The Pension Digest

September 2003
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Also in this issue –

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

IRS Modifies Reporting Requirements for 2003 Form 1099-Q

In our March 2003 newsletter we discussed the "Major Reporting Changes for Coverdell ESAs for 2003."

The major change was that the financial institution would have to now determine the basis portion and the earnings portion of a gross distribution from a Coverdell ESA. In March of 2003, the IRS issued a new reporting form, 1099-Q (Distributions from qualified education programs under sections 529 and 530) reflecting the new rules and procedures. The IRS had changed, quite dramatically, the reporting requirements for distributions from CESAs and also contributions to CESAs.

As was to be expected, some taxpayers informed the IRS what they thought of the changes. A number of comments were submitted stating the financial institution had not collected the historical data needed to determine the basis and the earnings portions of a gross distribution and they had not collected such data with respect to transfers. This was reasonable for IRAs established before 2003, since prior rules had not required the collection of such data.

In August of 2003, the IRS modified its position. Set forth on the next page is the original 2003 Form 1099-Q and the revised form. It is set forth so that it can be reviewed as you read the IRS' new approach.

The IRS has modified its rules and procedures by allowing a CESA custodian to comply in two ways and not just the way set forth in the original forms and instructions. A financial institution will have a choice of which method it wishes to use for 2003 purposes. And until further guidance is issued, this modification will continue to apply. The IRS expects to publish further guidance about required reporting for CESA distributions made in 2004 and future years. An institution may use the alternative, or second method, only if it is unable to calculate the earnings and the basis portions of a gross distribution.

The second method provides that a trustee or custodian will satisfy the alternative reporting requirements if it prepares a 2003 Form 1099-Q in the following manner:

Box 1 - complete it to show the gross distributions, including the amount of any excess contributions and earnings thereon distributed to a participant during the 2003 calendar year;

Boxes 2 and 3 - leave these boxes blank unless the gross distribution includes a distribution of earnings related to an excess contribution. If so, the earnings are to be inserted into box 2. Use one of the two authorized methods for calculating the net income attributable to an IRA excess. See IRA Notice 2000-39 and Proposed regulation 1.408.11.

Box 4 - this box may be left blank if the trustee or custodian does not have the records indicating whether a gross distribution from a CESA made in 2003 was a trustee-to-trustee transfer. In most situations, a financial institution should know if it did a transfer. Therefore, box 4 should not normally be left blank.

Empty Box below boxes 5 and 6 - Must show the fair market value of the CESA (and labeled as such) as of December 31, 2003, and must mention Publication 970 (Tax Benefits for Education), as provided in the instructions to Form 1099-Q, so the recipient will know how to calculate the earnings portion of the gross distribution.

The payer/trustee and recipient information on the left side of the form, of course, must be completed.

Reasons for the IRS' Modification. The IRS was reasonable in concluding that financial institutions had not been given sufficient time

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IRS Modifies Reporting Requirements,
Continued from page 1

to change their CESA distribution forms and their computer reporting capabilities. We believe the IRS is serious about implementing this basis/earnings approach. We believe it is only a matter of time before such information becomes mandatory. For some reason, the IRS has decided they want to apply the taxation rule on a per-CESA basis rather than aggregating all CESAs.

The IRS has asked for comments as to: (1) what information should be used to establish basis and earnings; (2) what information will be satisfactory if provided by another financial institution; (3) what rule should be used if documentation is not available; and (4) other comments about CESA reporting matters that may be appropriate for future guidance.

2003 Form 1099-Q as originally issued.

CORRECTED (if checked)

PAYER'S/TRUSTEE'S name, street address, city, state, ZIP code, and telephone number

1 Gross distribution
$

2 Earnings
$

OMB No. 1545-1760
2003
Form 1099-Q

Payments From Qualified Education Programs (Under Sections 529 and 530)

PAYER'S/TRUSTEE'S Federal identification no.

RECIPIENT'S social security number

3 Basis
$

4 Trustee-to-trustee rollover

Copy B
For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

RECIPIENT'S name

5 Check one:
Section 529 program—
Private or State
Coverdell ESA

6 If this box is checked, the recipient is not the designated beneficiary

Street address (including apt. no.)

City, state, and ZIP code

Account number (optional)

Form 1099-Q (keep for your records) Department of the Treasury - Internal Revenue Service

2003 Form 1099-Q and instructions as revised.

CORRECTED (if checked)

PAYER'S/TRUSTEE'S name, street address, city, state, ZIP code, and telephone number

1 Gross distribution
$

2 Earnings
$

OMB No. 1545-1760
2003
Form 1099-Q

Payments From Qualified Education Programs (Under Sections 529 and 530)

PAYER'S/TRUSTEE'S Federal identification no.

RECIPIENT'S social security number

3 Basis
$

4 Trustee-to-trustee transfer

Copy B
For Recipient

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.

RECIPIENT'S name

5 Check one:
- Qualified tuition program—
Private or State
- Coverdell ESA

6 If this box is checked, the recipient is not the designated beneficiary

If an **FMV** amount is shown below, see **Pub. 970,** Tax Benefits for Education, for how to figure earnings.

Street address (including apt. no.)

City, state, and ZIP code

Account number (optional)

Form 1099-Q (keep for your records) Department of the Treasury - Internal Revenue Service

Instructions for Recipient

Box 1. Shows the gross distribution (including in-kind distributions) paid to you this year from a qualified tuition program (section 529) or a Coverdell ESA (section 530). This ~~amount is the total of the amounts shown in box 2 and box~~ 3. See **Pub. 970**, Tax Benefits for Education, for more information.

Box 2. Shows the earnings part of the gross distribution shown in box 1. This may be taxable to you.

Under a qualified tuition program, the amount in box 2 is taxable to you if there has been **(a)** more than one transfer within any 12-month period with respect to the same beneficiary (see box 4), or **(b)** a change in the designated beneficiary and the new designated beneficiary is not a family member.

Under a Coverdell ESA, the amount in box 2 is taxable to you if there has been a change in the designated beneficiary and the new designated beneficiary is not a family member or is over age 30 (except for beneficiaries with special needs).

Also, an additional 10% tax may apply to part or all of any taxable earnings from the Coverdell ESA or qualified tuition program. See **Form 5329**, Additional Taxes on Qualified Plans (including IRAs) and Other Tax-Favored Accounts, and your tax return instructions for information about how to report any income.

If a final (total) distribution is made from your account and you have not recovered your contributions, you may have a deductible loss. Claim any loss on the "Other expenses" line of **Schedule A (Form 1040),** Itemized Deductions.

Box 3. Shows your basis in the gross distribution reported in box 1.

Box 4. This box is checked if you transferred the amount in box 1 from one education program to another education program in a trustee-to-trustee transfer.

Box 5. Shows whether the gross distribution was from a qualified tuition (private or state) program or from a Coverdell ESA.

Box 6. This box is checked if you are not the designated beneficiary under the Section 529 program or a Coverdell ESA.

The Pension Digest

IRA IQ Test

School is back in session. We thought it appropriate to prepare a pre-IRA season test. Set forth below are 44 IRA questions. The source of these questions is the IRS. From 1998-2001 the IRS has posed these questions to individuals attempting to earn the status of an enrolled agent. To some extent the test is unfair because you must remember what the old laws and limits were. Try your best. The test is supposed to be fun. Answers are found on page 7.

1. Contributions on your behalf to a traditional IRA do not reduce your limit for contributions to a Roth IRA.

☐ True ☐ False

2. Betty, who is single, has income in 1998 totaling $2,000. She is 35 years of age, and the income she received consists of $1,500 earned from clerical work and $500 from interest income. What is the maximum amount of money that she can contribute to a traditional IRA?

☐ A. $2,000
☐ B. $1,500
☐ C. $500
☐ D. -0-

3. Margaret is fully vested and will receive social security benefits at retirement, but has no other retirement plan coverage. Her present and past employers have not had retirement plans available. In 1998, she files as single, and her earnings are $34,000. Also, in 1998, she contributes $2,000 to a traditional IRA. how much of the $2,000 contribution may she deduct?

☐ A. -0-
☐ B. $1,200
☐ C. $2,000
☐ D. $800

4. Tony and Janet are married, filing jointly. In 1998, Tony's taxable compensation is only $1,500; and Janet's compensation is $58,500. Tony contributed all $1,500 of his earnings to a Roth IRA. Neither Tony nor Janet is covered by a retirement plan. What is the maximum amount Janet may deduct for traditional IRA contributions for herself and for Tony?

☐ A. $2,500
☐ B. $4,000
☐ C. $2,250
☐ D. -0-

5. For traditional individual retirement arrangements (IRAs) for tax year 1998, which of the following is correct?

☐ A. The modified AGI limitation range for filers has not changed.

☐ B. The Roth IRA contribution is deductible for a spousal IRA.

☐ C. Contributions may be made up to the due date of the return including extensions.

☐ D. If your spouse is covered by a retirement plan, and you are not, your traditional IRA deduction is not limited if your modified AGI on a joint return is less than $150,000.

6. All of the following types of accounts are permitted for Individual Retirement Arrangements except:

☐ A. A trust or custodial account at an IRS approve entity.

☐ B. An individual retirement annuity.

☐ C. An employer and employee association trust account.

☐ D. Individual savings bonds clearly designated as an IRA.

7. Which of the following is correct regarding education IRAs for 1998?

☐ A. Contributions are deductible.

☐ B. Contributions other than cash may be made.

☐ C. Contributions may be made until age 30.

☐ D. The annual contribution limit is $500 for each child, no matter how many education IRAs are set up for that child.

8. Generally, the excess contribution to an IRA is subject to tax. Which of the following is correct?

☐ A. You will not have to pay the six percent if you withdraw the excess contribution and any income earned on the excess contribution before the date your tax return for the year is due, including extensions.

☐ B. The six percent tax is due on both the excess contributions and any income earned on the excess contribution.

☐ C. You will not have to pay the six percent tax if you withdraw the excess contribution; and the earnings on the excess contribution are less than six percent.

☐ D. You will not have to pay the six percent tax if you withdraw only the earnings on the excess contribution for the current year and subsequent years as well.

9. Generally, you must begin receiving distributions from your traditional IRA no later than which of the following dates?

☐ A. Six months after your 70th birthday.

☐ B. December 31st of the year in which you reach age 70½

☐ C. April 1st of the year in which you reach age 70½.

☐ D. April 1st of the year following the year in which you reach age 70½.

10. Generally, a non-working spouse may make contributions to a traditional individual retirement account (IRA) up to $2,000, even if the working spouse's earnings are less than $4,000 and the working spouse also makes a $2,000 contribution.

☐ True ☐ False

11. The rules regarding excess accumulations in a traditional individual retirement account (IRA) state that a 50% excise tax must be paid for that year on the amount not distributed as required.

☐ True ☐ False

12. Contributions to a Roth IRA (individual retirement account) may be deducted if they fall below certain income limits.

☐ True ☐ False

13. Generally, any assets remaining in an education IRA must be withdrawn or distributed within 30 days of the time when either the designated beneficiary reaches age 30 or the designated beneficiary dies.

☐ True ☐ False

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IRA IQ Test, Continued from page 3

14. A contribution to an individual retirement plan (IRA) is deductible for tax year 1999 in which of the following situations:

☐ A. The individual's employer does not have a retirement plan at any time during 1999.
☐ B. The contribution is made on August 15, 2000, under a properly filed and accepted extension.
☐ C. The individual is covered by a retirement plan, but does not have any compensation in 1999.
☐ D. All of the above.

15. Lenny and Norma file a joint return for tax year 1999. Lenny is covered by a retirement plan, but Norma is not. Norma wishes to make a contribution to a traditional IRA, and her earnings alone are $1,500. The combined earnings on the joint return are $150,000 (the same as the modified AGI). Which of the following is correct:

☐ A. Norma may make a nondeductible contribution of $1,500.
☐ B. Norma may make a deductible contribution of $2,000.
☐ C. Norma may not make any contribution.
☐ D. Norma may make a deductible contribution of $1,500 and a nondeductible contribution of $500.

16. Which of the following is compensation for the purpose of contributions to an individual retirement account?

☐ A. Deferred compensation received.
☐ B. Foreign earned income excluded from income.
☐ C. Pension or annuity income.
☐ D. Taxable alimony and separate maintenance.

17. Owners of traditional individual retirement accounts (IRAs) are required to begin receiving distributions no later than the following:

☐ A. By April 1 of the year following the year in which the owner reaches age 70½.
☐ B. By April 1 of the year in which the owner reaches age 70½.
☐ C. By January 1 of the year in which the owner reaches age 70½.
☐ D. By April 1 of the year following the year in which the owner reaches age 59½.

18. Which of the following is correct regarding contributions to a Roth IRA?

☐ A. Contributions may be made regardless of age provided other requirements are met.
☐ B. Contributions may be deducted if you are within certain income limits.
☐ C. Contributions may be deducted if you are not covered under a retirement plan.
☐ D. Contributions may not be deducted, but earnings are taxable when distributed.

19. Scott McTavish made a rollover contribution from his traditional IRA to a newly created Roth IRA on December 1, 1998. Also, on February 1, 2000, he made another rollover contribution from an employer IRA to the same account. Which of the following is correct?

☐ A. He may not withdraw the funds tax free earlier than December 1, 2003.
☐ B. He may not withdraw the funds tax free earlier than February 1, 2005.
☐ C. He must make the February 1, 2000, rollover contribution into a separate Roth IRA account to properly identify another five-year holding period.
☐ D. He may not withdraw the funds tax free earlier than January 1, 2003.

20. Generally, which of the following rules apply to **both** traditional IRAs and Roth IRAs?

☐ A. Non-rollover contributions are generally limited to $2,000 each year or 100% of compensation, whichever is less.
☐ B. Contributions are always non-deductible.
☐ C. Contributions may not be made for the tax year in which you reach age 70½ or for years thereafter.
☐ D. Contribution phaseout limits are the same for both traditional IRAs and Roth IRAs.

21. After many years as a bachelor, Buddy, age 50, married Penny, age 63. Penny's only income was $10,800 of social security. They filed a joint return for year 2000, with a modified adjusted gross income of $100,000. Buddy is covered by a retirement plan at work where he receives compensation of $85,000. He wishes to contribute to an IRA for himself and for Penny. Which of the following will provide them the greatest allowable tax benefit.

☐ A. He may contribute $2,000 to each IRA, but only take a deduction for the $2,000 to his IRA.
☐ B. He may contribute $2,000 to each IRA, but take no deduction for either IRA.
☐ Ca. He may contribute $2,000 to each IRA, and take a deduction of $2,000 for each IRA.
☐ D. He may contribute $2,000 to each IRA, but only take a deduction for the $2,000 to Penny's IRA.

22. Which of the following amounts may be converted directly to a Roth IRA, provided all requirements are met?

☐ A. Amounts in a SIMPLE-IRA, and the two-year participation period have been met.
☐ B. Amounts in an inherited traditional IRA.
☐ C. Hardship distribution from a 401(k) plan.
☐ D. Required minimum distributions from a traditional IRA.

23. Joe Smith never married, and had no children. When he died, he left all of his assets, including his traditional IRA, to his nephew, David. What is David allowed to do with the inherited IRA?

☐ A. He could make additional direct contributions to the IRA, treating it as his own.
☐ B. He could roll over amounts out of the inherited IRA to another IRA tax free.
☐ C. He could make additional contributions, which were rollovers from

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**IRA IQ Test,
Continued from page 4**

Roth IRAs.

☐ D. None of the above.

24. Edwin and Donna were married. He had established a traditional IRA to which he made contributions, and had taken no distributions. The total value of the IRA was $50,000, of which $20,000 was nondeductible contributions. As the spousal beneficiary, which of the following applies to Donna?

☐ A. Edwin's $20,000 basis in the IRA may be treated as basis to Donna.

☐ B. When Donna receives the distribution, she may **not** roll it over to her own traditional IRA.

☐ C. Donna must begin receiving periodic distributions by December 31 of the fifth year following Edwin's death.

☐ D. Donna must pay a 10% penalty on the funds in the IRA if she receives an immediate distribution after Edwin's death.

25. Celeste, who is single, worked recently for a telephone company in France, and earned $1,500 for which she claimed the foreign earned income exclusion. In addition to that, she earned $1,200 as an employee of an answering service while she was in the U.S. She also received alimony of $400 for the year. What is her maximum amount of allowable contribution to a traditional IRA for year 2000?

☐ A. $1,600
☐ B. $2,000
☐ C. $1,200
☐ D. $1,900

26. Which of the following is **more** than the allowable contribution amount to a self-employed retirement plan?

☐ A. Contribution of $10,000 to a self-employed individual's own defined contribution Keogh plan. The individual's net earnings from self-employment (on Schedule C) are $40,000.

☐ B. $15,000 to the SEP-IRA of an employee who earned $100,000 in 2000.

☐ C. $6,000 contribution into a SIMPLE-IRA by an employee who earns $30,000.

☐ D. A contribution of $10,000 to an employee's account in a defined contribution plan. The employee earned $40,000.

27. Joaquin is a small business owner who maintains a SEP for his employees:

- Jan, a 42-year-old part-timer who has worked for Joaquin in this business since 1992. She works 15 hours per week. She earned $13,500 in 2000.
- Malik, a 72-year-old seasonal worker who works from September through December. He has worked for Joaquin in this business since 1995 and earned $6,000 in 2000.
- Monica is 21 years old and works 10 hours per week, all year. She has worked for Joaquin since June 1999 and earned $4,800 in 2000.

Joaquin's business had net taxable income in 2000 of $62,300. All employees and Joaquin are U.S. citizens and none of them are union members. Which of the individuals listed below can be excluded from being covered under the SEP in 2000?

☐ A. Jan
☐ B. Malik
☐ C. Monica
☐ D. Joaquin

28. Carmine is a self-employed consultant who has one employee, Devin, who earned $48,000 in 2000. Devin contributed the maximum amount of his compensation to the SIMPLE 401(k) plan under which an employee can choose to make salary contributions of up to 15% of pay. Carmine made a 3% matching contribution. Which of the following correctly represents the amount that Carmine will deduct for compensation and benefits paid to Devin in 2000?

☐ A. $48,000 wages and $6,000 retirement plan contribution.

☐ B. $48,000 wages.

☐ C. $48,000 wages and $1,440 retirement plan contribution.

☐ D. $48,000 wages and $7,440 retirement plan contribution.

29. Lenore, who is 43 years old, opened a SIMPLE-IRA on January 19, 1999. On September 22, 2000, she withdrew the entire $10,000 value of the account. The distribution does not meet any early withdrawal exceptions to the additional tax on early distributions. How much additional tax (penalty) is this distribution subject to?

☐ A. $600
☐ B. $1,000
☐ C. $1,500
☐ D. $2,500

30. Which of the following is **not** a disqualified person for purposes of determining whether a prohibited transaction has been entered into under the qualified retirement plan rules?

☐ A. A plan fiduciary who deposits contributions into his or her own account and uses the funds to pay personal business expenses.

☐ B. A 70-year-old individual who receives a distribution of the full value of his retirement account from a plan established by a business that he owns.

☐ C. A fiduciary that invests the plan's assets in FGH partnership. FGH deposits 10% of the plan's assets into the fiduciaries' own account.

☐ D. An individual who receives a loan from a plan.

31. Rena is a 72-year-old single chemical engineer. She works part-time for a pharmaceutical company, and earned $22,000 in 2000. Her modified adjusted gross income is $35,000. She participates in her employer's pension plan and profit sharing plan. In 2000, she contributed $2,000 to a traditional IRA. How much of her contribution can Rena deduct in 2000?

☐ A. $0
☐ B. $1,200
☐ C. $1,400
☐ D. $2,000

32. Peter and Jill are married and file a joint return. In 2000, Jill was a media relations manager for a large firm and earned $98,000; Peter owns a graphic design business that

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IRA IQ Test, Continued from page 5

shows a net profit of $500. In 2000, Jill was covered by an employer's plan, Peter was not. Their Modified Annual Gross Income was $155,000. What is the maximum deductible that Peter can contribute to a traditional IRA.

- ☐ A. $0
- ☐ B. $500
- ☐ C. $1,000
- ☐ D. $2,000

33. Joe has a traditional IRA with a basis of $8,800. In 2000, this was his only IRA. On December 31, 2000, he converted $44,000 of the $88,000 total value of the IRA to a Roth IRA. He files as head of household, and his AGI, without the conversion, is $62,000. What amount of income will be included on Joe's 2000 return as the result of his conversion?

- ☐ A. $8,800
- ☐ B. $35,200
- ☐ C. $39,600
- ☐ D. $44,000

34. Joseph is a single taxpayer. His modified adjusted gross income in 2000 was $140,000, of which $116,000 was earned income. In 2000, he made a $2,000 contribution to his previously-established Roth IRA. What is the penalty for excess contributions if he doesn't withdraw the contribution (and all attributable earnings) by the due date of the return (including extensions), or recharacterize the contribution by the due day of the return (including extensions)?

- ☐ A. $0
- ☐ B. $120
- ☐ C. $150
- ☐ D. $200

35. Maria has a traditional IRA, from which she has taken a taxable distribution of $8,000. Under which of the following circumstances will the distribution be subject to the 10 percent penalty for premature distributions?

- ☐ A. Maria's AGI is $30,000 and she had $13,000 in unreimbursed deductible medical expenses which exceed 7.5% of her adjusted gross income.
- ☐ B. Maria's granddaughter is a sophomore in college and Maria paid her tuition expenses of $10,000.
- ☐ C. Maria is age 57. The distribution is not part of a series of equal periodic payments. She has no qualifying expenses or condition.
- ☐ D. The distribution was made pursuant to an IRS levy on Maria's IRA.

36. Deb is self-employed and has no other employees. Her net earnings, after the deduction for one-half of self-employment tax but before deducting any contributions she makes to her own SIMPLE, are $12,000. What is the most that can be contributed to Deb's SIMPLE for 2000 (employer and employee contributions)?

- ☐ A. $2,000
- ☐ B. $5,000
- ☐ C. $6,000
- ☐ D. $6,360

37. Minnie's tax return for 2000 shows the following income:

- $800 wages
- $6,490 unemployment compensation
- $1,000 alimony
- $8,000 rental income from apartment buildings she owns

What is Minnie's earned income for the purpose of determining how much she can contribute to an IRA?

- ☐ A. $800
- ☐ B. $7,290
- ☐ C. $1,800
- ☐ D. $16,290

38. Which of the following are prohibited transactions with a traditional IRA?

- ☐ A. Selling property to it.
- ☐ B. Using it as security for a loan.
- ☐ C. Buying property for personal use with your IRA funds.
- ☐ D. All of the above.

39. Joyce was recently divorced. Per a court order, she must transfer her IRA to her ex-spouse. To avoid paying taxes on the withdrawal, Joyce must do which of the following?

- ☐ A. Direct rollover.
- ☐ B. Change the name on the current account.
- ☐ C. Withdraw funds and deposit them into another qualified plan.
- ☐ D. All of the above.

40. George, a single taxpayer, has W-2 income of $31,000. During the 2000 tax year he contributed $2,500 to his traditional IRA. George has excess contributions of how much?

- ☐ A. $2,500
- ☐ B. $2,000
- ☐ C. $500
- ☐ D. None of the above.

41. Charles, a sole proprietor, contributes to his self-employed pension plan. Where will he take his deduction on his income tax return?

- ☐ A. Form 1040, Schedule C.
- ☐ B. Form 1040, Page 1.
- ☐ C. Form 1040, Schedule A.
- ☐ D. None of the above.

42. Which of the following is **not** considered earned compensation for IRA contribution purposes.

- ☐ A. Deferred compensation.
- ☐ B. Wages and salaries.
- ☐ C. Self-employed income.
- ☐ D. Commissions.

43. If distributions from your traditional IRA are less than the minimum required distribution for the year, you may have to pay an excise tax for that year on the amount not distributed as required. The excise tax is how much?

- ☐ A. 10%
- ☐ B. 40%
- ☐ C. 50%
- ☐ D. None of the above.

44. Winston turned 70½ on June 1, 2000. What date must he receive his minimum distribution by.

- ☐ A. April 15, 2001.
- ☐ B. December 31, 2000.
- ☐ C. June 20, 2000.
- ☐ D. None of the above.

See page 7 for answers.

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Compensation Limits & SIMPLE-IRAs

The SIMPLE-IRA rules either require an employer to make a matching contribution equal to an employee's compensation multiplied by 3% (in some situations, 1% or 2% is permissible, and there are limits as discussed below which apply) or a nonelective contribution equal to an employee's compensation multiplied by 2%.

Note that the 2% nonelective contribution must be made on behalf of all eligible employees. The law expressly provides that compensation for this purpose is limited to $200,000. The effect of this limit is that the QNEC for any person earning $200,000 or more is restricted to $4,000. Such a rule, in effect, discriminates against the highly-compensated employees.

The matching contribution is only made to those employees who make salary-reduction contributions. The law does NOT provide an express limit on compensation for purposes of applying the rules which apply to an employer making a matching contribution. Such a rule also has the effect of discriminating against those employees earning over $200,000. This is illustrated below.

The employer's matching contribution is the lesser of: (1) the statutory limit which applies to the person; or (2) the amount of the salary reduction contribution made by the employee. In addition, the employer's matching contribution percentage is limited to being the employee's salary reduction percentage.

The statutory salary reduction limit has changed over the past few years and will be changing for the next couple of years:

	Under Age 50	Age 50 and Older
2000	$6,000	$6,000
2001	6,500	6,500
2002	7,000	7,500
2003	8,000	9,000
2004	9,000	10,500
2005	1,000	12,000
2006	10,000	12,500

The following examples illustrate these rules/limits.

Example #1. Laura is a SIMPLE-IRA participate. She is 53. Her compensation for 2003 is $60,000. Her employer set the matching contribution at 3%. Laura makes a salary-reduction contribution of $9,000. Her salary reduction contribution percentage is 15% ($9,000/$60,000). The matching contribution which her employer must make is $1,800 ($60,000 x 3%) since this is less than the statutory amount of $9,000 or the amount she deferred of $9,000.

Example #2. Kelly is a SIMPLE-IRA participant. She is 53. Her compensation for 2003 is $60,000. Her employer set the matching contribution at 3%. Kelly makes a salary reduction contribution of $1,500. The matching contribution which her employer must make is $1,500. Her salary reduction percentage was only 2.5% of her compensation ($1,500/$60,000). The employer is only required to match her required salary-reduction percentage if it is less than the set percentage of 3% (or 1% or 2%, if applicable).

Example #3. Nancy is a SIMPLE-IRA participant. She is 53. Her compensation for 2003 is $100,000. Her employer set the matching contribution at 3%. Nancy makes a salary-reduction contribution of $9,000. Her salary reduction contribution percentage is 9% (9,000/10,000). The matching contribution which her employer must make is $3,000 (100,000 x 3%).

Example #4. Cheryl is a SIMPLE-IRA participant. She is 53. Her compensation for 2003 is $400,000. Her employer set the matching contribution at 3% Laura makes a salary reduction contribution of $5,000. Her salary reduction contribution percentage is 1.25% ($5,000/$400,000). The matching contribution which her employer must make is $5,000.

Originally, the salary reduction limit was $6,000. This meant the employer's match would never exceed $6,000 regardless of the employee's compensation. Since the employer was only required to match up to $6,000, the practical effect was that compensation was limited to $200,000 ($6,000 = "X" multiplied by 3%).

The effect of the increase in the salary-reduction limit is to increase the employers match with respect to those employees who earn more than $200,000. For example, if the applicable matching rate is 3%, and an employee has a salary reduction of $8,000, then the employer will have to make a matching contribution of $8,000 only if the employee has compensation of $266,667 ($8,000/3%) or more. If the employee's compensation was $200,000, the employer's match would be $6,000 ($200,000 x 3%).

Conclusion. The law does not expressly provide a compensation limit for SIMPLE-IRA matching contributions. There is a $200,000 limit for the employer's qualified nonelective contributions. There is, however, an indirect matching contribution limit determined as follows: the current year's salary-reduction limit for a person divided by 3% (or the applicable limit, if less than 3%).

Answers to IRA Questions

1. F	13. T	25. A	37. C
2. B	14. A	26. A	38. D
3. C	15. B	27. C	39. B
4. A	16. D	28. C	40. C
5. D	17. A	29. D	41. B
6. D	18. A	30. B/D	42. A
7. D	19. D	31. A	43. C
8. A	20. A	32. C	44. D
9. D	21. D	33. C	
10. F	22. A	34. B	
11. F	23. D	35. C	
12. F	24. A	36. D	

Divorce Court Order and IRAs – A "Be Careful" Topic

Sometimes attorneys and judges are not as well versed about IRAs as they should be.

Code section 408(d)(6) authorizes the transfer of assets from an IRA of one spouse to the IRA of the other spouse. In such situations, the transfer will not result in any tax consequences. The court decree and/or property settlement should always reference Code section 408(d)(6) and authorize a transfer. The order should stipulate that both spouses must maintain his or her own IRA. It should define how much is to be transferred and when the transfer must be consummated.

Can the ex-spouse roll over an IRA distribution? The law is unclear. The conservative approach is that it cannot be done. Why? The IRS has adopted the position that federal tax law does not authorize a distribution to the non-IRA accountholder spouse. The IRS adopted this position in the following tax court case. The court adopted the IRS' position. The practical effect is that if a state court orders the husband's IRA to make a distribution to an ex-spouse's IRA, it is the husband who will have to include the distribution in his income and pay the 10% pre-59½ tax, if applicable. It also appears the ex-spouse would not have the right to roll over the distribution, since the distribution is considered to have been made to the husband, and the right to do a rollover is personal.

Some attorneys try to use the IRA as a source of cash if the spouse falls behind in paying marital support, or child support. Some judges adopt such suggestion in the orders which they issue with respect to the divorce. For purposes of this article, it is assumed the court has the authority to issue such an order. However, we at CWF believe such an order would create a prohibited transaction. The assets of the IRA are being used for a purpose other than as the Tax Code permits (i.e. they are being used as collateral to ensure the person makes various payments he or she has promised to make). The person is receiving a personal benefit. He or she does not have to come up with other assets to serve as collateral or other assets to satisfy the other spouse. Once the court order is issued, we at CWF believe you would have to treat the situation as if a distribution of the account has occurred. IRS instructions for Form 1099-R have a specific reason code (5) to be used when there has been a prohibited transaction. It may be possible the court would correct its order. Technically, we do not believe a prohibited transaction can be corrected, since the statute is clear that a distribution is deemed to have taken place. Your institution should consult with its attorney to determine your institution's position on these issues.

Duties of an Institution as the "Designated Financial Institution" for a SIMPLE Plan

Summary Description–

If your institution is a "Designated Financial Institution" for a SIMPLE plan, it would normally be required to send out a Summary Description to the plan participants 60 days prior to the start of the next plan year. What if the employer has not made a contribution for 2003? Would the institution still be required to send out the Summary Description for the 2004 plan year? CWF believes that the institution is required to send out the Summary Description unless the institution has received written instruction from the employer that the plan was terminated prior to the 2003 plan year, or that the plan is now terminated. Unless the institution is provided written notice of termination of the SIMPLE, it is obligated to send out the Summary Description.

No Employer Contribution–

Under a SIMPLE plan, the employer MUST make its promised match or non-deductible contribution, unless the plan is terminated. What liability does an institution have when the employer quits making SIMPLE contributions? Although the institution has no duty to collect funds on behalf of the plan participants, it needs to furnish formal notice to the employer that it is terminating its relationship with the employer, and will no longer be the designated financial institution for the SIMPLE plan. We would assume the employer has properly notified the plan participants that the plan is terminated. If the employer did not notify the plan participants of such plan termination, the employer will have some liability to make its promised contribution.

Terminating a SIMPLE Plan–

The IRS does not discuss how to terminate a SIMPLE plan. For the 2003 plan year, the employer would have to notify its employees by October of 2002 if it were not going to make its promised contribution for the 2003 plan year. The plan would then be considered terminated, because the only recourse the employer has for not making the contribution is to terminate the plan. Simply not making the contribution IS NOT an option if the plan is still in force.

Reinstating a Terminated SIMPLE Plan–

Although an employer certainly has the right to terminate a SIMPLE plan, an employer cannot simply "reinstitute" the SIMPLE plan if it decides to again make contributions. It would have to comply with the 60-day notice requirement, and it basically would be setting up a second SIMPLE plan, since the first one was terminated. Therefore, if the employer wished to contribute for 2004, the plan participants would have to receive notice 60 days prior to 2004 (by November 1, 2003). Note that the employer would not have until 10/1/04 to set up the plan.