The Pension Digest

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"The Pension Specialists "

Will 2014 be the last year for Traditional IRA Contributions?

We hope not, but time will tell. A recently introduced tax bill, the Tax Reform Act of 2014 would make some drastic changes to IRA laws and pension laws.

One Congress is soon ending and another Congress will soon be starting. The current chairmen of the Tax and Ways Committee is Mr. David Camp. He has proposed many major tax, law changes in a proposed tax bill, the Tax Reform Act of 2014.

This article discusses these proposed IRA changes. The adjacent article will discusses the pension changes.

Not too many politicians are willing to expressly promote that major changes be made to social security, but it will be interesting to see whether they are willing to change the IRA and pension laws which have existed for 40 years. Individuals have relied on the tax laws in deciding to make contributions. Many of the tax laws require a mandatory increase in various IRA/pension limits to reflect the impact of inflation. These mandatory increases result in less revenue being available to the federal government.

As with any law, Congress and the President may always change a law, whether it be social security or IRAs or pensions. Congressional representatives are always looking for new or additional sources of revenue. This is as true today as it was in

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Tax Law Proposals Will Cut by 50% the Pre-Tax Elective Deferral Limit

Many people in Congress believe the federal government needs additional tax revenues and Congress is considering changes to accomplish this goal. This article discusses the proposed law changes for 401(k), 403(b) and governmental section 457(b) plans. An adjacent article discusses the proposed IRA changes. Except as stated otherwise, the new laws, if enacted, would be effective for the 201 5 tax year. Time will tell if these or similar changes will be enacted.

Proposed change #1. Reduce the 20 14 annual maximum 401(k) limit from $17,500/$23,000 to $8,750/$11,500 for Pre-Tax Elective Deferrals.

The $17,500 limit applies to those individuals younger than age 50 and the $23,000 limit applies to those individuals age 50 or older. Under existing law a participant may make both pre-tax elective deferrals and post-tax elective deferrals totaling $17,500/$23,000. Post-tax elective deferrals are called designated Roth contributions.

The right to make pre-tax deferrals would be reduced 50%. As under existing law, an employer would not be required to write its 401(k) plan to give the participants the right to make designated Roth contributions. But there would now be large tax incentive to do so. The only way for a person to make the maximum elective deferrals of $17,500 and $23,000 is

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1986 when the decision was made to take away the right of many taxpayers to make tax deductible contributions. Prior to 1987, individuals contributed 35 billion dollars of deductible contributions, but that amount has now deceased to around 12 billion per year. Many individual are contributing to their employer's 401(k) plans and not making contributions to their traditional IRAs. Existing law allows a person to do both.

What are the IRA changes within the proposed Tax Reform Bill of 2014? Except as stated otherwise, the new laws would be effective for the 2015 tax year.

Proposed change #1. All taxpayers with compensation will be eligible to make an annual Roth IRA contribution. Under existing law, individuals who incomes are "too high" are ineligible to make an annual Roth IRA contribution.

Proposed change #2. The right to make annual traditional IRA contributions is repealed. This includes both deductible and nondeductible contributions.

Proposed change #3. The 2014 and 2015 IRA contribution limit is $5,500 if under age 50 and $6,500 if age 50 and older. This limit is to be adjusted by a cost-of-living adjustment of $500 when the accumulated change is $500. This adjustment would be suspended until 2023.

Proposed change #4. The special rules applying to the withdrawal of traditional IRA and Roth IRA funds if used for a first-time home purchase would be repealed. Withdrawing funds from a Roth IRA for a first-time home purchase would no longer be a qualified (tax-free) distribution. And taxable funds withdrawn from either a traditional, SEP, SIMPLE or Roth IRA by a person under age 59½ would be subject to the 10% additional tax.

Proposed change #5. The right for an employer to establish a new SEP-IRA plan is repealed as of December 31, 2014. However, an employer with a SEP as of December 31, 2014 is grandfathered and is allowed to continue its SEP plan as long as such plan meets the existing requirements for such plan year and every year thereafter.

Proposed change #6. The right for an employer to establish a new SIMPLE-IRA plan is repealed as of December 31, 2014. However, an employer with a SIMPLE-IRA plan as of December 31, 2014 is grandfathered and is allowed to continue its SIMPLE-IRA plan as long as such plan meets the existing requirements for such plan year and every year thereafter.

Proposed change #7. Under existing law the amount of compensation used to determine a person's maximum SEP-IRA contribution is $210,000 with a maximum contribution amount of $52,000. This limit is to be adjusted by a cost-of-living adjustment, but only if the adjustment is $1,000 or any multiple of $1,000. For example, the maximum contribution for 2015 will be $53,000 if this proposed change is not adopted. This annual adjustment would be suspended until 2023.

Proposed change #8. Under existing law the maximum deferral amount for 2014 is $12,000 if a person is under age 50 and $14,500 if the person is age 50 or older. These limits are to be adjusted by a cost-of-living adjustment but only if the adjustment is $500 or any multiple of $500. For example, the maximum limits will be $12,500 and $15,000 for 2015 if this proposed change is not adopted. This annual adjustment would be suspended until 2023.

Proposed change #9. Current law permits a person to recharacterize an annual contribution and also to recharacterize a Roth IRA conversion contribution. In the case of annual contribution it allows a person who has made a traditional IRA contribution to switch it to be a Roth IRA contribution or vice versa. In the case of a Roth IRA conversion contribution it allows an individual to un-do it for any reason. The proposed law would repeal the law authorizing recharacterizations. Why?

When one recharacterizes a prior Roth IRA conversion, the federal government will not collect the tax revenues which would have been paid if the individual was unable to un-do the conversion. That is, a conversion once made would be irrevocable.

With respect to recharacterizing a current year contribution, the administrative work for IRA custodians and the individual are very labor/paper intensive and complex for all parties involved, including the IRS. In order to simplify IRA administration, the proposal is to revoke such rules. Being able to do a recharacterization can be quite beneficiary for an individual, so CWF would have a less extreme suggestion. Allow the IRA custodian to charge reasonable fees to process a recharacterization.

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The recharacterization rules give an individual substantial flexibility in planning and executing various transactions. Some people feel the law is too generous and that individuals should not be granted such planning flexibility.

Proposed change #10. Current law allows a beneficiary to withdraw his/her required distributions over his/her life expectancy. For example, a beneficiary age 39 would be able to take RMDs over a 43 time period. The new law would define the new general RMD rule to be – the beneficiary must use the 5-year to determine his/her RMDs. That is, all funds within the inherited IRA must be distributed by December 31 of the fifth year following the year the IRA owner died. An individual will almost always pay larger tax bills than is the case under existing law. The federal government will be able to collect more taxes much sooner than under existing law.

Mr. Camp, as apparently many other representatives, has concluded that too much tax revenue is being deferred too long by allowing an inheriting IRA beneficiary to be able to stretch distributions over his/her life expectancy. Unless taxpayers inform their representatives that they will not tolerate this change, this type of change is coming. The representatives may be thinking that most beneficiaries are in their 30's or 40's. The reality is, most beneficiaries are in their 50's, 60's or 70's and they will have a desire to use such funds for their retirement. More IRA accountholders are living into their 80's and 90's. Under current IRS rules, a beneficiary has his/her RMD calculated using the life distribution rule unless he/she is able to and does elect to the 5-year rule. Some beneficiaries called eligible beneficiaries will still be able to use the life distribution rule. For many beneficiaries, the use of the life distribution rule is repealed.

If a person meets any of the following requirements as of the IRA owner's death, he/she is an eligible beneficiary:

1. He/she is the surviving spouse;
2. Disabled;
3. Chronically ill;
4. An individual who is not more than 10 years younger; or
5. A child of the IRA owner who has not yet attained age 22.

As under existing law a spouse beneficiary who is the sole beneficiary is not required to take a distribution until December 31 of the year the deceased spouse would have attained age 70½. And if he/she dies before such date, the surviving spouse is treated as the IRA for the purpose of determining the required to be made to the beneficiaries of the surviving spouse.

A beneficiary who is the child of the IRA owner will generally not be an eligible beneficiary and will be required to deplete the inherited IRA using the 5-year rule. The exception is when the child beneficiary is not yet age 22. A child is no longer an eligible beneficiary once he/she attains age 22. The 5-year rule will then apply. The 5-year rule will always apply once an eligible beneficiary dies.

The new rules would apply to an IRA owner dying after December 31, 2014.

For those beneficiaries of an IRA owner who died or dies before January 1, 2015, the current RMD rules continue to apply. However, upon the death of such a beneficiary the 5-year rule will apply and the next beneficiary must withdraw his/her share by the end of the fifth year after the death of the beneficiary.

Of course, the insurance companies have been lobbying the law makers so that certain IRA annuities will not be subject to the 5-year rule and will be paid out over longer time periods. That is, once the IRA owner dies the beneficiary will not be required to close the IRA annuity under the 5-year rule.

In the case of an IRA owner who dies after December 31, 2014, the 5-year rule does not apply to any qualified annuity that is a binding annuity contract in effect on the date of enactment and all times thereafter. An annuity must meet three requirements to be a qualified annuity. First, it must be a commercial annuity. Secondly, it must provide annuity payments which are substantially equal periodic payments not less frequently than annually over the joint life expectancy of the IRA owner and the designated beneficiary according to RMD rules for annuities in effect on the date of enactment. Third, annuity payments must have commenced to the IRA owner before January 1, 2015 and the IRA owner must have irrevocably elected before January 1, 2015, the method and the amount of the annuity payments to the IRA owner or any designated beneficiary.

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An IRA annuity which is not a qualified annuity solely because annuity payments have not started irrevocably before January 1, 2015, may still be a qualified annuity if the IRA owner had made an irrevocable election before the date of enactment as to the method and amount of the annuity payments to the IRA owner or any designated beneficiary.

IRA annuities which have already commenced distribution to an inheriting beneficiary will not be subject to the 5-year rule and will be able to stay in existence and be paid out according to the terms of the annuity.

The above proposals are just proposals. But when the chairman of the ways and means committee is supporting them they must be taken seriously. Although the federal government needs additional tax revenues, gaining such revenues by changing the rules so radically after 40 years with little or no public discussion or guidance is unwise and unfair. I

One will need to ask the politicians why they are so willing to radically change the rules applying to IRAs and pension plans. Most politicians would not dare to make similar changes to the social security laws. CWF suggests that individuals communicate to Congress and the President that the proposed changes are too radical. CWF's suggestion: leave existing law alone or if a change is needed substitute a 15 or 20-year rule for the proposed 5-year rule.

Pension Tax Law Proposals,
Continued from page 1

for an employer to have a 401(k) plan authorizing designated Roth elective deferrals. In fact, an employer could restrict its 401(k) plan so that the only type of elective deferral which could be made by plan participants would be Designated Roth contributions.

The federal government at least on a short term basis will immediately realize more tax revenues from this change. Remember that a pre-tax elective deferral reduces a person's income subject to federal taxation. For example, a 51 year old person earning $100,000 and deferring $23,000 would see his/her taxable income increase to $88,500 from $77,000 and thus he/she will pay income taxes on the additional $13,500. An individual would be able to make Designated Roth elective deferrals assuming the employer's 401(k) plan authorizes such contributions.

This change would be effective for 2015 and such limits would not be changed until 2023. That is, the cost-of-living adjustments would be suspended.

Proposed change #2. Under existing law the amount of compensation used to determine a person's maximum pension contribution is $210,000 with a maximum contribution amount of $52,000. This limit is to be adjusted by a cost-of-living adjustment, but only if the adjustment is $1,000 or any multiple of $1,000. For example, the maximum contribution for 2015 will be $53,000 if this proposed change is not adopted. This annual adjustment would be suspended until 2023. Again, this change will raise revenue.

Proposed change #3. Beneficiaries of pension plans would become subject to the new RMDs rules very similar to those discussed within the IRA article. Again, this change would raise revenue.

Proposed change #4. In a limited situation there is a loophole in the RMD rules applying to a person who becomes a 5% owner after the year he or she attained age 70½, but he or she is still working. Must this person take an RMD now that he/she has become a 5% owner. The law does not clearly require such a distribution. Under existing law, a plan participant who is not a 5% may have a required beginning date of the April 1 of the year following the year he/she separates from service if such year is later than the year he/she attains age 70½. That is,

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he/she is not subject to the general rule that a person's required beginning date is April 1 of the year following the year he/she attains age $70^1/_2$. However, a participant who is a 5% in the year he/she attains age $70^1/_2$, then such person has a required beginning date of April 1 following the year he/she attained age $70^1/_2$.

Under the proposal, this person's required beginning date is defined the April 1 of the year following the year he or she became a 5% owner regardless that the person has not yet retired.

Proposed change #5 will reduce the age for allowable in-service distributions to age $59^1/_2$ for all plans – profit sharing, pension, 403(b) and governmental 457(b) plans. An employer may write its plan to provide for in-service distributions, but it is not required to do so. Under current law the earliest a pension plan may be written to allow an in-service distribution is age 62.

Proposed change #6 will repeal the requirement that a participant is prohibited from making elective deferrals for 6 months once he/she receives a hardship distribution of his/her elective deferrals. A participant receiving a hardship distribution would not be prevented from making subsequent elective deferrals for any period of time.

Proposed change #7 would revise the rollover rules applying to a distribution which has been reduced by a loan offset. It would not change existing law that a deemed distribution arising from a loan default is ineligible to be rolled over even though the participant must include such amount is his/her income and pay the 10% additional tax, if applicable. In the case of a loan offset, the participant is eligible to roll over the amount of the loan offset, but he/she must comply with the 60-day rule. For example, Jane Marple has a 401(k) account balance of $49,000 of which $8,000 is a loan made to herself. She instructs to directly rollover the non-loan amount of $41,000 to a traditional IRA. She is eligible to rollover such $8,000 but she must come up with the $8,000 and do so within the 60-day limit. If she does not do so, she will be required to include the $8,000 in her income, pay tax on it plus the 10% tax if applicable.

A new law would apply a new deadline to a participant in Jane Marple's situation to roll over the $8,000 or some portion thereof. The new law would be very generous, she would have until until her tax filing deadline (including extensions) for filing the federal income tax return for the tax year during which the plan loan offset occurs. For example, if Jane Marple directly rollover her $41,000 on January 30, 2015, she would have until April 15, 2016 to make a rollover contribution of $8,000 and such deadline could be extended to October 31, 2016 if she had a tax extension.

Proposed change #8 would revise the rules applying to contributions to 401(k), 403(b) and governmental 457(b) plans to coordinate such rules. Presently contributions to a governmental 457(b) plan are not coordinated. In addition, there would be repeal of the rules allowing special catch-up and additional contributions to 403(b) and governmental 457(b) plans at certain times. And there would be repeal of the special rules allowing employer contributions to section 403(b) plans for up to 5 years after termination of employment and the special rules for church employees and missionaries.

Proposed change #9. A distribution from a governmental section 457(b) to an individual not yet age $59^1/_2$ would become subject to the 10% additional tax. Present law does not impose this tax.

The primary purpose of most of the proposed law changes is to raise additional revenue. Lowering the maximum limit of pre-tax elective deferrals will accomplish this goal as will imposing the 5-year on most inheriting beneficiaries. The 5-year rule seems very harsh when it is more likely that relatively large balances will be within 401(k), 403(b) or section 457(b) plan. Time will tell if these proposed changes will be enacted into law.

Email Guidance

Spouse IRA Beneficiary

Q-1. I have a customer that passed away and left his spouse as sole beneficiary on his IRA. I opened an IRA account titled with the wife's name as beneficiary to the husband. She decided that she did not want to treat the IRA as her own and so I closed the beneficiary account and transferred the funds as a normal distribution to her checking account. Should this have been coded as a death distribution?

-or-

Should I have closed the beneficiary account and opened an individual account and then have transferred the funds to the checking as a normal distribution?

A-1. It is not clear to me what the surviving wife wished to do.

Did she wish to take a distribution and close the inherited IRA and pay tax on the amount withdrawn or did she wish to maintain it as an inherited IRA and then periodically take distributions from the inherited IRA and pay tax at those later times?

A wife who is the sole beneficiary has the right to transfer the funds from his IRA into her IRA. This is called treating his IRA as her own IRA. The same result can be accomplished by her taking a distribution from the inherited IRA and then making a roll over contribution into her own IRA. A distribution from her IRA would be a normal distribution assuming she is over age 59½.

You indicate the beneficiary account is now closed and the money is in her checking account. She will be required to include this amount in her 2014 income unless she makes a roll over contribution within the 60 day period.

You indicated you have treated the distribution as a normal distribution. Since the funds were withdrawn from the inherited IRA, it should be treated as a death or code 4 distribution.

Roth IRA 5-Year Reporting

Q-2.. I have an Roth IRA accountholder coming to take money out of her Roth on Monday. She has had the account over 5 years but not met any of the other criteria. I'm not sure which code to use?

A-2. Since the 5 year rule has not been met, the distribution is nonqualified and a J or T will be used. T is used if the individual is age 59½ or older or disabled. Otherwise the J is used.

Some RMD Calculations May be Wrong

Q-3. I have a customer with Traditional IRAs in our bank and another bank. He is 87 years old and wanted me to calculate the RMD for 2014. When I did that, it came out to a much lower amount that he was told at the other bank. Maybe I am using the wrong table. The one I had is using his balance as of Dec 31, 2013 and dividing by 13.4, but he said the other bank divided by 6.7. Which is correct... or are we both wrong??

A-3. I may need more information. The 13.4 is coming from the Uniform Lifetime table. See Pub. 590. This is the table used 95% of the time to calculate the RMD for a living person who has his/her own IRA. The other 5% use the Joint Life table because their spouse is their sole beneficiary and he/she is more than 10 years younger that the 70½ IRA accountholder.

The 6.7 is coming from the single life table and it is to be used to calculate the RMD for a person who "inherited" the IRA from another person and that person had died. Also see Pub 590 for the single life table.

If your accountholder acquired his IRA at your bank from his deceased wife and he elected to treat her IRA as his IRA, the 13.4 is correct.

If he acquired his IRA at the other bank from his deceased wife and he did <u>not</u> elect to treat her IRA as his own, then the 6.7 is also correct.

The smaller the divisor the larger the RMD. This situation illustrates why a surviving spouse normally wants to elect to treat a deceased spouse's IRA as his/her own.

If the individual has always had his own IRA and his former wife's IRA is not involved, the other bank is just using the wrong table and has been probably been calculating his RMD incorrectly since 2002.

Prior to 2002 a person's RMD depended on who or what entity the individual had designated as his or her IRA beneficiary. For example, if a person had designated his church, estate or another non-person, then the single life table had to be used. In 2002 in order to simplify this RMD calculation, the IRS changed the rules so that the

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Uniform Lifetime table (a joint table) was used to calculate RMDs for almost all IRA owners age 70½ and older. The single table was no longer to be used.

If your IRA accountholder is 87 in 2014, he was 75 in 2002. He was already taking RMDs in 2002 when the IRS made the change. It may be that the other institution did not update their IRA software as it should have done. Or, one could argue, the mainframe software vendor should have made the change for the bank, but failed to do so. That is, the software should be written (changed) to not use the single life table using the one-year reduction method and not the recalculation method. Since 2002 the recalculation may only be used by a spouse beneficiary who is the sole beneficiary.

Once Per Year Rollover Rule

Q-4. A question came up regarding the new Rollover rule for 2015. If a customer in with a check and wants to open up 3 IRA accounts with the one check. Would that still be considered 1 rollover or 3 because we are opening 3 separate accounts with the money?

A-4. It is the distribution which is limited. In 2015 a person will be eligible to rollover only one distribution occurring during a 12 month period. However, he or she may make multiple rollover contributions of that one distribution. For example, Jane withdraws $15,000 on January 20, 2015. As long as she complies with the 60 day rule, she could make a rollover contribution of $6,000 on January 31, 2015, a rollover contribution of $4,000 on February 10, 2015 and then make a third rollover contribution of $5,000 on March 4,2015.

Any additional distribution by the same individual occurring during the period of January 20, 2015 to January 21, 2016 from any of his or her IRAs is ineligible to be rolled over tax free.

Rolling Beneficiary 401(k) Funds to a Beneficiary IRA

Q-5. We are receiving two Inherited IRAs from a Profit Sharing & Retirement Plan. The decedent was less than 70½ and passed in July 2013. The non-spouse beneficiaries were not paid their RMDs prior to the Plan's distribution to the Inherited IRAs. The TPA is treating this as a Rollover.

We are awaiting the information relative to the 12/31/13 balance to determine what the RMD should be. The Inherited IRA, although labeled as such with the decedent's name, will carry the beneficiary's social security number. Is it correct to post these distributions as Rollovers? Can we even deposit the "RMD" amount into this IRA?

A-5. Technically, the RMD should not be directly rolled over. If the RMD was directly rolled over. it should get reported in box 1 on the Form 5498 since it is an excess contribution, it is not a proper rollover amount. And then the excess would be withdrawn.

The remaining non-RMD portion must be directly rolled over.

If the RMD would not be separated and it is rolled over, the bank could accept it, report it in box 2 of the Form 5498 (for the inherited IRA) and then pay out as soon as possible the RMD amount (or larger amount) for 2014. Since a payment is made to a beneficiary, the reason code will be "4" for death.

The IRS has not really discussed the titling when the funds are inherited funds coming from a 401(k) plan. I would suggest, Jane Doe as inheriting IRA beneficiary of John Doe. Or something similar. I don't think the IRS wants to see or needs to see 401(k) plan in the title.

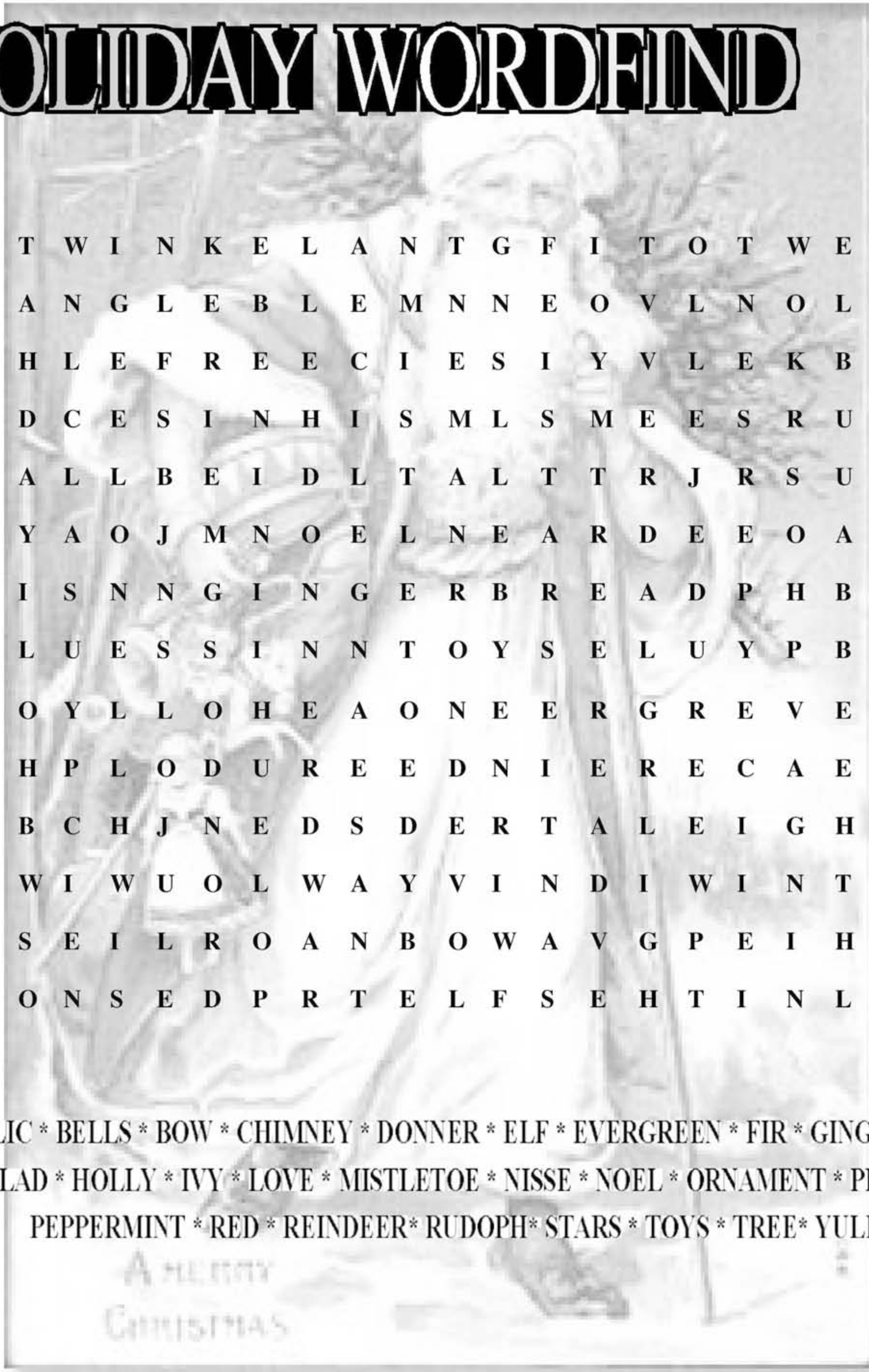
A Trust as the IRA Beneficiary

Q-6. A customer is requesting for her contingent beneficiary, a Trust which is created under a Living Trust. So just for visual: the (David Barnes Trust created under the David Barnes Living Trust dated 9-19-10, as amended). That is the wording. Does this mean there is a Trust within a Trust?

A-6. Naming a trust as a contingent IRA beneficiary is permissible. In this case, the trust is authorized and created under his revocable living trust which presumably becomes irrevocable upon his death.

I have not had this question asked as often as I would have expected. With the increased use of revocable trusts, some married individuals will designate their spouse as the primary beneficiary and then designate a trust to be the contingent beneficiary rather than naming children or another person directly. This may be a prudent thing to do in some cases, but I would think it would still be simplest and best in most cases to name children or grandchildren directly as the beneficiairy(ies).

HOLIDAY WORDFIND



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ANGELIC * BELLS * BOW * CHIMNEY * DONNER * ELF * EVERGREEN * FIR * GINGERBREAD *
GLAD * HOLLY * IVY * LOVE * MISTLETOE * NISSE * NOEL * ORNAMENT * PEACE *
PEPPERMINT * RED * REINDEER* RUDOPH* STARS * TOYS * TREE* YULE *