it doesn’t mean that if the business is expanded and employees are added, the plan is only for one employee. If the new employee meets the eligibility requirements under the plan, then he or she will be required to enter the plan and be eligible for salary deferrals. Assuming that the new employee is a nonhighly compensated employee, the plan is now subject to nondiscrimination testing, known as the ADP and ACP tests. And what happens if the new employee decides that they don’t want to defer anything? Then the self-employed individual will not be able to defer anything. Zip. Zilch. Nada. The advantage of the 401(k) over a SEP evaporates.

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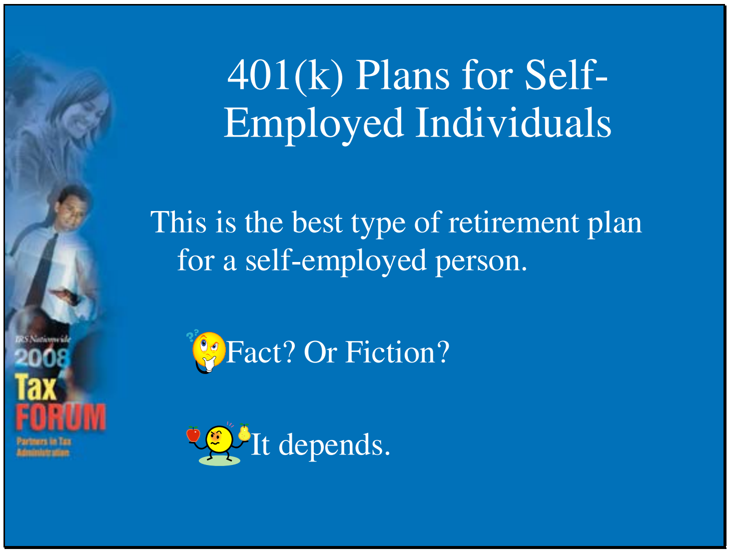

One size does not fit all when choosing a retirement plan for a self-employed person. Besides the compensation level, the owner should look at factors such as the size and type of the business and the employer goals for a retirement plan. Is the employer located in a spot where plan administration services are handy? If not, the employer may not want to adopt a defined benefit plan or a 401(k) plan, which need more administration than the IRA-based plans. Are the company earnings predictable or do they vary greatly from year to year? If they do vary a lot, a profit-sharing plan or a SEP are good choices if the employer wants to decide from year to year in making a contribution. A defined benefit plan may not be a good idea in this case, because a contribution is required every year and there is an excise tax when it is not made.

These are just a few of the items that an employer should think about when deciding which type of retirement plan to adopt. Please join us in our session later today/tomorrow on “Retirement Plan Choices for Self-Employed Individuals” for a more in-depth talk of the factors that an employer should think about before signing on the dotted line.

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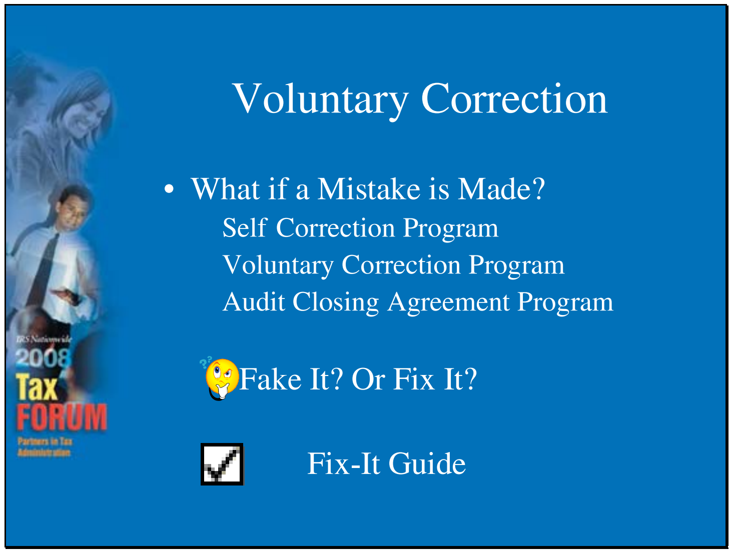

So what happens if your client has a 401(k) plan and a mistake is made in the operation of the plan? The Employee Plans Compliance Resolution System, or EPCRS, is a group of correction programs that can be used to correct a plan error. The Code is written in such a way that if a mistake is made in the operation of a plan, the difference between the plan being tax-qualified or not qualified is a bright line. Pass/Fail. Yes/No. So, under the letter of the law, if one mistake is made, no matter how minor, the plan loses its tax-exempt status and all favorable tax benefits that go with it. Fortunately, to remedy this harsh approach, the IRS has had an administrative policy since 1991 that allows a plan that has an error to fix the error retroactively and treat the plan as if it had met all the requirements. The Pension Protection Act of 2006 provided that the Treasury has the full authority to establish and implement the Employee Plans Compliance Resolution System, including the power to waive income, excise or other taxes and to ensure that any tax, penalty or sanction is not excessive and bears a reasonable relationship to the nature, extent and severity of a plan mistake. The Treasury is instructed to give special attention to the concerns and circumstances that small employers face with respect to compliance and correction of plan mistakes.

The IRS's helpful correction programs provide incentives for finding and correcting mistakes earlier rather than later. If an error is made in the plan's operation, the employer may want to correct the error using one of the IRS correction programs.

The IRS frequently finds the following mistakes in retirement plan examinations:
● not covering the proper employees
● not limiting employee deferrals and employer contributions to the proper maximum limits
● not keeping the plan document up to date for current law
● not operating the plan according to its terms
● using the correct compensation amounts

Mistakes don't get fixed by themselves. The IRS correction programs are structured to provide financial incentives for finding and correcting mistakes earlier rather than later. In fact, many mistakes can be corrected easily, without penalty and without notifying the IRS.

The IRS system of retirement plan correction programs, EPCRS, helps business owners protect participant benefits and keep their plans within the law.

EPCRS includes:

● Self-Correction Program (SCP) - With this program, you, or your client can find and correct a mistake before an examination. It will cost less if you find the error and fix it. A problem found within two years of when it first occurred can often be self-corrected. If an error has continued for longer than 2 years, your client may have to pay a fee.
● Voluntary Correction Program (VCP) - You may correct the plan's mistakes with help from the IRS. There is a fee involved with this program.

● Audit Closing Agreement Program (Audit CAP) - If the IRS examines the plan and finds an error, the problem can still be corrected. The fee will be larger than if you or your client had found and fixed the error under the Self-Correction Program or the Voluntary Correction Program.

We have additional information on the IRS Correction Programs on our web site under “Correcting Plan Errors.” Also, you can either stop by our booth and pick up or order on-line our Pub 4050, *Retirement Plans Correction Programs CD-ROM.*

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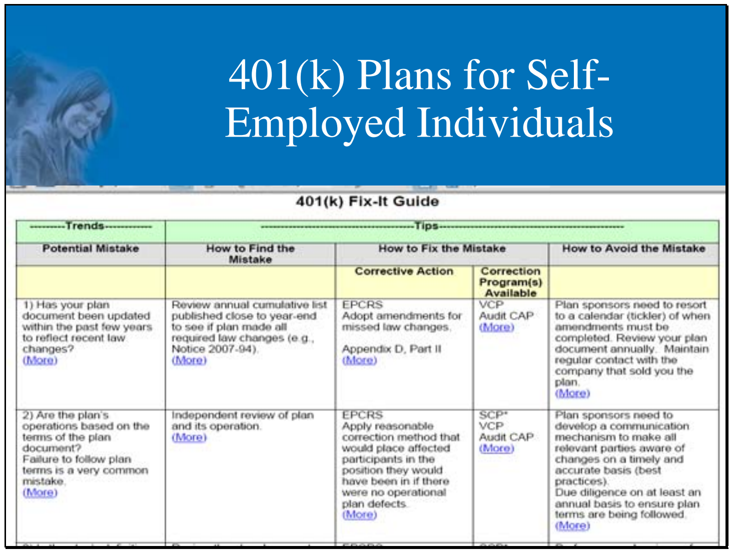

401(k) Fix-It Guide

---------Trends------------	------------Tips------------			
Potential Mistake	**How to Find the Mistake**	**How to Fix the Mistake**		**How to Avoid the Mistake**
		Corrective Action	**Correction Program(s) Available**	
1) Has your plan document been updated within the past few years to reflect recent law changes? (More)	Review annual cumulative list published close to year-end to see if plan made all required law changes (e.g., Notice 2007-94). (More)	EPCRS Adopt amendments for missed law changes. Appendix D, Part II (More)	VCP Audit CAP (More)	Plan sponsors need to resort to a calendar (tickler) of when amendments must be completed. Review your plan document annually. Maintain regular contact with the company that sold you the plan. (More)
2) Are the plan's operations based on the terms of the plan document? Failure to follow plan terms is a very common mistake. (More)	Independent review of plan and its operation. (More)	EPCRS Apply reasonable correction method that would place affected participants in the position they would have been in if there were no operational plan defects. (More)	SCP* VCP Audit CAP (More)	Plan sponsors need to develop a communication mechanism to make all relevant parties aware of changes on a timely and accurate basis (best practices). Due diligence on at least an annual basis to ensure plan terms are being followed. (More)

We have recently posted a new web-based tool on our web site for sponsors of 401(k) plans. This compliance tool helps 401(k) plan sponsors find, fix, and avoid common errors. The tool, we call the "**401(k) Fix-It Guide**," includes a chart that identifies 11 problem areas in 401(k) retirement plans, including:

- plan document updates;
- plan operation;
- definition of compensation;
- nondiscrimination test failures; and
- excess deferrals.

The chart leads you to a series of questions, tips, and examples that can help you pinpoint potential errors. And if you uncover a mistake, it describes the various correction programs available under the Employee Plans Compliance Resolution System and includes an explanation of how to correct the mistake. The chart also provides tips on avoiding the mistake to facilitate ongoing and future plan compliance.

The chart can be found on our web site, www.irs.gov/ep, by selecting "Types of Plans" in the left pane and then "401(k) Fix-It Guide" under 401(k) plans.

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We at the IRS have developed many tools to assist you and your clients in the retirement plan area, whether your question is "How do I choose a retirement plan?" or "How much money can I contribute to my retirement plan?" or "This plan isn't working for me anymore. How do I terminate it?"

You can visit our web site at www.irs.gov/ep. The Retirement Plans Community web page can be found on the main www.irs.gov landing page. You will find information for "Benefits Practitioner," "Plan Participant/Employee" and "Plan Sponsor/Employer." The pages are populated with all of the retirement plan information that you have come to expect from EP. You will find many 401(k) plan resources on our web pages, including our 401(k) checklist, our joint publication with the Department of Labor, *401(k) Plans for Small Businesses*, and our Designated Roth Accounts publication. These can all be found at our booth in the Exhibit hall as well.

There are two different ways that you can discuss your questions with a retirement plan specialist. You can call our Customer Account Services at (877)

829-5500. This is a toll-free number. The call center is open 8:30 a.m. to 4:30 p.m. Eastern Time.

If you would prefer, you can e-mail your questions to RetirementPlanQuestions@irs.gov. All questions submitted via e-mail must be responded to via telephone, so please remember to include your phone number in your message and a customer service representative will call you with the answer to your questions.

Finally, we have two free newsletters that you can subscribe to. The first is the *Employee Plans News*. This newsletter is geared toward the practitioner community and is more technical and involved than our newsletter geared toward plan sponsors, *Retirement News for Employers*. Each is an electronic newsletter and is posted on our web site as a PDF document each quarter. Being a web-based product, the newsletters make an excellent reference guide, as they are chock-full of embedded links to guidance sources, products and other sites.

Subscribing to these newsletters will keep you and your clients abreast of all the latest news regarding retirement plans, legislation, trends, and tips on various subjects, as well as keeping you informed of the latest product releases from the office of Employee Plans Customer Education & Outreach!

Subscribing is easy. Just go to “Newsletters” under our web page, www.irs.gov/ep, click on “Employee Plans News” or “Retirement News for Employers,” click on “Subscribe,” then provide us with your e-mail address. That’s all it takes

You will receive a message in your e-mail inbox alerting you to when our latest issues or Special Editions are posted on our web page with a link directing you to the newsletter when you are ready to read it.

Please be sure to attend our presentation on “Retirement Plan Choices for Self-Employed Individuals,” which will discuss in greater detail the different types of retirement plans available for self-employed individuals and how to choose the right one for their business.

Thank you for your attention and please stop by the TE/GE booth for additional retirement plan information.