The Pension Digest

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ALSO IN THIS ISSUE –

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

Administering IRAs After DOMA Ruled Unconstitutional

The IRS has released Revenue Ruling 2013-17 setting forth its positions on various tax issues as a result of the Supreme Court's ruling in United States v. Windsor that Section 3 of the Defense of Marriage Act is unconstitutional as it violates the equal protection principles of the fifth amendment. The IRS does not expressly address the impact on IRAs.

Under DOMA the IRS had concluded that because of Section 3 of DOMA, the two individuals comprising a same-sex marriage could not be considered to be married for federal tax purposes as Section of 3 of DOMA defined marriage to mean only a legal union between one man and one woman as husband and wife, and the word spouse refers only to person of the opposite sex who is a husband or a wife.

This article focuses on administering IRAs after Windsor.

Under the U.S. tax laws there are "tax bonuses" and "tax penalties" for individuals who are married.

The first marriage tax bonus associated with IRAs is the spousal contribution rule. The spouse with the lesser compensation is allowed to use the other spouse's income to make a larger contribution for himself or herself than if he or she was not married. Example, John and Mark are married. John is age 48 and Mark is age 44. For 2013 John has com-

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Proposed IRA Law Changes by Senator Hatch

On July 8th, Senator Hatch introduced a tax bill which would change many IRA and pension laws. Set forth is a summary of the IRA changes. The pension plan changes are discussed in a separate article. The insurance industry and the securities industry are suggesting changes which will benefit their members to the detriment of banks, credit unions and trust companies.

In general these changes would apply to 2014 (i.e. plan years commencing in 2014). Some changes would be effective as of July 8, 2013.

Considering the political situation, the fate of these proposals is uncertain. It may be possible that some will be enacted to show there can be bi-partisanship between Republicans and Democrats.

1. **Mortality Tables for RMDs Must be Updated.** Within one year of enactment the IRS shall either update the existing mortality tables or provide new tables. Any "new" table shall apply to plan years beginning after the date which is one year after publication. The IRS is to issue new tables at least every five years thereafter.
2. **RMD will be Eligible to be Converted to Roth IRA.** Under current law a person is ineligible to convert funds within a traditional IRA to a Roth IRA since the law does not permit a person to rollover a required distribution.

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IRS Issues Draft Version of the 2014 Form 5498 – Major Change

The IRS recently issued its draft of the 2014 Form 5498. The IRS is proposing a major change for reporting the value of certain investments. Most often the draft form will be adopted by the IRS as the final form.

Two new boxes have added – box 15a and 15b.

Box 15a is titled FMV of certain specified assets.

Box 15b will be used to furnish info on the type of the investment. It is titled "Codes."

The IRS is trying to develop an administrative approach so that it can better administer IRAs that hold non-market assets. Such IRAs may either be trust IRAs or self-directed custodial IRAs. It appears the IRS will choose to audit more IRAs holding non-market assets than those holding only market assets. Without a doubt, it is more likely that prohibited transactions occur with respect to IRAs holding non-market assets than market assets.

Box 5 will still be used to report the FMV of the entire IRA. The total FMV will equal the FMV of the easy to value assets plus the FMV of the hard to value assets. An asset where there is a readily available market to determine an asset's value is an easy to value asset. When there is no readily available market to be used to determine as asset, this is a hard to value asset. It is also known as a non-market asset.

Box 15a will be used to report the FMV of all of the non-market assets. These are the assets which are not readily tradable on an established U.S. or foreign securities market or option exchange or that do not have a readily available FMV. The IRS does not define what is meant by "does not have a readily available FMV." As for box 5, the IRS states that the FMV must be determined annually. The amount in box 15a may be the same as in box 5, but most likely will be less as will be the case when there are both easy to value and hard to value assets in the same IRA.

The FMV of the "market" assets may be determined by subtracting the FMV of the non-market assets (box 15a) from box 5.

In box 15b, one or two letter codes must be inserted to identify the type or types of the non-market investment. If only one code applies, insert that one code. If only two codes apply, then insert both codes. However, if more than two codes apply, then enter a Code H. Code H means there are more than two non-market assets held in the IRA. From the perspective of the IRA accountholder, he or she may prefer to have at least three hard to value assets rather than just one or two because when an "H" is used the IRS does not know specifically what assets are owned and would need to obtain this information from additional communications with presumably the IRA accountholder.

There are 7 identifying codes:

A – Stock or other ownership interest in a corporation that is not readily tradable on an established U.S. or foreign securities market.

B – Short or long-term debt obligation that is not traded on an established securities market.

C – Ownership interest in a limited company or simular entity (unless the entity is traded on an established U.S. or foreign securities market.

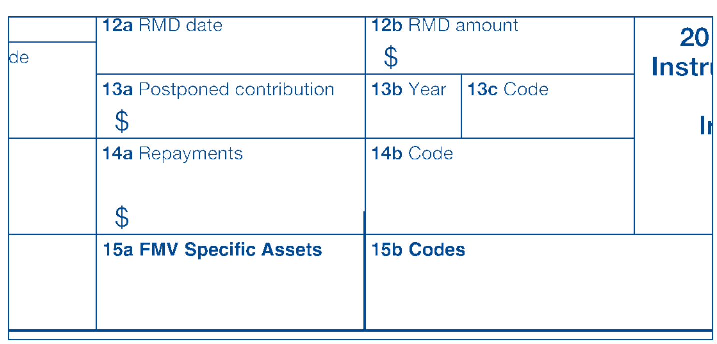
D – Real Estate

E – Ownership interest in a partnership, trust, or similar entity (unless the entity is traded on an established U.S. or foreign securities market).

F – Option contract or similar product that is not offered for trade on an established U.S. option exchange or established foreign option exchange.

G – Other asset (i.e. not described in A-F) that does not have a readily available FMV.

In summary, the IRS has proposed revisions to the Form 5498 for 2014. The IRS will be gathering additional information regarding the hard to value investments. Computer software for preparing the Form 5498 will need to be revised for those IRA custodians/trustees with hard to value assets. The deadline to furnish the 2014 Form 5498 to the IRS and the individual is June 1, 2015, since May 31 is a Sunday.


de	12a RMD date	12b RMD amount $		20 Instr
	13a Postponed contribution $	13b Year	13c Code	I
	14a Repayments $	14b Code		
	15a FMV Specific Assets	15b Codes		

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Will the IRS Revise the IRA/Pension Life Expectancy Tables in 2013?

The IRS will not. In the June newsletter we had asked the question – Will the IRS require the IRA/Pension life expectancy tables in 2013? An IRS representative called us very promptly in late July. She informed CWF that the IRS does not intend to update the IRA life expectancy tables in 2013 or 2014. It is uncertain even if the updating would occur in 2015 or 2016. Why the wait?

It may seem minor, but if the IRA life expectancy tables are revised to reflect longer life expectancies, individuals will pay less in income taxes. The U.S. Treasury (IRS) is in no rush to take an action resulting in less tax revenue.

More Americans are living longer. The IRA/pension life expectancy tables should be revised to reflect individuals living longer. If so the RMDs of most individual RMDs would decrease slightly. This would be true for both accountholders and also inheriting beneficiaries. Many IRA accountholders and inheriting beneficiaries do not want to withdraw a penny more than the law requires. There are proposed bills in Congress to eliminate for individuals with IRA balances less than a certain amount (e.g. $75,000) to take an RMD.

In 2002 when the IRS issued the current life expectancy tables it did so as a result of a tax law requiring the IRS to use "updated" tables. Another new law is what it may well take for the IRS to issue updated tables again. The Senator Hatch bill would require the IRS to update the life expectancy tables within one year and every five years thereafter.

Proposed IRA Law,
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The proposal would allow RMDs to be rolled over or converted to a Roth IRA.

3. **Expand Law on Correcting Errors to Include IRAs**. Except for the special letter program for missed rollovers the IRS has not developed any procedures to correct errors occurring with respect to traditional IRAs and Roth IRAs. Substantial filing fees apply to use the rollover letter program ($500-$3,000). The IRS has adopted procedures for SEP-IRAs and SIMPLE-IRAs. For its own reasons the IRS has not been proactive in providing additional guidance on correcting IRA mistakes. The IRS seems to forget that IRAs hold 27% of retirement assets while pension plans hold 22%.

   The proposed law would be, as for pension plans, any inadvertent RMD error with respect to an IRA shall be able to be self-corrected, without the imposition of the 50% tax as long as the late distribution is distributed no more than 180-days after it was required to be made.

   In addition the IRS is to amend its EPCRS program to provide that inadvertent IRA errors may be corrected as long as such errors were not the fault of the IRA owner. Some of the errors which may be corrected are those discussed below, but it is intended that additional errors may also be self-corrected.

   There needs to be a waiver of the 60 day deadline for a rollover where the deadline is missed for reasons beyond the reasonable control of the accountholder.

   A nonspouse beneficiary will be allowed to return a distribution from an inherited IRA if the distribution was caused by the inadvertent error of the IRA custodian which gave the beneficiary the reasonable belief he or she could rollover such distribution so that the distribution would not be taxable.

4. **New Joint Authority for the IRS and the DOL Regarding Prohibited Transactions Associated with IRAs and Pension Plans.** Under current law the authority to grant exemptions for prohibited transactions related to pension plan and IRAs is held by the DOL.

   The proposed law would give joint authority to the IRS and the DOL. The IRS and DOL would be required to issue joint rulings. This change would be effective as July 8, 2013.

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Proposed IRA Law,
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The securities industry does not like how it is being treated by the DOL. The DOL has agreed to only offer a limited prohibited transaction exemption and the securities industry finds this unacceptable. The power of the DOL will be reduced.

5. **Authorize an Employer to Substitute a Safe Harbor 401(k) Plan for a SIMPLE-IRA Plan.** Under current law an employer sponsoring a SIMPLE-IRA plan is not allowed to terminate the plan before January 1 of the following year. An employer would be authorized to terminate the SIMPLE-IRA plan during the current year as long as the employer substitutes a safe harbor 401(k) plan as of the date of termination. A combined elective deferral limit would apply.

6. **Authorize New Rollover to an IRA.** Under current law, if a qualified plan holds on behalf of a participant a qualifying insurance contract, such contract is not eligible to be directly rolled over into a traditional IRA The insurance contract either must be liquidated for cash or distributed to the individual in-kind.

   This law would be changed to allow the rollover or direct rollover of an insurance contract within a qualified plan into a traditional IRA even though the general rule is that IRA funds may not invest in life insurance contracts.

7. **New Type of Deemed IRA.** Current law authorizes funds within a 403(b) custodial account then the custodial account will become a deemed IRA with the financial institution holding the 403(b) assets as of the date of the termination. The deemed IRA will be created only if the financial institution holding the assets has demonstrated to the IRS that it is qualified to serve as a IRA trustee/custodian.

8. **Required Distribution Rules Modified for IRAs, 403(b) and Defined Contribution Plans When a Deferred Annuity is Bought Prior to Age 70$^1/_2$.** It is ironic. The IRS cannot be persuaded to voluntarily update the RMD tables so people will be allowed to take smaller RMDs, but the IRS and the DOL are enamored with the planning features of deferred annuities. The argument being made by insurance companies and people who sell annuities is that people are living longer. Therefore, to ensure they will have money when they are in their 80's they should be able to reduce their RMDs when in their 70's.

The RMD proposal would be that amount invested in a deferred annuity would not be counted as part of the IRA's fair market value for the RMD calculating. In order to receive this treatment the following rules must be met.

1. Under such an annuity, payments are deferred past age 70$^1/_2$ but such payments must commence no later than the date the individual attains the age of 85.
2. The annuity must be a commercial annuity, a single life annuity for the life of the individual, providing substantially equal periodic payments at least annually. Or the annuity may be a qualified joint and survivor annuity which is the actuarial equivalent of the singe life annuity.
3. The annuity must be purchased on or before the individual's required beginning date.
4. The individual's investment in the annuity cannot exceed 25% of the individual's entire interest in all plans (defined contribution, IRA and 403(b)) determined as of the close of the calendar year preceding the calendar year in which the purchase occurs.

   A special rule applies if the individual dies before his or her required beginning date and he or she does not purchase a qualified deferred annuity and the designated beneficiary is his or her spouse. In this case, the surviving spouse may invest any portion of the entire interest (not 25%) in the same manner as the spouse who died, but the required beginning date and the deferral period will be based on the dates the deceased spouse would have attained age 70$^1/_2$ or 85.

   The deferred annuity has features very similar to those found in a a lifetime income investment. A lifetime income investment is to have a lifetime income feature. This means a feature that guarantees a minimum level of income at least annually for the remainder of the employee's life (or the remainder of the employee's life along with his or her designated beneficiary) or an annuity where the payments are made in substantially equal periodic payments over the employee's life (or the remainder of the employee's life along with his or her designated beneficiary).

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Proposed 401(k) and Other QP Law Changes by Senator Hatch

On July 8th, Senator Hatch introduced a tax bill which would change many IRA and pension laws. Set forth is a summary of the QP changes. The IRA changes are discussed in a separate article. The insurance industry and the securities industry are suggesting changes which will benefit their members to the detriment of banks, credit unions and trust companies.

In general these changes would apply to 2014 (i.e. plan years commencing in 2014). Some changes would be effective as of July 8, 2013.

Considering the political situation, the fate of these proposals is uncertain. It may be possible that some will be enacted to show there can be some bi-partisanship between the Republicans and Democrats.

1. **Deadline to Establish Qualified Plan.** Current law requires an employer to establish a plan by December 31 (or the end of a month if the employer has a fiscal year) in order to be able to claim a tax deduction for a plan contribution for such year. The law would be changed to adopt the IRA rule. If an employer adopts a plan after the close of the taxable year but before the tax filing deadline, the employer may elect to treat the plan as having been adopted on the last day of the tax year.
2. **Modify Deadlines for Certain 401(k) Safe Harbor Plans.** Current law requires an employer to adopt a safe harbor 401(k) plan prior to the current year. This law change would allow an employer to adopt a safe harbor during the current year or even later if certain rules are met.

   The plan must be amended and notice given to the employees before the 30th day before the close of the plan year. However, if the employer decides to make a nonelective contribution equal to 4% of the employee's compensation for the entire year then the plan may be amended at any time before the deadline to return excess contributions. Normally, this is March 15.
3. **Allows an Employer to Amend a Safe Harbor 401(k) Plan During Current Year.** An employer would be allowed to amend its safe harbor 401(k) plan as long as such amendment would not reduce the amount of the employer's promised matching contributions. such an amendment may be effective during the plan year it is adopted.
4. **Revoke Top-Heavy Rules.** A qualified plan has had to comply with the top heavy rules since 1982. Such rules would be revoked for plan years beginning after December 31, 2013.

   When a plan is top heavy, the plan must use a 6-year graded vesting schedule and all employees must receive a contribution equal to the rate given to the person with the highest compensation or 3% whichever is less.
5. **Modify the Tax Rules Applying to Hardship Withdrawals.** Under current law a participant who has incurred a hardship is restricted as to what 401(k) funds he or she may withdraw. In general, the participant is restricted to withdrawing his or her elective deferrals and then the earnings on such deferrals.

   The law as changed would allow a participant who has incurred a hardship to withdraw the following – employer contributions satisfying the 2-year period if the plan so provides, qualified nonelective contributions, qualified matching contributions, and earnings on such categories.

   Under current law, it is impossible for a participant to take a hardship distribution if he or she is eligible to take a loan but has not yet done so. This law would be revoked.

   Under current law, it is impossible for a participant to make elective deferral contributions for the 6-month period after taking a hardship distribution. The proposed law would eliminate this requirement.
6. **New Type of 401(k) plan authorized.** An employer could establish a "starter 401(k) plan" which is a plan providing for automatic employee deferrals, limited deferrals ($8,000) and simplified Form 5500 filing requirements if certain rules are met.
7. **Expansion of Small Employer Start-Up Credit.** Current law provides a $500 tax credit to certain small employers which establish a retirement plan. The credit is made substantially larger for some employers. The credit would be the greater of – $500 or the lesser of $5,000 or $250 for each employee who is not a highly compensated employee. Thus, a

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Proposed QP Law,
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business with 20 employees with 18 nonhighly compensated employees would be entitled to a credit of $4,500 if it had incurred costs to establish the plan with at least $4,500. This credit would apply for the year of establishment and the immediate two years.

8. **Authorize an Employer to Substitute a Safe Harbor 401(k) Plan for a SIMPLE-IRA Plan.** Under current law an employer sponsoring a SIMPLE-IRA plan is not allowed to terminate it before January 1 of the following year. An employer would be authorized to terminate the SIMPLE-IRA plan during the current year as long as the employer substitutes a safe harbor 401(k) plan as of the date of termination. A combined elective deferral limit would apply.

9. **Forfeitures May Be Used to Make a Matching Contribution or a Nonelective Contribution.** Under current law forfeitures are restricted to being used as an employer's regular profit sharing contribution and cannot be used to make a matching contribution or a nonelective contribution. This change would allow such forfeitures to be used as a matching contribution or a nonelective contribution.

10. **Modify Deadlines for Adopting Pension Plan Amendments so the Deadline for Adopting the Amendment Coordinates With the Remedial Plan Review.** If certain required amendments are timely adopted, then the plan is to be treated as if it has been operated in accordance with the plan during the remedial period an it does not fail to meet the anti-cutback rules.

Any required amendment is adopted before the end of the remedial period, the plan is operated as if the required amendment were in effect during the remedial period and the required amendment applies retroactively for the remedial period.

The remedial period for any amendment is the period which begins on the date the amendment (as a result of a law or a regulation) is to take effect and ending on the last day in the remedial plan review period. This period is established by the IRS under the authority of section 401(b) to determine if the plan is qualified under section 401(a).

If certain discretionary amendments are timely adopted, then the plan is to be treated as if it has been operated in accordance with the plan during the remedial period and it does not fail to meet the anti-cutback rules.

If any discretionary amendment is to take effect during a plan year and is adopted by the last day prescribed for filing the tax return then such amendment shall be timely.

11. **Modify Qualification Rules for Multiple Employer Defined Contributions Plans.** These changes are significant. There is authority that a person, party or entity may serve as the designated plan provider for a multiple employer defined contribution plan. This person is responsible to perform all of the administrative duties so that the plan remains qualified. Such person will need to register with the IRS and consent to audits. There will be simplified IRS/DOL reporting. In order to be a qualified multiple employer plan for the preceding year the plan could not have more than 2,500 participants and no one employer could have more than 500 employees as participants.

12. **Portability of Lifetime Income Options.** A defined contribution plan will continue to be a qualified plan even if it continues to allow qualified distributions of a lifetime income investment, or distributions of a lifetime income investment in the form of a qualified plan distribution annuity contract on or after the date that is 90-days prior to the date on which such lifetime income investment is no longer authorized to be held as an investment option under the plan except as may otherwise be provided by regulations.

A lifetime income investment is to have a lifetime income feature. This means a feature that guarantees a minimum level of income at least annually for the remainder of the employee's life (or the remainder of the employee's life along with his or her designated beneficiary) or an annuity where the payments are made in substantially equal periodic payments over the employee's life (or the remainder of the employee's life along with his or her designated beneficiary).

13. **Permissive Consolidation of Notices for a Defined Contribution Plan.** The IRS and DOL would be required to issue a regulation within 18-

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**Proposed QP Law,
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months of a new law setting forth rules as to how an employer could combine various notices, summary plan descriptions, summary of material modifications, etc.

There are many rules where an employer is required to furnish a notice "within a reasonable period of time before each plan year." This rule would be replaced by a rule allowing the employer to furnish the notice within a reasonable period before the arrangement applies to a participant or beneficiary, and thereafter at least once with any 2-month period.

14. **Performance Illustrations for Asset Allocation Funds.** The proposed law would require the DOL to modify its regulation under section 404 of ERISA to provide that, in the case of a designated investment alternative that contains a mix of asset classes, the plan administrator may, but is not required to, use an illustration that is a blend of different broad-based securities market indices. The following requirements need to be met. First, the blend is reasonably representative of the asset class holdings of the designated investment alternative. Second, for purposes of determining the blend's returns for 1-, 5-, and 10-calendar year periods, the blend is modified at least once per year. Third, each securities market index that is used for an associated asset class would separately satisfy the requirements of such regulations for such asset class.
15. **Required Distribution Rules for a Defined Contribution Plan/IRA/403(b) Modified When a Certain Deferred Annuity is Purchased.** See the discussion in the IRA changes article.
16. **Authorize a Designated Annuity Provider.** Under current law it is common for a pension plan to buy an annuity from a commercial issuer so that the monthly or annual payment is made for the participant's life. The pension plan remains liable to pay the individual should the commercial annuity issuer fail.

The proposed law provides that a pension plan would be able to transfer this payment obligation to a designated annuity provider who becomes liable for any failure and the pension plan would be freed of any liability. This would be authorized under both the IRS and Labor sections of ERISA.

A person who is a fiduciary of the pension plan must conduct a prudent review in the selection process of the designated annuity provider. There must be a periodic review of the annuity provider. The term "periodic review" is not defined.

Under the proposed law, the pension plan will be deemed to exercise the necessary fiduciary tasks with respect to determining the ability of the annuity provider to take all payments due under the contracts to the extent that such payments are guaranteed by a state guaranty association under applicable state law in effect as of the date of issuance of the contract.

A designated annuity provider is defined to be a person licensed under the laws of any state to issue annuity contracts which has a contract with a pension plan to provide annuity contracts to plan participants and beneficiaries. The requirements of Code section 417 and section 401(a)(11)) must be met by such annuities, including providing such annuities in proper from, providing any notice or written and explanations during any applicable notice period, and the providing the opportunity for participants and their spouses or beneficiaries to make appropriate elections during any applicable election period.

The proposed law expressly authorizes that the plan may pay the reasonable expenses of the annuity provider associated with performing those duties.

The proposed law states that to the maximum extent practical, any notice and explantation to be furnished to individuals shall be provided in electronic form.

17. **Expand Law on Correcting Errors in Pension Plans.** The proposed law would require within 1-year of date of enactment the IRS to change EPCRS to allow the correction of the following errors.

A loan error shall be able to be self-corrected. And the DOL shall treat any error corrected under EPCRS also as being corrected under the Voluntary Fiduciary Correction Program.

The EPCRS shall be expanded to apply to section 457(b) plans.

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Administering IRAs,
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pensation of $55,000 and Mark has compensation of $2,600 and dividend and interest income of $40,000. Since they are married under federal income tax law, Mark is able to make a $5,500 IRA for himself using John's excess compensation.

It does not appear that Mark will be able to make a contribution in 2013 for 2010, 2011 or 2012 based on the argument he would have made a contribution had he known he could. Had Mark made contributions based on John's compensation and such contributions had been considered to be excess contributions, such contributions would now be considered to qualifying spousal contributions.

The second marriage tax bonus associated with IRAs is that a spouse beneficiary who is the sole beneficiary has the right to treat the deceased spouse's IRA as his or her own IRA. Any spouse beneficiary has the right to a take a distribution from the deceased spouse's IRA and then rollover such distribution to the extent that no required distribution is rolled over. The same-sex surviving spouse will now have such rights to treat as own or to make a rollover contribution.

What policies and procedures will the IRS be applying with respect to same-sex marriage?

The IRS will still be applying the general rule that whether one is married or not is determined by state law. The IRS will also be applying the following rules.

First, for federal tax purpose, the terms "spouse," "husband and wife," "husband," and "wife" include an individual married to a person of the same sex if the individuals are lawfully married under state law, and the term "marriage" includes such marriage between individuals of the same sex. That is, a state must have revised its marriage laws to include same-sex marriages.

Secondly, for federal tax purpose, the IRS adopts a rule that as long as the same-sex couple has been married in a state authorizing same-sex marriages that they are not required to live or be domiciled in a state which has authorized or recognizes same-sex marriages.

Thirdly, the IRS makes the rule that the terms "spouse," "husband and wife," "husband," and "wife" do not include individuals (whether the same sex or the opposite sex) who have entered into a registered domestic partnership, civil union, or other similar formal relationship recognized under state law, but which is not "marriage" under such state law.

The same-sex couple has the discretion to file original or amended returns to reflect being married for a prior tax year if such tax year is still open. The couple is not required to file or amend their tax return for a prior year claiming a married status. If they wish to change their filing status they may do so only if a prior tax year is still open under th statute of limitations. Tax years 2010, 2011 and 2012 are still open. Generally, the deadline for filing a refund claim is three years from the date the return was filed or two years from the date the tax was paid, whichever is later.

Most likely the transaction to lead a same-sex surviving spouse to file an amended tax return will be when he or she will choose to treat the inherited IRA of a deceased spouse as his or her IRA. In this situation the same-sex surviving spouse might have been required to take an RMD as he or she did not qualify as a spouse at the time. Such distributions may certainly be stopped on a prospective basis. As to past distributions, the IRS may be receptive to a request to waive the 60 day rollover rule. That is, the IRS might authorize the same-sex spouse to rollover such distribution amounts.

Proposed QP Law,
Continued from page 7

Any inadvertent RMD error shall be able to be self-corrected, without the imposition of the 50% tax as long as the late distribution is distributed no more than 180-days after it was required to be made.

In order to encourage and promote the use of automatic enrollment in 401(k) plans and automatic escalation of deferrals, EPCRS should be changed to allow specific correction for errors arising from enrollment and escalation in deferrals.