THE Pension Digest

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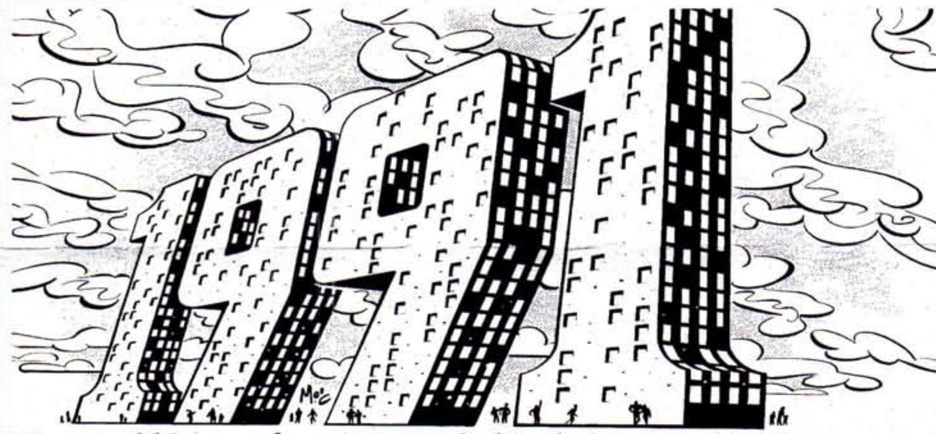

Deadline for Establishing a SEP: December 31 or April 15?

Employers considering establishing a Simplified Employee Pension (SEP) for themselves and/or their employees are quite naturally concerned about the deadline for signing the necessary documents to establish the plan. For such a plan to be in compliance with the IRS Code, and to provide tax deferral for participants' contributions, it must of course "meet the deadline."

But what is the deadline?

What the law says, and doesn't say

In such matters the IRS Code is primarily concerned with two things:

(1) the date the plan document is signed, and

(2) the date by which contributions must be made.

The law is clear that an employer (including a one-person business) has until the tax filing deadline—plus extensions—to actually fund (make contributions to) a SEP or qualified plan.

The law is silent, however, as to the deadline for establishing a SEP plan, as it is also for qualified plans.

For QPs, past "standard procedure" has been to require that these plans be established by December 31st (or the last day of the applicable fiscal year). SEPs, however,have been treated more leniently, with plan establishment commonly being done up through the tax deadline, plus extensions.

Rumors of a deadline change for plan establishment

In the November 23 Kiplinger Tax Letter, it was stated that "SEPs for '90 payins must be set up THIS YEAR (emphasis ours), same as other company plans. Proposed rules saying SEPs can be set up before return is due don't apply..." This was attributable to an IRS conversation, and would certainly be a conservative approach, as well as a change from past practice.

But a national office IRS official we spoke with in early December indicated quite the opposite—that for the 1990 tax year, the past practice of allowing the April 15-plus-extensions date for SEP plan establishment will be acceptable.

There have been internal discussions within the IRS suggesting that this will be reviewed, but no guarantee that it will be made official with respect to future years.

This would certainly be an appreciated clarification. PD

Beneficiary Waivers vs. Accountholder Elections: Courts Differ, Confusion Reigns

A recent decision handed down by the U.S. Court of Appeals in Cincinnati has made it clear that the disposition of a retirement plan holder's assets to beneficiaries is not at all cut-and-dried. "Who gets what," can often be a case of where you are, and what retirement plan is being considered.

Georgia Supreme Court: An IRA Case

As reported in the October Pension Digest, the Georgia Supreme Court upheld a former wife's release of interest in her ex-husband's IRA, as set out in a divorce decree signed by her. Even though her ex-husband had never changed the beneficiary designation, the court held that her action showed "a clear intent . . . to release all interest in the IRA." The assets in question therefore went to the deceased accountholder's estate.

U.S. Court of Appeals/Cincinnati: An ERISA Plan

The case of McMillan v. Parrott took a decidedly different turn. A qualified plan participant had two plans, yet four years after a divorce, had not replaced his ex-spouse as beneficiary. He remarried, subsequently died, whereupon the plan administrator brought a declaratory court action to determine who had rights to the deceased's portion of the fund (that portion not affected by a pre-retirement survivor annuity).

The U.S. District Court held that, under state law, the previous wife had waived her interest in the plan in their divorce agreement. His estate was therefore entitled to the funds.

But on appeal, the U.S. Court of Appeals reversed that decision, stating

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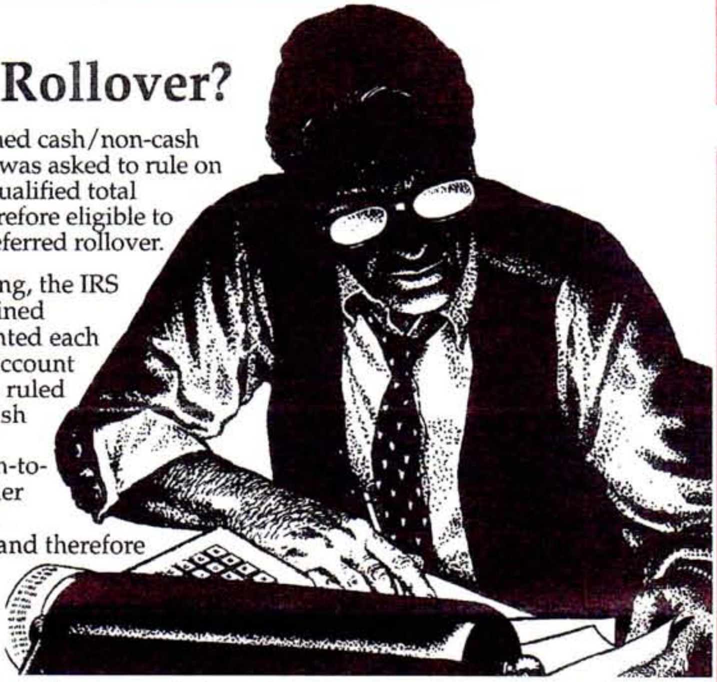
Are Non-Liquid Assets Eligible for Distribution and Rollover?



When a qualified plan distributes to a participant their vested account balance, the participant is usually paid out in cash - a "liquid" asset. Typically, circumstances such as termination of the plan, separation from service, death, or disability, result in a qualified total distribution (QTD) which is eligible for tax-deferred rollover treatment.

But what happens when some of the qualified retirement plan assets are NOT cash, or liquid, but instead are stocks, bonds or certificates that represent ownership interest in assets such as real estate? A little known fact is that such plans are permitted to be written in such a way as to allow participants to be paid with non-liquid assets.

A recent Private Letter Ruling exemplified such a situation, stating that real estate certificates—even though non-negotiable unless sold—were nevertheless eligible for rollover and protected from immediate taxation.

The case in question developed in this way:

A qualified profit-sharing plan was terminated, and proceeded to distribute plan assets to its planholders. The distribution of liquid assets—cash—was simple enough. However, real estate assets were also held by the plan. They were transferred to a nonqualified trust, administered by an independent trustee.

Plan participants were allowed to elect to receive their share of the plan's cash assets, as well as certificates representing their proportionate share of the real estate trust.

Given this combined cash/non-cash distribution, the IRS was asked to rule on whether this was a qualified total distribution, and therefore eligible to be treated as a tax-deferred rollover.

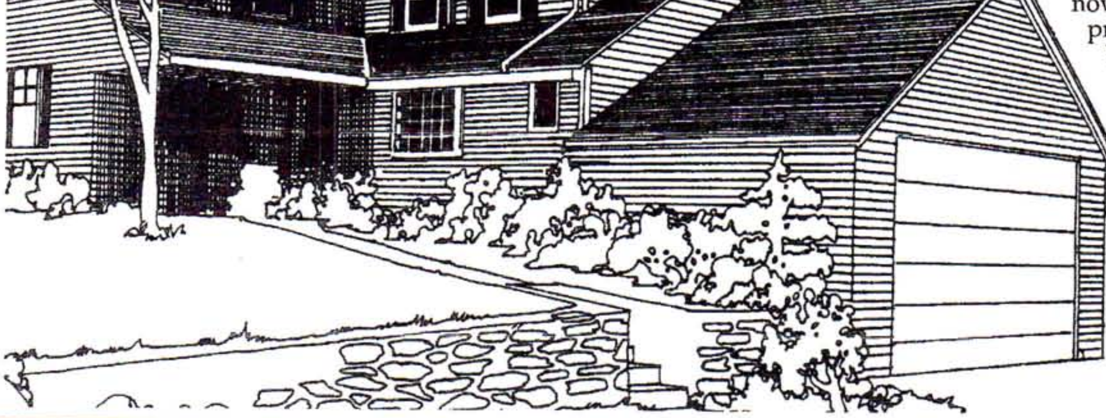
In making its ruling, the IRS noted that the combined distribution represented each participant's entire account balance. It therefore ruled that movement of cash plus the real estate certificates from plan-to-trust-to-accountholder was a qualified total distribution (QTD), and therefore eligible for tax-deferred rollover treatment. (Internal Revenue Code section 402(a)(5) authorizes the rollover of money, actual property which is distributed, or money realized from the sale of such distributed property.)

Other non-negotiable assets—such as stocks, bonds, etc. — are similarly eligible under similar circumstances. That is:

1. they can be distributed from a plan, and

2. when fully distributed, and in proportion to the plan participants' interest in the total plan assets, they represent a qualified total distribution, eligible for the tax-deferred protection afforded by a rollover.

Likewise, the distribution and rollover of non-liquid assets may be acceptable if structured properly when the distribution is from a multi-participant qualified retirement plan, an IRA, or the Keogh of a self-employed individual. PD



Customers, Banks Giving Keoghs a Second Look

Keogh retirement plans for self-employed business persons have ebbed and flowed in popularity during the past decade. But today, for those eligible, the reasons for having a Keogh versus an IRA are probably more compelling than they have ever been.

In the early 1980's, IRAs were still enjoying their meteoric rise in popularity, in great part because they were fully deductible for tax purposes, regardless of whether or not the accountholder was a retirement plan participant where they were employed.

Then, too, Keoghs at that time had additional "strings attached" in terms of reporting requirements, and lacked at least one important provision that is now contributing to their renewed popularity. Changes in both plans—and renewed customer demand—have been responsible for many financial institutions now asking Keogh prototype providers if they should get back into the marketplace in a significant way.

The answer that Collin W. Fritz and Associates, Ltd. is giving to this question is a clear "yes." Why?

While additional limitations have been placed on IRAs through the years, liberalization has taken place with Keoghs.

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Marketing Pension Products and Services The Direct Approach

Last month we discussed using on-premises or "contact" methods to improve your marketing of IRAs or other retirement plans. We promised that this month we would touch on direct marketing by phone and mail. Here goes . . .

Existing Customers

One of the truest of business truisms says that the best sales prospect is an existing customer.

That makes IRA or pension promotion to your existing customer base a first step in expanding this facet of your business.

Marketing Efficiency

Marketing to existing customers is not only the most effective—unless you've already saturated that market—it is also the most efficient. Unlike general media advertising that aims a scattergun blast in the general direction of the market in the hope that some of the prospects are "hit," marketing to existing customers is "rifle" marketing. You know who they are, and they can hardly escape a well-directed message aimed their way.

Methods: Mail, Phone, Both

In the October Pension Digest we covered some important demographic characteristics of good IRA prospects. We also suggested that you review your existing IRA customers to see if there was a similar—or just as importantly, a different—pattern of age, income, marital status, homeowning status, education, etc.

Refer to these characteristics when you're sifting through your customer base for new prospects. If you've got customer data on computer files, this will obviously be easier.

How about non-IRA plans?

To successfully market Keoghs or small business retirement plans, once again, you must have accurately identified characteristics that make a person or business a good prospect. If you have doubts, try to meet with a selected sampling or "focus group" of these customers, and identify what led them to open their plans, and what characteristics they share. Then focus on these shared characteristics when identifying other prospects within your customer base.

Prospecting By Mail—

Sales Piece — Direct mailing to your chosen prospects is the quickest and cheapest method of sending your message, when all expense items have been factored in.

Whether it's a brochure mailed as a statement stuffer, or a stand-alone salespiece, make sure that your message conveys the following:

✓ benefit ✓ urgency ✓ call to action

If you have a competent designer on-staff, use their talents. If not hire the most competent outside assistance you can afford. Be honest about your on-staff expertise. With the degree of direct-mail competition in the average mailbox today, your salespiece HAS to be good to even get opened! (An entire segment could—and in future issues will—be devoted to just this subject . . . getting a salespiece opened and read.)

Retirement Plan Newsletter — A *Retirement Plan Newsletter* or "Did you know?" fact sheet—whether fancy and expensive or simple and thriftily done—is a great tool for keeping and gaining IRA customers. Interesting and worth-while material is easy to find if staff members are on the lookout for it, in newspapers, periodicals, government journals. Many sources are noncopy-righted, and other material may be usable with a source credit.

Yet another option is the use of a custom, or a "personalized-generic" newsletter, published and provided by a retirement services firm.

Building a reputation as an informed, credible source of IRA and retirement plan information will yield long-term dividends.

Marketing by Phone

One approach is to simply follow up a mailing with telephone contact. In fact, any mailing can be more effective if you do.

Or, you may telemarket FIRST to uncover customer interest, and receive permission to send additional material. Phone and mail are a great 1-2 punch.

Keep the contact professional and somewhat soft-sell. Invite the prospect to spend time with an IRA advisor when they next visit the bank. If the opportunity presents itself, make a formal appointment for that purpose. If they want a callback at another time, try to accommodate.

Phone contact is one-to-one selling. It has the disadvantage of higher cost per contact, but the decided advantage of "persuasion applied to a qualified lead," a good formula for success in any selling effort.

Non-Customer Prospects

Since there is a direct correlation between retirement plan purchase and such factors as age, income, education, and marital and homeowning status—to name a few—build a non-customer prospect list, either yourself, or through the services of a name list company. If you have staff time to devote to this project, you can probably do a better job yourselves in the long run.

✓ Target by profession, such as the white-collar professions, unionized trades-people, two-income families earning over $50,000, etc.

✓ Target geographically; by suburb, by neighborhood, (often segmentable and reachable by zip code or mailing route), or by property type (such as lakeshore or recreational property . . . with such owner information often obtainable through your county recorder or registrar's office).

Personalize your promotions by recipient's name whenever possible—though the more extensive your prospecting, the more likely you'll encounter situations when you can't.

Business Retirement Plans

When marketing plans to small business prospects, create a "hit list" for your sales staff, based on your knowledge of local or regional employers. With these customers more so than IRA customers, you may want to use the one-on-one advantages of phone marketing—telemarketing—to gauge their interest. From that point it often becomes a matter of personal contacts and salesmanship.

Summary

Direct marketing methods are not the only ways to increase your institution's retirement plan business. But when planned and executed well, they can be a very cost-effective way for ANY institution—large or small—to be a proportionately "big player" in their retirement plan market. PD

Keoghs—*Continued from page 2*

This greatly enhances their attractiveness to the self-employed.

IRA Limitations

As is now well known, IRA deductibility for tax purposes was restricted by the Tax Reform Act of 1986. The Act limited full deductibility to:

a) those households without an active participant in an employer retirement plan, or

b) those households having adjusted gross income below certain threshold levels. Incomes above these levels gradually have the deductibility of their IRA contribution phased out. Currently, "married-filing-jointly" households with an AGI of $50,000 receive no tax deduction for their contributions.

Furthermore, IRA contribution limits are relatively low compared to a Keogh, with a maximum individual contribution of $2,000.

Keogh Enhancements and Advantages

Keogh plans, on the other hand, have much higher tax-deferred contribution limits than IRAs. A Keogh with a money-purchase option may receive and tax defer up to 25% of an individual's income.

Advantages to Beneficiaries

Keoghs also offer some advantages to beneficiaries of the planholder that IRAs do not. While both plans offer rollover and distribution options for spouses, and several distribution options for non-spouse beneficiaries, only the Keogh offers the $5,000 death benefit exclusion (for a full discussion of the DBE, see the June, 1990 issue of The Pension Digest).

This provision allows $5,000 of plan assets to be received free of income tax liability. The DBE was not available for self-employed individuals until the 1984 tax year, and then—as now—only when a lump-sum (total) distribution is taken from the Keogh. A spouse has several options for tax sheltering the remainder of the Keogh's assets, including rollover to an IRA, or 5/10 year averaging of the distribution. A non-spouse has only the option of 5/10 year averaging for the remainder above the $5,000 death benefit exclusion amount.

(Participants themselves also have the 5/10 year averaging distribution option, providing certain conditions are met.)

There is no tax-free exclusion amount for beneficiaries of an IRA accountholder.

Other Benefits?

Reporting has also been simplified for Keogh plans. Prior to the 1990 tax year, all Keogh accounts with a balance greater than $25,000 required the filing of form 5500EZ by the accountholder, but generated and kept on file by the custodian institution.

But now, form 5500EZ is needed only for those accounts with a balance greater than $100,000. For financial institutions, this eliminates the reporting and recordkeeping requirement for the great majority of Keogh accounts.

Conclusions

1. Keogh accounts have grown in tax-advantaged status when compared to IRAs.

2. Keogh deposit limits remain substantially higher than those of an IRA.

3. Keogh reporting requirements have been reduced, making their administration much easier for custodian institutions.

The foregoing facts have been a major influence in the renewed interest in Keogh plans for self-employed persons. More and more institutions may find it advantageous to resume or rededicate themselves to active promotion of these profitable and beneficial plans. PD

✔✔Check It Out

Question: The interest rate in our passbook savings is 5.00%, and 5.25% in our IRA accounts. Can we use a projection in our IRA document that uses 6%?

✔ No. The governing IRA regulation stipulates that the interest rate used in the projection must be no greater than that actually offered to the customer.

Question: I have an IRA customer who is age 73, and his wife is age 61. She also has an IRA. He is retired. She still is employed and will have W-2 income of $25,000 for 1990. His required minimum distribution for 1990 is $1,000.

If she contributes $2,000 after he withdraws $1,000, then—on balance—they appear to have avoided that requirement to take a minimum distribution. Is this permissible?

✔ Yes, it is. The Internal Revenue Code, in general, defines the rules for contributions and distributions on a per person basis and only in limited circumstances takes marital status into account. He needs to take his minimum amount. She may make those contributions to which she is entitled, regardless of his age.

Question: What effect, if any, does a change in the beneficiary of an IRA (before or after the required beginning date of the accountholder) have on the RMD (Required Minimum Distribution) calculation?

✔ The proposed regulations allow for accountholders to change their designated beneficiary. Beneficiary elections are generally irrevocable for purposes of calculating the RMD. That is, if beneficiaries are not chosen prior to the required beginning date, they cannot be named later. The required beginning date, April 1 of the year after turning 70-1/2, is the "lock-in" date for beneficiaries. Until that date beneficiaries can be changed without problem even if the account is in distribution. However, once the accountholder reaches the required beginning date, the rule is always that payout can be speeded up but not slowed down. If the change is to a younger beneficiary, the life expectancy of the prior beneficiary must be used. If the new beneficiary is older, then that life expectancy must be used and it will speed up the payout .

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.

Waivers—*Continued from page 1*

that the state law cited was preempted by ERISA in the matter of beneficiary designation. The terms of the plan document were binding on the administrator, the court found. Why? ERISA prohibits any alienation by a plan participant unless it's by a Qualified Domestic Relations Order (QDRO). ERISA and the IRS also require that a plan must be administered as written. Since the deceased planholder had the authority to change the beneficiary designation, but did not, his prior designee—his ex-wife—was entitled to his interest in the plan funds.

What can be expected in other cases?

We would expect most federal courts to follow the philosophy of the McMillan case when the plan in question is a qualified plan. We would also expect state courts (which generally have jurisdiction) to vary widely in making their decisions when the plan is an IRA.

What's to be learned from this?

The direction of court rulings in these matters is unpredictable at best. In order for an accountholder/planholder to have his or her wishes carried out after death, it is advised that they not only have a prior beneficiary waive future interest in their assets, but also MAKE SURE that they update their beneficiary designation, properly and timely. PD