

**RETIREMENT PLANNING & EMPLOYEE BENEFITS FOR FINANCIAL PLANNERS
4TH EDITION UPDATES**

CHAPTER 8

Example 8.8, Page 374

Jack has Schedule C net income of \$200,000 and wants to know the maximum amount he can contribute to a Keogh profit sharing plan. In this instance Jack can contribute \$38,199.57 to the plan. The contribution is calculated as follows:

1. Calculate the self-employed individual's contribution rate:

$$\text{Self-Employed Contribution Rate} = \left(\frac{25\%}{1 + 25\%} \right)$$

$$\text{Self-Employed Contribution Rate} = 20\%$$

2. Calculate Self-Employment Tax:

| | | | |
|--|--------------------|---|--|
| | \$200,000 | Net Self-Employment Income | |
| | x 0.9235 | Times: 92.35% | |
| | \$184,700 | | Net Earnings subject to Self-Employment Tax |
| | x 15.3%/2.9% | Times: 15.3% up to <u>\$102,000</u> + 2.9% over <u>\$102,000 (\$82,700)</u> | |
| | <u>\$18,004.30</u> | | Equals: Self-Employment Tax (<u>\$15,606</u> + <u>\$2,398.30</u>) |

3. Calculate the self-employed individual's contribution:

| | | | |
|--|---------------------|--|---|
| | \$200,000 | Net Self-Employment Income | |
| | <u>\$9,002.15</u> | Less: ½ of Self-Employment Taxes (50% x <u>\$18,004.30</u>) | |
| | <u>\$190,997.85</u> | | Equals: Adjusted Net Self-Employment Income |
| | x 0.20 | Times: Self-Employed Contribution Rate | |
| | <u>\$38,199.57</u> | | Equals: Self-Employed Individual's Qualified Plan Contribution |

Check figure:

$$\frac{\underline{\underline{\$38,199.57}}}{\underline{\underline{\$190,997.85}} - \underline{\underline{\$38,199.57}}} = 25\%$$

Example 8.9, Page 375

Thus, in the example above, Jack's earned income is calculated as follows:

| | |
|---------------------------|--|
| \$200,000 | Schedule C net income |
| - <u>\$9,002.15</u> | Less: ½ self-employment taxes |
| - <u>\$38,199.57</u> | Less: Keogh contribution |
| <u>\$152,799.28</u> | Earned income |
| x 0.25 | Times: 25% to determine Keogh contribution |
| <u><u>\$38,199.57</u></u> | Total Keogh contribution |

Notice that the maximum Keogh contribution is exactly 25% of the earned income.