THE Pension Digest

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ALSO IN THIS ISSUE –

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

Confusion Exists For Completing IRS Form 5500-EZ For Terminated One-Person QP Plans

The statutory law clearly provides that a person who terminates a one person plan is not required to file the Form 5500EZ for the termination year. In 2006 the Pension Plan Protection Act of 2006 was enacted. It adopted a simple filing requirement. The Form 5500-EZ only needed to be filed for a year where the plan assets had a value exceeding $250,000 at the close of the year. If a plan is closed during the year, the plan asset value will be zero and the Form 5500- EZ need not be filed.

The IRS has chosen to never follow this 2006 law. It is understandable why. The IRS believes that it cannot properly perform its duty to administer such plans (and collect taxes when such plans have not been properly administered by individuals) unless there is a requirement that a final Form 5500-EZ be filed.

Consequently, the IRS has adopted the tax position that a sponsor of a one person pension plan is required to file the Form 5500-EZ for the year the plan is terminated even if the plan's fair market value for such year was always less than $250,000. The IRS will generally assess a maximum fine of $15,000 if such form is not filed. For the reasons discussed below, an individual may or may not be able to argue that he or she had a rea-

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An Individual's Duty To Report A Qualified Roth IRA Distribution on His/Her Federal Income Tax Return

A qualified Roth IRA distribution to a Roth IRA accountholder or an inheriting Roth beneficiary is a tax-free distribution. The individual does not include the distribution in his or her income and does not owe any tax on the amount withdrawn from the Roth IRA.

Some individuals believe that since he or she will not owe any income tax with respect to the Roth IRA distribution that he or she need not report this transaction on his or her income tax return.

This is not the approach which the IRS has adopted. The IRS has adopted the tax administration approach that the individual has the duty to inform the IRS that a distribution has been taken from his/her Roth (or inherited Roth IRA) and that such distribution is not taxable since he or she has met the requirements to have a qualified distribution. The way the IRS is informed is that the individual will complete line 15a (gross amount) of Form 1040 with the total distribution amount, and then will complete line 15b (taxable amount) with a -0- and when necessary attach a note of explanation. Alternatively, the individual will complete line 11a (gross amount) of Form 1040-A with the total distribution amount, and then will complete line 11b (taxable amount) with a -0- and when

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sonable cause why such form was not filed. Most likely the IRS will not find that a person had reasonable cause for not filing and he or she will be required to litigate the issue.

On May 16, 2014 the IRS issued Revenue Procedure 2014-32, it sets forth a temporary one-year pilot program providing tax relief to businesses which should have filed the Form 5500-EZ, but which did not do so. See the article on page 4. If a non-filer takes certain correcting actions with respect to filing the Form 5500-EZ for prior years by June 2, 2015, then the IRS will waive any tax penalty due under current laws and regulations.

Commencing with 2007, the IRS has explained in a confusing manner the filing requirement. In the 2007-2013 instructions for filing the Form 5500-EZ, the IRS stated, "Final plan year. All one participant SHOULD file the Form 5500-EZ for their final plan year indicating that all plan have been distributed." In the 2006 instructions for Form 5500-EZ the IRS wrote, "all one participant plans MUST file a Form 5500-EZ for their final plan year even if total plan assets were less than $100,000."

Maybe under old formal English the word "should" meant the same as "shall" , but this is not the every day meaning. Today "should" is used to mean a recommendation only and not an act which is mandatory. After reading the IRS instructions, many individuals reasonably concluded that filing the Form 5500-EZ for the year of termination was not required as long as the plan assets were less than $250,000 as of the end of the year.

Note, there are two situations which could apply to a person. First, John Doe had a one person profit sharing plan with $90,000 and he terminates it. The IRS position is, he must file a Form 5500-EZ even though he never had to file the form before as he had always been under the $250,000 limit. Second, Jane Roe had a one person profit sharing plan with $360,000 and she terminates it. For prior years, she had to file the Form 5500-EZ for each year the plan balance exceeded $250,000. The IRS position is, she must file a Form 5500-EZ even though the plan has a zero balance at the close of the year.

What is the legal authority for the IRS to require an individual to file the Form 5500-EZ and why is the IRS fighting the Lawmakers?

On August 17, 2006, President Bush signed into law a tax bill titled, The Pension Protection Act of 2006 (Pub. L. No. 109- 280). In 2006 the Republican party held a majority in both the House of Representatives and the Senate. Section 1103(a) (1) of PPA 2006 reads as follows:

" (a) Simplified Annual Filing Requirement For Owners and Their Spouses ---

(1) In general. The Secretary of the Treasury shall modify the requirements for filing returns with respect to one person retirement to ensure that such plans with assets of $250,000 or less as of the close of the plan year need not file a return for that year. . . . "

This law change applied for 2007 (i.e. for plan years beginning after 2006).

In the 2007 Instructions for Form 5500-EZ in the section setting forth " Changes to Note" the statement is made that " Plans beginning on or before December 31, 2006, for which a Form 5500-EZ was required to be filed, will not need to continue filing the Form 5500-EZ, unless their total plan assets (for one or more one participant plans, separately or together) exceed $250,000 at the close of the plan year beginning on or after January 1,2007." There is no mention of the termination subject.

The Instructions for the 2006 Form 5500-EZ had stated that a Form 5500-EZ had to be filed if a plan at any time during its existence had a total plan value of $100,000 or more. And the 2006 instructions contained the following. " Note. All one participant plans must file a Form 5500-EZ for their final plan year even if the total plan assets have always been less than $100,000. The final plan year is the year in which distribution of all plan assets completed. Check the " final return" box at the top of Form 5500-EZ if all assets under the plan(s) (including insurance/annuity contracts) have been distributed to the participants and beneficiaries or distributed to another plan."

The IRS revised the discussion for who had to file the 2007 Form 5500-EZ. The IRS revision was murky in the 2007 instructions and later year instructions have also

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been murky since the 2007 instructions were the basis of the 2008-2013 instructions.

The instructions on page 2 read, You do not have to file Form 5500-EZ (or Form 5500) for a plan year (other than the final plan year) that begins on or after January 1,2007, if you meet the five conditions above and you have one or more one-participant plans that separately or together had total assets of $250,000 or less at the end of that plan year."

Note that there is no express statement that a Form 5500-EZ must be filed for the final plan year as there was in the 2006 instructions.

On page 2 of the 2007 instructions, there is discussion of the final plan year by revising the Note paragraph found in the 2006 instructions as follows.

"Final plan year. All one participant plans SHOULD file a Form 5500-EZ for their final plan year indicating that all assets have been distributed. The final plan year is the year in which distribution of all plan assets completed. Check the " final return" box at the top of Form 5500-EZ if all assets under the plan(s) (including insurance/annuity contracts) have been distributed to the participants and beneficiaries or distributed to another plan."

One can certainly understand why the IRS wants (and believes it needs to require) that a person inform the IRS that a pension plan has been terminated. It will assist their tax administrative duties. However, section 1103 of PPA 2006 expressly provides in order to simplify the filing requirement that " plans with assets of $250,000 or less as of the close of the plan year need not file a return for that year. . . " If Congress had wanted the rule to be less simple and to require an individual to file the Form 5500-EZ for the year the plan is terminated, then Congress would have added a provision requiring a filing if the plan was terminated during such year. Congress did not do so.

Congress was well aware of the IRS position as stated in the 2006 instructions. The changes made by the 2006 law were intentional. First, once the plan assets decreased to less than the $250,000 a filing was not required even though at one time the amount was greater than $250,000. Under the old IRS approach, a filing was required if the plan assets had ever exceeded $100,000. Secondly, no exception to the simple $250,000 filing limit requirement was created for a plan which was terminated during the year.

During 2007-2014 the IRS could have asked the Congress for the authority to require a filing for the year a plan terminates, but the IRS has not not done so.

In summary, an individual who did not file a final Form 5500-EZ for the year he or she terminated a plan during 2007-2013 will wish to discuss this situation with their attorney or accountant. Some individuals may choose to use this special relief program and file the Form 5500-EZ for the termination year. Others may choose to not use such program. The public would welcome an explanation from the IRS why it believes it has the authority to impose tax penalties on an individual sponsor of a one person plan who terminates his or her plan and does not file a final Form 5500-EZ. It may be that a one-person plan should seek a declatory judgement ruling from the U.S. Tax Court.

IRS Grants Temporary Relief to Sponsors of One-Person Plans Who Failed to File One or More 5500-EZ Forms, Including For a Terminated Plan

The IRS is beginning a one-year pilot program on June 2, 2014, to help individuals and partnerships which failed to file one or more 5500-EZ forms. Such filers will be able able to be relieved from paying the maximum penalty of $15,000 per year for failing to file a Form 5500-EZ by filing such non-filed form or forms. The IRS announced this special program in Revenue Procedure 2014-32 as published on May 16. This relief will apply to 5500-EZ forms filed during the period of June 2, 2014 until June 2, 2015. Forms filed after June 2, 2015 will not be entitled to the relief.

Since 1995 the Department of Labor (DOL) has had a correction program available to employers of plans covering multiple participants. It is called the Delinquent Filer Voluntary Compliance (DFVC) program. Sponsors of multiple participant plans use the DFVC correction program to come into compliance with the law on a voluntary basis by filing the missed forms and by paying a correction fee much less than the amount owed if the DOL and/or the IRS discovered the failure to file the 5500 forms.

In 2002 the IRS adopted the administrative practice that it would not impose applicable tax penalties (in addition to he DOL penalties) on an employer for it not filing the Form 5500 as long as the filer was eligible to use the DOL's DFVC program and satisfied the requirements of such program by filing the non-filed 5500 forms.

Until now, the IRS has not had a correction program for one person plans. The DOL has no authority over one person plans except for the prohibited transaction topic.

Under this special IRS relief program, an individual with a one person plan will not be required to pay any fee for participating in the IRS pilot program. The IRS is asking the public if this pilot program should be adopted on a permanent basis, and, if so, how the correction amount or fees, should be determined.

Individuals who are not in compliance will generally want to take advantage of this special opportunity. The IRS has said that the pilot program will end on June 2, 2015. CWF will prepare such a filing for $150 per plan.

For discussion purposes, assume that Sarah Andrews, a sponsor of a one person profit sharing plan failed to file a 2011 Form 5500-EZ even though her profit sharing plan had a balance of $280,000 as of December 31, 2011. Sarah forgot that a filing was required when the plan balance exceeded $250,000 as of any December 31st. She did file the 2012 Form 5500-EZ showing a year-end balance of $325,000 and the 2013 Form 5500-EZ showing a year-end balance of $365,00. Sarah will wish to use this special pilot program to file her missed 2011 Form 5500-EZ and avoid the penalty amount due of $15,000.

The tax penalty is $25 per day to a maximum of $15,000 per return. The $15,000 is reached when a filer is 600 days late. Many times this 600th day is reached as many times the IRS has not yet determined that the employer had not filed a required form. For example, in the Sarah example, since her plan had never exceeded the $250,000 limit, the IRS did not know that she had missed a required filing.

When is a filing required for a one person plan which was terminated during the year?

Always is the IRS position. However, the IRS has done a poor job of communicating this position.

The IRS discusses in Revenue Procedure 2014-32 that not withstanding the PPA 2006 provision that a one person plan with assets of $250,000 or less at the end of the year are not required to file Form 5500-EZ, the IRS has " determined" that a filing is required when a plan is terminated and all of the assets have been distributed. The IRS does not cite any legal authority for its position.

An individual who has failed to file a Form 5500-EZ has two courses of action. He or she may file under this pilot program or may use the general rule that such penalty is to be waived if the IRS finds the individual had a reasonable cause as to why the form was not filed. A request for relief for reasonable cause may be attached to the delinquent return or it may be filed separately. A reason must be given explaining why the return is late. It is not be filed with the IRS office where the most current Form 5500-EZ is to be mailed.

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Who may use the pilot program? It is available to the plan sponsor or administrator of a retirement plan that is subject to the filing requirements of Internal Revenue Code sections 6047(e), 6058 and 6059, that has a delinquent return, and which is not subject to the filing requirements imposed under ERISA Title I. Such plans will either be one-participant plans or certain foreign plans. Relief is not available if the IRS has already furnished to the plan sponsor or administrator a CP 283 Notice, Penalty Charged on Your Form 5500 Return for an applcble delinquent year.

Note that relief is available to the sponsor of certain foreign plans. Apparently, such plans may also not be subject to the requirements of Title I of ERISA. A foreign plan is a retirement plan maintained outside the Uninited States primarily for nonresidents. The plan may be sponsored either by a domestic employer or a foreign employer with income derived from sources within the United State subsidiaries of domestice employers, that deducts contributions to the plan on its U.S. income tax return.

One-Participant Plans. This article discusses the rules and procedures set forth in the pilot program for sponsors of one person plans. The rules and procedures applying to foreign plans are not discussed. Certainly those sponsors of foreign plans who have failed to file a required Form 5500 will want to review the rules and procedures applying to foreign plans.

Requirement to Submit and Mail a Complete Form 5500-EZ For the Missed Year (s).

The Form 5500-EZ for the missed or delinquent year must be completed and signed by the sponsor. A complete return includes all applicable schedules. A complete return consists of a signed, filled-out paper version of Form 5500-EZ for the year the filer is delinquent. It is impossible for an individual to make his or her filing by using the DOL1s EFAST2 filing system. A Form 5500-SF may not be filed as a substitute for the missed Form 5500-EZ. The IRS warns a sponsor that any attempt to use the DOL1s EFAST2 filing system would subject the filer to the $25 per day penalty to a maximum of $15,000.

The paper version of Form 5500-EZ may either be ordered from the IRS or the electronic version may be printed.

Such form must be mailed to: Internal Revenue Service, 1973 North Rulon White Blvd., Ogden, Utah, 84404-0020. An applicant may choose to use a private delivery service rather than the U.S. postal service. An applicant would need to comply with the special IRS rules for using an eligible private delivery service.

The delinquent return must be marked to put the IRS on notice that the return is being submitted under the special pilot program. " The applicant must mark in red letters in the top margin of the first page (above the title of the form): Delinquent return submitted under Rev. Proc. 2014-32, Eligibility for Penalty Relief." Failing to mark the return in the manner, allows the IRS to return the submission and then assess all of the applicable penalties.

The IRS has created a new form, Appendix A, Revenue Procedure 2014-32 Transmittal Schedule. See page 6. This Transmittal Schedule must be completed and attached to the front of of each delinquent return. Again, failing to complete and attach the Transmittal Schedule allows the IRS to return the submission and then assess all of the applicable penalties.

It will be possible for an individual to submit a single submission containing the delinquent forms for multiple years for one or more plans. A Transmittal Schedule must be prepared for each Form/Schedule. No fee is required regardless of the number of submissions as long as the forms are filed by June 2, 2015.

In summary, the IRS has created a pilot relief program allowing individuals who did not file a Form 5500-EZ for one or more years during 2007-2013when required to file such form(s) and not owe the penalty taxes. Arguments can be made whether the IRS has the authority to require the filing of such forms in certain situations. Rather than litigating the issue with the IRS, many individuals may find it easiest for them to simply file the non-filed form by June 2, 2015. For example, if John Doe terminated his profit sharing plan in 2011, but he did not file the 2011 Form 5500-EZ because it only had plan assets of $135,000, he may find it worthwhile to eliminate any tax uncertainty by filing the 2011 Form 5500-EZ using the procedures set forth in Rev. Procedure 2014-32. Alternately, he could adopt the position that such a filing was made unnecessary by the PPA 2006 law change.

OMB 1545-0956

Appendix A
Revenue Procedure 2014-32 Transmittal Schedule

1. Applicant's Name (Plan Sponsor or Plan Administrator)

2. Plan Name

3. Applicant's Address

4. Applicant's Employer Identification Number (EIN)

5. Three-Digit Plan Number (PN)

6. Plan Year End Date (Enter MM/DD/YYYY)

7. Required Form and Filing Address (Check one):

☐ A. In accordance with sections 5.02(1)(a) and 5.04 of the revenue procedure, the enclosed version of **Form 5500-EZ** was required to be filed for the year of delinquency and is being mailed to:

Internal Revenue Service
1973 North Rulon White Blvd.
Ogden, UT 84404

☐ B. In accordance with sections 5.02(1)(a) and 5.04 of the revenue procedure, the enclosed version of **Form 5500** was required to be filed for the year of delinquency and is being mailed to:

Internal Revenue Service
Employee Plans Delinquent Filer Program
EP Classification
9350 Flair Drive
El Monte, CA 91731-2828

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Qualified Roth IRA,
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necessary attach a note of explanation. See the excerpt from Form 1040 below showing a qualified Roth IRA distribution of $1200.

A Roth IRA custodian will furnish an individual with one or more Form 1099-Rs for the Roth IRA distribution(s). If box 7 of the Form 1099-R shows a "Q", then both the IRS and the individual are informed that the Roth IRA custodian has determined that the distribution has met the rules to be a qualified distribution.

In some cases, a distribution will be qualified even though the Form 1099-R shows a reason code "T" in box 7. When the Roth IRA custodian determines that the code T is the proper code (exception to the 10% tax applies, but the five year requirement has not been met with the Roth IRA custodian), then if the individual has met the five year rule on account of opening a Roth with another financial institution more than five years ago, the distribution is still a qualified distribution for the individual's tax purposes. The individual will need to attach a note informing the IRS of the year he or she first made a Roth IRA contribution.

Income						
Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.	7	Wages, salaries, tips, etc. Attach Form(s) W-2			7	
	8a	**Taxable** interest. Attach Schedule B if required			8a	
	b	**Tax-exempt** interest. **Do not** include on line 8a	8b			
	9a	Ordinary dividends. Attach Schedule B if required			9a	
	b	Qualified dividends	9b			
	10	Taxable refunds, credits, or offsets of state and local income taxes			10	
	11	Alimony received			11	
	12	Business income or (loss). Attach Schedule C or C-EZ			12	
	13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			13	
	14	Other gains or (losses). Attach Form 4797			14	
If you did not get a W-2, * * see instructions. * *	15a	IRA distributions	15a 1200.00	b Taxable amount	15b	0.00
	16a	Pensions and annuities	16a	b Taxable amount	16b	
	17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E			17	
	18	Farm income or (loss). Attach Schedule F			18	
	19	Unemployment compensation			19	
	20a	Social security benefits	20a	b Taxable amount	20b	
	21	Other income. List type and amount			21	
	22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶			22	

Helping a Father,
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funds are sent to your bank, you will be able to process the direct rollover check as he and the 401(k) administrator have instructed.

The right of a nonspouse beneficiary to set up an inherited IRA for funds arising from decedent with a 401(k) account did not exist until January 1, 2007. There will be mothers, fathers, brothers, sisters, and friends who will wish to establish an inherited IRA. You want to be ready to service these individuals. Almost always, they will be long term customers as they will be taking partial distributions over their life expectancy.

Helping A Father Who Has Inherited His Daughter's 401(k) Account

Raul Eisel, age 58, has been a bank customer since 1998. He presently does not have an IRA. He does have a 401(k) account at his employer. His daughter, Laura, age 31, died in March, 2014, in a car accident. Laura had designated her father to be the beneficiary of her 401 (k) account. The 401 (k) plan administrator had contacted Raul to inform him that he was Laura's beneficiary and that her account balance was approximately $60,000. He has come into the bank seeking some help.

Raul is fairly sure that he will decide to establish an inherited IRA with your financial institution.

Raul will want to ask the 401(k) administrator to provide him the following information: a copy of the plan's summary plan desciption, a copy of plan's distribution form and a copy of Laura's most recent participant statement showing her various investment account balances.

The summary plan desciption will provide a discussion of the rights of a nonspouse beneficiary once he has inherited the 401(k) balance of a deceased beneficiary. The plan could be written to allow him to keep the funds within the 401(k) and then withdraw annual required distributions from such plan. Most likely the plan will be written to require Raul as a nonspouse beneficiary to withdraw the inherited IRA funds within a 3-5 year period. One of his options will be to instruct to directly rollover the inherited 401(k) funds into an inherited traditional IRA and/or an inherited Roth IRA. He then could withdraw annual required distributions from the inherited IRA using the life distribution rule. The 401(k) distribution form must present Raul with the following three options. Sometimes the distribution form does a poor job of explaining that there is the third option.

Option #1. He could elect to withdraw the entire balance of $60,000. Since he, as any nonspouse beneficiary, does not have the right to rollover this $60,000, the rule requiring mandatory withholding at the rate of 20% does not apply. The tax rules would require that 10% of the distribution be withheld, but he would have the right to instruct to have no withholding. If he chose to withdraw the $60,000, it would be prudent for him to have 15-25% withheld since he will need to include the $60,000 in his income and pay the applicable tax liability. As a beneficiary he is does not owe the 10% penalty tax even though he is younger than age 59½.

Option #2. He could elect to directly rollover the $60,000. He has three (3) sub-options. First, he could elect to directly rollover the $60,000 into an inherited traditional IRA. Although he is required to commence taking required distributions, he will be defering taxation on most of the funds until later. Second, he could elect to directly rollover the $60,000 into an inherited Roth IRA. Such a distribution will require him to include the $60,000 in his income and pay the applicable taxes. He will also be required to commence annual required distributions from the Roth IRA. Once the 5 year rule has been met all such distributions will be tax-free. Third, he could directly rollover a portion to an inherited traditional IRA and then he could directly rollover the remaining portion into an inherited Roth IRA.

Although the law provides a general rule that if the five year rule applied to the distributions under the 401(k) plan then this rule is to continue to apply to the inherited IRA, there is a major exception which allows the beneficiary to elect to use the life distribution rule. Two requirements must be met. First, the funds must be directly rolled over before the end of the year following the year of death. Secondly, the life distribution rule must be determined using the same nonspouse beneficiary.

Option # 3 , He would withdraw some of the $60,000 and then he would directly rollover the remaining balance. For example, he could instruct to withdraw $10,000 and then he would directly rollover the remaining $50,000 into an inherited traditional IRA and/or inherited Roth IRA. The withholding rules as discussed under Option #1 would also apply to the withdrawal of the $10,000.

Raul will complete this 401(k) distribution form and he will furnish it to the 401(k) administrator. Raul should also furnish a copy of this form to you as the IRA custodian of his new inherited IRA. He will need to execute the inherited IRA plan agreement and instruct you how he wishes to have such funds invested. When the

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