THE Pension Digest

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ALSO IN THIS ISSUE –

Inheriting IRA Beneficiary's Right to Designate a Subsequent Beneficiary

Federal income tax law clearly contemplates that funds are accumulated in a traditional IRA to provide retirement income while the accountholder is alive, and that those funds not yet distributed at the time of accountholders death, will be paid to his or her beneficiaries.

The federal income tax law also requires certain minimum distributions be made to a beneficiary by certain deadlines. Lump-sum distributions are not required.

In April of 2002, the IRS adopted new final required distribution regulations. These regulations radically changed the rules as they had been first proposed in 1987. One of the rules in the 1987 proposed regulations was that if any beneficiary had the right to name his or her own beneficiary, then the RMD calculations had to be done using the rules which applied if the accountholder had NOT designated a person as a beneficiary. This had the negative consequence that a beneficiary was required to use the five-year rule, if the accountholder died before his or her required beginning date, (i.e. no life-payout option) and a beneficiary was required to use a single life-expectancy factor rather than a joint factor if the accountholder had died after his or her required beginning date. Therefore, prior to 1992, most writers of IRA plan documents did not allow a beneficiary to designate his or her own beneficiary.

The IRS, in the 2002 regulation, eliminated the rule that there would be adverse consequences if a beneficiary designated his or her own beneficiaries. In the introduction of the final regulations, and the regulation itself, the IRS expressly uses and defines the terms, "subsequent beneficiary" and "successor beneficiary." The IRS clearly contemplates that a grandparent may give her IRA to her daughter who, in turn, may give it to her daughter (i.e.

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Inherited IRA Plan Agreement Now Available

CWF has created new IRA plan agreements specifically for inheriting beneficiaries. As you know, the rules for beneficiaries differ considerably from those of the original accountholder. A financial institution normally handles a beneficiary situation by merely placing the original plan agreement in the beneficiary's file. In an amending situation, as was required in 2002, it is confusing as to how to amend the plan agreement. Normal amending would still be geared toward only the original accountholder. CWF believes it would simplify things for the financial institution, and the rules would be more clearly understood by the beneficiaries, if the plan agreement detailed the rules as they apply to beneficiaries.

The new agreements highlight important beneficiary issues such as the ability of a beneficiary to, in turn, designate their own beneficiary(ies), the various distributions options and required beginning dates, and the deadline to change from the 5-year rule to the life-distribution rule. These are important issues of which beneficiaries must be made aware to enable them to make informed decisions concerning their inherited account. These issues are not thoroughly explained in the plan agreement which the original accountholder would have signed. We at CWF believe this is a valuable product to aid your institution in providing excellent customer service by helping your staff and accountholders understand the special rules which apply to beneficiaries.

We have created new forms for the traditional and Roth IRA numbered 40-TI, 41-TI and 42-TI for the traditional IRA, and 40-RI, 41-RI and 42-RI for the Roth IRA. These forms will be available for purchase by June 20. These new plan agreements will also be included on CWF's next IRA Laser FormSystem (Platform) update which is scheduled to be released in late August 2003.

Collin W. Fritz and Associates, Inc.,
"The Pension Specialists"

IRS Tax Filing Statistics

Table I

Size of adjusted gross income			Number of returns with modified taxable income	Cumulative percentage of total returns (reverse order)	Percentage of total returns	Cumulative percentage of total returns	Tax generated at all rates	Cumulative Tax Generated At All Rates Reverse order
	Under	$2,000	728,355	100.00	.69	.69	53,222	1,008,640,395
$2,000	Under	$4,000	772,689	100.00	.73	1.42	175,650	1,008,587,173
$4,000	Under	$6,000	1,770,153	100.00	1.68	3.10	345,189	1,008,411,523
$6,000	Under	$8,000	2,168,907	98.85	2.06	5.16	660,409	1,008,066,334
$8,000	Under	$10,000	2,975,905	96.79	2.82	7.98	1,114,373	1,007,405,925
$10,000	Under	$12,000	2,920,227	93.97	2.77	10.75	1,701,847	1,006,291,552
$12,000	Under	$14,000	3,396,633	91.32	3.22	13.97	2,419,538	1,004,589,705
$14,000	Under	$16,000	3,977,962	87.98	3.79	17.76	3,341,833	1,002,170,167
$16,000	Under	$18,000	4,192,127	84.19	3.98	21.74	4,249,634	998,828,334
$18,000	Under	$20,000	4,287,589	80.21	4.07	25.81	5,293,477	994,578,700
$20,000	Under	$25,000	9,585,445	76.14	9.10	34.91	16,109,360	989,285,223
$25,000	Under	$30,000	8,235,563	67.04	7.82	42.73	19,046,013	973,175,863
$30,000	Under	$40,000	13,410,399	59.22	12.74	55.47	44,307,242	954,129,850
$40,000	Under	$50,000	10,376,331	46.48	9.85	65.32	49,596,589	909,822,608
$50,000	Under	$75,000	17,026,414	36.63	16.17	81.49	123,389,614	860,226,019
$75,000	Under	$100,000	8,585,345	20.46	8.15	89.64	103,922,256	736,836,405
$100,000	Under	$200,000	8,076,677	12.31	7.67	97.31	185,016,291	632,914,149
$200,000	Under	$500,000	2,132,745	4.64	2.02	99.33	144,638,780	447,897,858
$500,000	Under	$1,000,000	395,413	2.62	.37	99.70	75,682,396	303,259,078
$1,000,000	Under	$1,500,000	99,333	.225	.094	99.79	35,307,670	227,576,682
$1,500,000	Under	$2,000,000	44,504	.131	.042	99.83	22,634,618	192,269,012
$2,000,000	Under	$5,000,000	66,651	.089	.063	99.89	58,561,043	169,634,394
$5,000,000	Under	$10,000,000	17,576	.026	.016	99.92	34,570,570	111,073,351
$10,000,000	Or more		11,201	.010	.010	99.93	76,502,781	76,502,781
Total			**105,254,144**		**100.00**		**1,008,640,934**	

The purpose of this article is to discuss various tax statistics, including various statistics with respect to IRAs, pension plans, etc.

The above IRS table shows by various levels of adjusted gross income the total number of tax returns filed with modified taxable income (MTI), the percent of the total filed returns, the total amount of income tax paid and also the percent of total taxes paid.

The above table and the other tables come from "IRS, Statistics of Income, Individual Income Tax Returns 2000, Publication 1304(Rev. 42003). All figures are estimates based on samples. For 2000, the total number of returns was 129,373,500. Of this amount, 105,254,144 had modified taxable income (MTI). This means that 23,894,426 returns did not have any taxable income because of such items as credits, itemized deductions, exemptions, IRA deductions, etc.

The money amounts are shown in thousands of dollars. Therefore, the total amount of taxes from individual returns for 2000, while shown as $1,008,640,394, is really $1,008,640,344,000, or $1 trillion dollars.

Observations from Table I

1. Approximately 65.32% of the returns (68,752,000) showed adjusted gross income of less than $50,000. All of these filers (except for married persons filing separate returns) would be able to deduct their IRA contributions.

2. The top 2/10 of 1% of filers pay 22.5% of the total federal income tax. These are the filers whose adjusted gross income (AGI) is in excess of $1,000,000.

3. The top 4.64% of filers pay 45% of the total federal income tax. These are the filers whose adjusted gross income (AGI) is in excess of $200,000.

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IRS Tax Filling Statistics, Continued from page 2

Percentage of total tax generated	Cumulative percentages of tax generated	Cumulative percentages of tax generated (reverse order)
.01	.01	100.00
.02	.03	99.98
.03	.06	99.92
.07	.13	99.89
.11	.24	99.82
.17	.41	99.71
.24	.65	99.54
.33	.98	99.30
.42	1.40	98.97
.52	1.92	98.55
1.60	3.52	98.03
1.88	5.40	96.43
4.39	9.79	$\boxed{94.55}$
4.91	14.70	90.16
12.23	26.93	85.25
10.30	37.23	$\boxed{73.02}$
18.34	55.57	62.72
14.34	69.91	$\boxed{44.38}$
7.50	77.41	30.04
3.50	80.91	$\boxed{22.54}$
2.24	83.15	19.04
5.80	88.95	16.80
3.42	92.37	11.00
7.58	99.95	7.58
100.00		

4. The top 20% of filers pay 73% of the total federal income tax. These are the filers whose adjusted gross income (AGI) is in excess of $75,000.

5. The top 59% of filers pay 95% of the total federal income tax. These are the filers whose adjusted gross income (AGI) is in excess of $30,000.

Table II – Filing Status

	Number of Returns	Percent of Total	Income Tax Generated	Percent of Total
Single persons	45,575,998	43.30	$222,742,594	22.08
Heads of households	12,421,206	11.80	$41,833,044	4.15
Separate returns of married persons	2,222,887	2.11	$19,979,927	1.98
Joint returns and surviving spouses	45,034,053	42.79	$724,077,757	71.79
Total	105,254,144	100.00	$1,008,633,322	100.00

Observations from Table II

1. Taxpayers who are not married (single and heads of household) paid 26.23% of the 1 trillion dollars, or $264 billion. Married taxpayers paid 73.77% of the 1 trillion dollars, or approximately $744 billion.

2. There were more returns filed by single individuals (43.3 million) than were by filed married couples filing jointly (42.8 million).

Table III – Wages and Business Income

All money amounts are in thousands of dollars

Tax Item Returns, Wages, & Businesses	1996	1997	1998	1999	2000	2001
Number of all returns	120,351,208	122,421,991	124,770,662	127,075,145	129,373,500	130,456,253
Number of returns with salary & wages	102,748,874	104,404,985	106,535,263	108,183,782	110,168,714	111,600,674
Amount of salaries & wages All filers	3.38 tril.	3.61 tril.	3.88 tril.	4.13 tril.	4.45 tril.	4.61 tril.
Number of returns with business income	16,735,827	16,937,575	17,104,786	17,312,125	17,600,010	18,041,086
Income All filers	176,903,956	186,741,216	200,400,115	208,414,067	213,865,353	210,195,005

Observations from Table III

1. The number of returns has increased from 120 million in 1996 to 130 million in 2001. The growth rate is approximately 2%.

2. For 2001 the number of returns reporting wages or salary was 111 million. All 111 million are eligible to make a traditional IRA contribution which may or may not be deductible. Only those with a MAGI of less than $150,000 would be eligible to make a full Roth IRA contribution.

In 2001, only 3.5 million returns claimed a tax deduction with respect to an IRA contribution (see Table V on page 4). The average deduction amount was $2,252. Remember that the maximum deduction for a married couple filing jointly was $4,000 for 2001.

3. In 2001, there were wages of 4.6 trillion dollars versus $210 billion of business income. But to be fair to the small businesses, they paid many of those wages to their employees.

4. The number of returns reporting business income was 18 million. As long as there was net income from the business activity, the filer will be eligible to make a SEP, SIMPLE, Keogh or IRA contribution.

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IRS Tax Filing Statistics, Continued from page 3

Table IV – IRA Distributions

All money amounts are in thousands of dollars

Tax Item	1996	1997	1998	1999	2000
Number of returns with an IRA distribution	6,456,820	6,761,089	8,530,379	8,751,378	9,381,311
Gross amount of IRA Distributions					
All filers	70,006,464	79,008,673	133,357,445	125,316,324	138,323,846
Filers with MTI	58,338,720	64,340,125	106,345,650	98,287,313	104,949,807
Number of returns with taxable IRA distributions	5,831,146	6,214,044	7,774,091	8,129,376	8,732,291
Taxable amount of IRA distributions					
All filers	45,538,743	55,182,520	74,094,367	87,140,912	98,966,627
Filers with MTI	37,948,953	44,936,906	59,086,417	68,345,813	75,088,488
Number of returns rollovers and other nontaxable	625,674	547,045	756,288	622,002	649,020
Amount of rollovers and other nontaxable					
All filers	24,467,721	23,827,153	59,263,078	38,175,412	39,357,219
Filers with MTI	20,389,767	19,403,219	47,259,233	29,941,500	29,861,319

Observations from Table IV

1. Note the substantial increase in the amount of gross IRA distributions from 1996 to 2000. $70 billion was distributed in 1996, versus $138 billion in 2000.

2. The difference between the above two categories (gross amount and taxable amount) should be those IRA distributions which were NOT taxable either because they were rolled over, they were the return of nondeductible contributions, or the return of excess contributions. Presumably most of the difference is due to rollovers.

Table V – IRA Contributions Which Were Deducted

All money amounts are in thousands of dollars

Tax Item	1996	1997	1998	1999	2000	2001
Number of returns with an IRA distribution	4,374,281	4,068,958	3,868,017	3,687,149	3,505,032	3,489,724
Amount of the IRA deductions						
Filers with MTI	7,189,612	7,054,311	6,529,866	6,183,089	5,673,046	Not Available
All filers	8,627,534	8,662,644	8,188,452	7,883,438	7,477,074	7,509,629
Average deduction (all filers)	$1,972	$2,129	$2,117	$2,138	$2,133	$2,152

Observations from Table V

1. The number of returns claiming an IRA deduction has been decreasing each year. This is only 2.67% of all returns. Many taxpayers are not taking advantage of IRAs.

2. The deduction amount for 2001 was $7.5 billion.

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SEP, SIMPLE, & Keogh Questions

The IRS gives tests to those individuals who wish to become enrolled agents. We have selected 23 questions from the 1999-2002 tests. See how you do. The answers are on page 8. Your institution may wish to give more attention to SEPs/SIMPLEs/Keoghs because the amount deducted (i.e. contributed) for SEP/SIMPLE/Keogh plans for 2001 was 12.5 billion versus 7.5 billion for IRAs.

1. For retirement plan purposes, a sole proprietor is treated as his or her own employer; but a partnership is the employer of each partner.

☐ True ☐ False

2. The SEP and Keogh retirement plans may be set up any time, up to the due date of the employer's return, including extensions.

☐ True ☐ False

3. If you contribute more to the retirement plans than you can deduct for the year, you can carry over and deduct the excess in later years, subject to certain limitations.

☐ True ☐ False

4. In general, a 10% excise tax applies to nondeductible contributions made to qualified pension, profit sharing, stock bonus, or annuity plans, and to simplified employee pension plans (SEPs).

☐ True ☐ False

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SEP/SIMPLE/Keogh, Continued from page 4

5. The initial tax on prohibited transactions of retirement plans is 15% of the amount involved for each year (or part of a year) in the taxable period. However, if the transaction is not corrected within the taxable period, an additional tax of 100% of the amount involved is required.

☐ True ☐ False

6. Form 5500-EZ is required for a one-participant plan, in the final plan year, even if the total plan assets have always been less than $100,000.

☐ True ☐ False

7. An employer who sets up a simplified employee pension plan (SEP) must set up a traditional IRA for each employee who meets certain conditions (age, length of service, earnings). An employer can establish less restrictive participation requirements for its employees than those required, but not more restrictive ones.

☐ True ☐ False

8. Which of the following is required for an individual to qualify for a self-employed retirement plan?

☐ A. You must not be covered by another retirement plan.

☐ B. Self-employment net loss is subtracted from any salaries and wages when figuring total compensation.

☐ C. Individual must not be age 70 1/2 by the end of the tax year.

☐ D. None of the above.

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IRS Tax Filing Statistics, Continued from page 4

Table VI – KEOGH/SEP Deductions

All money amounts are in thousands of dollars

Tax Item	1996	1997	1998	1999	2000	2001
Number of returns w/ Keogh/SEP deductions	1,079,413	1,189,981	1,177,487	1,264,007	1,287,706	1,279,319
Amount of the Keogh/SEP deductions						
Filers with MTI	7,482,818	8,336,827	8,803,575	9,355,484	9,465,399	Not Available
All filers	8,979,382	10,237,623	11,039,683	11,928,242	12,475,346	12,471,858
Average deduction (all filers)	$8,319	$8,603	$9,375	$9,437	$9,688	$9,750

Observations from Table VI

1. The number of returns claiming a Keogh/SEP deduction has consistently been approximately 1.280 million tax returns. This is only 9.41% of those filers with business income (and farms were not included). Again, individuals are not taking advantage of these programs to the extent one would expect.

2. The deduction amount for 2001 was $12.47 billion versus $8.98 billion in 1996.

3. It will be interesting to see what the increase in the average contribution for 2002 will be because of the larger EGTRRA limits which applied for 2002.

Table VII – Pension Distributions

All money amounts are in thousands of dollars except for the averages.

Tax Item	1996	1997	1998	1999	2000	2001
Number of returns with a pension distributions	20,675,450	20,948,184	22,211,348	23,180,716	23,793,404	Not Available
Gross amount of pension distributions						
Filers with MTI	287,422,589	311,837,118	352,090,419	398,617,157	418,823,723	Not Available
All filers	344,907,107	382,935,981	441,521,385	508,236,875	552,009,667	Not Available
Average gross amount of pension distribution (all filers)	$16,682	$18,280	$19,878	$21,925	$23,200	Not Available
Number of returns with taxable pension distributions	19,272,307	19,496,575	20,473,407	21,343,646	21,765,211	22,541,155
Taxable amt of pension distributions						
Filers with MTI	198,989,009	211,491,247	223,803,986	238,675,070	247,213,734	Not Available
All filers	238,786,811	259,711,251	280,650,198	304,310,714	325,827,702	344,248,974
Average taxable amount of pension distribution (all filers)	$12,390	$13,321	$13,708	$14,258	$14,970	$15,272
Number of returns with rollovers and other nontaxable						
Filers with MTI	1,403,143	1,451,609	1,737,941	1,837,000	2,028,193	Not Available
All filers						
Amount of rollovers and other nontaxable						
Filers with MTI	88,433,580	100,345,871	128,286,433	159,942,087	171,609,989	Not Available
All filers	106,120,296	123,224,730	160,871,187	203,926,161	226,181,965	Not Available
Average amt of rollovers (all filers)	$74,920	$84,889	$92,566	$111,010	$111,519	

Observations for Table VII

1. Note the substantial increase in the amount of QP distributions from 1996-2000. $345 billion was distributed in 1996 and $552 billion was distributed in 2000.

2. The difference between the gross amount and taxable amount is those QP distributions which were not taxable either because of being rolled over, were the return of nondeductible contributions, or were the distribution of employer stock.
Presumably most of the difference is due to rollovers.

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IRS Tax Filing Statistics,
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Table VIII Additional Taxes from Forms 5329 and 5330

All money amounts are in thousands of dollars except for the average amount of tax due

Tax Item	1996	1997	1998	1999	2000
Number returns with tax due Form					
All filers	3,434,814	3,415,245	3,786,186	4,076,050	4,334,527
Amount of tax due from Form 5329/5330					
All filers	2,189,148	2,335,845	2,669,419	3,094,825	3,414,692
Average amount of tax due	$637	$684	$705	$759	$788

Observations from Table VIII

1. A taxpayer must complete form 5329 when he or she owes one of the many "penalty taxes" which can apply to IRAs, SEPs, SIMPLEs and Keoghs. There is a 6% tax if an excess contribution is made. There is a 10% tax if a pre-59 1/2 distribution is received. There is a 50% tax if there is an excess accumulation when the RMD rules apply. There is a 25% tax if there is a pre-59 1/2 distribution from a SIMPLE IRA within the first two years.

2. The number of returns being filed with these penalties has increased substantially, from 3.4 million returns in 1996 to 4.3 million returns in 2000.

3. The amount of tax due has increased from 2.2 billion to 3.4 billion.

4. The average amount of penalty tax owed per return has increased from $637 per return to $788 per return.

Summary of Income Tax Returns for 2000

We have presented these tax statistics because some of the information is informative. This information clearly shows why financial institutions are interested in obtaining rollover/transfer dollars. It also clearly shows that many people are not taking advantage of IRAs, SEPs, Keoghs, and SIMPLE-IRA plans. It appears these plans do not sell themselves as they once did.

Income tax generated	$1,008,633,322,000
Number of total returns	129,373,500
Number of returns with modified taxable income	105,254,144
Number of returns with salary and wages	110,168,714
Number of returns with business income	18,041,086
Number of returns with IRA deductions	3,505,032
Amount of IRA deductions	$7,477,074,000
Average IRA deduction amount/return	$2,133
Number of returns with Keogh/SEP/SIMPLE deductions	1,287,706
Amount of QP/SEP/SIMPLE deductions	$12,475,346,000
Average Keogh/SEP/SIMPLE deduction/return	$9,688
Number of returns with Form 5329/5330	4,334,527
Penalties owed from 5329/5330	$3,414,692,000
Average penalty amount	$788
Taxable amount of IRA distributions	$98,966,627,000
IRA rollovers and other nontaxable IRA distributions	$39,357,219,000
Taxable amount of QP distributions	$325,827,702,000
QP rollovers and other nontaxable QP distributions	$226,181,965,000

SEP/SIMPLE/Keogh,
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9. Which of the following types of income is NOT considered to be earnings from self-employment?

☐ A. Income passed through to shareholders of S Corporations.

☐ B. Guaranteed payments to limited partners, which are paid for services to the partnership.

☐ C. Commissions.

☐ D. Fringe benefits.

10. Your only employee, Manny Sales, earned $200,000 in 1998. What is the maximum contribution you can make to his SEP-IRA for the year?

☐ A. $6,000

☐ B. $30,000

☐ C. $2,000

☐ D. $24,000

11. When figuring the deduction for contributions made to your own SEP-IRA, compensation is your net earnings from self-employment, which takes into account:

☐ A. A reduction for all of your self-employment tax.

☐ B. A reduction for the maximum allowable contribution into your own SEP-IRA.

☐ C. The deduction for one-half of your self-employment tax and the deduction for contributions to your own SEP-IRA.

☐ D. A & B above.

12. Your employee, Jane Wood, earned $85,000 and elected to defer 10% of her salary. You make a 2% nonelective contribution. The total contribution that may be made for Jane under a SIMPLE-IRA plan is:

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SEP/SIMPLE/Keogh, Continued from page 6

☐ A. $10,200
☐ B. $8,500
☐ C. $1,700
☐ D. $7,700

13. Which of the following would most likely qualify as self-employment earnings for Keogh plan purposes?

☐ A. Fees a minister reports on Schedule C for performing marriages and baptisms.
☐ B. Income earned as a full-time insurance salesperson.
☐ C. Income an U.S. citizen earns in the U.S. as an employee of a foreign government.
☐ D. None of the above.

14. Generally, if a distribution is made to an employee under the retirement plan before he or she reaches age 59 1/2, the employee may have to pay 10% additional tax on the distribution. All of the following distributions are exceptions to this rule, except:

☐ A. Distributions made to a beneficiary (or to the estate of the employee) on or after the death of the employee.
☐ B. A series of substantially equal periodic payments beginning after separation from service and made at least annually for the life or life expectancy of the employee.
☐ C. Distributions made to an employee after separation from service if the separation occurred before the calendar year in which the employee reached age 55.
☐ D. Distributions made to an alternate payee under a Qualified Domestic Relations Order (QDRO).

15. Regarding retirement plans, prohibited transactions are transactions between the plan and a disqualified person. Which of the following is exempt from the prohibited transaction rules?

☐ A. A fiduciary of the plan.
☐ B. A person providing services to the plan.
☐ C. An employer, any of whose employees are covered by the plan.
☐ D. A disqualified person receiving any benefit to which he or she is entitled as a plan participant or beneficiary.

16. A Keogh plan must meet certain requirements. Which of the following is not a requirement of a Keogh plan?

☐ A. The plan must make it impossible for its assets to be used for, or diverted to, purposes other than for the benefit of employees and their beneficiaries.
☐ B. Contributions or benefits must not discriminate in favor of highly compensated employees.
☐ C. Minimum coverage requirements must be met.
☐ D. The plan cannot provide for payment of retirement benefits before the normal retirement age.

17. An employer may establish a simplified employee pension (SEP) plan and make contributions to IRAs for qualifying employees. To qualify, an employee must be at least 21 years old. an employer may raise, but not lower, the age restriction for participation.

☐ True ☐ False

18. Marie is a sole proprietor. She has no employees, but has established a 401(k) SIMPLE plan. Net profit on her Schedule C is $8,000. Marie made an elective deferral of $6,500 to her 401(k) SIMPLE. Marie can exclude the entire $6,500 from her income as an elective deferral.

☐ True ☐ False

19. Your qualified 401(k) plan can include what type of contribution arrangement?

☐ A. Cash
☐ B. Elective deferral.
☐ C. All the above.
☐ D. None of the above.

20. Zachary owns a small business (not a partnership) for which he has established a Keogh plan. The plan participants are Zachary and his one employee, who is unrelated to Zachary. The highest total assets of the plan during the year were $55,000. Zachary is eligible to file Form 5500-EZ.

☐ True ☐ False

21. Frederick changed jobs in 2000. During the year he had elective deferrals of $7,200 for his 401(k) plan at the old job and elective deferrals of $6,000 for his 401(k) plan at his new job. Frederick has an excess deferral.

☐ True ☐ False

22. Amy, a self-employed consultant, contributes more to her profit-sharing plan than she can deduct for the year. Amy can carry over and deduct the excess in later years combined with her normal contributions. Her contribution in later years is limited to which of the following?

☐ A. 15% of the participating employee compensation.
☐ B. 10% of the participating employee compensation.
☐ C. 25% of the participating employee compensation.
☐ D. None of the above.

23. In December 2000, Gail worked for ABC Co. and participated in their retirement plan. On February 1, 2001, Gail was employed by XYZ Corp. which has a qualified retirement plan. On March 1, 2001, the ABC Co. plan administrator distributed to Gail her vested share of the plan. Gail was 42-years old at the time of distribution. What must Gail do in order to avoid paying taxes and penalties on her withdrawal?

☐ A. Deposit the plan funds in a local bank.
☐ B. Contribute the distribution to the XYZ Corp.
☐ C. Donate the plan funds to a charity.
☐ D. None of the above.

See page 8 for answers.

Inheriting IRA Beneficiary, Continued from page 1

the original accountholder's granddaughter) upon the daughter's death.

Because of this change, CWF modified its IRA plan agreement forms to make it clear that a beneficiary could designate his or her own subsequent beneficiaries. We at CWF thought this was a better result than requiring the funds to be paid to the beneficiary's estate. Most older IRA plan agreement forms had been written to require any remaining funds be paid to the beneficiary's estate upon the death of the beneficiary.

Note that CWF's forms have been written so that the IRA accountholder understands that he or she is granting the initial beneficiary and all successor beneficiaries the power to designate their own beneficiaries, once they become the IRA "owner."

Does state law affect or supercede federal law on this issue? Here is CWF's analysis of state law as it affects IRA beneficiaries.

1. IRAs are primarily created under federal law. Federal law defines what an IRA is and creates tax benefits under federal income tax law. Unlike ERISA pension laws, the federal IRA laws do not expressly exempt any state laws concerned with IRAs.

2. Each state decides whether or not it will grant the same or different income tax benefits to IRAs that are bestowed under federal income tax law. For tax administrative reasons, many states adopt the same tax rules as the federal tax laws. Not all states do so.

3. Under federal law, it is very clear that IRAs are intended to benefit the accountholder and his or her beneficiaries. The final RMD regulation grants, to the accountholder and his or her initial beneficiary(ies), the right, in general, to stretch out distributions over the life expectancy of the initial beneficiary. This is a very valuable tax right. CWF believes a state, in general, does not have the right to enact laws which would force a distribution from the IRA earlier than federal income tax rules would require.

For example, Liz Redd, a 75-year-old IRA accountholder, dies in 2003. Liz is a resident of the state of Iowa. Liz had designated her daughter, Ann, to be her sole primary beneficiary. Ann was age 37 in 2003. Ann is also a resident of the state of Iowa. The fair market value of Liz's IRA was $208,000 as of her date of death. Under the new RMD regulations, as based on Code section 401(a)(9), Ann is entitled to have the $208,000 (plus any earnings) paid to her beneficiary(ies) over a distribution period of 45.6 years. The RMD regulation indicates that the IRS has the understanding there may well be successor beneficiaries.

4. A state could impose its own income tax distribution rules for state purposes. A state does not have to allow a 45.6-year payout period. It could impose its own laws, including requiring the funds to be taxed regardless of whether or not there has been a distribution. Obviously, this would create a tax accounting nightmare for both the individuals and the state. Because of the existence of a special taxation rule as discussed below, states must be careful, because a person can always change his or her state of residence. If a person changes his or her state of residence, the original state loses its right to tax those funds.

5. There is currently a federal law which provides that a state does not have authority to tax distributions from IRAs of individuals who are not residents of such state. CWF believes such law may be unconstitutional, but at this point in time, no state has made the unconstitutional argument.

6. The rule for qualified plans is that the plan document controls most everything: contributions, distributions, investing of plan assets, accounting topics and rights, designation of beneficiaries, and rights of inheriting beneficiaries. One can argue that the same concept or rules should apply for IRAs. As mentioned previously, this concept works for qualified plans, since, with only a few exceptions, federal law preempts all state laws. Such is not the rule for IRAs, as there is no federal preemption.

7. CWF has written its IRA forms to set policies and procedures for contributions, distributions, accounting, investing assets, designating beneficiaries and defining the rights of an inheriting beneficiary. We have written the IRA plan agreement forms (including our comprehensive amendments) so that the IRA accountholder expressly authorizes an inheriting beneficiary to designate his or her own successor beneficiary once he or she owns the IRA because the accountholder has died.

8. We expect most states will adopt rules and laws which will adopt the concept that the provisions of the IRA plan agreement will control, and state laws will be applied only if the IRA plan agreement does not expressly contain a provision on a certain topic. For example, a Missouri law provides that a designated beneficiary must survive the decedent by 120 hours, unless the IRA plan agreement expressly sets a different requirement.

At this time, we are not aware of any law prohibiting a grantor from giving this authority to a beneficiary.

Answers to SEP, SIMPLE, & Keogh Questions

1. T	5. T	9. A	13. A	17.* T/F	21. T
2. F	6. T	10. D	14. C	18. F	22. C
3. T	7. T	11. C	15. D	19. C	23.* D
4. T	8. D	12. D	16. D	20. F	

Additional CWF Comments

Question #17. We believe the IRS meant to say—It is permissible for the employer to raise the age restriction from age 21 to age 22 or 23. The law does not permit this. But the question was worded poorly so the IRS said both T or F would be treated as the correct answer.

Question #23. We are not sure why the IRS decided to treat any answer as correct. To us "D" is the correct answer as "A" and "B" did not say the funds were being rolled over into an IRA. They only said they were being deposited to a bank or contributed to the next employer. Although donating the distribution to a charity might create a deduction, it would not eliminate the 10% pre-59½ tax.