THE Pension Digest

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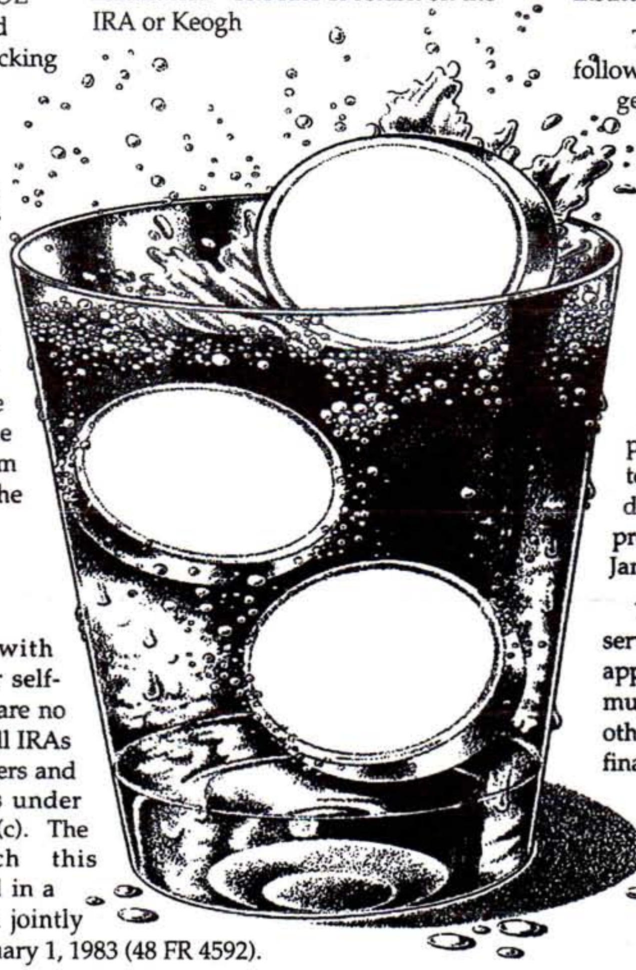
IRS Offers Temporary Relief for Linking Free Services to IRAs

In mid-1989, the Department of Labor (DOL) issued an advisory opinion which concluded that it would be a prohibited transaction if free services were provided as an inducement to establish or fund an IRA account. The advisory opinion was issued to a bank that wrote to the DOL and asked if it would be a prohibited transaction if the bank gave free checking to those IRA accountholders who maintained a $2,000 balance.

The DOL's reply that this would be a prohibited transaction set off shock waves hroughout the banking industry. Many banks, state banking associations, and the American Bankers Association protested strongly and lobbied aggressively to change this ruling. With the release of Announcement 90-1, the IRS has offered temporary relief from the potentially onerous effects of the previous DOL ruling.

The New Rules

Announcement 90-1 deals with certain IRAs and with Keoghs for self-employed individuals where there are no employees. The covered IRAs are all IRAs except those established by employers and certain associations of employees under Internal Revenue Code section 408(c). The cash or property to which this announcement applies is described in a Prohibited Transaction exemption jointly issued by the IRS and DOL on February 1, 1983 (48 FR 4592).



The services covered under the ruling are those offered by financial institutions to IRA and Keogh customers which are . . . "consistent with and incidental to the business of banking, and permitted by the laws applicable to such financial institution." The rate of return on the IRA or Keogh investments . . . "must be within reasonable range of the prevailing rates of return that are applicable in the normal course of business of the financial institution to comparable investments that are generally offered by the financial institution to all customers."

The Announcement states that the following additional conditions are generally effective April 17, 1990; but then goes on to state as follows: "However, any services that were not offered by the financial institution with respect to IRA or Keogh investments are subject to the conditions below as of January 1, 1990."

In other words, the following additional conditions are effective January 1, 1990 *if* a bank has a new promotional program with respect to IRA or Keogh investments which did not exist (the promotional program did not exist) prior to January 1, 1990.

1) In determining eligibility for the services to which this Announcement applies, IRA and Keogh accounts must be treated in the same manner as other accounts maintained by the financial institution;

2) The provision of the services to which this Announcement applies may not result in a lower return on

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the IRA or Keogh investment than the return on comparable investments maintained by the financial institution that are generally offered by the financial institution to all customers (except to the extent prohibited by applicable banking or securities laws), regardless of whether they avail themselves of such services; and

3) The services to which this Announcement applies must be generally available (with or without a service charge or fee) to other customers of the financial institution.

In Announcement 90-1, the IRS acknowledges receiving a request for an administrative exemption from the prohibited transaction provisions permitting the continuation of the services generally described above, provided that certain conditions are met. However, the IRS states that Announcement 90-1 will be effective until the IRS makes a final determination on this administrative exemption request.

What to do Now

If your institution is using promotional programs tying IRAs or Keoghs with services, cash, or property, make certain you are in compliance with this ruling. Understand that this is a temporary ruling by IRS. The DOL is considering the request, made by the American Bankers Association, to exempt these transactions from the prohibited transaction rules. It may take months before the DOL issues a ruling on this request. In the interim, comply with the spirit of the Announcement and you should avoid having your promotional program labeled a prohibited transaction.

Revenue Reconciliation Act Modifies Definition of Compensation for IRA Deduction Purposes

The Revenue Reconciliation Act of 1989 modifies the definition of compensation for IRA deduction purposes for certain people. The affected people are those whose compensation is exempt from self-employment tax because of their religious beliefs.

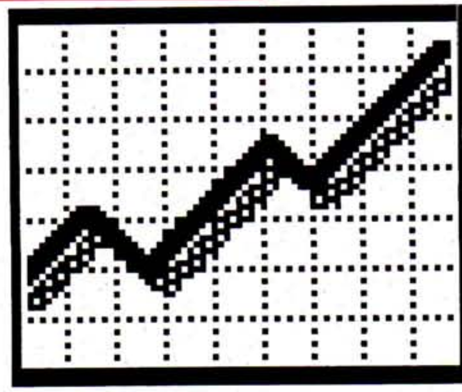
This provision affects certain ministers who are exempt from paying OASDI tax. For these affected people, even though their compensation is exempt from OASDI, it still qualifies as "compensation" for IRA deduction purposes. (Internal Revenue Code section 219(f), as amended by section 7841(c) of the Revenue Reconciliation Act of 1989.)

Bush Budget Proposal Includes Rule Changes

President Bush's January 29 budget proposal brought kudos from some people, boos from some others, and yawns from others. One of the largely overlooked facets of the proposed budget is a proposal to expand the early withdrawal exceptions for IRAs.

The proposal would allow withdrawals of up to $10,000 by first time home buyers without the 10% premature distribution penalty of IRC section 72(t) applying. However, there are several qualifying rules. To take advantage of this exception, individuals could not have owned a home in the last three years. Also, the purchase price of the home could not be more than 110% of the median house price in the area of that house.

Similar proposals have been made in the past. We will have to wait and see if this proposal survives the legislative process or ends up on the garbage heap of failed initiatives.



Cost of Living Increases Mean New Contribution Limits for SEPs, 401(k)s, and Defined Benefit Plans

The IRS has just released IR 90-15, which lists cost of living increases affecting a number of dollar limitations for retirement plans. These changes are generally effective January 1, 1990. IR 90-15 states that administrators of qualified plans that have received favorable determination letters do not need to refile for new letters just because of these dollar limitation changes.

The defined contribution limit on annual additions is still $30,000. However, the defined benefit limit has been raised from $98,064 to $102,582.

The limitation on salary deferrals for 401(k) and salary deferral SEP plans has been raised from $7,627 to $7,979.

Several other SEP limits have changed. In 1989, employees earning $327 or less in compensation could have been excluded from participation in the plan. For 1990, this limit has been raised to $342. Also, the top heavy rules provided that only the first $200,000 of compensation could be taken into account in determining the contribution that each eligible employee would receive. For 1990, this figure has been raised to $209,200.

Finally, for purposes of the definition of highly compensated employees under IRC section 414(q), two dollar limits have been increased. The 414(q)(1)(B) limit was increased from $81,720 to $85,485. The 414(q)(1)(C) limit of $54,480 was increased to $56,990.

Magnetic Media Reporting Still Not Required if Fewer Than 250 Forms are Being Filed

In the January issue of The Pension Digest we described section 7713 of the Revenue Reconciliation Act of 1989, which calls for "uniform requirements" for magnetic media. One well-known publisher of pension information had interpreted this provision to mean that if a filer files 250 or more information returns in total for a calendar year, then the filer must file using magnetic media. As we explained on page 4 of that issue, based upon our reading of the Act and the Committee Report, we disagreed with this interpretation. Our position was and is that a filer is exempt from filing on magnetic media if it files less than 250 of each type of form. For example, if Bank A files 260 5498s and 15 1099-Rs, only the 5498s must be filed on magnetic media.

IRS has issued Notice 90-15, which clearly states as follows: "The 250 threshold applies separately to each type of form. Thus, for example, if a person is required to file 200 returns on Form 1099-INT and 350 returns on Form 1099-MISC for a calendar year, the person is not required to file Forms 1099-INT on magnetic media, but is required to file Forms 1099-MISC on magnetic media."

Notice 90-15 also makes it clear that the 250 threshold applies separately to both original and corrected returns. For more information on this Notice, contact Ms. Owens of the IRS at 202-566-4430.

FDIC Proposes New Deposit Insurance Limits Affecting IRAs and Pension Deposits

The retirement and pension plan deposit insurance policies of the Federal Deposit Insurance Corporation (FDIC) and former Federal Savings & Loan Insurance Corporation (FSLIC) may soon be considerably more uniform, under a recent FDIC proposal. As discussed below the FDIC has proposed to amend the FDIC coverage regulations. These amendments are being proposed pursuant to the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, which requires the FDIC to promulgate uniform deposit regulations in all insured depository institutions, taking into account the regulations, principles and interpretations for deposit insurance coverage by the former FSLIC.

In the past many times the FDIC based its maximum coverage on a "per account" basis whereas the FSLIC many times based maximum coverage on a per-person basis.

The first major change in the proposed regulation deals with the topic of what is the insurance level when an accountholder has both an IRA and a Keogh.

New Rule for IRAs and Keoghs

Under FSLIC policy, if a depositor holds an IRA and either a Keogh and/or other pension plan deposits within a single institution, each such account has its own $100,000 insurability ceiling. But under current FDIC coverage, deposits may in certain circumstances be aggregated to reach the $100,000 insurability ceiling, substantially reducing maximum coverage. A primary example is a depositor who has both an IRA and a Keogh account in the same institution.

Now, however, the FDIC has proposed to adopt the FSLIC approach, wherein each IRA and Keogh account would "be separately insured from each other and from all other accounts maintained by the settlors, trustees and beneficiaries of such plans at the same insured depository institution." This change is being proposed in the interest of uniformity (and also perhaps equity), and because the FDIC believes the proposed change "would simplify and thus expedite deposit determination for such accounts."

New Rule for Overfunded Pension Plans

The second major change is that the FDIC is also proposing adopting similar policy with regard to "overfunded" pension plans, those in which assets exceed the total present value of all participants' accrued benefits under the plan. If this overfunded portion was (based on the plan documentation) determined to be owned by the corporation, this overfunded amount has until now been aggregated with other corporate funds for determining maximum insurability limits. If plan documentation determined that the overfunding was owned by the employees, each employee's share was aggregated with his or her other interest in the pension plan deposit.

The FSLIC however, has historically treated the overfunded portion of a pension as a trust estate, and has insured that portion up to $100,000 separately from any other funds attributable under the plan to either the employee or the corporation.

The FDIC is now proposing to adopt FSLIC's policy and insure such funds separately, for a combination of reasons. First, doing so would eliminate the need for the often extremely difficult determination of whether the employer or the employees have a greater ownership interest in the overfunded portion of a pension plan deposit. Second, this will simplify deposit insurance determinations on pension plan deposits, as well as payment of the insured portions of such deposits.

No Change for Deferred Compensation Plans

The FDIC, however, plans to maintain its current aggregation policy regarding Deferred Compensation Plans for employees of state or local government, or other tax-exempt organizations. Currently such plans that qualify under Section 457 of the Internal Revenue Code

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("IRC"), 26 U.S.C 457(a "457 Plan"), are given coverage up to $100,000 in the aggregate - that is the total plan - rather than coverage on a per-participant basis. (As was the case with the two examples described previously, the FSLIC has taken the more liberal approach and insured these plans on a per-participant basis.)

In explaining its position, the FDIC cites the fact that, until distribution, these funds belong to the employer, and the employee has no prior right to them. This is supported by Section 457 of the Internal Revenue Code, which states that the funds of such plans "remain (until made available to the participant or other beneficiary) solely the property and rights of the employer *** subject only to the claims of the employer's general creditors."

Further, under the FDIC's proposed amended regulations, these funds would be combined with any other similar deposits that are maintained by the same organization at the same insured depository institution.

The effect of this approach is to greatly limit potential liability of FDIC, when compared to the alternative of insuring each participant's interest up to the $100,000 maximum.

Insurance Limits for Rollovers, After-Tax Contributions

In an interesting turnabout, FDIC has - in certain insuring areas - provided separate per-participant or per-beneficiary maximum coverage, while FSLIC has not. One example is in the area of after-tax and rollover contributions. The FSLIC has treated voluntary after-tax employee pension plan contributions - as well as rollovers - as individually owned funds. As such, FSLIC combined these funds with any other single-ownership accounts of each participant in the same insured institution, with an aggregate insurable limit of $100,000.

FDIC, however, has treated these same voluntary employee and rollover contributions as part of the individual's interest in the overall pension plan deposit, and not to be aggregated with his or her individually owned accounts. In fact, FDIC has honored the $100,000 per-participant limit regardless of whether the funds are from before or after-tax employee contributions, employer contributions, or rollover contributions.

However, if the individual (beneficiary) holds an interest in any other employee benefit plan or plans established by the same employer or employee organization, all such funds would be aggregated for insurance purposes, with a $100,000 ceiling. The FDIC's proposal would continue this treatment.

Fiduciary Relationships and Insurance Limits

Another area of more liberal FDIC insuring policy includes accounts held by an insured depository institution in a fiduciary capacity, that is, as trustee, executor, administrator, guardian or agent.

FDIC language (section 7(i) of the FDI Act (12 U.S.C. 1817(i)) has provided that such funds, whether held in either its trust department or any other department of the fiduciary bank - or even in another insured bank - would be insured up to $100,000 for each trust estate represented. This coverage would be in addition to, and separate from, insurance on any other deposits of these funds, owners or beneficiaries.

Until recently, FSLIC did not provide a separate $100,000 limit for trust estate funds of each fund owner or beneficiary. In fact, FSLIC had no such statutory provision comparable to the FDI Act. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 - FIRREA - (Section 208) has amended the FDI Act to apply to deposits in ALL insured depository institutions, making the $100,000 per-trust estate account universal.

Fiduciary Relationship Record-Keeping, and Its Bearing on FDIC Liability

In the past, the FDIC has allowed depositors to argue or prove the presence of a fiduciary relationship, and therefore its liability with respect to insurance limits. Even an improperly stated relationship could be corrected by this process. But FDIC is now proposing to tighten its existing recordkeeping regulations with respect to disclosure and recordkeeping in fiduciary relationships, if a depositor wishes to obtain what is known as "pass-through" insurance on funds held by a fiduciary.

The fiduciary relationship on the part of an insured financial institution would have to be expressly disclosed, with clear and specific references in its deposit account records. One way of satisfying the proposed regulations would be to incorporate such terms as trustee, nominee, agent, custodian, guardian or executor, in the title of such an account.

This proposed regulation would not change current FDIC policy of allowing a third party (such as a plan administrator or actuarial firm) to maintain such records on behalf of the depositor.

Existing interpretations of varying or multiple levels of fiduciary relationships would also become law under the proposed FDIC regulations.

Whose Records Determine Insurance Liability?

Accountholders with funds deposited in insured institutions may have always assumed that - in event of loss - their records play a part in determining a settlement. Not necessarily so, according to presently ambiguous - and now officially proposed - FDIC language on the subject.

The FDIC's policy is to presume that an accountholder's funds are owned to the extent indicated on THE FINANCIAL INSTITUTION'S account records, unless there is reason for the FDIC to believe that these account records inaccurately represent ownership. In such cases FDIC has allowed depositors to present evidence other than the deposit account records to prove ownership of funds in an insured account.

In cases where the FDIC has believed that deposit account records OVERSTATE insured deposit amounts, it has commonly considered other evidence than deposit account records, and paid claims accordingly, based on actual rather than the misrepresented ownership. PD

Publication 590 Now Available — The 1989-tax-year version of IRS Publication 590 has just been released by the Internal Revenue Service. Publication 590 is a 32-page booklet that may be helpful in the handling of IRA documentation for the 1989 tax year. While its initial availability from government sources - particularly in quantity - may be limited, it is available from Collin W. Fritz and Associates for a fee of $3.00 per copy plus shipping.

Current subscribers to the CWF IRA Procedures Manual, however, will receive a copy free as part of their scheduled update.

Legislation Watch: Will the 101st Congress Create a New IRA–Plus Account?

In the January newsletter, we reported that the Bush administration was considering creating new long term savings plans. These plans would be similar to IRAs in trying to encourage personal savings, but would not be limited to saving for retirement. President Bush again advanced this idea in his State of the Union message.

In late January, the 101st Congress reconvened for its second session. It is expected that key members of Congress who advanced pro-IRA proposals in last year's Fall session of Congress will again push their own IRA proposals as alternatives to the Bush plan.

Here are some of the key members to watch, along with several previous IRA proposals:

Senators Robert Packwood & William V. Roth, Jr.: These Senators are proponents of a new "IRA Plus" savings account, which would gradually phase in a $3,000 annual contribution limit. While contributions would not be deductible, at retirement earnings could be withdrawn tax free. The withdrawal of up to 25% of the account would also be permitted for first time home buyers, college expenses, and catastrophic medical expenses.

Senator Lloyd Bentsen: Senator Bentsen previously offered a 50% deductible IRA contribution. While Bentsen's proposal would permit withdrawal under the same circumstances as the Packwood and Roth proposal, Bentsen's bill would have retained the $2,000 annual contribution limit.

Congressman Dan Rostenkowski: House Ways and Means Committee Chairman Rostenkowski is a long-time supporter of IRAs and a key player in budget reconciliation matters.

Encouraging savings is one of the hot "buzz words" in government. It remains to be seen whether this trendy talk will lead to definite action. We'll keep you posted on future developments. PD

Don't Forget Schedule P!

Among the administrative duties of a qualified plan administrator is the annual filing of IRS 5500-series reports, including 5500, 5500-C, 5500-R and 5500EZ.

But in order to fully comply, the plan administrator—usually a designated individual in the case of a multi-participant plan, or the actual accountholder in the case of a Keogh - must attach a completed Schedule P form. Schedule P is entitled Annual Return of Fiduciary of Employee Benefit Trust. The financial institution serving as custodian or trustee of a qualified plan is responsibile for providing Schedule P to the administrator.

The function of Schedule P is to begin the running of the three-year statute of limitations on the assessment and collection of any tax that may be owed by the trust/qualified plan. If, however, a willful attempt is made to evade taxes, or if a fraudulent or falsified return is filed, the statute of limitations does not apply.

Please note that if a qualified plan uses more than one trust or custodial account for its funds, a Schedule P form should be filed for each trust or custodial account.

Enclosed with this newsletter you will find a copy of the just-released IRS Schedule P for the 1989 tax year, which you may duplicate and use as needed. PD

Is the Farmer's Contribution Deadline March 1 or April 16?

Every year at this time, the same question arises: "What is the deadline for farmers to contribute to an IRA?" The answer, which has sometimes provoked debate, is April 16, 1990, the deadline for filing 1989 tax returns. The deadline is April 16 this year because the 15th falls on a Sunday. If the question had been "What is the deadline for making SEP or Qualified Plan (Keogh) contributions?", the answer would have been April 16 plus extensions.

The Code stipulates that taxpayers have until the time prescribed by law for filing the tax return for a given year to make contributions for that year (IR Code sections 404(g)(1)(B), 404(a)(6), and 219(f)(3)) Taxpayers making SEP and Qualified Plan contributions are given until the tax return due date, plus extensions.

The tax return due date for farmers and fishermen is not March 1. Farmers and fishermen have the same tax return due date as other calendar year taxpayers, April 16th. **It is only for purposes of estimated tax payments that some farmers will file their return by March 1.** Estimated tax payments are made shortly after the end of every quarter by many self-employed businesses. While businesses can be fined if they do not make these estimated tax payments, farmers have some special exemptions from these rules. Farmers are not required to make these estimated tax payments if they meet one of two exceptions:

A) They pay all their estimated tax by January 15, but file their return by the normal due date (April 16 this year); or

B) They file their tax return by March 1st of the following year and pay all of the tax due by March 1st.

Many farmers consider March 1 to be their due date for filing their tax return. March 1 is really their deadline for paying in their income tax, if they choose to take advantage of this special exception to the estimated tax rules. However, as noted earlier, the time "prescribed by law" for filing their return is generally April 15, although it is April 16 this year because the 15th is on a Sunday. PD

Reminder: File W-2Ps & 1099-Rs by End of February

Don't forget that there's a major filing deadline to meet in February. Your bank's W-2Ps and 1099-Rs must be filed with both the Social Security Administration and IRS by the end of this month. PD

IRS Releases New 5329 for 1989

Form 5329, the worksheet taxpayers use to report a variety of penalties they owe on retirement plans, including IRAs, has been revised for 1989. Previously, the title of the form was "Return for Individual Retirement Arrangement and Qualified Retirement Plans Taxes. The new title is "Return for Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts."

While the title has changed, the form remains basically the same. The 5329 is the worksheet used by taxpayers to calculate and report various penalties owed on retirement plans. The amount from Form 5329 is then carried over to line 52 of Form 1040, which reads as follows: "Tax on IRA or a qualified retirement plan (attach Form 5329)."

IRS Releases 1989 Form 5500-C/R Instructions

The IRS has just released the 1989 instructions for Forms 5500-C and 5500-R. For 1989, the 5500-C and 5500-R have been combined into Form 5500-C/R. The new format will save printing expenses for the IRS, eliminating the need for a separate 5500-R, and also save some preparation time for 5500-C/R filers.

Page one of the combined form has a new format. This format allows IRS to preprint the historical plan information on the Form 5500-C/R that IRS will mail out each year once the report for the initial plan year has been filed.

It is still possible to file the short two page form two out of every three years. The two page form will be pages one and two of the combined form.

Many pension plans cover only one participant, or the participant and his/her spouse, who are able to file the relatively brief Form 5500-EZ. The 1989 Form 5500-EZ and instructions were not released by IRS along with the new 5500-C/R. We'll tell you about the 1989 5500-EZ in The Pension Digest after it is released. PD

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Question: We're helping many customers to withdraw in 1990 their excess IRA contributions that were made in 1989. In what year is this taxable—1989 or 1990?

✓ To correct the 1989 IRA excess before the tax return due date, plus extensions, both the amount of the excess and the earnings on the excess must be withdrawn. These earnings (interest) on the excess must be included in income by the customer on his or her 1989 tax return, even though your bank will report this in January/February of 1991 using your 1990 W-2P or 1099-R. As a service to your customers, you should remind them to include these earnings in income on their 1989 tax return.

Question: We are considering offering SEP plans for our bank customers to adopt. What benefits do SEP prototypes offer over the IRS Model SEP-Form 5305-SEP?

✓ Here is a comparison of prototype SEPs and the IRS Model SEP (Form 5305).

SEP Prototype	IRS Model SEP Plan
• Can integrate employer SEP contributions.	• Cannot integrate employer SEP contributions.
• Can maintain another qualified plan in addition to a SEP.	• Cannot maintain another qualified plan in addition to a SEP.
• Can maintain with a defined benefit plan if the proper filings are made.	• Cannot maintain a SEP if the employer had a defined benefit plan, even if now terminated by the employer.

Question: I know that there are billions of dollars deposited in pension plans, but just how much money is there in these plans? does anyone keep track of this? Considering the underfunded state of the Pension Benefit Guarantee Corporation, you'd think that someone would be keeping a close watch on pension funds.

✓ You've raised several questions. The Department of Labor recently released a book entitled "Trends in Pensions" that addresses some of these questions. According to the book, in 1987 there were nearly two trillion dollars in private pension assets. The Department of Labor does try to keep track of these funds and enforce the rules and regulations governing pension plans. The DOL asked for an increase of $15,000,000 for its 1991 budget. This appropriation would include, among other things, 100 new employees for the enforcement of ERISA and other rules. The General Accounting Office is also lobbying the House and Senate for tighter enforcement of ERISA rules. PD

The Pension Digest invites your questions and comments.
Please address to "Check It Out," Collin W. Fritz & Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

Keogh/Form 5500-EZ Reporting Requirements Simplified

The administrative reporting of Keogh (self-employed, one-person or husband-wife retirement) plans has now been greatly simplified, thanks to recently released instructions for preparing IRS Form 5500-EZ. This development may further enhance the attractiveness of these plans, both to potential accountholders and to custodian/trustee financial institutions.

Now—with the release of 1989 tax year instructions—unless accounts have a balance of $100,000 (including the aggregate balance if there are multiple accounts), no reporting is necessary.

Formerly, all such plans with an account balance of $25,000 or more were required to have IRS Form 5500-EZ and Schedule P completed and filed annually by the accountholder. In addition, this documentation had to be kept on file for each accountholder, subject to IRS recordkeeping requirements.

The new IRS instruction is expected to eliminate a financial institution's reporting and recordkeeping requirements for the vast majority of such accounts. PD