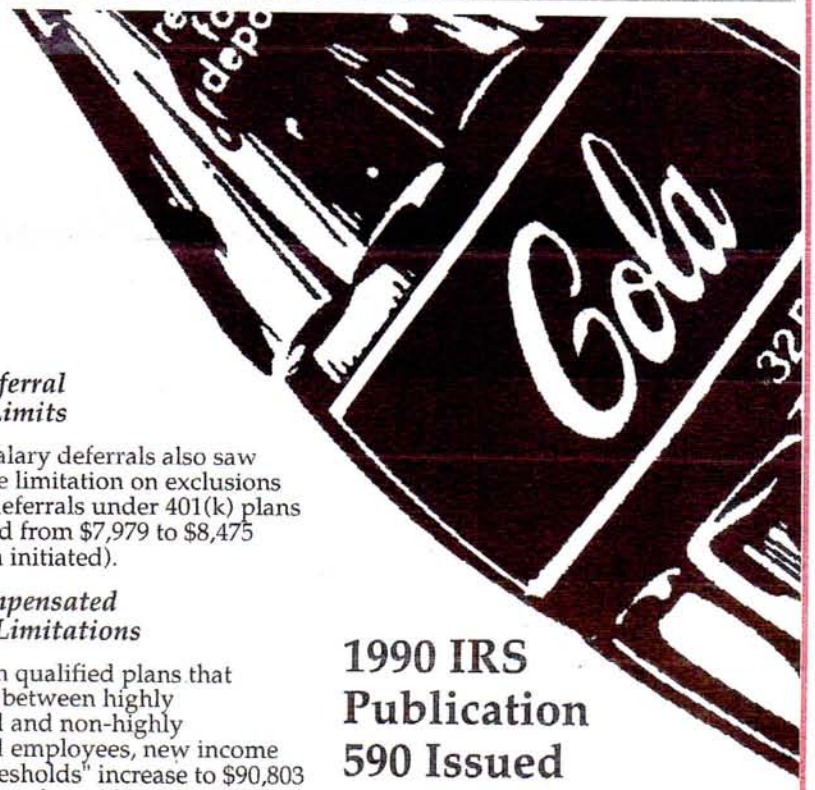
THE Pension Digest

Published Since 1984 Collin W. Fritz & Associates, Inc., *"The Pension Specialists"* February, 1991

Certain Pension Limits Rise, In Keeping With IRS "COLA" Provisions



Certain SEP (simplified employee pension) and qualified plan income and qualification limits have risen as of January 1, 1991, in keeping with Cost of Living Adjustment (COLA) provisions of IRS law. Following is a summary of some of these changes.

SEP Changes

Employers making contributions to Simplified Employee Pension (SEP) plans for their employees are exempt from making contributions for those earning less than $363. This exempt amount rose via cost of living indexing from $342 for the 1990 plan year (just one more in a series of increases from the initial base amount of $300, which is still listed on the Form 5305-SEP, 6-88 version).

Further SEP adjustments were made, including the employee compensation threshold below which all contributions made on behalf of employees must be the same percentage of their total compensation. Employees whose compensation is above the threshold level do not have to receive a SEP contribution that is the same percentage of compensation as all other employees.

This compensation threshold was initially established at $200,000, and it too has been modified each year in accordance with cost of living adjustments. For 1991 it rises to $222,220, up from $209,200 in 1990.

Elective Deferral Exclusion Limits

Elective salary deferrals also saw changes. The limitation on exclusions for elective deferrals under 401(k) plans was increased from $7,979 to $8,475 ($7,000 when initiated).

Highly Compensated Definition Limitations

For certain qualified plans that discriminate between highly compensated and non-highly compensated employees, new income limits or "thresholds" increase to $90,803 and $60,535, up from $85,485 and $56,990. These began initially at $75,000 and $50,000.

Defined Benefit Plans

Defined benefit plans have had their benefit limitation increased from $102,582 to $108,963 for 1991, also the result of application of a COLA factor to the previous limit.

Defined Contribution Plans

Defined contribution plans however, will retain their $30,000 benefit limit, the same as for 1990. This is because the law under which these limits are set provides that defined contribution plan limits will remain at the $30,000 level until the defined benefit limit exceeds $120,000, by virtue of further COLA adjustments. PD

1990 IRS Publication 590 Issued

The IRS recently issued the 1990 tax-year version of its Publication 590, the 36-page IRA instruction folder to be used in preparing 1990 tax returns.

Publication 590 includes the most important IRA rules and procedures, sample forms, and both life expectancy and minimum-distribution-incidental-benefit (MDIB) tables.

Simplified Employee Pension (SEP) rules, options and procedures are also discussed, since such plans require the use of an IRA account and documentation to establish and administer.

Copies of this publication are available through Collin W. Fritz and Associates, Box 426, Brainerd, MN 56401 (800-346-3961), for $7.00 each, five for $25.00, or in larger quantities at greater savings if desired. PD

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Schedule P's Purpose; Its Role With New 5500EZ Rules

Schedule P is one of several important schedules that can be filed with the annual returns for pension benefit plans, and is used when the plan in question is set up as a trust. The types of plan returns it is filed with include:

(A) 100+ participant employee benefit plans (Form 5500); (B) less than 100-participant employee benefit plans (5500-C/R); and (C) one-participant pension benefit plans (5500EZ)

Schedule P Starts Three-Year Statute of Limitations

Schedule P's primary role is to set in motion the three-year statute of limitations for information filed on Forms 5500, 5500-C/R or 5500EZ. Schedule P may be filed by any trustee of a trust created as part of an employee benefit plan as described in section 401(a), or any custodian of a custodial account described in section 401(f).

Schedule P To Be Filed Only With 5500-Series Forms

Schedule P is not to be filed by itself, that is, without one of the 5500-series forms to which it is to be attached, according to IRS instructions for the 1990 tax year, under "C. How to File."

How About Those Below 5500EZ Filing Threshold?

This poses a question for many one-participant pension benefit plans (owner and spouse) with less than $100,000 in plan assets. Under the newest IRS rules, those with such balances—either singly or in aggregated plans—need not file the Form 5500EZ.

Does this mean that these non-filers' custodian/trustees do not receive the benefit of the statute of limitations? The Schedule P is itself a return, filed to protect the trustee or custodian, moreso than the plan administrator of participants. IRS instructions do not address this issue. And in the absence of such guidance, a literal interpretation might suggest that this is the case; no filing of 5500EZ, no filing of Schedule P. No Schedule P, no statute of limitations. To clarify this matter, we contacted the IRS.

Schedule P Without a 5500-Series Form?

The IRS' Mark O'Donnell of its Employee Benefits Plans & Projects Branch conceded that the regulation gap is a real one. O'Donnell points out that the IRS filing system for these plans is in itself based on the Form 5500-series, not the custodian/trustee's name. Without a file-based form (5500) to attach it to, the IRS will not keep records of a Schedule P filed by itself.

"People have and do send in Schedule Ps by themselves," says O'Donnell. "It's not prohibited, but it's likely that the form will be sent back." O'Donnell continued that the IRS is not especially interested in the records that would be missed when Form 5500EZ is not filed (on less than $100,000 in assets). He alluded to "bigger fish" that the IRS is more interested in.

Yet "we can't refuse to allow someone to start the statute of limitations running ... or force them into an unlimited statute of limitations," said O'Donnell.

He commented that if the issue ever *did* arise as to whether a Schedule P was filed by itself, and the statute of limitations had been started and run, "... it would become a question for the courts,"said O'Donnell. "Our guess is that the court would accept a well supported case ...whether or not we accept the form would be irrelevant."

O'Donnell added that if a custodian/trustee really felt it necessary to start the statute running when no 5500EZ is filed, that sending the Schedule P via registered mail might be advised, to provide supporting evidence of its having been sent.

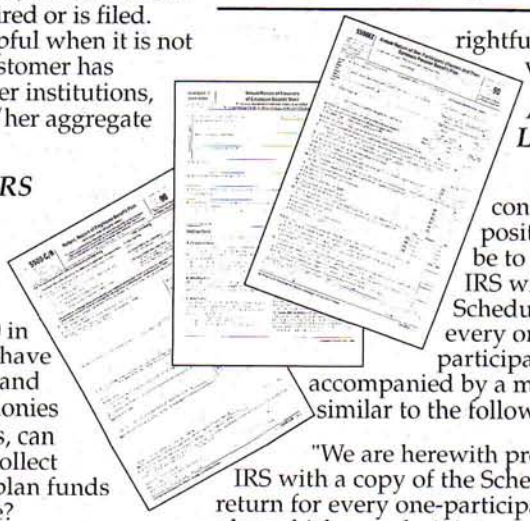
Schedule P and the Bank Customer

A conservative position for banks that serve as the trustee for one-person employee benefit trust plans, would be to complete the Schedule P and provide it to every such plan holder, and keep a record (copy) of it in their bank file. In this way banks' fiduciary obligations to that customer with respect to Schedule P reporting have been met, whether or not a Form 5500EZ is required or is filed. This is particularly helpful when it is not known whether the customer has other such plans at other institutions, and the amount of his/her aggregate asset balance.

Schedule P and the IRS

Meeting responsibilities to the IRS may be another matter. If a customer with less than $100,000 in assets should prove to have a non-qualifying plan, and thus owe the IRS tax monies plus potential penalties, can the IRS argue for and collect from the trustee if the plan funds are no longer reachable?

This scenario is certainly not inconceivable. Without a statute of limitations for protection, a trustee can rightfully feel vulnerable.



A Model Letter

A similarly conservative position would be to provide the IRS with a copy of Schedule P for every one-participant plan, accompanied by a message similar to the following:

"We are herewith providing the IRS with a copy of the Schedule P return for every one-participant trust plan which we administer, whose participants may or may not be filing a

Continued on page 3

5500-Series Forms Issued

The 1990 5500-series forms for the annual returns/reports of ERISA-governed employee benefit plans have now been issued, as they are each year jointly by the IRS, the Pension Benefit Guaranty Corporation, and the Pension and Welfare Benefits Administration.

A new Schedule E has been added this year for plans containing ESOP benefits.

The forms include:

Form 5500 — for employee benefit plans with 100 or more participants.

Forms 5500-C/R — for EBPs with less than 100 participants.

Form 5500EZ — for one-participant plans (those who have less than $100,000 in assets in such plans—either in one plan or in aggregated plans—are not required to file a Form 5500EZ).

Available now also are the following schedules for the 5500-series forms:

Schedule A (insurance information

Schedule B (actuarial information)

Schedule C (service provider & trustee information)

Schedule E (employee stock ownership plan—ESOP—info)

Schedule SSA (may be needed for separated participants)

Schedule P (filed to begin the 3-year statute-of-limitations term)

These forms and schedules are available from IRS—call 1-800-424-3676 8 a.m. to 5 p.m. (weekdays) and 9 a.m. to 3 p.m. (Saturdays). PD

Form 8300 for Cash IRA Transactions?

In January of 1990 the Internal Revenue Service printed a new form, the Form 8300, requiring the reporting of cash payments over $10,000 received in a trade or business. The form states that "the information is useful in criminal, tax and regulatory investigations, for instance by directing the Federal Government's attention to unusual or questionable transactions. Trades or businesses are required to provide the information under 26 USC 6050I."

This form was also the topic of an Internal Revenue Service Notice in October 1990 [Notice 90-61, October 1, 1990]. The Revenue Reconciliation Act of November 5, 1990 clarified definitions and reporting requirements. With all of this information, it was not entirely clear how this applied to IRA or other pension contributions or transactions. The following information may be helpful to you in handling cash IRA contributions in the coming year.

We contacted the office of Robert C. Harper, Jr. at the Exempt Organizations Technical Division of the IRS, who drafted the Notice. His assistant Tom Miller informed us that this question has been common, and the reporting required does apply to IRA or pension contributions in excess of $10,000, but only to those that are in cash.

Cash is defined by the regulations as the "coin and currency of the United States or of any other country, U.S. notes and Federal Reserve notes. It does not include bank checks, travelers checks, bank drafts, wire transfers or other negotiable or monetary instruments not customarily accepted as money."

In the event of a transfer or rollover (where the money comes in the form of a check or bank transfer) the reporting is not necessary. Nor is the reporting necessary if the financial institution is already required to file a Form 4789, Currency Transaction Report.

Branch banks are considered to be separate businesses, and each responsible for its own reporting unless—in the ordinary course of business—the branch would have reason to know the identity of payers making cash payments at other branches; that is, if there is a central unit that receives all such information.

General instructions for the form state that transactions with an initial payment in excess of $10,000 must be reported. So must two related transactions within 24 hours totalling over $10,000. If a recipient knows or has reason to know that transactions occurring over a longer time period are related, those must be reported

Continued on page 4

Are Participants in "Frozen" Plans Considered "Active" for IRA Purposes?

What happens if you're a plan participant in a qualified pension or profit-sharing plan whose assets are frozen, and you want to make an IRA contribution? Are you still considered an active participant, and therefore limited by adjusted gross income (AGI) in the IRA amount that is tax deductible?

"Yes," says the IRS. Under such circumstances you must check box 6 of Form W-2 indicating that you are an active participant, and follow the normal active-participant rules as they apply to IRA contributions.

Most such situations involve qualified pension or profit-sharing plans affected by statutory changes ordered by the Tax Reform Act of 1986 (TRA 86). The change with respect to these plans took effect on January 1, 1989. However, due to the complexity of the amendments necessary under the Act, employers have been given until the last day of 1992 to amend their plans.

Many employers have adopted the transitional Model Amendment 2 or Model Amendment 3. Under their conditions, no additional plan benefits accrue during the period between adoption and final amending.

"Active Status" Yet No Accruing Plan Benefits?

What at first glance may seem an injustice may in most circumstances not be so. The IRS has indicated that adoption of the Model 2 or 3 Amendments by an employer usually indicates an intent by the employer to continue providing plan benefits once the amendment takes effect, including providing them on a retroactive basis.

This being the case, the IRS has opted for retaining active status for the plan member, if they otherwise qualify under the guidance previously given by the IRS in Notice 87-16.

This position is no doubt taken because of the difficulties that would arise if plan participants who were temporarily not accruing qualified plan benefits were allowed to make deductible contributions to other plans such as IRAs, and then subsequently received retroactive qualified pension or profit-sharing plan contributions from their employers. This could—depending on the participants' AGI—make their prior IRA contributions excesses, with accompanying penalties.

If Retroactive Benefits Are Not Provided . . .

While it is the norm for employers to provide retroactive benefits, the Model Amendments do not require this. But if the employer does not intend to continue benefits, it would very likely not adopt Model Amendments 2 or 3. When the employer does not intend to provide retroactive accrued benefits, then plan participants are NOT CONSIDERED ACTIVE PARTICIPANTS for purposes of participation in other plans. PD

Schedule P's Purpose—*Continued from page 2*

Form 5500EZ. We seek the same protection of the statute of limitations as that afforded to trustees whose customers must and do file Form 5500EZ, and who thereby begin the running of that statute.

Copies of the schedules will be kept in our files, in the event that verification of the date of filing and the start of the running of the statute of limitations is needed.

We are aware that IRS in the past has had no system for accepting and filing the Schedule P if it is not submitted with a 5500-series form, and that you have provided instructions not to submit it in such fashion. However, this policy is viewed by us as one that does not provide trustee entities with the full statute-of-limitation protection that they should be afforded. For that reason we have made this submission."

Since an IRS representative has described the agency as comparatively less interested in the fiduciary/Schedule P consequences of plans not required to file Schedule P (under $100,000), this may seem an unnecessarily elaborate step to take for purposes of self-protection. That is a decision you as a trustee institution must make yourself, based on the plans you administer, and therefore your potential level of risk. PD

Form 8300—*Continued from page 3*

as well. Furthermore if all the transactions are related and within a one year period tally more than $10,000, the form must be used to report those transactions.

Qualifying transactions must be reported within 15 days of receipt. This 15-day deadline begins to run at the time the aggregate amounts exceed $10,000. If two or more separately reportable transactions occur within 15 days of one another they may be reported on the same Form 8300, but the due date is 15 days after the first transaction.

Businesses filing the return must fill in the identification information on the blanks of the return. If the recipient knows that the payer is an agent of another, this will be two parties instead of one. By regulation, the identity of the payer must be verified by the usual form of identification, such as passport, immigration document, driver's license or credit card.

A statement of the information that was filed on the form must be given to the payer in any form by January 31 of the year following the transaction. Copies of the returns must be kept for five years.

The form may also be filed in the event that the recipient views a transaction as suspicious. There is a special box to be checked in that instance. Penalties for not reporting to the IRS as required, or for filing fraudulent reports, are set out on the instructions and are both civil and criminal, and include up to five years imprisonment.

At this printing we are unaware of specific penalties for failing to provide this information to customers by January 31. PD

✓ Correction to Calculation for Self-Employed

In the January, 1991 Pension Digest newsletter we erred in the discussion of the new method to be used to calculate the deductible contribution amount for a self-employed person contributing to a Keogh or a SEP for 1990.

For the purpose of calculating the proper contribution amount for a self-employed person, we were correct in stating that a self-employed person must adjust (i.e. reduce) his or her net earnings by two amounts: (1) the deduction which he or she is allowed to take for self-employment taxes and (2) the deduction amount for his or her pension contribution.

In general, the deduction amount for self-employment taxes equals 50% of the amount which he or she must pay in self-employment taxes.

We erred in calculating what the self-employment tax amount would be.

In our first example, we erred in calculating the self-employment tax because we multiplied the net income of $50,000 by 15.30% to determine such tax. It is not this simple. If one multiplied the net earnings by .1530, the individual would pay too much self-employment tax.

Internal Revenue Code sections 1401 and 1402 define the assessment of the self-employment tax. Section 1402(a) defines net earnings as gross income from a trade or business, less related business expenses, less the deduction provided by 1402(a)(12). Subsection (12) provides for a special deduction equal to the net earnings (determined without regard to this paragraph) times 50% of the sum of the tax rates of section 1401(a) and (b) for such year.

The best way to determine and illustrate the calculation of a self-employed's self-employment tax is to complete the 1990 Form SE. Line 4 is the special deduction authorized by subsection (12).

Set forth below is a completed sample of the SE form using net earnings of $50,000, the same amount as in example #1 of the January newsletter.

This calculation shows the self-employment tax to be $7,064.78 and not the $7,650 as originally shown. Thus, the $50,000 is to be reduced by $3,532.39 (50% of $7,064.78) and then multiplied by the special percentage of 13.04348%. The proper contribution amount is then $6,060.99 rather than the $6,022.61 as shown in the January newsletter.

No error was made in the second example because the tax rate of .1530 is applied against the maximum amount of $51,300. This will be the case whenever the net earnings times .9235 is equal or greater than $51,300. Thus, any time the net earnings are more than $55,549.54 ($55,549.54 x .9235 = $51,300), the self-employment tax will be the maximum of $7,848.24 and the 50% deduction amount will be $3,929.45.

The IRS has recently issued the 1990 Publication 560—Retirement Plans for the Self-Employed. On page three, the following worksheet is used to calculate the contribution amount for a self-employed person. We recommend the use of this worksheet. PD

Section A—Short Schedule SE (Read above to see if you must use the long Schedule SE on the back (Section B).)

1	Net farm profit or (loss) from Schedule F (Form 1040), line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a	1		
2	Net profit or (loss) from Schedule C (Form 1040), line 29, and Schedule K-1 (Form 1065), line 15a (other than farming). See Instructions for other income to report.	2	50,000	00
3	Combine lines 1 and 2. Enter the result	3	50,000	00
4	Multiply line 3 by .9235. Enter the result. If the result is less than $400, **do not** file this schedule; you **do not** owe self-employment tax. ▶	4	46,175	00
5	Maximum amount of combined wages and self-employment earnings subject to social security or railroad retirement (tier 1) tax for 1990	5	$51,300	00
6	Total social security wages and tips (from Form(s) W-2) and railroad retirement compensation (tier 1). **Do not** include Medicare qualified government wages on this line	6	0	00
7	Subtract line 6 from line 5. Enter the result. If the result is zero or less, **do not** file this schedule; you **do not** owe self-employment tax. ▶	7	51,300	00
8	Enter the **smaller** of line 4 or line 7	8	46,175	00
9	Rate of tax	9	x.153	
10	**Self-employment tax.** If line 8 is $51,300, enter $7,848.90. Otherwise, multiply the amount on line 8 by the decimal amount on line 9 and enter the result. Also enter this amount on Form 1040, line 48 **Note:** *Also enter one-half of this amount on Form 1040, line 25.*	10	7,065	78

For Paperwork Reduction Act Notice, see Form 1040 Instructions. **Schedule SE (Form 1040) 1990**

Self-Employed Person's Rate Worksheet

1) Plan contribution rate as a decimal (for example, 10% would be 0.10) .....
2) Rate in Line 1 plus 1, as a decimal (for example, 0.10 plus 1 would be 1.10) .....
3) Divide Line 1 by Line 2. This is your self-employed rate as a decimal .....

Figuring your deduction. Now that you have your self-employed rate, you can figure your deduction for contributions on behalf of yourself by completing the following steps:

Step 1
Enter your rate from the *Self-Employed Person's Rate Table* or *Self-Employed Person's Rate Worksheet* .....

Step 2
Enter the amount of your net earnings from Line 29, Schedule C (Form 1040) or Line 36, Schedule F (Form 1040) ..... $

Step 3
Enter your deduction for self-employment tax from Line 25, Form 1040 .....

Step 4
Subtract Step 3 from Step 2 and enter the amount ..... $

Step 5
Multiply Step 4 by Step 1 and enter the amount .....

Step 6
Multiply $209,200 by your plan contribution rate. Enter the result but not more than $30,000 ..... $

Step 7
Enter the smaller of Step 5 or Step 6. This is your deductible contribution. Enter this amount on Line 27, Form 1040. ..... $