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AUGUST 2004

**IMPORTANT CHANGES**

**Deemed IRA under a qualified plan.**

For plan years beginning after 2002, a qualified plan can maintain a separate account or annuity under the plan to receive voluntary employee contributions. If the separate account or annuity otherwise meets the requirements of a traditional IRA or Roth IRA, it is deemed a traditional IRA or Roth IRA. A deemed IRA is subject to IRA rules and not to qualified plan rules. Also, the deemed IRA and contributions to it are not taken into account in applying qualified plan rules to any other contributions under the plan. Voluntary employee contributions must be designated as such by employees covered under the plan. They are includible in income. If you want to provide for a deemed IRA, you will have to amend your plan. For information on amending the plan, see Revenue Procedure 2003-13 in Internal Revenue Bulletin 2003-4.

**Elective deferrals.**

The limit on elective deferrals increases to \$12,000 for tax years beginning in 2003 and then increases \$1,000 each tax year thereafter until it reaches \$15,000 in 2006. These new limits will apply for participants in SARSEPs, 401(k) plans (excluding SIMPLE plans), and deferred compensation plans of state or local governments and tax-exempt organizations. The \$15,000 figure is subject to cost-of-living increases after 2006. Catch-up contributions. A plan can permit participants who are age 50 or over at the end of the calendar year to also make catch-up contributions. The catch-up contribution limit for 2003 is \$2,000. This limit increases by \$1,000 each year thereafter until it reaches \$5,000 in 2006. The limit is subject to cost-of-living increases after 2006. The catch-up contribution a participant can make for a year cannot exceed the lesser of the following amounts.

- ◆ The catch-up contribution limit.
- ◆ The excess of the participant's compensation over the elective deferrals that are not catch-up contributions.

**SIMPLE plan salary reduction contributions.**

The limit on salary reduction contributions to a SIMPLE plan increases to \$8,000 beginning in 2003 and then increases \$1,000 each tax year thereafter until it reaches \$10,000 in 2005. The \$10,000 figure is subject to adjustment after 2005 for cost-of-living increases. Catch-up contributions. A SIMPLE plan can permit participants who are age 50 or over at the end of the calendar year to make catch-up contributions. The catch-up contribution limit for 2003 is \$1,000. This limit increases by \$500 each year thereafter until it reaches \$2,500 in 2006. The limit is subject to cost-of-living increases after 2006. The catch-up contributions a participant can make for a year cannot exceed the lesser of the following amounts.

- The catch-up contribution limit.

· The excess of the participant's compensation over the salary reduction contributions that are not catch-up contributions.

#### **Important Reminders**

**Credit for startup costs.** You may be able to claim a tax credit for part of the ordinary and necessary costs of starting a SEP, SIMPLE, or qualified plan. The credit equals 50% of the cost to set up and administer the plan and educate employees about the plan, up to a maximum of \$500 per year for each of the first 3 years of the plan. You can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective. You must have had 100 or fewer employees who received at least \$5,000 in compensation from you for the preceding year. At least one participant must be a non-highly compensated employee. The employees generally cannot be substantially the same employees for whom contributions were made or benefits accrued under a plan of any of the following employers in the 3-tax-year period immediately before the first year to which the credit applies.

1. You.
2. A member of a controlled group that includes you.
3. A predecessor of (1) or (2).

The credit is part of the general business credit, which can be carried back or forward to other tax years if it cannot be used in the current year. However, the part of the general business credit attributable to the small employer pension plan startup cost credit cannot be carried back to a tax year beginning before January 1, 2002. You cannot deduct the part of the startup costs equal to the credit claimed for a tax year, but you can choose not to claim the allowable credit for a tax year. To take the credit, get Form 8881, *Credit for Small Employer Pension Plan Startup Costs*, and the instructions.

**Retirement savings contributions credit.** Retirement plan participants (including self-employed individuals) who make contributions to their plan may qualify for the retirement savings contributions credit. The amount of the credit is based on the contributions participants make and their credit rate. The maximum contribution eligible for the credit is \$2,000. The credit rate can be as low as 10% or as high as 50%, depending on the participant's adjusted gross income. The credit also depends on the participant's filing status. Form 8880, *Credit for Qualified Retirement Savings Contributions*, and the instructions explain how to claim the credit.

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#### **A Fact Sheet on Reverse Mortgages**

Until recently, there were two main ways to get cash from your home:

- you could sell your home, but then you would have to move; or
- you could borrow against your home, but then you would have to make monthly loan repayments.

Now reverse mortgages give you a third way of getting money from your home. And you don't have to leave your home or make regular loan repayments.

A reverse mortgage is a loan against your home that you do not have to pay back for as long as you live there. It can be paid to you all at once, as a regular monthly advance, or at times and in amounts that you choose. You pay the money back plus interest when you die, sell your home, or permanently move out of your home.

#### **Who's Eligible**

All owners of the home must apply for the reverse mortgage and sign the loan papers. All borrowers must be at least 62 years of age for most reverse mortgages. Owners generally must occupy the home as a principal residence (where they live the majority of the year). Single-family one-unit dwellings are eligible properties for all reverse mortgages. Some programs also accept 2-4 unit owner-occupied dwellings, along with some condominiums, planned unit developments, and manufactured homes. Mobile homes and cooperatives are generally not eligible.

### **How They Work**

Reverse mortgage loans typically require no repayment for as long as you live in your home. But they must be repaid in full, including all interest and other charges, when the last living borrower dies, sells the home, or permanently moves away.

Because you make no monthly payments, the amount you owe grows larger over time. As your debt grows larger, the amount of cash you would have left after selling and paying off the loan (your "equity") generally grows smaller. But you can never owe more than your home's value at the time the loan is repaid.

Reverse mortgage borrowers continue to own their homes. So you are still responsible for property taxes, insurance, and repairs. If you fail to carry out these responsibilities, your loan could become due and payable in full.

### **What You Get**

These loans can be paid to you all at once in a single lump sum of cash, as a regular monthly loan advance or as a credit line that lets you decide how much cash to use and when to use it. Or you may choose any combination of these payment plans. Some reverse mortgages are offered by state and local governments. These "public sector" loans generally must be used for specific purposes, such as paying for home repairs or property taxes. Other reverse mortgages are offered by banks, mortgage companies, and savings associations. These "private sector" loans can be used for any purpose. The amount of cash you can get from a private sector reverse mortgage generally depends on your age, your home's value and location, and the cost of the loan. The greatest cash amounts typically go to the oldest borrowers living in the most expensive homes on loans with the lowest costs.

The amount of cash you can get also depends on the specific reverse mortgage plan or program you select. The differences in available loan amounts can vary greatly from one plan to another. Most homeowners get the largest cash advances from the federally insured Home Equity Conversion Mortgage (HECM). HECM loans often provide much greater loan advances than other reverse mortgages.

### **What You Pay**

The lowest cost reverse mortgages are offered by state and local governments. They generally have low or no loan fees, and the interest rates are typically low or moderate as well. Private sector reverse mortgages include a variety of costs. An application fee usually includes the cost of an appraisal and a credit report. Other loan costs typically include an origination fee, closing costs, insurance, and a monthly servicing fee. These costs generally can be paid with loan advances, which mean they are added to your loan balance (the amount you owe). Interest is charged on all loan advances. Reverse mortgages are most expensive in the early years of the loan, and then become less costly over time. The cost can be very high in the short term, and is least costly if you live longer than your life expectancy. The federally insured Home Equity Conversion

Mortgage (HECM) is almost always the least expensive private sector reverse mortgage. Consumers considering a private sector reverse mortgage other than a HECM should carefully consider how much more it is likely to cost before applying.

**Taxes, Estates, and Public Benefits**

Reverse mortgages may have tax consequences, affect eligibility for assistance under Federal and State programs, and have an impact on the estate and heirs of the homeowner.

An American Bar Association guide states that generally "the IRS does not consider loan advances to be income."

(2003, 03). A fact sheet on reverse mortgages. Message posted to AARP, archived at <http://www.aarp.org/revmort-basics/Articles/a2003-03-21-revmortfactsheet.html>