THE Pension Digest

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FDIC notification update

... Must New IRA Accountholders Receive FDIC Notices After Initial Notification Mailing?

Financial institutions are required to notify all customers potentially affected by the new insurance coverage limits placed to certain retirement plans. The deadline for such notification is October 10, 1993, but many financial institutions have already mailed these notices, which must be given to customers with an IRA, self-directed Keogh plan account, "457" plan account or a plan in which their institution is acting in a fiduciary capacity.

But how about customers who open an IRA account after the institution has made its notification mailing to all potentially affected customers?

The Regulation is not as explicit as would be ideal, but our recommendation is as follows:

Accounts Opened After Mailing but Prior to October 10 Deadline

Because the FDIC expects institutions to make a good-faith effort to identify and notify all potentially affected customers, we feel it is the safe, conservative and sensible approach to furnish the FDIC notice at the time an account is opened.

Notices vary, however. Our firm, for example, offers two Notice forms:

1) One (Form #720) is intended solely to inform the customer of the new insurance coverage limits.

2) The other (Form #730) also contains language that modifies or adds a reference in the customer's IRA plan agreement pertaining to FDIC insurance coverage of the IRA plan assets.

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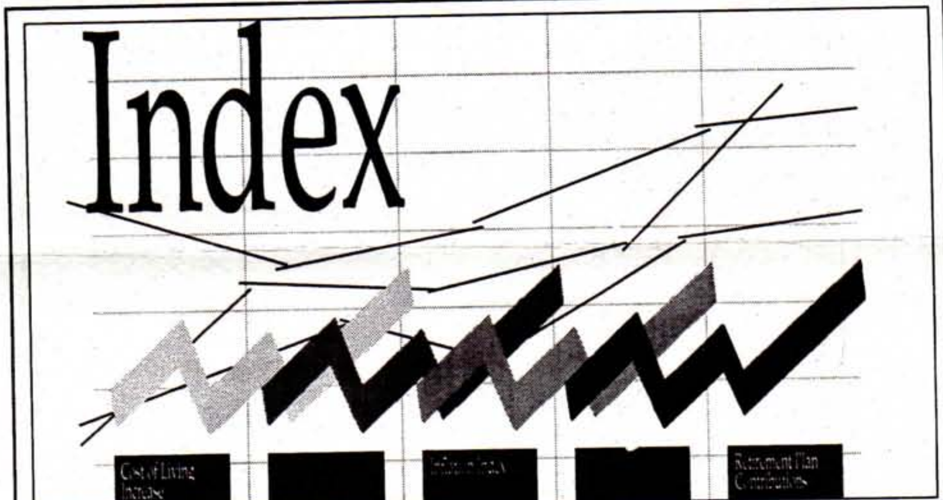

1993 Indexed Amounts for Various Pension Plans

Both IRA and non-IRA qualified retirement plans have maximum annual contribution limits that must be observed by contributors. But unlike IRAs, many pension plans are governed by regulations that have provided a mechanism to increase maximum contributions to accompany the inevitable rise in the cost of living. This mechanism is known as indexing.

The following is a listing and description of key pension contribution types, as well as their 1992 and 1993 levels as indexed for inflation.

Elective Deferrals

Code section 402(g) imposes an annual limit on the amount of elective deferrals which any one individual may defer into one or more plans, even, if these plans are sponsored by different employers. The original limit was $7,000, but it is indexed and increases each year. The limit for 1993 is $8,994; the limit for 1992 was $8,728. Note that this limit applies on a per person basis and not per employer.

Category	1992 Indexed Amt.	1993 Indexed Amt.
SEP Plans Minimum Compensation Threshold		
Code section 408(k)(2)(c) which deals with participation requirements for SEP plans requires an employer to make a contribution for an employee only if he or she received at least $300 in compensation as indexed for that year.	$363	$385

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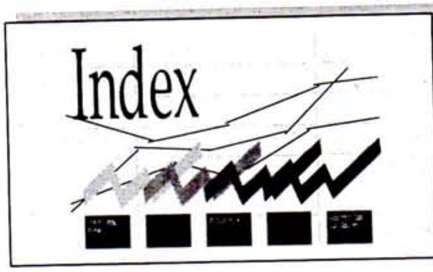
Indexed Amounts—*Continued from page 1*

Category	1992 Indexed Amount	1993 Indexed Amount
SEP and Qualified Plan Maximum CompensationThreshold		
Code section 401(a)(17) limits the annual compensation which can be taken into consideration for plan purposes to $200,000 as indexed.	$228,860	$235,840
Section 415 Limits		
Code section 415 limits the benefits and/or contributions under qualified plans. The annual defined benefit limit is $90,000 as indexed.	$112,221	$115,641
The annual defined contribution plan limit is $30,000 as indexed but will not change until the defined benefit amount exceeds $120,000.	$30,000	$30,000
Excess Distribution Tax Threshold		
Code section 4980A imposes a tax equal to 15% of the excess distributions of individuals or it imposes an estate tax equal to 15% of the individual's excess retirement accumulation. An excess distribution means the aggregate amount of retirement distributions to any individual during any calendar year, to the extent such amount exceeds the greater of $150,000 or $112,500 (as indexed).	$140,276	$144,551
However, if the individual elects 5-year averaging, then the 15% tax applies only to the extent such amount exceeds the greater of: $150,000 x 5 = $750,000, or $112,500 (as indexed for 1993) x 5 = $562,500.	$701,380	$722,755



Top-Heavy Plans

Code section 416 sets forth special rules for top heavy plans. A defined contribution plan is top heavy if, as of the determination date, the aggregate of the accounts of key employees under the plan exceeds 60% of the aggregate of the accounts of all employees under the plan. Code section 416(i) defines the term "key employee" as an employee who, at any time during the plan year or any of the four preceding plan years is —

	Category	1992 Indexed Amount	1993 Indexed Amount
1.	an officer of the employer having compensation in excess of 50% of the defined benefit dollar amount (in effect under 415(b)(1)(A). These numbers are the result of this defined benefit dollar limit ($112,221 and $115,641).	$56,111	$57,821
2.	an employee who is one of the top 10 owners who own (1) more than a 1/2% and have the largest percentage ownership value and (2) whose income exceeds $30,000	$30,000	$30,000
3.	any employee who is a 5% owner	N/A	N/A
4.	a 1% owner having annual compensation in excess of $150,000.	$150,000	$150,000

Highly Compensated Employees and Definition of Compensation

The governing rule of Code Section 401(a)(4) is that a qualified plan cannot discriminate in favor of a highly compensated employee (HCE) except as the law permits in limited situations.

Congress has chosen to simply define most small business owners as highly compensated regardless of their net income. The remainder of the definition is not as simple. An HCE can come from either of the following two groups: (1) highly compensated active employees; or (2) highly compensated former employees.

For purposes of the year for which the determination is being made (the determination year), a highly compensated employee is any employee who, with respect to this employer: (1) performs service during the determination year and (2) is described in any of the groups below:

Look-back year calculations (e.g. 1992): (1) The employee is a 5% owner at any time during the look-back period; (2) the employee receives compensation in excess of $75,000 as indexed during the look-back period; (3) the employee receives compensation in excess of $50,000 as indexed during the look-back period and is a member of the top paid group for the look-back year; or (4) the employee is an "includable officer" during the look-back year. In general, an includable officer is one who receives compensation greater than $45,000.

Determination year calculation (e.g. 1993): (1) The employee is a 5% owner at any time during the determination period; (2) the employee receives compensation in excess of $75,000 as indexed during the determination year and is one of the 100 employees who receive the most compensation during the determination year; (3) the employee receives compensation in excess of $50,000 as indexed during the determination year and is a member of the top paid group for the determination year and is one of the 100 employees who receive the most compensation during the determination year; or (4) the employee is an "includable officer" during the determination year and is one of the 100 employees who receive the most compensation during the determination year.

The employee:

	Category	1992 Indexed Amount	1993 Indexed Amount
1.	was at any time a 5% (or greater) owner,	N/A	N/A
2.	received compensation from the employer in excess of $75,000 as indexed	$93,518	$96,368
3.	received compensation from the employer in excess of $50,000 as indexed and was in the top paid group for such year (in general, the top 20%),	$62,345	$64,245
4.	was at any time an officer and received compensation greater than the defined contribution section 415 limit of $45,000 as indexed.	$56,111	$57,821

PD

QP/TSA Direct Rollover Update ...

Direct Rollover Privilege Cannot be Subject to Return Condition in Case of Plan Overpayment

The direct rollover provision of UCA '92, which calls for mandatory 20% withholding from any eligible QP or TSA distribution not directly rolled over to another eligible retirement plan, has forced plan administrators, participants and the IRS to consider many new ramifications and uncertainties.

One resulting question recently faced by the IRS was whether a plan administrator could place a condition on a direct rollover payout that would require a custodian or trustee of a receiving retirement plan to return any portion of the rollover that was paid out incorrectly. Further, this condition would provide for a return ON DEMAND at the discretion of the originating plan's administrator.

Regardless of the outcome, this was a pertinent question, because incorrect payouts from qualified retirement plans are not uncommon.

The IRS considered and then rejected this request on the grounds that allowing it would result in the limiting of rollover options for plan participants. In the opinion of the IRS, a receiving plan administrator might refuse to accept a direct rollover if the distributing plan required an on-demand return of overpayment. The administrator could justify this refusal on the grounds that to do so might jeopardize the qualified status of their entire plan, under Section (401(a) or 408(a) or (b). The upshot of this would "effectively eliminate the distributee's opportunity to elect a direct rollover," the IRS said.

This, the IRS further concludes, violated its direct rollover guideline that "a plan administrator may prescribe any procedure for a distributee to elect a direct rollover, provided the procedure is reasonable" (Section 1.401(a)(31)–1T, Q&A–6).

Although listed as a "Special Ruling" dated June 3, 1993, the text of the IRS commentary from the Employee Plans Actuarial Division ended with the caution "this is not a ruling". However, it would be hard to argue that it does not set a precedent that would influence future requests of a similar nature.

Similar Requests With Respectto an IRA?

Speaking purely speculatively, what would be the IRS' position if the receiving eligible plan were an IRA and not another QP or TSA? The Service did not address this but simply answered the question posed by the administrator of the distributing plan.

Admittedly, the consequences from the return of an incorrect payment directly rolled to an IRA would be limited, impacting one individual rather than the multiple participants of a QP or TSA. For an IRA accountholder forced to return an improperly rolled-over pension payout, the result would be an excess contribution, the prescribed 6% excise tax and a corrective tax return filing.

Despite the more limited effect in such an IRA situation, it should not be presumed that this would be acceptable to the IRS. The accountholder might indeed be responsible for the return of an overpayment, though perhaps with some compensation for the adverse consequences to him or her caused by the plan's mistakes.

But whether or not a plan could PRE-CONDITION a direct rollover privilege with any kind of agreement for on-demand return of funds – whether by a QP/TSA plan administrator or a bank IRA custodian – is a deeper question still to be answered. PD

FDIC notification — *Continued from page 1*

(Some IRA service providers sell plan documents that are silent on the matter of insurance coverage. We feel that this is an oversight, inasmuch as the degree of coverage of plan assets easily falls within the definition of an important plan provision, which should be described to the accountholder.)

Account Opened After October 10, 1993

If your IRA plan agreement is sufficiently up-to-date to include the new FDIC plan aggregation rules, no Notice is needed. If not, we recommend providing a form such as our #730, which contains not only the Notice language but also language "amending" or adding this provision to an IRA plan. PD

Prohibited Transaction Exemption 93–33 Extends PTE–2 Relief to SEPs

In the March, 1993 issue of *The Pension Digest*, we discussed Prohibited Transaction Class Exemption 93-2, known as PTE 93-2, which took effect May 11, 1993 and spelled out the conditions under which an IRA accountholder or Keogh plan owner might receive free or reduced-cost banking services without risking a prohibited transaction, and thereby losing the tax-deferred status of his or her account.

Prohibited Transaction Class Exemption 93-33 was issued shortly thereafter on May 28, 1993 and modifies PTE 93-2, which as of 5/28/93 is to be considered amended and redesignated PTE 93-33.

The specifics of 93-33 remain much the same as 93-2. Rather than reprint them here in their entirety, we will present only the 93-33 modifications (copies of the March Pension Digest article are available by sending $2 and a stamped, self-addressed envelope to The Pension Digest, P.O. Box 426, Brainerd, MN 56401).

Modifications to 93-2

In its simplest terms, 93-2 permitted "... the receipt of services at reduced or no cost by an individual for whose benefit an IRA or Keogh plan is established or maintained, or by members of his or her family, from a bank, provided that the conditions are met ... ."

PTE 93-2 applied only to IRA and Keogh plans not considered "employee benefit plans" and thereby covered by Title I of ERISA. And while the Department of Labor at that time indicated that it considered it appropriate to provide administrative relief from sections 406(a)(1)(D) and 406(b) for SEP plans, it determined that this was beyond the scope of its original proposal and did not include SEP plans at that time.

PTE 93-33, however, now extends 93-2's relief to any individual for whose benefit a Simplified Employee Pension (SEP) plan as defined under section 408(k) of the Code has been established, PROVIDING THAT the SEP plan gives participants the unrestricted authority to transfer their SEP assets to an IRA sponsored by another financial institution.

All other conditions of PTE 93-2 must be met.

Such relief is not, however, provided for the receipt of services by a "third party", such as the employer who established the SEP plan on behalf of his or her employees. PD

Last Call ...

August 8-11, 1993

As the 1993 CWF Conference Classic draws near, we want to give you a glimpse of some of the topics to be covered during this three-day workshop:

- ★ Truth-in-Savings – Retirement Plans
- ★ FDIC Requirements – Retirement Plans
- ★ Curing Qualified Plan Defects
- ★ 401(k) Issues
- ★ Relationship Banking
- ★ The New Rollover/Transfer Rules
- ★ Auditing IRA Files
- ★ Legal issues
- ★ Beneficiary Distributions In-Depth

For further information, call 1-800-346-3961

FDIC Insurance Notice Clarification

In the June issue of *The Pension Digest*, we scribed the type of accounts for which FDIC-insured institutions must furnish a Notice of Insurance Coverage changes. This Notice requirement affects accountholders who have IRAs, self-directed Keogh plan accounts, "457" plan accounts or accounts in which the insured institution is acting in a fiduciary capacity.

We referred to the date by which such Notice must be given, which for most accountholders is October 10, 1993, and to the exception of certain accounts that would not otherwise receive a regular monthly or quarterly statement prior to that date. This exception allows

FDIC-insured financial institutions some flexibility in providing Notices to minimize the need for special mailings.

We wrote in June that the Notice deadline for the latter group of accounts is " ... by an instrument's first date of maturity after October 10, 1993."

In fact, the deadline for such accountholders is "... prior to the later of: (1) 60 days before the first maturity date of that time deposit; or (2) October 10, 1993."

For example, if the maturity date for a time deposit is February 1, 1994, an institution is not required to furnish the Notice until prior to December 1, 1993. PD

✔✔ Check It Out

Question: Do the Truth-in-Savings rules always require that account disclosures be furnished 30 days in advance of the maturity of a time account which renews without notice from the consumer (i.e. automatically)?

✔ Answer. No. The final rule provides that: (1) disclosures may be given closer to maturity rather than a full 30 days in advance as long at least a five-day grace period is provided; (2) maturity notice for time accounts with maturities of one year or less need not provide all the information contained in an account disclosure; and (3) no advance notice is required for time accounts with maturities of one month or less.

If an institution provides a grace period of at least five days with respect to an account which would otherwise automatically renew or rollover, then the institution is permitted to provide the required disclosures 20 days before the end of the grace period. For example, if an institution offers a five-day grace period, then it must send the required disclosures at least 15 days before the maturity date (or 20 days before the end of the grace period). If the institution offers a 10-day grace period, then it must send the required disclosures at least 10 days before the scheduled maturity date (or 20 days before the end of the grace period).

An institution which does not offer a grace period of at least five days must give the 30 days advance notice.

Question: David Santarella, a longtime customer, died on July 3, 1993. He was a participant in his employer's 401(k) plan and the account balance is currently $43,000. His wife Gloria is seeking some help. the plan administrator has sent Gloria a form indicating that she may have the $43,000 paid to her (less 20% withholding) or she may directly rollover the $43,000 to an IRA. Do any special rules apply to direct rollovers when there has been a death?

✔ Answer. The answer is yes. And since many plan administrators/personnel officers are not aware of the special rules, you should be.

Code Section 101 provides for a $5,000 death benefit exclusion. Code Section 101(b) provides that a beneficiary may exclude from his or her gross income an amount received (whether in single sum or otherwise) to the extent of $5,000 if such amounts are paid by or on behalf of an employer, and are paid by reason of the death of the employee.

With respect to nonpension funds, this exclusion is not available if the employee had the right to be paid these funds unconditionally prior to his or her death.

With respect to pension funds, any nonvested portion of the account balance will qualify for exclusion. The vested portion will only qualify if the funds are paid to the beneficiary in a lump sum distribution as defined in Code section 402(e)(4).

The reason this death benefit exclusion rule is important is that such funds are ineligible to be rolled or directly rolled over to an IRA. If such an impermissible rollover or direct rollover took place, then it will be an excess contribution.

You (and your customer Gloria) may well find it worthwhile to write the QP administrator and instruct them that $5,000 is to be paid directly to Gloria via check (there should be no withholding since withholding only applies to funds which are taxable) and the remainder is to be directly rolled over to your institution as the IRA custodian for Gloria Santarella.

Congress is giving serious consideration to eliminating the $5,000 death benefit exclusion discussed in this question. If you have customers in this situation, it's in their best interest to take the distribution from the qualified plan before the law is passed so they will be eligible for the death benefit exclusion. PD

The Pension Digest invites your questions and comments.

THE Pension Digest EXTRA

A supplement to your monthly pension newsletter.

Can Farmland Be Held as an IRA Investment?

For the most part, federal tax code restrictions on non-cash property that may be held in an IRA account are clear, and federal law places relatively few restrictions on property which may constitute an IRA investment. For example, stocks, bonds, mortgages, real estate and even certain government-issued gold or silver coins are permissible. The main federal restrictions prohibit investment in insurance contracts and most collectible items such as antiques, rare wines, etc.

A primary motive in prohibiting investment in collectibles is that a federal policy of IRAs is to raise investable capital (i.e. cash). The reason for the prohibited transaction rules is that it is simpler administratively to prohibit such investments, which are ripe for self-dealing/conflicts of interest, than to maintain the necessary staff to supervise them.

But how about other restrictions on IRA holdings? Are there circumstances in which other governmental or regulatory entities may influence the investments that may be held in an IRA?

One of the most common questions asked of our consultants is whether farmland is a permissible IRA investment. While there are no federal prohibitions, there may be "local" restrictions. For instance, Iowa statute 172C.4 states that "No corporation or trust, other than a family farm corporation, authorized farm corporation, family trust, authorized trust or testamentary trust shall, either directly or indirectly, acquire or otherwise obtain or lease any agricultural land in this state ..." (There are several exceptions, which pertain to encumbrances, research and certain non-profit and for-profit corporate acquisitions and uses.)

As may also be true in other farm states, the intention of this statute seems to be to limit the ease with which a corporate or non-farm entity can acquire farmland. The statute seems designed to keep farmland in individual, active-farming ownership.

Therefore, can an individual hold Iowa farmland in a self-directed IRA account under the terms of this statute? Although an IRA account is titled IN THE NAME OF an individual, technically it is in fact being held IN TRUST FOR an individual. Such a trust is not one of the named exceptions. In the absence of any specific authorization to the contrary, this Iowa statute would appear to exclude the option of an IRA holding farmland, even though there is no such provision in IRA law.

It is our opinion that lawmakers may not have intended this consequence, and simply overlooked the technicality that appears to have excluded this option. Whether this would require legislative action to change, or could be corrected by the issuance of a clarification or judicial opinion, we feel it is something that IRA holders and their custodian/trustee institutions should be aware of, both in Iowa and in other farm states. This will help the IRA accountholder avoid a transaction that may have unexpected and unwelcome consequences.

We make no generalizations about other "farm states", and in fact have not researched other statutes to compare them with Iowa statute 172C.4. But we would not be at all surprised to learn of others aimed at achieving the same result – to limit the ability of certain corporations and trusts to own farmland – and thus having the same secondary impact on IRA investment options. PD

SEP & QP Plan User Fees Announced

The IRS has recently released its comprehensive schedule of user fees for retirement plan sponsors seeking IRS rulings and determination letters. This fee schedule covers many areas of retirement plan administration, including some that are very obscure.

Some that are of the widest interest include Opinion Letters on prototype IRA and SEP plans as well as Opinion and Advisory Letters on master and prototype qualified plans. Fees for these letters are listed below. (For a complete schedule of IRS user fees, please send check for $5 with stamped, self-addressed envelope to: User Fees, CWF & Associates, P.O. Box 426, Brainerd MN 56401.

Effective date; Exceptions

The user fees listed here, and others in the more comprehensive IRS schedule, went into effect May 10, 1993. However, all requests that were pending with the national or district IRS offices as of May 10, 1993, will not be subject to increased fees. In the case of user fees that have been reduced, however, such reduced fees will also be applied to those pending requests.

Where to submit:

Most requests for employee plans opinion letters, advisory letters or notification letters (notification letters (notification letters with respect to mass submitters' regional prototype plans) should be sent to:

Assistant Commissioner
(Employee Plans and Exempt Organizations)
Internal Revenue Service
Attention: E:EP:Q
P.O. Box 14073
Ben Franklin Station
Washington, D.C. 20044

(Those seeking other types of IRS determinations will automatically receive the list of appropriate addresses for submitting requests, when they purchase the comprehensive IRS fee listing described above. PD

Opinion and Advisory Letters on Master and Prototype Plans	**Fees**
(1) Mass submitter plan, per basic plan document (new or amended, regardless of number of adoption agreements)	$3,000
(2) Sponsoring organization's word-for-word identical adoption of mass submitter's basic plan document (or an amendment thereof), per adoption agreement (mass submitters that are sponsoring organizations in their own right are liable for this fee)	$100
NOTE: If a mass submitter submits, in any 12-month period ending January 31, more than 300 applications on behalf of word-for-word adopters with respect to a particular adoption agreement, only the first 300 such applications will be subject to the fee; no fee will apply to those in excess of the first 300 such applications submitted within the 12-month period.	
(3) Sponsoring organization's minor modification of mass submitter's plan document, per adopting agreement	$400
(4) Nonmass submission (new or amended) by sponsoring organization, per adoption agreement	$3,000
(5) Mass submitter's request for an advisory letter with respect to the addition of optional provisions following issuance of a favorable opinion letter (see section 18.031(c) of Rev. Proc. 89-9), per basic document (regardless of the number of adoption agreements)	$400
(6) Mass submitter's addition of new adoption agreements after the basic plan document and associated adoption agreements have been approved, per adoption agreement	$400
(7) Assumption of sponsorship of an approved plan, without any amendment to the plan document, by a new entity, as evidenced by a change of employer identification number	$400
(8) Adoption, by mass submitter or nonmass submitter, of non-model amendment pursuant to the limited amendment procedure described in Rev. Proc. 93-12, 1993-3 I.R.B. 14, to comply with section 401(a)(3) of the Code.	$400
Opinion Letters on Prototype Individual Retirement Accounts/ Annuities and Simplified Employee Pensions (SEPs), Including Salary Reduction SEPs (SARSEPS).	
(1) Mass submitter plan, per plan document, new or amended	$1,000
(2) Sponsoring organization's word-for-word identical adoption of mass submitter's prototype IRA or SEP, per plan document or an amendment thereof	$100
NOTE: If a mass submitter submits, in any 12-month period ending January 31, more than 300 applications on behalf of word-for-word adopters with respect to a particular adoption agreement, only the first 300 such applications will be subject to the fee; no fee will apply to those in excess of the first 300 such applications submitted within the 12-month period.	
(3) Sponsoring organization's minor modification of mass submitter's prototype IRA or SEP, per plan document	$400
(4) Nonmass submission (new or amended) by sponsoring organization, per plan document	$500
(5) Amendment of an approved SEP or SARSEP by a mass submitter, an identical adopter, or other sponsoring organization solely by the adoption of the Model Amendment reproduced in the Appendix to Rev. Proc. 91-44, per plan document.	$100