The Pension Digest

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

SIMPLE-IRA Summary Description— Due by October, 2007 for Tax Year 2008

What are a financial institution's duties if it is the custodian or trustee of SIMPLE IRA funds? After a SIMPLE IRA has been established at an institution, it is the institution's duty to provide a Summary Description each year within a reasonable period of time before the employees' 60-day election period. CWF believes that providing the Summary Description 30 days prior to the election period would be considered "reasonable." The actual IRS wording is that the Summary Description must be provided "early enough so that the employer can meet its notice obligation." You will want to furnish the Summary Description in September or October. The employer is required to furnish the summary description before the employees' 60-day election period.

IRS Notice 98-4 provides the rules and procedures for SIMPLEs. This notice is reproduced in CWF's 2007 IRA Procedures Manual. If you do not have this resource manual, an order form is enclosed for your convenience.

The Summary Description to be furnished by the SIMPLE IRA custodian/trustee to the sponsoring employer depends upon what form the employer used to establish the SIMPLE IRA plan.

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Tax Rules Influencing an IRA Accountholder to Not Designate his or Her Estate as the IRA Beneficiary

Some IRA accountholders designate his or her estate to be the designated beneficiary of the IRA funds. For the reasons discussed below, there are times when this action will produce less favorable tax results. An individual may think he or she is adopting a simple, but comprehensive approach by stating in his or her will (and not an IRA beneficiary designation form) how he or she wants the IRA funds distributed after his or her death. But, by designating his estate as his beneficiary, he may be imposing larger required minimum IRA payments on his or her estate or the beneficiaries of the estate than would have been the case had the individuals been designated directly as the IRA beneficiaries.

The IRA laws have two sets of required distribution rules. An IRA accountholder must take a required distribution for the year he or she attains age 70½ and each subsequent year. This duty of the IRA accountholder to take a distribution ceases upon his or her death. After the IRA accountholder dies, his or her beneficiary(ies) will be required to take a required distribution in an amount as defined by the IRA laws.

The required distribution amount for the year of death is calculated under the fiction that the individual did not die.

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SIMPLE-IRA Summary Description,
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As you are probably aware, the employer may complete either Form 5305-SIMPLE (where all employees' SIMPLE IRAs are established at the same employer-designated financial institution) or Form 5304-SIMPLE (where the employer allows the employees to establish the SIMPLE IRA at the financial institution of his or her choice).

There will be one Summary Description if the employer has used the 5305-SIMPLE form. There will be another Summary Description if the employer has used the 5304-SIMPLE form. If you are a user of CWF forms, these forms will be Form 918 and 918A.

The general rule is that the SIMPLE IRA custodian/trustee is required to furnish the summary description to the employer. This Summary Description will only be partially completed. The employer will be required to complete it and then furnish it to his employees. The employer needs to indicate for the upcoming 2008 year the rate of its matching contribution or that it will be making the non-elective contribution equal to 2% of compensation.

However, in the situation where the employer has completed the Form 5304-SIMPLE, the IRS understands that many times the SIMPLE IRA custodian/trustee will have a minimal relationship with the employer. It may well be that only one employee of the employer establishes a SIMPLE IRA with a financial institution. In this situation, the IRS allows the financial institution to comply with the Summary Description rules by using an alternative method.

To comply with the alternative method, the SIMPLE IRA custodian/trustee is to furnish the <u>individual</u> SIMPLE IRA accountholder the following:

- ✔ A current 5304-SIMPLE — this could be filled out by the employer, or it could be the blank form
- ✔ Instructions for the 5304-SIMPLE
- ✔ Information for completing Article VI (Procedures for withdrawal) (You will need to provide a memo explaining these procedures.)
- ✔ The financial institution's name and address.

Obviously, if an institution provides the employee with a blank form, he/she will need to have the employer complete it, and, the employee may well need to remind the employer that it needs to provide the form to all eligible employees.

CWF has created a form (reproduced on page 3) which covers the "alternative" approach of the Summary Description being provided directly to an employee.

<u>The penalty for not furnishing the Summary Description is $50 per day.</u>

Special Rule for a "transfer" SIMPLE IRA

There is also what is termed a "transfer" SIMPLE IRA. If your institution has accepted a transfer SIMPLE IRA, and there have been no employer contributions, then there is no duty to furnish the Summary Description. However, if there is the expectation that future contributions will be made to this transfer SIMPLE IRA, then the institution will have the duty to furnish the Summary Description.

Reminder of Additional Reporting Requirements

The custodian/trustee must provide each SIMPLE IRA account holder with a statement by January 31, 2008, showing the account balance as of December 31, 2007, (this is the same as for the traditional IRA), and include the activity in the account during the calendar year (this is not required for a traditional IRA). There is a $50 <u>per day</u> fine for failure to furnish this statement (with a traditional IRA, it would be a flat $50 fee). ◆

SIMPLE-IRA Summary Description, Continued from page 2

SIMPLE — Summary Description for the 2008 Calendar Year
(Alternative Method)

To: SIMPLE Accountholder

Name ____________________
Address ____________________
City ____________________ State _____ Zip __________

From: SIMPLE-IRA Custodian

Date: ____________________

Each year, we, as your SIMPLE-IRA custodian, are required to furnish either you or your employer with a legal document called a SUMMARY DESCRIPTION. The furnishing of this summary is to remind you of your rights under the SIMPLE-IRA plan which your employer sponsors. In general, during the period of November 1 to December 31, 2007, you have the right to make or change how much will be deferred or withheld from your paychecks during 2008 to be contributed to your SIMPLE-IRA. In addition, you have the right to change the financial institution at which your SIMPLE-IRA contributions are made.

Your employer has created the SIMPLE-IRA plan it sponsors by executing the IRS Model Form 5304-SIMPLE (Savings Incentive Match Plan for Employees of Small Employers (SIMPLE) — Not for use with a Designated Financial Institution). Our relationship with your employer is very limited. We deposit funds as paid to us by your employer to be contributed into your SIMPLE-IRA. The contribution amount is attributable to your elective deferrals and your employer's matching contributions.

The IRS has authorized two alternatives for us to furnish the 2008 summary description. We may either furnish a completed copy of the Form 5304-SIMPLE to your employer who then is required to furnish you with a copy. Alternatively, we are permitted to furnish you with a blank copy of the Form 5304-SIMPLE and the following information as set forth below. We have chosen to use this alternative method.

1. The current instructions for the Form 5304-SIMPLE;

2. Our name and address as follows:

   Name ____________________
   Address ____________________
   City ____________________ State _____ Zip __________

3. The procedures, (including describing all fees and charges) which govern your withdrawing funds from your SIMPLE-IRA are as follows:

   ____
   ____
   ____
   ____
   ____
   ____
   ____
   ____
   ____

4. A reminder that your employer will need to complete the first two pages of the Form 5304-SIMPLE and to distribute completed copies to all eligible employees. The employer will also need to inform you if it will be making a matching contribution equal to the employees' salary-reduction contributions subject to a percentage limit of 1-3% which the employer will need to define, or a non-elective contribution equal to 2% of employees' compensation.

SIMPLE #918-B for 2008 (8/07) Special Insert
For Form 5304 SIMPLE Kit

White — Employer Yellow — Trustee

When May a Person Make His or Her HSA Contributions?

The general rule is that an individual can make his or her HSA contribution for the tax year in one or more payments, at the convenience of the individual or the employer. Such contribution must be made at any time prior to the time prescribed by law (without extension) for filing the person's federal income tax return for that year, but not before the beginning of the year. For calendar year taxpayers, the deadline for HSA contributions is generally April 15 of the following year for which the contributions are made. Although an individual's annual contribution amount, in general, is determined on a monthly basis, he or she may contribute this amount at any time between January 1 of such year and April 15th of the following year.

Example. Maria, age 43, has been eligible to contribute to an HSA since March 1, 2005. She is in the process of changing jobs and employers. She is going to become covered by a low deductible health plan as of September 1, 2007. She will have been covered by a HDHP for the first eight (8) months of 2007. So far, she has contributed $2,000. She wants to contribute as much as she can to her HSA for 2007. She is wondering what her deadline is.

Her maximum contribution for 2007 is $3,766.67 ($5,650 x 8/12). Since she had already contributed $2,000 she is eligible to contribute another $1,766.67. She need not rush and make this contribution before she goes to work for the new employer or before she is covered by the low deductible health plan. She has until April 15, 2008, to contribute the $1,766.67.

Warning. There is an exception to the above rule that a person has until April 15th of the following year to make his or her contribution.

The IRS has adopted another rule that HSA contributions are no longer authorized once a person enrolls in Medicare. In fact, the IRS states that a person "may contribute to an HSA until the month that the individual is enrolled in Medicare." This means a person who enrolls in Medicare on June 28 is no longer eligible to make a contribution after May 30.

It is not clear why the IRS adopted this position. Code section 223(b)(7) does not expressly support the IRS position. This subsection provides that the monthly limitation is zero for the first month a person enrolls in Medicare and for each subsequent month. There is no statutory language supporting the result that the monthly limitation is also to be zero for those months prior to enrolling in Medicare if the person failed to make the contributions prior to enrolling.

It is a tax trap for the unwary and the IRS should revise the rule. It should not matter that one becomes ineligible for additional HSA contributions because one becomes covered by a low deductible health plan or if one becomes enrolled in Medicare. In the first situation the individual has until April 15th of the following year to make their contributions. In the latter situation, the individual must rush in to make their contributions before the month they enroll in Medicare. We at CWF do not agree with the IRS position, but one is to follow the IRS position until it is changed. ◆

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When is A Person Wiser to Withdraw Money from a Pension Plan Versus an IRA?

In divorce situations it is generally much wiser to withdraw money from a pension plan than an IRA. The 10% pre-age 59½ tax applies to distributions from an IRA even if the distribution is on "account of a divorce." The 10% tax does not apply to a distribution from a pension plan to an ex-spouse or other alternate payee if the distribution is pursuant to a qualified domestic relations order.

In some "death" situations it is also wiser to take the distribution from the pension plan rather than from an IRA. A surviving spouse in some situations will not want to roll over all of the pension funds into his or her own IRA. Why?

The following example will illustrate a situation where it is wiser to take the distribution from the pension plan versus the IRA. Katrina Arnold is married to John. Katrina has $60,000 in her 401(k) plan. She dies in July of 2007 at age 44. John is age 56. John concludes that he needs to withdraw $6,000 from the pension plan. He wants to directly rollover the other $54,000. He will include the $6,000 in income and pay tax, but he will not owe the 10% additional tax since he is a beneficiary. However, if the QP administrator (or the IRA custodian) convince him that he should rollover the entire $60,000, and he does so and he withdraws $6,000 from the IRA, he would pay income tax on the $6,000 and also owe the 10% additional tax ($600). ◆

Baucus, Grassley Ask IRS to Better Publicize Saver's Credit

The Committee on Finance of the U.S. Senate issued a news release on July 12, 2007.

Washington, DC — Senate Finance Committee Chairman Max Baucus (D-Mont.) and Ranking Republican Member Chuck Grassley (R-Iowa) today called on the Internal Revenue Service (IRS) to better publicize the Saver's Credit, a non-refundable tax credit that encourages low - to middle-income Americans to save money for retirement. Created in 2001 and made permanent by the Pension Protection Act of 2006, the Saver's Credit provides a tax credit of up to 50 percent of the first $2,000 of retirement contribution for families earnings up to $50,000 a year. In a letter to Acting IRS Commissioner Kevin Brown, the Senators requested that the IRS improve targeted advertising to ensure that eligible taxpayers are aware that they can use the credit, permit taxpayers to claim the credit on the 1040EZ, and refer to the Saver's Credit consistently in all IRS forms and publications.

"Thus Saver's Credit has helped millions of Americans save for their retirement, but it could be helping even more," said Baucus. "Many eligible taxpayers are not claiming the Saver's Credit simply because they don't know about it. It's hard for families to put away dollars for retirement, and the IRS should do all it can to help Americans maximize their savings with the Saver's Credit. Making it possible to claim this credit on the 1040EZ form used by many Americans eligible for the Saver's Credit would be a vital step."

Grassley said, **"Every bit helps when you're saving for retirement. But this tax break can help only if people know about it. I hope the IRS will work with us to publicize the saver's credit as much as possible so every eligible taxpayer is aware of the benefit. Congress made this a priority, and we want to see people use it and watch their savings grow."**

The text of the Senators' letter follows here.

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**Saver's Credit,
Continued from page 5**

July 12, 2007
Mr. Kevin M. Brown
Acting Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington DC 20224

Dear Acting Commissioner Brown:

The Saver's Credit was added to the Internal Revenue Code (the "Code") by the Economic Growth and Tax Relief Reconciliation Act of 2001 (Code section 25B). More recently, the Saver's Credit was made permanent by the Pension Protection Act of 2006. The Saver's Credit encourages workers to save for retirement by providing a non-refundable tax credit of up to 50% of the first $2,000 of retirement contributions for families earning up to $50,000 per year. This credit has helped millions of workers save for retirement. We believe the effectiveness of the credit could be improved, however, through changes to IRS forms and publications. As you prepare tax forms and other guidance for the 2007 tax year, we ask that you make the following changes:

1. Use the term "Saver's Credit" consistently in all IRS forms, instructions, publications, and other IRS guidance. The tax credit for retirement savings contributions is commonly referred to as the "Saver's Credit." This terminology is referenced in certain IRS publications, announcements, and Tax Topics, but it is generally not used or referred to in the tax forms and instructions. The consistent use of terminology in all IRS guidance would assist in ensuring maximum comprehension and use of the credit.

2. Allow taxpayers to claim the Saver's Credit on form 1040EZ. Form 1040EZ can be used by certain taxpayers with taxable income of less than $100,000. As such, Form 1040EZ covers the Saver's Credit targeted population of taxpayers with adjusted gross income of $50,000 or less. While we understand that the Form 1040EZ does not currently allow for attachments, we believe that the improvement in awareness and utilization that will be accomplished by adding the Saver's Credit to Form 1040EZ outweighs the additional processing burden, especially in light of the number of returns filed electronically. In addition, although the Saver's Credit is not the most commonly claimed credit according to the 2004 Statistics of Income 2004 estimated data line counts, the fact that there is no nexus between the Saver's Credit and the dependency exemption causes its applicability to Form 1040-EZ filers to increase dramatically in relation to certain other credits, such as the child tax credit, credit for child and dependent care expenses, and the education credits.

3. Use better targeted advertisements on the Saver's Credit to ensure that taxpayers are aware that they may be able to claim the credit. For example, alert taxpayers of the availability of the credit on the IRA deduction worksheet and in the instructions for employees on W-2.

Taxpayers who have heard about the Saver's Credit should find it easy to claim. We believe these changes would make the credit more effective, and better carry out its intended purpose.

Keep us informed about your progress in implementing these changes. Any questions concerning this request may be directed to Judy Miller or Chris Condeluci at (202) 224-4515. Thank you for attention to this matter.

Sincerely,
Max Baucus
Charles Grassley
Chairman Ranking Member ◆

Solving an IRA Administrative Problem

We all make mistakes. This includes the personnel of IRA custodians/trustees. Sometimes there are "good" solutions to the problem.

An IRA custodian/trustee recently called with the following situation. An IRA accountholder had asked to have a distribution of $900. Of this amount, he wanted $90 withheld (10%) and paid to the IRS; he wanted $80 withheld and paid to the state department of revenue, and he wanted the remainder of $730 paid to himself. The bank remitted the withheld tax amounts ($170) to the IRS and the appropriate state. An error occurred when the bank paid him $900 rather than

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Solving an IRA Administrative Problem,
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the $730 he was due. That is, the bank overpaid him by $170. The bank has tried to contact him to have him return the $170, but to no avail at this point.

What action may the IRA custodian/trustee consider?

The IRA custodian/trustee may consider an action to recover this overpayment,but it is not required to do so. By seeking to recover the overpayment of $170, you are only trying to assist your customer. He asked for a distribution of $900, but he was paid, or deemed paid $1,070. The tax laws will require him to include in income the amount that he received.

If he does not want to participate in the correction of this over-distribution, then he will need to include in income the $1,070, and you will be correct in your action of preparing a Form 1099-R showing a distribution of $1,070. You would report the withheld income amounts in the appropriate boxes.

It may well be that the bank did not withhold as much as he wanted (e.g. 10% of the distribution amount), but we don't consider the shortage as being material for either the IRS or the state. ◆

Time to Reconsider "Keogh" Plans — Or, Why "Keogh" Plans Won't Die

Many banks and other financial institutions have decided to service the qualified plans (e.g. profit sharing plans) they have, but not set up or establish any new plans. Some institutions will have their trust departments service such plans. Other banks have simply decided to no longer offer any QP services. Other banks have decided that they will allow their "investment" department, or an affiliate, to handle these accounts.

The use of the term qualified plan means any plan which meets the requirements set forth in Code section 401(a) of the Internal Revenue Code. The plan could be a profit sharing plan, a money purchase plan, a defined benefit plan, an ESOP plan, or a 401(k) plan.

This article is going to limit the discussion to a 401(k) profit sharing plan since the laws are now very favorable for 401(k) plans. Under a 401(k) plan, an employer is able to make contributions which are allocated to the eligible participants. In addition, the employees are allowed to make elective deferral contributions with respect to which the employer may, or may not,make matching contributions. A one-person business (whether a sole proprietor or a corporation) may now also sponsor a 401(k) plan.

Here are the main reasons why ANY business, including one-person businesses, will in the majority of cases want a 401(k) plan versus a SEP or a SIMPLE-IRA plan.

1. The maximum contribution amount is, in many cases, larger. In the case of a 401(k) plan, the maximum contribution is 25% of the participants' compensation plus the amount of elective deferrals. For example, Jane established a corporation. Her net worth is $600,000. Jane is age 46. She is single. Her salary is$120,000 per year. For 2007, she makes an elective deferral contribution of $15,000 to the 401(k) plan. The corporation also makes a contribution of $30,000 ($120,000 x 25%) on her behalf. That is, the total amount contributed to her 401(k) account is $45,000. In contrast, the maximum SEP contribution would be $20,000.

2. Jane is ineligible to make a contribution to a Roth IRA since her income exceeds the 2007 limit of $114,000. However, the 401(k) plan document can be written to authorize a person to make her IRA contribution (it can be either a traditional IRA or a Roth IRA or a combination of both) to the 401(k) plan. Jane, and others like her, will want such a plan. It will give her the ability to fund a deemed Roth IRA within her 401(k) plan.

3. Jane, as a participant of the 401(k), will have the right to borrow from her 401(k) account as long as the 401(k) plan has been written to authorize such loans. Most small business owners will like this option, that if needed, the plan could be the source of a certain amount of cash flow for the business. We at CWF do not foresee the law ever changing to allow a person with a SEP-IRA or SIMPLE-IRA to borrow from such IRAs.

Conclusion. 401(k) plans give a person substantially more tax and business planning capabilities than do SEPs and SIMPLEs. ◆

Tax Rules Influencing an IRA Accountholder, Continued from page 1

The beneficiary is required to be paid by December 31 whatever RMD amount, if any, had not been paid to the IRA accountholder prior to his or her death.

The rules applying to an inheriting beneficiary depend upon whether the accountholder died before or on/after his or her required beginning date and the "category" of the beneficiary(ies). See the enclosed pages summarizing the rules and options applying to an inherited IRA beneficiary.

I want to make clear that there are at least two situations where the beneficiaries will be hurt (i.e. be forced to take larger distributions than they otherwise would have been required to take) if the IRA accountholder designates his or her estate as the beneficiary versus designating children or other individuals as the beneficiary(ies).

Dying Before the Required Beginning Date

Let's assume John Doe was born in 1943. John has an IRA with a balance of $300,000. He has designated his estate to be his beneficiary. Within his will he has designated his two children to be the beneficiaries of his estate. Each is to receive a 50% share. For example, an individual born in 1943 will attain age 70 in 2013. He or she will attain age 70½ in either 2013 or 2014. A person's required beginning date is the April 1 following the year he or she attains age 70½. Now let's assume that John dies in 2007 (i.e. before his required beginning date). What rules apply to his IRA (i.e. the inherited IRA)?

His estate is his beneficiary. His IRA will need to be distributed under the 5-year rule. The life distribution rules apply only if the beneficiary is a living person or a qualifying trust. Because the estate is the beneficiary, the inherited IRA must be closed within 5-6 years. The life-distribution rule does not apply. The size of the required distribution will be much larger than if the distribution would have been able to be spread out over the life expectancy of the person who was a beneficiary. In many cases, this could be 30-45 years, Technically, the deadline under the 5-year rules is the December 31 of the year which contains the fifth anniversary of the IRA accountholder's death.

Dying on or After the Required Beginning Date

A similar result happens if an individual designates his or her estate as their beneficiary and dies after the required beginning date.

Here is an illustration. Jane Doe has an IRA with a balance of $75,000. She designates her estate as her beneficiary. In her will, she designated her daughter, Ann, as her beneficiary. Ann is age 48 in 2007 and will be 49 in 2008. Jane dies in August of 2007 at the age of 77. She had been paid her required distribution amount for 2007 in June of 2007.

Her daughter will need to take required distributions for 2008 and every subsequent year. Since the estate was the beneficiary, the measuring life for purposes of the RMD formula is Jane. The initial factor for 2008 will be 11.1 (12.1-1.0). The 12.1 comes from the Single Life Table using Jane's age in 2007. The factor, or divisor, for later years will be determined by subtracting 1.0 for each elapsed year.

If Jane would have designated Ann as her IRA beneficiary rather than her estate, the required distribution amounts would have been much less (only 33% of what she is required to take). The initial factor for 2008 would have been 36.0 since Ann would be age 48 in 2008. The 36.0 comes from the Single Life Table using Ann's age in 2008. The factor, or divisor, for later years will be determined by subtracting 1.0 for each elapsed year.

Summary. The two illustrations demonstrate that the required distribution amount will be much larger (and presumably more taxes paid) when an estate is designated as the IRA beneficiary versus when an individual(s) has been designated directly as the IRA beneficiary.

An individual will wish to consult with their attorney and/or accountant regarding the designation of their IRA beneficiary(ies). ◆