StatonWalsh

Financial Clarity Through Transparency

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Keogh Plans

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Keogh plans are retirement plans for self-employed individuals, e.g., sole proprietors, partners in a partnership,[1] and employees of either. The differences between Keogh plans and corporate sponsored plans are small and are limited to different tax treatment of life insurance.

The Basics of Keogh Plans

- **Plan type:** A Keogh plan may be either a defined contribution plan or a defined benefit plan[2].
- **Defined contribution plans:** In 2023, contributions for individual participants may not exceed the lesser of 100% of includable compensation[3] or $66,000 per year. At the employer level, no more than 25% of the covered compensation of all participants may be deducted. Thus, if the Keogh plan covers only one participant, the effective contribution limit becomes 25% of the includable compensation[3] of the business owner,[4] not to exceed $66,000.
- **Defined benefit plans:** For defined benefit plans, the plan actuary determines the contributions. The deduction for contributions to a defined benefit plan may not exceed net self-employment income. In some circumstances, the required contribution may exceed the allowable deduction. The nondeductible portion of the contribution may be carried over as a deduction in future years.
- **Benefit limits:** Defined benefit Keogh plans are subject to the same percentage of average compensation and dollar limits that apply to all defined benefit plans. For 2023, these figures are 100% and $265,000.
- **Framework:** May use a trust, a custodial account or an insurance company annuity.

[1] A partner who owns more than 10% of the capital or profits of the partnership is considered to be an owner-employee. See Reg. Sec. 1.401-10(d).

[2] The term "Keogh" plan is largely obsolete since all entities can sponsor the same plans.

[3] The "net" self-employment income of the owner or partner, less the contribution and the deduction allowed for one-half of the self-employment tax. For 2023, $330,000 is the maximum income that may be considered.

[4] This is the same as 20% of the gross pre-contribution net income.

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- **Evidence of plan:** The plan must be in writing and meet certain coverage and non-discrimination requirements for present and future employees.

- **Distributions:** Distributions are generally taxed as ordinary income. Distributions prior to age 59½ may also be subject to a 10% income tax penalty, unless the distribution meets one of the exceptions listed in IRC Sec. 72(t). Except for more-than-5% owners, required minimum distributions (RMDs) must begin by April 1 of the later of (a) the year following the year the participant reaches age 72, or (b) the year following the year in which the participant retires. More-than-5% owners must begin to receive distributions by April 1 of the year following the year they reach age 72.[1]

- **Phased retirement:** Federal law allows retirement distributions to employees who are at least age 59 ½ even if they have not separated from employment at the time distributions begin.[2]

- **Available payment plans**

  - Lump-sum distribution.

  - Lifetime of the participant (and spouse if desired).

  - Fixed period of years not to exceed the participant's life expectancy or the joint life expectancy of the participant and a designated beneficiary (see IRC Sec. 401(a)(9)).

- **Other plans:** A participant in a Keogh plan may also have a traditional, deductible IRA (subject to certain income level limitations based on filing status), a traditional, nondeductible IRA, or a Roth IRA.

- **Taxation:** Distributions are generally taxed as ordinary income. Special 10-year income averaging may be available for certain individuals.[3]

- **401(k) feature:** A 401(k) feature may be added, if desired, to a profit sharing plan.

[1] The age 72 "trigger" date applies to distributions required to be made after December 31, 2019, to individuals who reach age 70½ after that date. Under prior law, age 70½ was the mandated age for beginning RMDs.

[2] If allowed by the plan; prior to 2020, federal law required employees to be at least age 62.

[3] Those born before 1936 may be able to elect 10-year averaging or capital gain treatment; these strategies are not available to those born after 1935.

- **Allocation methods:** The same kinds of allocation methods that are available under an employer-sponsored defined contribution plan are also available under a Keogh plan. These can be age-weighted, tiered, or integrated with Social Security.

- **Participant loans:** Participant loans are permitted without any adverse consequences, provided they follow the regular rules for participant loans.

- **Top-heavy defined contribution plans:** If more than 60% of plan assets are allocated to key employees,[1] non-key employees must receive the same percentage contribution as that received by the key employee with the highest contribution percentage. This requirement applies only to a contribution of up to the first 3% of includable compensation; a higher contribution may be required in some instances, such as when the plan is combined with a defined benefit plan.

- **Top-heavy defined benefit plans:** If more than 60% of the accrued benefits are attributable to key employees,[1] the plan must provide a minimum level of retirement benefits. This is 2% of compensation at retirement for each year of participation, not to exceed 10 years (20%).

- **Federal bankruptcy law:** ERISA and federal bankruptcy law provide significant protection from creditors to participant accounts or accrued benefits in tax-exempt retirement plans.

Coronavirus Aid, Relief, and Economic Security (CARES) Act

- **Coronavirus-related distribution (CRD):** One section of the Coronavirus Aid, Relief, and Economic Security (CARES) Act provided for a “Coronavirus-related distribution,” or CRD. A CRD – optional (not mandatory) for a qualified retirement plan sponsor – was a distribution made from January 1, 2020, through December 30, 2020, from an IRA or qualified retirement plan. A CRD could not exceed $100,000 in aggregate per individual, was exempt from the usual 20% mandatory federal income tax withholding, and must have been made to an individual (or spouse or dependent) who was diagnosed with SARS-CoV-2 or COVID-19, or who experienced an adverse

[1] A “key” employee is someone who, at any time during the plan year was: (1) an officer of the employer whose compensation from the employer exceeded $215,000; or (2) a more than 5% owner; or (3) a 1% owner whose compensation from the employer exceeded $150,000.

financial consequence as a result of the COVID-19 pandemic. A CRD was exempt from any 10% early withdrawal penalty that may have applied and, unless the individual chose otherwise, the CRD could be included in taxable income ratably over a three-year period. A CRD may be re-paid, without regard to the normal contribution limits, over a three-year period.

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Assumed rates of return are not in any way to be taken as guaranteed projections of actual returns from any recommended investment opportunity. The actual application of some of these concepts may be the practice of law and is the proper responsibility of your attorney.

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