taking some positions which are supported by the statute, while others are not. No one knows exactly what regulations will result in many of these areas. When they do come out, they will be sufficiently complex to cause record-keeping problems. We will be spending a great deal of time, money, and effort pursuing something which I feel could better be handled in some other way.

II.

EDWARD F. MARTIN*

Mr. Benjamin and I have divided the subject matter, and it's my turn to spend some time on employee benefits, particularly qualified plans since this is an important part of your tax planning and the reason why you incorporated, if you did incorporate. First of all, my impression is that you are all either sole proprietors or one-person corporations, and that you do not have other employees except maybe a secretary.

Qualified plans have been a superb tax shelter, and they continue to be a pretty good idea. As you know, you get a deduction for the money going in and you have the tax-free buildup in the value of the trust. The benefits when distributed in a lump sum may be eligible for special tax averaging. There are drawbacks if you have employees since there are some discrimination rules with which you have to comply.

An initial question is: Are qualified plans still a good deal, considering the lower tax brackets? With the different tax scene that we're living with now and the calculations I have seen, the answer is yes, it still makes sense, considering the benefits from getting deductions now and the tax-free buildup you end up with. Even if you have to pay taxes at ordinary rates when you receive the benefits, you'll end up with more money when you retire than if you don't have the plan. However, the 1986 Act has tightened the screws in a lot of ways to limit excessive use of qualified plans for the tax benefits that I have described.

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Defined Contribution Plans

Defined contribution plans—the profit-sharing plan and the money-purchase pension plans—still are subject to the $30,000 annual contribution limitation, that is, the lesser of $30,000 or 25 percent of compensation. Probably that's going to stay that way for a long time.

If you have an employee, some of the new rules require you to provide more benefits for that employee. You can still integrate a defined contribution plan with Social Security. But after 1988 the rate of contribution as a percentage of the Social Security wages must be at least 50 percent of the rate of contribution applied to compensation in excess of the Social Security wage base. So, you cannot have an integrated plan with little or nothing contributed for the lower paid employee.

You probably all have top-heavy plans, and I expect you are already aware of the accelerated vesting requirement.

You may well have a plan that requires, say, three years of service to become a participant, with immediate 100 percent vesting. After 1988 you can require only two years of service to become a participant in a 100 percent vested plan.

The 25 percent rule that I mentioned is a limitation on the amount that you may allocate to your account. As far as deductibility is concerned, you still have the rule that for a profit-sharing plan the limit is 15 percent, and for a money-purchase pension plan or a combination of the two, the limit is 25 percent.

A change has been made with respect to profit-sharing plans. Formerly, if you did not contribute the maximum of 15 percent, you could carry over to future years and contribute more than 15 percent. But you will not be able to do that after 1986 except for carryovers that come from years before 1987.

To discourage the use of qualified plans for tax-free buildup, several things have been done. One of them is to discourage voluntary contributions. You may be contributing up to the maximum deductible amount and then also putting in some extra funds, even though they can't be deducted, because they can be invested on a tax-deferred basis and you can pull out the contributions anytime you want to without any tax as long as you leave in the earnings. That's discouraged now by a couple of changes made last year. One is that 100 percent of your non-deductible contributions will be included as part of your $30,000

annual contribution limitation. Thus, if you put in $5,000 of nondeductible contributions and you are highly compensated, you will be able to contribute on a deductible basis only $25,000. Furthermore, there is a new rule that, as to voluntary contributions made after 1986, anytime you make a withdrawal from the plan, there will be a pro-rata allocation between your contribution and the earnings, so there will be a tax on the withdrawal. My own view is that voluntary contributions probably shouldn't be made any more.

Furthermore, there are problems if you have an employee because there is a new discrimination test—the same as the discrimination test on 401(K) plans—which makes it impossible for highly paid employees to make substantial voluntary contributions unless the lowest paid employee is also making voluntary contributions at close to the same rate.

And, of course, the 1986 Act further discourages tax-deferred deductible contributions with respect to IRAs. As you know, if you are earning more than $50,000 and you are married, you cannot make a deductible IRA contribution anymore. The 401(K) plans have also been limited, but, since they are not widely used by you, I am not going to discuss them. If anyone has a 401(K) plan, check with me later.

Defined Benefit Plans

Looking at defined benefit plans, the deductibility rules have been substantially changed, and much for the worse, so far as being able to make deductible contributions. As you know, when you have a defined benefit plan, you must employ an actuary to tell you how much you may put in on a deductible basis to fund a benefit at your expected retirement age. If you start funding a plan like that at an older age (and generally I mean about age 45 or older), you will probably be able to deduct more than $30,000 a year. Therefore, defined benefit plans often have been used to allow larger deductible contributions than a defined contribution plan allows. Now the ability to make those contributions is much impaired.

The maximum benefit at normal retirement date is still $90,000 or 100 percent of pay, whichever is less. Several things have been changed, however. First, starting in the year 2005, the Social Security retirement date is going to be moved up to age 66

and then to age 67. The normal retirement date for defined benefit plans will also be moved back, so that the $90,000 benefit will be based on retirement at age 67 for you younger people.

If you retire before the normal retirement date, whatever it will be for you, the maximum benefit is reduced to less than $90,000. Under the 1986 Act, early retirement maximum benefits are much less than what they were. For instance, whereas before it was possible to fund a $90,000 benefit at age 62, now you may fund only a $72,000 benefit. And where the benefit at age 55 could have been $75,000, it may now be only $40,000. Obviously, these lower benefit limits reduce the allowable contributions substantially.

If you have a defined benefit plan, where you have already funded to pay a larger benefit, you don't have to reduce your accrued benefits, however. You are grandfathered, and you may continue in the knowledge that the plan will pay you that accrued benefit, but you may not accrue any additional benefits. If you have reached a fully funded situation, you may also be unable to contribute to a defined contribution plan. You may no longer be able to make deductible contributions to any qualified plan.

If you have a fully funded defined benefit plan, as long as that plan remains in existence, even though you make no more contributions to it, it continues to be a plan for which you must make annual reports to the IRS on Form 5500. So it will continue to be a nuisance for you until you retire and take that benefit out. You might instead terminate the plan and purchase for yourself an annuity benefit beginning at retirement. If you have a surplus in the plan and the surplus comes back to you or to your corporation, you will pay ordinary income tax on the surplus, plus a 10 percent excise tax.

If you're in the early stages of a defined benefit plan and are expecting a substantial deduction for your contributions, be very careful about how your actuary computes the amount you contribute. If your actuary makes assumptions that are very conservative (which means that they appear to justify a very large contribution), the IRS may attack these assumptions. If the IRS prevails and you have contributed more than you are allowed to contribute and take a deduction for, you will not only lose the deduction but also pay as much as a 30 percent penalty tax.

I tell you that the new rules are really discouraging use of defined benefit plans. However, if you are at age 50 or older, you may still be able to contribute more than $30,000 a year under such a plan.

In that regard I want to point out another new catch that went into the 1986 law, namely, that you cannot get the full $90,000-or-less benefit that your plan calls for until you have been a participant in the plan for 10 full years. So you may not establish a plan with a retirement date that is, say, 5 years from the time you establish it and expect to get a full benefit. If you're in the plan for only 5 years, you will be able to get only 50 percent of what would otherwise be the maximum benefit.

Premature Distributions

There are a number of new taxes to encourage use of qualified plans to provide benefits at retirement. One of these is a 10 percent tax on early distribution from a qualified plan. This applies also to IRAs. If you receive benefits prior to age 59½, you will be subject to ordinary income tax plus a 10 percent excise tax. There are exceptions: If you retire before age 59 but after age 55, you won't have to pay the extra 10 percent tax. Also, if you take a lump sum benefit and roll it over into an IRA, you not only defer the income tax but you also avoid having to pay the 10 percent excise tax at that point. If you later get the money out of the IRA before age 59½, you must pay the 10 percent excise tax at that point.

Loans

Loans are likely to be the only practical way to get benefits out of a plan before you actually reach retirement age. As you know, you may borrow up to $50,000 or 50 percent of your vested account balance, whichever is less. You may still do that, but the rules are very restrictive. For one thing, unless the loan is made to acquire a home, you must pay it back over 5 years.

You must repay any loan on an amortized basis. You may not wait until the end of the 5-year term and then make a balloon payment. Payments of principal as well as interest must be made uniformly over the period of the loan.

Furthermore, the $50,000 limit applies so as to prevent you from paying off the loan and immediately borrowing back the money. In determining how much is available to you, you look at the largest loan balance over the past 12 months. This means that if you have a loan of $50,000 and pay it all back, you must wait 12 months before you may borrow anything from the plan.

In addition to the consumer interest deduction problems involved with any kind of loan, there are special restrictions on deductions of interest on loans made from a qualified plan. If you are a key employee, as you all are, you will not be able to deduct any of the interest. So, I think loans are not nearly as useful as they used to be. I think it still may be helpful to have loan provisions in your plan to take care of emergency situations, but I don't think you should look to loans as a long term use of your plan money. And I need to mention that, if you're not incorporated and you are in an HR–10 plan, then you are still prohibited from making a loan; that is one remaining drawback to being unincorporated.

Excess Benefits

Another tax, which I think is designed to assure that qualified plans are used for retirement and to discourage really excessive accumulation of funds in a plan, is the new 15 percent excise tax on excess benefits. If the amount of an annual benefit from the total of all your qualified plans and IRAs exceeds $150,000, there is a 15 percent tax on the excess. There has to be a fairly large accumulation to induce that tax. If you take a lump sum benefit from a plan and elect income averaging, there is a separate maximum of $750,000. There is also a grandfather provision: If you have accumulated substantial amounts in your plan as of August 1, 1986, you may make an election to grandfather the amount of those accrued benefits. This must be done on a return you file for a year no later than 1988. You have to look very carefully to see whether it makes sense to make that election.

There are some exceptions to the 15 percent tax. If you receive a benefit and roll it over into an IRA, you don't have to pay the tax at that point. You may pay it later as you get benefits from the IRA. Payments under a qualified domestic relations order to your spouse are exempt, and that presents an interesting possibility: If you have a large accumulation, you might

consider (if you are from a community property state) getting a qualified domestic relations order that recognizes your spouse's interest in the plan.

The 15 percent excise tax does not apply at death, but there is a separate estate tax on excess accumulations in a qualified plan and in IRAs that will come about at death. The amount taxed is determined by an interesting calculation: You determine what the accrued benefits are at the time of death, and you figure out how much of an annuity that would buy, based on your life expectancy as of the moment of your death (looking not at your doctor's death certificate but at the tables in the IRS regulations). If the annuity would exceed $150,000 a year, the excess accumulation over the cost of a $150,000 annuity will be subject to tax. There are no credits and no deductions available to put off or reduce that tax. It's payable even if you have a spouse who survives you, when you would normally expect the estate not to pay any taxes because of the unlimited marriage deduction.

Estate and Gift Taxes

Are any of you from community property states? Okay, let me mention a couple of things on estate taxes and gift taxes. As you remember, there used to be an unlimited exemption from estate tax for qualified plan benefits, and that was taken out over a couple of sessions of Congress. There is now no exemption. I think Congress felt the exemption was unnecessary because the marital deduction suffices to protect the employee's spouse from having to pay any tax when the employee dies.

Until last year we were able to preserve in the Internal Revenue Code an exemption for the value of the nonemployed spouse's community interest in the employee's benefit, so that the nonemployed spouse's interest would not be subject to estate tax when that spouse dies first. However, that was taken out of the law in 1986. Now there is no exemption for the community spouse's interest from either a gift or an estate tax. If the nonemployed spouse dies first and has a community interest, it could well be subject to estate taxes at that spouse's death.

How do you calculate what the taxable amount will be, for instance, if the employed spouse has a defined benefit plan? The IRS has yet to tell us. To avoid many valuation and payment

problems, we strongly recommend that the nonemployed spouse by will specifically leave that community interest to the employed spouse.

Furthermore, if the nonemployed spouse consents to a designation of someone else as the beneficiary to take upon the death of the employed spouse, a taxable gift will be deemed to occur when the employed spouse dies and the death benefits go to someone other than the community spouse.

Income Averaging

The final tax change I want to mention you probably know about. It is a change in the tax treatment of qualified lump sum distributions. Until this year, 10-year averaging was available whenever a total distribution was made from a qualified plan, and the portion that accumulated before 1974 was also eligible for capital gains treatment. Now 5-year averaging has replaced 10-year averaging. Except for very large amounts, 5-year averaging produces a lower tax rate than ordinary income but not so low a tax rate as 10-year averaging.

There is also a grandfathering provision: If you were 50 years of age before 1986, you will still be eligible to elect 10-year averaging for lump sum distributions if you haven't already done so. But it's now a one-time election. If you elect 10-year averaging (or 5-year averaging) in a year in which you receive a lump sum benefit from one qualified plan, you will not be able to elect income averaging if you receive a lump sum distribution from another qualified plan in a later year.

Plans will need to be amended in order to bring them into compliance with the law. The amendments don't have to be made until your tax year beginning after 1988, so you have lots of time to make amendments, but you must remember that now your plan must operate in compliance with the law, at least for those provisions effective this year.

Now let's have questions.

Q. I have both an IRA and a KEOGH plan. May I contribute to both in 1987 from my 1987 income?

A. Well, if your income exceeds $50,000 and you are married, you are not going to be able to contribute to your IRA at all, unless you want to contribute on a nondeductible basis. I don't see a lot of benefit to doing that. And you should know a specific

reason why you should not, namely, that you will not be able to withdraw those nondeductible contributions from that IRA on a 100 percent tax-free basis. All your IRAs will be treated as one plan, in effect, and any time you withdraw from any one of them, there will be a ratio taken of your deductible and nondeductible contributions to determine the taxable percentage.

Q. But you could defer the taxability of any gains if you contribute to your IRA even though it is not deductible right now, isn't that correct?

A. Yes, that's true. The earnings will be tax deferred, and if you have no intention of ever making a withdrawal from that IRA before you retire, then you may want to do it.

Q. I have a plan started in 1974, an HR–10 plan. Are there going to be different limits to what I may contribute to that plan in 1986?

A. That's a profit-sharing type plan. There is no change in the essential deductibility rules—$30,000 and 15 percent are still your maximums.

Q. Does that apply to KEOGH plans?

A. It falls under the profit-sharing plan rules unless it's a money-purchase pension plan. There are no different rules now for KEOGH plans.

Q. But it was started as an HR–10 KEOGH plan with a defined benefit.

A. You have one of three possible plans—a defined benefit plan, a profit-sharing plan, or a money-purchase pension plan. Those are the three types of plans that have different deductibility rules. If it's a money-purchase pension plan, then you can put in 25 percent or $30,000, whichever is less.

Q. And for the other two kinds, 15 percent and $30,000?

A. For profit-sharing plans, it is 15 percent or $30,000. When you have a profit-sharing plan and a money-purchase pension plan, your combined limitation is $30,000 or 25 percent of compensation, whichever is less. When you have a defined benefit plan, your deductibility limit depends on what your actuary determines is the maximum you may contribute to fund the benefit that meets the requirements of the law.

Q. So it's not an income maximum?

A. It depends on your age when you set up the plan, and the amount of benefits you are funding. There is no dollar amount that's set forth in the statute to limit how much you may deduct for contributions to a defined benefit plan.

Q. I believe that what I have now is a defined contribution plan. If I decided to get out of the corporate form and go back to a sole proprietorship, may that plan in its present form simply be rolled into an HR–10 without any major modification and specifically without any further requalification from the IRS?

A. If you have a defined contribution plan, there is no problem whatsoever.

Q. My second question is with respect to the differences in loans. I recognize that I will not be able to take any loans as in the past, which is okay since I haven't been able to pay them back anyway. But, given even greater restrictions were I to stay in the corporate form for the benefit of the loans, and given the kind of reversal of the corporate versus personal tax rates, and given the extraordinary filing requirements (I realize that there is a medical reimbursement provision that can be helpful to some, but assume for my purposes that this is not meaningful), is there any reason on earth to stay in the corporate form under the revised tax laws?

A. The benefits to being incorporated are modest, as you are saying. The loan rules, the ability to deduct certain fringe benefits that you may not deduct if you're not incorporated, those are benefits to incorporation. For some people they are essential. I think, first of all, it would be a rare case where I would suggest that anybody incorporate who is not already incorporated. If you're already incorporated, however, I think it's a bit of a nuisance to get out of the corporate form; so, unless it's a serious problem, I wouldn't suggest doing it. I think Ed (Benjamin) may be able to address that problem better than I.

As to your comment about corporate tax rates, many of you can arrange things so that the corporation itself has little or no taxable income after paying compensation, both deferred and current. So the tax rate may not be that serious a consideration.

Q. My main concern, I guess, with the whole switch was the time and expense involved in the numerous filing requirements, including the 5500s and the separate corporate versus personal tax forms. In fact, I am doing two reportings every year, and I guess one option is simply to change accountants. But beyond that it seems to me that those are modest benefits.

A. You are going to have your 5500 filings regardless, as long as you have one or more qualified plans.

Mr. Benjamin (on getting out of the corporate structure): Well, there really isn't a great problem unless you have debt that exceeds your basis, assuming you don't have any appreciated

assets in the corporation. However, with the repeal of the *General Utilities* doctrine, any appreciated asset (including, perhaps, good will of the corporation) will be subject to tax if your liquidation occurs after 1988. Furthermore, if any of your corporation's fees are unpaid at its liquidation, and if your corporation was not on the accrual basis for tax purposes, it will probably be taxed on the unpaid fees' fair market value even if your corporation is liquidated before 1989.

Q. You could simply not pay the debt off and realize the excess debt as income, isn't that correct?

A. Yes, you could do that. Incidentally, a number of people have gotten out of corporations for the very reasons you mentioned, and particularly where personal professional liability is not a problem.

Q. My questions all relate to people who have reached the age of 70. First, I have been told that I cannot contribute any further to my KEOGH or HR–10 plan, but I can set up a new one every year, which seems to be kind of a silly proposition. Second, I rolled over from a qualified plan a very substantial amount of money into an IRA, which deprived me of the opportunity to do 10-year averaging but gave me 13½ percent interest computed daily. But I figured that was worth it. But I have been told that the required withdrawals are done by simply taking my life expectancy (which in the case of a full joint survivorship would be for 20 years), and saying I must take out an annual amount of 1/20 every year, which means it would be earning more money than I would be taking out of it each year. That seems silly, too, but I am perfectly willing to do it.

Third, I am told that I don't have to withdraw until the year after the year when I become 70½, but then I have to withdraw two years' worth, which also seems silly. Now, I don't know whether any of these things are true or not.

Mr. Martin: Some of them are. I am glad you asked the question because I had meant to cover that new rule that's going into effect after 1988. But let me tell you first what the law is right now. As long as you are still active, you may continue to contribute to a KEOGH plan. Under current law you must start taking out at age 70½, and you must continue to do this over your life expectancy. Now the way the life expectancy rule works is interesting because you recalculate it each year. It's calculated first in the year you start drawing it out, and say it's 20 years. The next year you make a new calculation, but it's not 19 years, it's about

19.2 years. Every year you divide the account balance at the beginning of the year by the life expectancy as newly determined that year, and that determines what must be paid out in the current year. In the end you never have to distribute all. If you reach age 106, you may have actually had to distribute everything, but otherwise you never run out of life expectancy, and you never have to complete the distribution of benefits from the plan.

Q. So I can continue to contribute to that same plan year after year even though I am past 70½? In other words, I can take it out with one hand and contribute to it with the other?

A. That's correct.

Q. The IRA is determined by my life expectancy. May I elect a 20 year or a 25 year guaranteed payment even though my life expectancy is only 16?

A. No, it's the same calculation for the IRAs as for the KEOGH: You divide by the life expectancy. What I wanted to mention is that after 1988 there is a new tax. If you don't take out of the plan or the IRA the amount you are supposed to take out, the IRS will assess you a 50 percent tax. I guess they decided the minimum distribution rule wasn't otherwise very easily enforceable.

Q. One question you didn't answer: Do I have to take out if I wait until the year after I'm age 70½? The statute says the year after you reach age 70½. Do I have to take out 2 years' worth in that year?

A. No, just for that year. You have to start in the year after you reach 70½, and you take out just for that year. (Note: IRS Proposed Regs. §1.401(a)(9)-1, issued June 1987, takes the position—not justified in my view by the statute—that two annual payments must be made in the first year if benefits commence in the year after the age 70½ year.)

Q. I had a defined contribution plan that I froze and started a new defined benefit plan in 1985. I was a little shocked and concerned about hearing that, if the actuary made a mistake, that subjected me to a 30 percent penalty, 30 percent of what?

A. 30 percent of the difference between the amount that was properly contributable and deductible and the amount you actually contributed and tried to deduct.

Q. Second question: Is there a cause of action against an actuary for making the wrong calculations?

A. I would think so, but it depends on what kind of instructions you gave your actuary.

Q. I hope I gave the right instructions. What are the limitations on the use of the contributions to the defined benefit plan? For example, may you use them to buy on margin, or to buy commercial real estate?

A. You can do with the money just about anything you want. You may not buy certain collectibles, but otherwise you may speculate to your heart's content. Of course, there are two problems. One is that you may lose your shirt and have an underfunded plan; the other is that you may make a whole lot of money and have to pay extra taxes because your benefits are too high. It may be better to invest conservatively in the plan and speculate outside it.

Q. I am 80 years old. I am not incorporated, but I have had a profit-sharing KEOGH plan since 1975. I think it was modified for some reason in 1984. I am now substantially but not completely retired, so I expect this year (and it was so last year) that I will have a loss. I have always reported all my business income and expenses on Schedule C as part of my general income tax return. Since I am way past age 70½, I am drawing a substantial amount out of that plan, which I expect to continue to receive. I am not suggesting that that be changed because it was figured on life expectancy at an earlier date. But I use my room in my home as an office. I have a formula for charging the equivalent rent for that space used as an office. Are there any substantial changes under the new law that I have to worry about? I will report a loss this year.

A. I take it you are talking about a KEOGH plan and that you are not contemplating any more contributions either this year or later. Therefore under those circumstances I don't think there is anything that really affects you.

Q. So I will just continue to receive my return from the plan according to our life expectancy, and it's still all right to continue to use a Schedule C and report what little income I get and what legitimate expenses I have incurred?

A. Mr. Benjamin says yes.

Q. My expenses to this conference will show up as a fairly substantial loss this year.

A. As long as you are still in the arbitration business, your expenses are deductible.

Q. And I can stay in business as long as I want to?

Mr. Benjamin: The IRS is the last arbiter of that.

Q. How will they determine that?

A. One of the ways that they determine it might well be the amount of net income that you have, if any, or the fact that you don't have any.

Q. So far at least, I have had some income; even though I am substantially retired, I have had some income, but expenses exceeded income. But suppose I reach a year when I don't have any business income at all.

A. I think the IRS will then take the position that you are not in business any more.

Q. Then I couldn't deduct business expenses?

A. I would think not, and they might well move on it early, at the time when the business expenses had exceeded the business income for several years. They are quick to look for causes that you are no longer in business, but that it is now merely a hobby or something of that nature, saying that you are using it as a way of deducting losses or expenses incurred in that activity against other income.

Q. But as long as the losses are not too great, I am probably all right?

A. You may well be. I can't give you any guarantees. However, I think you ought to keep it up. It sounds like a great life and very much worthwhile.

Q. I have a question on behalf of my secretary. Assuming that I have a 25 percent money-purchase defined contribution plan, may I establish a 401(K) so that my secretary can contribute from her salary to that 401(K), along with her IRA, a $2,000 deduction up to the new maximum, which I understand is $6,000? In other words, is it possible to have a 401(K) on top of a KEOGH when you're already at the maximum KEOGH?

Mr. Martin: If you are contributing to her account 25 percent of her compensation, then she's hit the ceiling. A 401(K) contribution is treated as an employer contribution under the Code, so the maximum that can be contributed to her account in the form of employer contributions is 25 percent, whether it's from reduction of her pay or just from the employer.

Q. Let me change the facts slightly. Let's say it is a 15 percent profit-sharing plan, then would it possible?

A. She may divert up to 10 percent of her income with the $7,000 ceiling that applies to 401(K) plans. (This is correct only if the employer's 15 percent plan is a money-purchase pension plan, not a profit-sharing plan.)

Q. Do your comments about the decreased advantages of incorporating apply equally to an S corporation? I am not incorporated; I looked into it a few years ago and decided to postpone it. Now I'm glad I did. But I heard something about S corporations that seemed to retain some of the advantages that corporations used to have. My other question relates to the new 90 percent rule on estimated tax. I had a devil of a time trying to estimate my income under the 80 percent rule. My arbitration income fluctuates a good deal, and I wonder if there is any magic by which we can come up with some guess without overpaying so that Uncle Sam has the use of our money.

A. I'll answer the first question. There's no benefit to an S corporation insofar as qualified plans are concerned. In fact, there are some drawbacks. For instance, the plan loan restrictions apply to an S corporation whereas they do not apply to a C corporation.

Mr. Benjamin: With reference to your second question, the only help I can give you is this: If at the end of every quarter you have kept records which show what your income is for that quarter, you may pay an amount within 90 percent of the total amount of income you received through the end of that quarter. Then you should be all right because, as income comes in in a subsequent quarter, you shouldn't be penalized retroactively since you couldn't tell whether it was going to come in or not. On the other hand, at the end of that subsequent quarter, of course, you must pick up whatever amount is required to comply with the 90 percent rule. In your situation you don't want to use 100 percent of the previous year because that could have been a very high year, and you could have a much lower year currently. If it was a low year, you might want to go to 100 percent of the previous year when you know your current year is higher. There is a lurking problem there: Even though you are protected by the 100 percent of the previous year, if in fact your income turns out to be way under that, there could be some liability under other provisions of the Code. Personally, I don't share that concern, but the way to handle the 90 percent, if you can do it, is to keep your records right up to snuff so that you know within the allowable 15-day grace period after the end of each quarter exactly where you are.

Q. I am one of the members of the growing group of superannuated arbitrators. I am still in practice, and my income has not fallen very much. My wife and I passed age 70½ about seven

years ago, and I have to take out a fairly substantial amount of my retirement income, which, added to my income, hurt quite a bit. She passed away four years ago. When she did, I contacted the KEOGH plan people in a bank in Philadelphia and asked if I had to take out as much as I had been taking out when she was alive. It shifted completely to my life expectancy after she passed away, and they pointed out something new, as far as I was concerned. They said I could name a beneficiary, a member of my family, my son who is 48 years old, and if I did that, the amount I would have to take out would drop about 50 percent. I did that and I was happy. Was that correct information?

Mr. Martin: A beneficiary other than the spouse can be used to determine the joint life expectancy. Presumably the spouse must consent, if the participant is married. It may not be possible, however, to have a beneficiary's life expectancy measure the term if the beneficiary is named after the distribution commences.

Q. I was told parenthetically that, when I passed away, my son would have to take all of the amount that was left in five installments. Is that correct?

A. If he is the beneficiary at your death and you had been receiving benefits over the joint life expectancies, he can receive the rest of it over the remainder of the most recent life expectancy. If you died before starting to receive benefits, he can take it out over his life expectancy at that point.

Q. I have a question on estimated taxes. Since our income fluctuates so much, if we make minimum payments in the second or third quarter and use the January payment to catch up, paying 70 or 80 percent of our ultimate tax liability that way, is that something that the IRS watches for? Is that a problem?

Mr. Benjamin: Yes, it is.

Q. If you still pay 100 percent of the tax liability from a previous year, does that still apply?

A. If you fit under the 100 percent rule, you should be all right.

Q. You can still wait until January to pay the majority of your tax as long as you hit the 100 percent rule?

A. I'm going to check that out. (You must pay at least one quarter of the previous year's tax each quarter.)

Q. Do their computers have the ability to check on that?

A. Yes, and they're doing it more and more.

Q. I didn't quite catch your comment on contributions to a spouse's IRA. I know I cannot deduct it, but I can still do it. Is that amount of the principal contribution taxable again when it's taken out, or is only the interim interest earned taxable?

Mr. Martin: Your spouse has no tax basis in a deductible IRA she may have been funding. And the problem is that the basis derived from the nondeductible IRA contribution is going to be divided uniformly between both IRAs or, if you have more than two, among all the IRAs. So, if she takes money out of any of them, a portion of it will be considered taxable. If she takes it all out at once, it won't matter.

Q. But what if she's not taking anything out?

A. There's still a basis, and she will not be taxed again on that money, but the determination of that basis is complicated.