The Pension Digest

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ALSO IN THIS ISSUE –

SPOUSAL IRA CONTRIBUTIONS TO A TRADITIONAL IRA

The spousal IRA contribution rules were changed as of January 1, 1997. No longer does the compensated spouse make a contribution on behalf of the noncompensated or lower compensated spouse. The current concept is—the noncompensated or lower compensated spouse must wait to see the compensation and contribution activity of the higher compensated spouse to his or her traditional IRA and Roth IRA before making a contribution for himself or herself.

In order to be eligible under the current IRA rules to make a spousal contribution, an individual must meet three eligibility requirements: (1) he or she must not attain age 70 1/2 during the year for which the contribution is made or during any earlier year; (2) he or she must file a joint return (so, must be married as of December 31) and (3) the individual's compensation for the year must be less than the amount of his or her spouse's compensation which is includible in gross income. Requirement #3 was new as of 1-1-97.

The practical effect of requirement #3 is that only one of the spouses ever qualifies for a spousal contribution, and it is the spouse with the lesser compensation! The spouse with the higher compensation must use and comply with the regular contribution rules.

Assume Mary and John are married. Mary is 68 with $1,500 of compensation. John is 73 with $1,000 of compensation. Mary and John have combined compensation of $2,500, but because John is 73 and because Mary's compensation is more than John's, Mary's maximum contribution is $1,500 and not $2,000. Mary is not entitled to use any portion of John's compensation in making a contribution for herself because she has more compensation than John.

Here are some additional observations about the spousal contribution rules. Assume now that John is age 65 and not age 73.

Observation #1—If the spouse with the higher compensation earns less than $2,000, then neither spouse will be able to contribute $2,000 unless the spouse with the higher income does not make a contribution for himself or herself. Mary is eligible to only contribute $1,500 for herself. If Mary would only contribute $500 for herself, then John could contribute $2,000 for himself ($1,000 from his compensation and $1,000 from Mary's compensation) as he is entitled to use her compensation to the extent she does not make contributions for herself ($1,500-$500).

Observation #2—If the compensation of one spouse is more than $4,000, then each spouse will be able to contribute $2,000 to his or her IRA.

Observation #3—If the compensation of one spouse is more than $2,000 but the combined compensation of the two spouses is less than $4,000, then the two spouses will not be able to contribute $4,000 because the combined contribution limit cannot exceed their combined income.

Observation #4—If Mary contributes $1,500 for herself, then John may still only contribute $1,000 because their combined contributions cannot exceed their combined compensations.

Observation #5—If John would not contribute any amount for himself, Mary's maximum contribution is still $1,500 (100% of her compensation) because she cannot use any of his compensation to make a contribution for herself.

Observation #6—Under the prior law there was no ability to add together the compensation of both spouses. Either the highest compensated spouse made the contribution for both spouses to the extent of his or her compensation or they each made their own regular contribution. Under the current rules, the lesser compensated spouse can use his or her spouse's compensation (but as reduced by any traditional and

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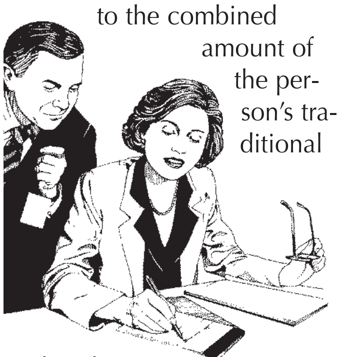
Roth IRA contributions made for the spouse) to make a contribution for himself or herself.

Observation #7—Under the pre-1977 rules, one spouse had the ability to elect to be treated as having no compensation. A spouse is no longer able to do this.

Also, remember that a person's contribution limit applies to the combined amount of the person's traditional



and Roth IRA contributions.

Conclusion. Married individuals may make either standard or spousal IRA contributions. A spousal contribution is a special type of IRA contribution. It is only the married individual with the lesser compensation who gets the benefit of using his or her spouse's larger compensation in making a regular or spousal IRA contribution, and this compensation must be reduced by his or her higher compensated spouse's traditional and Roth IRA contributions. ◆

WHAT TO DO— A CUSTOMER OR TAX ADVISOR WANTS THE IRA CUSTODIAN/ TRUSTEE TO CHANGE AN IRS REPORTING FORM

The simple answer is, you, as the IRA custodian or trustee, must not change a reporting form unless the form was prepared incorrectly. There must be evidence to support the correction.

From time to time we are asked about unique situations through our consulting services that are sufficiently important that we wish to cover the situation in a newsletter article.

The situation we were asked about began with a qualified plan participant dying in 1998. His account balance was over $500,000. His surviving spouse was his sole beneficiary. She was younger than age 59 1/2. She retained the services of an accountant. She had at least two distribution options available to her: (1) she could directly roll over to an IRA his entire account balance or (2) she could have a portion of his account distributed to her and the remainder could be directly rolled over to her IRA. Based upon the advice of her accountant, she chose to directly roll over the entire account balance to an IRA with a bank as the IRA trustee. She signed a rollover request form, she received the notice form provided by the qualified plan on which she elected the direct rollover option, and she completed and signed the rollover certification on the IRA application. After the direct rollover of more than $500,000, she took a distribution of more than $100,000 from her IRA. For simplicity purposes, for the remainder of this article it is assumed the distribution amount was $100,000.

In January of 1999, the bank prepared a Form 1099-R to report this $100,000 distribution to the surviving spouse and the IRS. Code "1" was inserted in box 7 (a premature distribution and no known exception) because she was younger than age 59 1/2. Upon receipt of this 1998 Form 1099-R, the accountant realized a serious error had been made. The 1998 form 1099-R showed that she owed the 10% additional tax of $10,000 on the $100,000. The fact was, the accountant had made a very bad planning mistake. The surviving spouse should have taken the $100,000 from the qualified plan and then directly rolled over the remainder of her deceased spouse's qualified plan balance to her IRA. If this had been done, the 10% tax ($10,000) would not have been owed because the distribution from the qualified plan would have been a "death/reason code 4" distribution. The ability to take a death distribution only occurs when the distribution comes out of the original plan, i.e. the qualified plan. Once a spouse beneficiary rolls the funds into his or her own IRA, the distribution no longer qualifies as a death distribution.

The accountant came up with what he thought was a solution to this tax predicament. He prepared a "corrected" 1998 Form 1099-R for the IRA distribution. This corrected form showed the distribution as a death distribution. The accountant then went to the bank and demanded that the bank sign these documents. He talked with senior bank management at a time when the IRA manager was not present. He stated that the bank had "advised" the rollover and as such should take measures to insure that the 10% additional tax would not be owed. The senior bank manager signed such forms for the accountant. The accountant then had the individual attached these "corrected" forms to her tax return. Because of the corrected form 1099-R, the individual did not show on her tax return that the $10,000 (i.e. the 10% additional tax) was owed and she did not pay it. The accountant believed he had corrected the situation.

Note that the Form 1096 and Form 1099-R were fled by the accountant with the individual's return and not sent in separately to the proper IRS service center as is required by IRS procedure.

By this time the bank's IRA manager had obtained CWF's advice that the IRS should be informed that an accountant had filed the Form 1099-R and 1096 purportedly on behalf of the bank. The bank needed to find out what it needed to do to "correct" for the "corrected" filing made by the accountant.

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Changing an IRS Form, Continued from page 2

That is, the bank needed to un-do what the accountant had done.

The IRS' response was very revealing. Since the corrected Form 1099-R and 1096 had been filed with the individual's tax return in contradiction of IRS procedure, the IRS considered these forms to never have been filed. The original 1998 Form 1099-R form was still controlling. THE IRS THEN ASKED FOR THE NAME OF THE ACCOUNTANT. The IRS indicated they fully intended to pursue disciplinary action (suspension or expulsion from performing tax services), if not criminal action, against the accountant. The IRS saw the accountant's actions as fraud. The IRS also indicated that the bank would have been looking at very serious repercussions if it had not acted to make sure the IRS had the proper reporting form(s).

We believe that had the bank filed the incorrect "corrected" form that it would have been subject to a number of possible penalties to be imposed by the IRS: (1) $100 for an intentional error; (2) six figure monetary penalties and possible time in prison for fraud as defined under Internal Revenue Code sections 7201, 7203 and 7206; and (3) the loss of the ability to serve as an IRA custodian/trustee. Certainly, the third penalty is extremely harsh and one would expect the IRS to pursue it only in the most serious of situations.

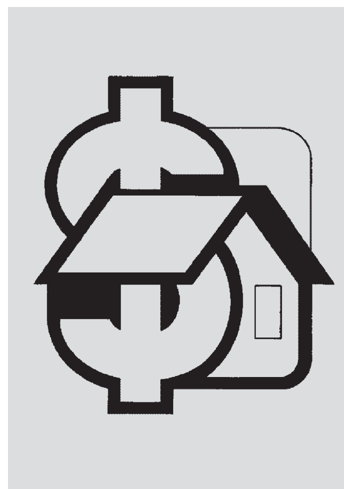
In the above situation, the bank felt quite comfortable that its personnel had not made an error. The bank was not that worried about the accountant trying to argue, "but for the actions of the bank's personnel, the surviving spouse would not have directly rolled over the entire balance." However, even if the bank's personnel did cause the error, IRA management and senior bank management must understand that the IRS reporting duties must still be performed correctly. Even though the bank may not want to accept responsibility or liability for a $10,000 error, the IRS would mete out much harsher consequences if the reporting forms were fraudulently changed to cover for an error made by bank personnel.

In summary, an IRA custodian/trustee must correct or change its IRS reporting forms only if it has documentation substantiating the correction. In many situations an IRA custodian/trustee must not accommodate a request by a good customer or accountant to change an IRS reporting form. ◆

GATT REMEDIAL AMENDMENT PERIOD EXTENDED

Employers sponsoring non-governmental qualified plans will not be required to amend their plans to conform to the requirements of GATT (General Agreement on Tariff and Trade) until December 31, 2000. Previously the amendment date was December 31, 1999.

Although the remedial amendment period has been extended, the drafting of the implementing Revenue Procedure has not been completed. An employer may not reduce a participant's benefit prior to amending the plan, and a plan that is amended before 2001 will avoid a violation of the Code Sec. 41 l(d)(6) anti-cutback rule, if a plan participant's benefit is reduced as a result of the amendment. ◆



POTENTIAL IRA AND PENSION CHANGES

William V. Roth, the Republican Senate Finance Committee Chairman and main author of the Roth IRA, and Max Baucus a Senior Finance Committee Democrat have introduced the "Retirement Savings Opportunity Bill of 1999" (S646). This bill will create more incentives for individuals to save for their retirement. Under the Roth-Baucus bill:

- Contribution limits on all IRAs would increase from $2,000 to $5,000 per person.
- The income caps would be eliminated, allowing all Americans to contribute to a Roth or a traditional IRA.
- The income cap on converting from a traditional to a Roth IRA would be increased from the current level of $100,000 to $1 million.
- 401(k) and 403(b) annuity contributions would increase from $10,000 to $15,000.
- The contribution limits on a SIMPLE-IRA or 401(k) would increase from $6,000 to $10,000.
- The limit on Code sec. 457 contributions would increase from $8,000 to $12,000. Individuals who are age 50 or older would be given an opportunity to make "catch up" contributions of an additional 50% of the annual limits (i.e., $7,500 for IRAs and $22,500 for 401(k) and 403(b) plans).
- This legislation would authorize the creation of "Roth" 401(k) and 403(b) plans.
- The current limit on qualified defined contribution plans is $30,000 or 25% of compensation. This includes both employee contributions and any matching contributions. The bill would eliminate the 25% of compensation limit, so the maximum contribution that could be made for any employee would be $30,000.
- Qualified defined benefit plans are currently limited to 150% of the current liability amount of the plan. The Roth-Baucus bill would eliminate that restriction.

President Clinton also had some potential retirement changes in his fiscal year 2000 budget proposal. President

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Potential Changes,
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Clinton wants to broaden pension coverage for low-income and part-time workers, women, and others not adequately served by current law. As Donald C. Lubick, Treasury Assistant Secretary of Tax Policy said, "Any new tax preferences should be targeted to moderate and lower-income people who are most likely to generate new savings as opposed to shifting their savings between different vehicles." The President's fiscal year 2000 budget contains a number of proposals that include:

• A small business tax credit for an employer's expenses when starting a new retirement plan.

• A simplified defined benefit-type plan for small business.

• IRA contributions through payroll deduction. Improved portability among different types of plans. Improvements in the vesting and annuity options to enhance retirement security for women.

Rep. Jim Saxton, the Vice Chairman of the Joint Economic Committee (R-NJ) introduced legislation (HR 876) along with eight cosponsors including Majority Leader Dick Armey (TX), Democratic Causus Chairman Martin Frost (TX), Representative Bob Stump (R-AZ), Dan Miller (R-FL), Chris Smith (R-NJ), Richard Baker (R-LA), Spencer Bachus (R-AL), and Steve Chabot (R-OH). Saxton said the bill would "correct much of the bias" in the tax code against personal savings. Their bill would:

• Raise the current $2,000 ceiling for deductible IRA contributions by $500 annually over 10 years.

• Increase income eligibility limits for full IRA deductions by $10,000 annually for six years for joint filers, and by $5,000 annually for single filers.

Two major retirement policy bills under consideration in 1999 are the Portman/Cardin bill and the Graham/Grassley bill. Rob Portman is a republican representative from Ohio and Benjamin Cardin is a democrat from Maryland. Their bill is HR 3788. Bob Graham is a democrat senator from Florida and Charles Grassley is a republican senator from Iowa. Their bill is S2339. The fact that Portman and Cardin are members of the House Ways and Means Committee and that Graham and Grassley, along with four other members of the Senate Finance Committee, are sponsoring the bills gives the bills an added advantage.

The Graham/Grassley bill calls for modification of the top-heavy rules on qualified plans.

The Portman/Cardin bill will include a provision that addresses tax code Section 401(a)(9) minimum distribution rules for qualified plans. The bill originally intended to raise the 70 1/2 RMD age to 75, and exempted $300 of defined contribution plan and IRA assets from the minimum distribution rules prior to the employee's death or after such death where the surviving spouse is the designated beneficiary. The current provision will most likely be scaled back however, because of the expense involved. While most provisions are relatively inexpensive, the minimum distribution rule provision would cost approximately $40 billion. ◆

OTHER POSSIBLE LAW CHANGES

Eliminating the Limit on Social Security Earnings

In 1999, seniors aged 65 - 69 start losing Social Security benefits after their working income reaches $15,500. There is no Social Security earnings limit after age 70.

House Speaker J. Dennis Hastert (R-ILL) said "It's nonsense that working seniors get penalized by Uncle Sam simply because they want to hold a job and contribute to society in their golden years." He has reserved bill HR 5 for an upcoming proposal to eliminate the Social Security earnings limit. The House Republican leadership has reserved the top bill numbers for proposals that reflect the GOP's legislative priorities.

House Ways and Means Committee member Sam Johnson (R-Texas) and Rep. Collin Peterson (D-MN) proposed a bill to eliminate the current limit on the amount of outside income seniors are allowed to earn without losing a portion of their Social Security benefits.

Per Hastert, President Clinton supports eliminating the Social Security earnings test, and wants this unfair tax on seniors to be repealed.

Borrowing from IRA for First Home Purchase

The First-Time Homebuyer Affordability Act (HR 1333) was introduced by Rep. John J. LaFalce (D-NY) to allow individuals to borrow from IRAs for a first-time home purchase.

The dream of a first home is sometimes only that, a dream, due to the difficulty in coming up with a down payment. Surveys have listed making the down payment as the biggest hurdle to home ownership.

We currently have the first-time homebuyer exception to the 10% premature distribution penalty tax when withdrawing from an IRA. But, as LaFalce said, this only grants "modest" relief because the transaction is still taxable. "When the average taxpayer withdraws $10,000 of his or her own money from an IRA to buy a home, he or she would be taxed $2,800, leaving little more than $7,200 for a down payment."

This proposal would allow individuals to borrow up to $10,000, tax and penalty-free, from their own or their parents' IRA or 401(k). The loan could run up to 15 years on a fully amortized or interest-only basis.

This bill eliminates an arbitrary but significant impediment to home ownership, and should encourage young families to start IRAs even while they are preparing to purchase their first house. ◆

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SEP, PROFIT SHARING, MONEY PURCHASE OR SIMPLE — WHICH PLAN IS BEST FOR MY BUSINESS?

A person who is self-employed or owns a small business needs to know which type of retirement plan they should set up for themselves and/or their business. The self-employed individual, or the owner/employer of a corporation, generally wants to contribute as much as possible for themselves, but they also need to weigh that against the amount they will need to invest for their employees, if they have any.

CHART A-1 – Lets start by looking at some examples of self-employed individuals that have no employees. We'll compare the maximum contribution they are eligible to make in each of the four plans.

The contribution for a self-employed person to a profit sharing, money purchase or SEP plan is calculated as follows:

• The sole proprietor must have net earnings from self-employment and file a Schedule C or Schedule F with his or her Federal income tax return to report self-employment income and expenses. The owner must also file a Schedule SE as an attachment to the Form 1040 to report Social Security taxes owed.

• A special calculation is used to determine the "compensation" that a self-employed individual uses to determine his or her contributions. The self-employed person must reduce their earned income by the amount of the contribution to be made for himself or herself, and by the deduction they are permitted for the self-employment tax they pay. On line 4 of Schedule SE, the Schedule C or F income is multiplied by .9235. This is done because the self-employed individual should not be required to pay the self-employed FICA tax on an amount which includes his FICA tax. He should be allowed to reduce his "gross" income by an amount equivalent to this FICA tax amount (100% -7.65% = 92.35%). 7.65% is the tax rate paid by both the employer and the employee in a corporate situa-

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CHART A-1

	Net Income from Schedule C or F	Net Income Less 1/2 of Self-Emp. Tax	Maximum SEP Contribution	Maximum Profit Sharing Contribution	Maximum Money Purchase Contribution	SIMPLE Total	SIMPLE Employee Deferral	SIMPLE Employer Match
1	10,000.00	9293.52	1,212.20	1,212.20	1,858.70	6,278.81	6,000.00	278.81
2	20,000.00	18,587.05	2,424.40	2,424.40	3,717.41	6,557.61	6,000.00	557.61
3	30,000.00	27,880.57	3,636.60	3,636.60	5,576.11	6,836.42	6,000.00	836.42
4	35,000.00	32,322.50	4,242.70	4,242.70	6,505.47	6,975.82	6,000.00	975.82
5	37,977.20	35,071.94	4,603.60	4,603.60	7,058.84	7,058.83	6,000.00	1058.83
6	40,000.00	37,174.09	4,848.80	4,848.80	7,434.82	7,115.22	6,000.00	1,115.22
7	50,000.00	46,467.61	6,061.00	6,061.00	9,293.52	7,394.03	6,000.00	1,394.03
8	60,000.00	55,761.14	7,273.20	7,273.20	11,152,23	7,672.83	6,000.00	1,672.83
9	64,281.48	59,363.94	7,792.20	7,792.20	11,948.03	7,792.20	6,000.00	1,792.20
10	65,000.00	60,470.90	7,887.52	7,887.52	12,094.18	7,814.13	6,000.00	1,814.13
11	70,000.00	65,054.66	8,485.40	8,485.40	13,010.93	7,951.64	6,000.00	1,951.64
12	80,000.00	74,687.94	9,741.92	9,741.92	14,937.59	8,240.64	6,000.00	2,240.64
13	90,000.00	84,554.03	11,028.80	11,028.80	16,910.81	8,536.62	6,000.00	2,536.62
14	100,000.00	94,420.12	12,315.69	12,315.69	18,884.02	8,832.60	6,000.00	2,832.60
15	150,000.00	143,750.59	18,750.11	18,750.11	28,750.12	10,312.52	6,000.00	4,312.52
16	190,795.55	184,000.00	24,000.00	24,000.00	30,000.00 *	11,520.00	6,000.00	5,520.00
17	207,012.70	200,000.00	24,000.00 *	24,000.00 *	30,000.00 *	12,000.00	6,000.00	6,000.00
18	250,000.00	223,286.51	24,000.00 *	24,000.00 *	30,000.00 *	12,000.00	6,000.00	6,000.00 *

* Limited

Chart A-1 shows the following:

1. As long as the self-employed individual's net income is less than $37,977, then the largest contribution is permitted by the SIMPLE plan. At $37,977, a 25% contribution to a money purchase plan will be $7,058.84—the same amount which arises from a $6,000 elective deferral to a SIMPLE-IRA plus the 3% matching contribution of $1,058.84 (3% X $35,294.20).
2. If the self-employed individual's net income exceeds $37,977, then the largest contribution will be permitted by a 25% money purchase plan. Because the section 415 limit is the lesser of 25% of compensation or $30,000, and because the compensation limit is

Which Plan is Best, Continued from page 5

tion. A corporate employee pays the 7.65% FICA tax on his wage income and not on his wage income as increased by the amount of his FICA taxes. A reduction is necessary for the self-employed person because he pays his self-employed FICA tax out of his gross earnings (net income plus FICA tax on his net income). An example will illustrate how the calculation is made for a self-employed individual. Assume he had gross earnings of $30,000. Determine the amount of self-employment tax he must pay. $30,000 x .9235 = $17,705 x .153 - $4,238.87. 50% of $4,238.87 is $2,119.43. Thus, his adjusted income is $27,880.57 ($30,000 - $2,199.43). From his adjusted amount he must subtract his own pension contribution and then this amount is multiplied by the contribution percentage of 15% for SEP and profit sharing plans and 25% for a money purchase plan. A mathematical shortcut which takes into account his own pension contribution is to multiply the adjusted amount by 13.0435% for a SEP and profit sharing plan and 20% for a money purchase plan. Thus, the maximum contribution under a SEP and profit sharing plan is $27,880.57 x .130435 or $3,636.60. The maximum contribution under a money purchase plan is $27,880.57 x .20 or $4,476.11.

• Contributions to a SIMPLE Plan are made as follows: A contribution of $6,000 is made by the employee. The $6,000 is not a percentage of income. The employer must match on a dollar-for-dollar basis what the employee has chosen to defer, up to 3% of the employee's compensation. The employer is considered both an employer and an employee. He or she makes a $6,000 contribution in his or her role as employee, and a 3% matching contribution in his or her role as employer.

Note that under the SIMPLE plan, the self-employed individual is NOT required to reduce his or her net earnings by the amount of his or her pension contribution as must be done for SEP, profit sharing and money purchase plans. The adjustment for the self-employment tax deduction must still be made.

CHARTS A-2 AND A-3 – Now lets look at two corporations and compare the amount of contributions the employer can make for himself or herself under each of the four plan types to the cost of the employee contributions. The first corporation has 6 employees (Chart A-2) and the second has 30 employees (Chart A-3). Note that there are no special calculations for the owner of a corporation who is a corporate employee. For purposes of these charts, it is assumed the maximum contributions (15%, 25% or 3%) are made by the employer. ◆

CHART A-2

	Compensation		SEP	Profit Sharing	Money Purchase	SIMPLE Total	SIMPLE Employee Deferral +	SIMPLE Employer Match =
1	160,000	(owner)	24,000	24,000	30,000	10,800	6,000	6,000
Subtotal	*160,000*		*24,000*	*24,000*	*30,000*	*12,000*	*6,000*	*6,000*
2	40,000	(EE)	6,000	6,000	10,000	2,400	1,200	1200
3	25,000		3,750	3,750	6,250	1,500	750	750
4	20,000		3,000	3,000	5,000	1,200	600	600
5	18,000		2,700	2,700	4,500	1,080	540	540
6	12,000		1,800	1,800	3,000	720	360	360
Subtotal	*115,000*		*17,250*	*17,250*	*28,750*	*6,900*	*3,450*	*3,450*
Totals	**$275,000**		**$41,250**	**$41,250**	**$58,750**	**$17,700**	**$9,450**	**$9,450**

Chart A-2 shows the following:

1. The cost for a full 15% SEP is $41,250 per year. The owner receives a contribution of $24,000 and the other employees receive a contribution of $17,250.
2. The cost for a full 15% profit sharing plan is $41,250 per year. The owner receives a contribution of $24,000 and the other employees receive a contribution of $17,250.
3. The cost for a full 25% money purchase plan is $58,750 per year. The owner receives a contribution of $30,000 and the other employees receive a contribution of $28,750.
4. The total cost for a SIMPLE plan with a 3% match is $17,700. The owner receives a contribution of $10,800 and the other employees receive a contribution of $6,900. For purposes of this calculation, it is assumed every employee will defer 3% of his or her compensation. In fact, some employees will defer less, which will mean the cost to the employer is less; some will defer more, but the cost for the employer will not increase since the employer cannot match at a rate higher than 3%.
5. Note the employer's cost of making the matching contribution to the SIMPLE for the other employees is $3,450.
6. The owner must decide if he or she is willing to receive a contribution of only $10,800 versus $24,000 to lower the contribution amount for the other employees from $17,250 to $3,450.
7. Note that a contribution of 6.75% to a profit sharing or SEP plan would give the owner a contribution of $10,800, which is the same amount he or she receives under the SIMPLE. However, 6.75% times the employees' compensation of $115,000 means the contribution for these employees will be $7,762.50. Thus, the owner can save $4,312.50 ($7,762.50-$3,450.00) by setting up a SIMPLE plan rather than a profit sharing or money purchase plan.

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CHART A-3

	Compensation		SEP	Profit Sharing	Money Purchase	SIMPLE Total	SIMPLE Employee Deferral	SIMPLE Employer + Match =
1	200,000	(owner)	24,000.00	24,000.00	30,000.00	12,000.00	6,000.00	6,000.00
Subtotal	*175,000*		*24,000.00*	*24,000.00*	*30,000.00*	*12,000.00*	*6,000.00*	*6,000.00*
2	75,000		11,250.00	11,250.00	18,750.00	4,500.00	2,250.00	2,250.00
3	50,000		7,500.00	7,500.00	12,500.00	3,000.00	1,500.00	1,500.00
4	40,000		6,000.00	6,000.00	10,000.00	2,400.00	1,200.00	1,200.00
5	30,000		4,500.00	4,500.00	7,500.00	1,800.00	900.00	900.00
6	27,500		4,125.00	4,125.00	6,875.00	1,650.00	825.00	825.00
7	25,000		3,750.00	3,750.00	6,250.00	1,500.00	750.00	750.00
8	24,500		3,675.00	3,675.00	6125.00	1,470.00	735.00	735.00
9	24,000		3,600.00	3,600.00	6,000.00	1,470.00	720.00	720.00
10	23,500		3,525.00	3,525.00	5,875.00	1,410.00	705.00	705.00
11	23,000		3,450.00	3,450.00	5,750.00	1,380.00	690.00	690.00
12	22,500		3,375.00	3,375.00	5,625.00	1,350.00	675.00	675.00
13	22,000		3,300.00	3,300.00	5,500.00	1,320.00	660.00	660.00
14	21,500		3,225.00	3225.00	5,375.00	1,290.00	645.00	645.00
15	21,000		3,150.00	3,150.00	5,250.00	1,260.00	630.00	630.00
16	20,500		3,075.00	3,075.00	5,125.00	1,230.00	615.00	615.00
17	20,000		3,000.00	3,000.00	5,000.00	1,200.00	600.00	600.00
18	19,750		2,962.50	2,962.50	4,937.50	1,185.00	592.50	592.50
19	19,500		2,925.00	2,925.00	4,875.00	900.00	450.00	450.00
20	19,000		2,850.00	2,850.00	4,750.00	1,140.00	570.00	570.00
21	18,750		2,812.50	2,812.50	4,687.50	1,125.00	562.50	562.50
22	18,500		2,775.00	2,775.00	4,625.00	1,110.00	555.00	555.00
23	18,250		2,737.50	2,737.50	4,562.50	1,095.00	547.50	547.50
24	18,000		2,700.00	2,700.00	4,500.00	1,080.00	540.00	540.00
25	16,000		2,400.00	2,400.00	4,000.00	960.00	480.00	480.00
26	15,000		2,250.00	2,250.00	3,750.00	900.00	450.00	450.00
27	12,000		1,800.00	1,800.00	3,000.00	720.00	360.00	360.00
28	8,700		1,305.00	1,305.00	2,175.00	522.00	261.00	261.00
Subtotal	*653,450*		*98,017.50*	*98,017.50*	*163,362.50*	*38,937.00*	*19,468.50*	*19,468.50*
Totals	**853,450**		**122,017.50**	**122,017.50**	**193,362.50**	**50,937.00**	**25,468.50**	**25,468.50**

1. The cost for a full 15% SEP is $122,017.50 per year. The owner receives a contribution of $24,000, and the other employees receive a contribution of $98,017.50.
2. The cost for a full 15% profit sharing plan is $122,017.50 per year. The owner receives a contribution of $24,000 and the other employees receive a contribution of $98,017.50.
3. The cost for a full 25% money purchase plan is $193,362.50 per year. The owner receives a contribution of $30,000 and the other employees receive a contribution of $163,362.50.
4. The total cost for a SIMPLE plan with a 3% match is $50,937.00. The owner receives a contribution of $12,000 and the other employees receive a contribution of $38,937. For purposes of this calculation, it is assumed every employee will defer 3% of his or her compensation. If fact, some employees will defer less, which will mean the cost to the employer is less; some will defer more, but the cost for the employer will not increase since the employer cannot match at a rate higher than 3%.
5. Note the employer's cost of making the matching contribution to the SIMPLE for the other employees is $19,468.50.
6. The owner must decide if he or she is willing to receive a contribution of only $12,000 versus $24,000 to a SEP or profit sharing plan to lower the contribution amount for the other employees from $98,017.50 to $19,468.50. Many employers would go with the SIMPLE.
7. Note that a contribution of 6.00% to a profit sharing or SEP plan would give the owner a contribution of $12,000, which is, the same amount he or she receives under the SIMPLE. However, 6.00% times the employees compensation of $653,450 means the contribution for these employees will be $39,207.00. Thus, the owner can save $19,738.50 ($39,207.00-$19,468.50) by setting up a SIMPLE rather than a profit sharing or money purchase plan.

ROLLOVER FROM PENSION PLAN BY U.S. CITIZEN WORKING IN CANADA—DENIED

Agreements between the United States and Canada, approved by both countries, said that an international organization located in Canada could employ both Canadian and U.S. citizens. The employees would be subject to relevant Canadian labor and other laws similar to Canadian employees.

The organization adopted a retirement plan (Plan X) for all of its employees. The organization made Plan X contributions for all of its employees to an investment registered plan purchased through a Canadian company, Company D.

Plan X was later frozen for the employees who were U.S. citizens, and contributions for the U.S. citizens were made to two annuity contracts held in a plan established in the U.S.

Still later, the funds previously invested for the U.S. citizens with Company D were deposited into Plan I, a registered plan. Then, all the funds held by Company D were converted into Group Plan J, a group registered retirement savings plan established in Canada. Next, all the funds held in Group Plan J were transferred to Group Plan K, another group registered retirement savings plan established in Canada.

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CHECK IT OUT

Question: One of our customers made a 1998 SEP contribution on March 5, 1999. We did a trial run of Form 5498s and this contribution was not included on his 5498. Why?

✓ Answer: SEP contributions are reported differently than contributions to a traditional or Roth IRA. The 1998 Form 5498 shows the SEP contributions that were made in 1998, whereas it shows contributions to the traditional and Roth IRA that were made for tax year 1998. It will show any SEP contribution made from January 1, 1998 through December 31, 1998, regardless of whether the contribution was made as a prior-year contribution for 1997 or a current-year contribution for 1998.

Question: Sandra Reynolds just opened a Roth IRA with us. She said she also had a SEP plan at another financial institution. She is no longer working for the employer who made the contributions, and would like to transfer her SEP funds to us to be put into her new Roth IRA, or if that is not allowed, she could open a traditional IRA with us. Is this OK?

✓ Answer: Yes. Once the employer makes the contribution, the funds are hers to do with as she pleases. If she was still working for the same employer who was making the contributions, she should leave a small amount in the IRA (which is actually just a traditional IRA) so that the IRA plan would be established for the employer to make future contributions into. Because she is no longer an employee under this plan, she can totally close her SEP IRA and transfer it to either another traditional IRA or a Roth IRA. She must be aware that if she transfers this to a Roth IRA, it will be a conversion and therefore a taxable event.

Question: If we have accountholders that have a traditional IRA and a Roth IRA, do they need separate Form 5498s for each plan, or can they be combined on one form?

✓ Answer: They need to be reported on separate Form 5498s. Each plan that is established must be reported separately. Therefore, if an accountholder has a traditional IRA, a Roth IRA and an Education IRA, each plan will need to be reported separately. Also, if an accountholder has two or more traditional IRAs due to having separate plans for different beneficiaries, or due to having a conduit IRA, separate reporting would be necessary for each plan.

Question: Can an Education IRA be used to pay off school loans that were previously made? Also, can the contributions or basis be withdrawn first, as that can be withdrawn tax-free?

✓ Answer: No to both questions. (1) Distributions from an Education IRA will be excluded from income tax to the extent that the distributions do not exceed the qualified higher educational expenses incurred by the designated beneficiary *in the year of the distribution.* (2) Like the traditional IRA, distributions from an Education IRA are treated as being made from both the contributions to the Ed IRA (always tax-free) and the earnings the account has experience. If money is withdrawn for a previous year's education expense, taxes will be owed on the distributions.

Question: When setting up an IRA, why is it necessary to give the name of the person establishing the plan?

✓ Answer: IRA Publication 590 states that the disclosure statement given by the plan sponsor must contain plain-language explanations of certain items. For example, the statement should provide information on when and how an IRA can be revoked, including the name, address, and telephone number of the person to receive the notice of cancellation. ◆

Rollover from Canada,
Continued from page 7

A U.S. citizen who has always lived in the U.S., commutes daily to work for this international organization. He intended to roll over his qualified plan funds to an individual retirement account established and maintained in the United States.

Revenue Canada advised the accountholder that the distribution would be subject to Canadian nonresident tax withholding, but if the accountholder could make the rollover without subjecting the distribution to U.S. taxation, then Revenue Canada would reconsider its decision with respect to Canadian nonresident tax withholding.

The IRS discussed Rev. Ruls. 89-95 and 89-45, dealing with article XVIII of the United States-Canada Income Tax Convention, which addresses pensions and annuities, as well as other articles and paragraphs dealing with the protocol of this treaty. The IRS stated in a private letter ruling 9832026 that the distribution from the plan would be a taxable event and did not qualify for tax-free rollover into an IRA maintained in the United States. ◆