



THE Pension Digest

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**Collin W. Fritz and
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Resigning As the IRA Custodian - A Be Careful Subject If the IRA Funds Are Not Being Transferred To Another IRA Custodian

There will be times when an IRA custodian wishes to resign as the IRA custodian. The traditional IRA plan agreement should set forth the procedures to be used to resign.

As a general administrative rule, the IRA custodian wants to close the person's IRA by transferring the IRA funds to a successor IRA custodian rather than distributing the funds to the IRA owner.

A financial institution might wish to resign due to its business decision to no longer provide certain services with respect to hard to value investments. For example, the IRA custodian would mail a letter to the IRA owner stating, "We have made the business decision to no longer service traditional IRAs which hold certain hard to value investments. Your traditional IRA holds such investments. You may instruct us to liquidate these investments and reinvest the proceeds. However, if you wish to retain these types of investments, you will need to establish an IRA with an IRA custodian willing to service IRAs with such investments. We hereby inform you we are resigning as the IRA custodian. Our resignation is effective as of _____. We are providing you 45 days rather than the 30 days set forth in paragraph 2.7 of Article VIII. We will assist in transferring your traditional IRA funds to your new IRA custodian. It is best if you transfer your IRA funds because there could be times when you intend to

rollover such distribution, but you then determine that you are ineligible to make a rollover contribution. You may wish to discuss your situation with your tax advisor."

Again, as a general rule, an IRA custodian never wants to make a distribution to an IRA owner unless the IRA owner has requested the distribution. Why?

There is a good chance of litigation if an IRA custodian distributes IRA funds to a person who has not requested the distribution and person is ineligible to rollover such distribution. Why? The individual has an income liability he or she did not expect to have. In 2014 the IRA rollover rules were changed to restrict a person's right to rollover only one distribution in a 12 consecutive month period. For example, if Jane Doe withdrew \$48,000 6 months ago and made a rollover contribution of the \$48,000 within the 60 day time period into another IRA, then the individual is not required to include the \$48,000 in her taxable income. However, if the IRA custodian makes a second IRA distribution of \$48,000 to Jane Doe within the 12 month period, this second IRA distribution cannot be rolled over. Is she was in the 25% tax bracket, her tax liability is \$12,000. This would be the result if the financial institution serving as the IRA custodian resigned and then made a distribution to Jane Doe 45 days later because Jane Doe had not responded to the financial institution's resignation letter.

If a financial institution wishes to resign as the IRA custodian, it is best that the IRA custodian has a plan of action to have each of the affected IRA owners find a new IRA custodian and then transfer such IRA funds.

Resigning As the Roth IRA Custodian - A Be Careful Subject If the Roth IRA Funds Are Not Being Transferred To Another Roth IRA Custodian

There will be times when an Roth IRA custodian wishes to resign as the Roth IRA custodian. The Roth IRA plan agreement should set forth the procedures to be used to resign.

As a general administrative rule, the Roth IRA custodian wants to close the person's Roth IRA by transferring the Roth IRA funds to a successor Roth IRA custodian rather than distributing the funds to the Roth IRA owner.

A financial institution might wish to resign due to its business decision to no longer provide certain services with respect to hard to value investments. For example, the Roth IRA custodian would mail a letter to the Roth IRA owner stating, "We have made the business decision to no longer service Roth IRAs which hold certain hard to value investments. Your Roth IRA holds such investments. You may instruct us to liquidate these investments and reinvest the proceeds. However, if you wish to retain these types of investments, you will need to establish an Roth IRA with a Roth IRA custodian willing to service Roth IRAs with such investments. We hereby inform you we are resigning as the Roth IRA custodian. Our resignation is effective as of _____. We are providing you 45 days rather than the 30 days set forth in paragraph 2.7 of Article VIII. We will assist in transferring your traditional IRA funds to your new IRA custodian. It is best if you transfer your Roth IRA funds because there could be times when you intend to rollover such distribution, but you then determine that you are ineligible to make a rollover contribution. You wish to discuss your situation with your tax advisor."

Again, as a general rule, a Roth IRA custodian never wants to make a distribution to a Roth IRA owner unless the Roth IRA owner has requested the distribution. Why?

There is a good chance of litigation if a Roth IRA custodian distributes Roth IRA funds to a person who has not requested the distribution and such person is ineligible to rollover such distribution. Why? The person may well have no tax liability because the distribution

might be qualified. However, the person who is unable to rollover the distribution has lost the right to have such funds earn tax free income for the next 40-70 years. The economic harm is great.

In 2014 the IRA rollover rules were changed to restrict a person's right to rollover only one distribution in a 12 consecutive month period. For example, if Jane Doe withdrew \$48,000 6 months ago and made a rollover contribution of the \$48,000 within the 60 day time period into another Roth IRA, then the individual is not required to include the \$48,000 in her taxable income and she is allowed to re-contribute the \$48,000 into a Roth IRA. However, if the Roth IRA custodian makes a second IRA distribution of \$48,000 to Jane Doe within the 12 month period, this second IRA distribution cannot be rolled over. This would be the result if the financial institution serving as the Roth IRA custodian resigned and then made a distribution to Jane Doe 45 days later because Jane Doe had not responded to the bank's resignation letter.

If a financial institution wishes to resign as the Roth IRA custodian, it is best that the Roth IRA custodian has a plan of action to have each of the affected Roth IRA owners find a new Roth IRA custodian and then transfer such Roth IRA funds.

UBIT - Real Potential For Causing Problems For An IRA Trustee

UBIT is the acronym for unrelated business income tax. An IRA trustee of a trust IRA or an IRA custodian of a self-directed IRA has the responsibility to determine if the IRA is required to file Form 990-T and pay any applicable tax liability. The title of Form 990-T is Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)).

If an IRA holds certain IRA investments and has related income of \$1,000 or more from such investments, then there is a duty to file the Form 1099-T. The fact the Form 990-T must be filed does not necessarily mean there is a tax liability. There is a tax liability only if there is taxable income from the business activity.

Code sections 511-514 (the unrelated business taxable income tax rules) were enacted in 1950 long before the IRA tax laws were enacted in 1974. The IRA laws did not set forth any discussion how the unrelated business income tax laws applied to IRAs, if at all. Therefore, the IRS adopted an administrative position to explain how the two laws interrelated. The IRS ruled there are times when an IRA or a 401(k) plan will be subject to the unrelated business income tax laws. In general, if the IRA investment is a passive investment such laws do not apply. However, if the IRA investment is an operating business or there is debt financing such laws will apply and the IRA must pay taxes on this businesses' taxable income.

With the growth in self-directed IRAs and hard to value IRAs more questions are arising regarding the unrelated business income rules. The IRS, of course, is always looking for tax areas where it can collect additional income tax revenue.

It is the IRA trustee who must decide if an IRA has unrelated business income, if the Form 990-T must be prepared and filed and must pay any tax which is owed.

The IRA trustee may ask the individual and the individual's accountant for assistance, but the IRA trustee should have its own staff or accountant perform the required tasks. An IRA trustee should charge reasonable fees for doing these tasks.

The IRA trustee must make the determination on an annual basis whether an IRA has any unrelated business

income. Often it is not clear if an IRA has unrelated business income.

The IRS position is, an IRA investment activity produces unrelated business income if it meets three requirements:

1. it is a trade or business,
2. it is regularly carried on, and
3. it is not substantially related to furthering the exempt purpose of the organization.

The Internal Revenue Service has defined the owning of any active trade or business as being unrelated to the IRA's tax exempt purpose.

The following types of income when paid to an IRA will generally not be unrelated business income:

1. dividends,
2. interest,
3. royalties,
4. rent from real estate, and
5. the sales proceeds from the sale of real estate as long as the facts do not show that there is a pattern of selling real estate.

The bank as the IRA trustee is in a difficult situation because there will be times when it is not clear if there is unrelated business income so the Form 990-T must be filed.

The conservative approach for the bank/IRA trustee is to prepare the Form 990-T (or partially prepare it) and attach a note to the tax return explaining why the IRA trustee believes there is no unrelated business income and request that the IRS make the determination that no tax is owed because there is no UBIT.

Another possible course of action, have the IRA owner furnish an opinion letter from an attorney or an accountant (and acknowledged by the individual) stating the law is unclear and that if the IRS would conclude otherwise that the IRA trustee is authorized to pay from the IRA the tax liability plus any interest and penalties.

A primary purpose of an IRA or a 401(k) plan is to have the plan assets earn income. The goal is to prudently maximize earnings. The more income earned means there will be more funds to be used for retirement purposes. The IRS' argument that an IRA which owns a business is not substantially related to furthering the exempt purpose of the IRA is not a strong argument.

The general tax rule applying to an IRA is - the income earned by the IRA is not presently taxed. In the case of traditional IRAs, SEP-IRAs and SIMPLE IRAs, the individual will include such income in his or her income when it is withdrawn from the IRA. This is true even though there is no distinction between withdrawing contributions versus withdrawing income. In the case of Roth IRAs, the individual is able to withdraw the income on a tax-free basis if the distribution is a qualified distribution. With a Roth IRA when the distribution is a non-qualified distribution there is a distinction between withdrawing contributions versus earnings.

The IRS' has adopted the tax position that - it is right to require an IRA to pay tax on income earned by a business-owned and operated by an IRA. However, there is no express statutory provision supporting this IRS position. And there is no statutory rule providing that the income earned within or by an IRA is subject to being taxed if the income arises from non-passive types of investments whereas passive income will not be taxed. Any argument counter to the IRS position is - the law as written, provides that all IRA income is not subject to current taxation.

Additional discussion of UBIT:

It appears that as long as rent is paid directly to the IRA and not through some passive entity, then such rent is not unrelated business income.

Selling one piece of real estate most likely would not be found to be a business and most likely would not be a business regularly carried on. However, if the person's IRA holds property primarily for sale then one could expect the IRS will argue this activity is a business so that it would owe the unrelated income tax.

In order to for UBIT to exist, there must be a trade or a business and it must be carried on regularly. If the business is not carried on regularly, the UBIT will not exist. The IRS has adopted "hobby" rules for when a person's activities do not rise to the level of being a business.

Presumably, this concept should carryover to IRAs. The IRA activity is not regular so there is no unrelated business income.

It should be clear to the IRS and Congress that Congress needs to rethink these tax rules and make needed changes. Until then, IRA trustees will need to adopt pro-

cedures to administer these IRAs to comply with existing laws. We at CWF lean towards more disclosure versus no disclosure.

A Taxpayer's Duty to Report a Roth IRA Distribution

A person who withdraws funds from a Roth IRA, including an inherited Roth IRA, must always report such withdrawal on his or her federal income tax return. It does matter if the distribution from the Roth IRA is tax-free or it is taxable. The person must report it on his or her federal income tax form. Some individuals incorrectly believe since their Roth IRA distribution is qualified and is not taxable, that it need not be reported on their tax return.

This article discusses the various IRS tax forms to be completed by the Roth IRA owner or Roth IRA beneficiary who withdraws Roth IRA funds. The individual will either complete Form 1040, 1040A or Form 1040NR. For purposes of this article, the completion of 2017 Form 1040 will be discussed and assumed that the Roth IRA distribution occurred during 2017 since the IRS has not yet released many of the 2018 tax forms.

The IRA custodian must prepare the 2017 Form 1099-R to report all IRA distributions occurring during 2017 on a per plan agreement basis as long as such distributions during the year totaled \$10 or more on. Such distributions might come from a Roth IRA, traditional IRA, SEP IRA or SIMPLE IRA. The distribution codes used to describe the Roth IRA distribution are generally different from the distributions used to describe distributions from traditional IRAs, SEP IRAs and SIMPLE IRAs. Although the IRA custodian is not required to prepare the Form 1099-R if the IRA distribution is less than \$10, the IRS asks IRS custodians to still prepare the Form 1099-R and report such amount. This implies that an individual has the duty to report all IRA distributions on their tax return, including those less than \$10.

The individual is to complete lines 15a and 15b of Form 1040 to report his or her IRA distributions. Line 15a is used to report the gross amount of the distribution. Line 15b is used to report the amount the person is required to include in their income (i.e. the taxable amount).

See Form 1040 2017 below:

Form 1040 2017:

| | | | |
|-----|---|-----|--|
| 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 <input type="checkbox"/> | 13 | |
| 14 | Other gains or (losses). Attach Form 4797 | 14 | |
| 15a | IRA distributions | 15a | |
| b | Taxable amount | 15b | |
| 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 | |

The individual has the duty to complete lines 15a and 15b to report his or her Roth IRA distributions. The are four basic Roth IRA distribution situations.

Situation #1. The Roth IRA distribution is qualified and the Roth IRA custodian knows it is qualified. That is, the Roth IRA owner is over age 59 1/2 and has had their Roth IRA for 5 years or longer with the Roth IRA custodian. The Roth IRA custodian will prepare the 2017 Form 1099-R to show a reason code Q in box 7, the gross amount in box 1 and a box 2a is to be left blank.

The individual is to complete lines 15a and 15b as follows. Line 15a is to be completed with the gross amount shown in box 1 of the Form 1099-R. The Q means her distribution was qualified. Line 15b is to be completed with 0.00 because the distribution is qualified.

For example, if a Roth IRA owner who was age 60 and who had her Roth IRA with the Roth IRA custodian for 10 years withdrew \$8,000 from her Roth IRA during 2017 and her Roth IRA custodian furnished her with a 2017 Form 1099-R with \$8,000 in box 1 and a reason code Q in box 7, then line 15a of her Form 1040 must be completed with \$8,000 (i.e. the gross amount set forth in box 1 from Form 1099-R) and line 15b is to be completed with 0.00. Form 8606 and Form 5329 do not need to be completed.

Situation #2. The Roth IRA distribution is qualified, but the Roth IRA has not been in existence at the current Roth IRA custodian for 5 years. The Roth IRA custodian will prepare the 2017 Form 1099-R to show a reason code T in box 7, the gross amount in box 1 and box 2a is to be left blank.

The individual is to complete lines 15a and 15b as follows. Line 15a is to be completed with the gross amount shown in box 1 of the Form 1099-R. The Q means her distribution was qualified. Line 15b is to be completed with 0.00 because the distribution is qualified.

The IRS instructions for Form 8606 expressly state that Part II of Form 8606 does not need to be completed for this situation.

For example, if a Roth IRA owner who was age 60 and who had her Roth IRA with the Roth IRA custodian for only 3 years withdrew \$8,000 from her Roth IRA, then this Roth IRA custodian will furnish her with a 2017 Form 1099-R with \$8,000 in box 1 and a reason code T in box 7. The T indicates the distribution was non-qualified. However, this person had established another Roth IRA with another Roth IRA custodian 10 years ago. This means for her tax purposes all Roth IRA distributions to her are qualified as the five year rule has been met because she is over age 59 1/2. Thus, she should complete line 15a of her Form 1040 with \$8,000 (i.e. the gross amount set forth in box 1 from Form 1099-R) and line 15b is to be completed with 0.00. In this situation she wants to attach a written note explaining why the distribution is qualified since the Form 1099-R indicates it was non-qualified.

Situation #3. The Roth IRA distribution is not qualified, but Code T is the proper reason code for Form 1099-R purposes because the individual is age 59 1/2, but has not met the 5 year rule.

The Roth IRA custodian will prepare the Form 1099-R to show a reason code T in box 7, the gross amount is reported in box 1 and box 2a is to be left blank.

Since the distribution is non-qualified, the individual will need to complete Part III of Form 8606. Because it is a non-qualified distribution, the individual must use the tax ordering rules to determine if any portion of the distribution is comprised of any earnings. The distribution of any earnings must be report on line 15b and Form 5329 will need to be completed if the individual is not yet age 59 1/2 or older.

Part III is set forth below:

Form 8606 2017:

Part III Distributions From Roth IRAs

Complete this part only if you took a distribution from a Roth IRA in 2017. For this purpose, a distribution does not include a rollover (other than a repayment of a qualified disaster distribution (see 2017 Forms 8915A and 8915B)), qualified charitable distribution, one-time distribution to fund an HSA, recharacterization, or return of certain contributions (see instructions).

| | | | |
|-----|---|-----|--|
| 19 | Enter your total nonqualified distributions from Roth IRAs in 2017, including any qualified first-time homebuyer distributions, and any qualified disaster distributions (see instructions). Also see 2017 Forms 8915A and 8915B | 19 | |
| 20 | Qualified first-time homebuyer expenses (see instructions). Do not enter more than \$10,000 | 20 | |
| 21 | Subtract line 20 from line 19. If zero or less, enter -0- | 21 | |
| 22 | Enter your basis in Roth IRA contributions (see instructions). If line 21 is zero, stop here | 22 | |
| 23 | Subtract line 22 from line 21. If zero or less, enter -0- and skip lines 24 and 25. If more than zero, you may be subject to an additional tax (see instructions) | 23 | |
| 24 | Enter your basis in conversions from traditional, SEP, and SIMPLE IRAs and rollovers from qualified retirement plans to a Roth IRA. See instructions | 24 | |
| 25a | Subtract line 24 from line 23. If zero or less, enter -0- and skip lines 25b and 25c | 25a | |
| b | Enter the amount on line 25a attributable to qualified disaster distributions from 2017 Forms 8915A and 8915B (see instructions). Also, enter this amount on 2017 Form 8915A, line 23, or 2017 Form 8915B, line 14, as applicable | 25b | |
| c | Taxable amount. Subtract line 25b from line 25a. If more than zero, also include this amount on 2017 Form 1040, line 15b; 2017 Form 1040A, line 11b; or 2017 Form 1040NR, line 16b | 25c | |

The individual is to complete lines 15a and 15b as follows. Line 15a is to be completed with the gross amount shown in box 1 of the Form 1099-R. Line 15b is to be completed with the taxable amount, if any, determined on the Form 8606. See line 25c.

For example, John Doe has had a Roth IRA for 3 years. He is age 62. During 2017, he withdraws \$18,000 of which \$16,500 were his own contributions and \$1,500 were the earnings. The Roth IRA custodian will prepare the 2017 Form 1099-R to show a reason code T in box 7, the gross amount in box 1 and a box 2a is to be left blank.

John Doe must complete Part III of Form 8608. On line 25c he will indicate that he has taxable income of \$1,500. He will also complete line 15b of Form 1040 with \$1,500.

Because he is older than age 59 1/2, he will not complete Form 5329 because it is inapplicable.

Situation #4. The Roth IRA distribution is not qualified, but Code J is the proper reason code for Form 1099-R purposes because the individual has not met the 5 year rule and or is not yet 59 1/2, disabled or has not yet died.

The Roth IRA custodian will prepare the 2017 Form 1099-R to show a reason code J in box 7, the gross amount is reported in box 1 and box 2a is to be left blank.

Since the distribution is non-qualified, the individual will need to complete Part III of Form 8606. Because it

is a non-qualified distribution, the individual must use the tax ordering rules to determine if any portion of the distribution is comprised of any earnings. The distribution of any earnings must be report on line 15b and the individual will need to complete Part I of Form 5329 because he or she not yet age 59 1/2 or older.

Part I of Form 5329 is set forth below.

Form 5329 2017:

| | | | | |
|--|--|--|--|---|
| 5329 | | Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts | | OMB No. 1545-0074 |
| Department of the Treasury Internal Revenue Service (99) | | ▶ Attach to Form 1040 or Form 1040NR. ▶ Go to www.irs.gov/Form5329 for instructions and the latest information. | | 2017 Attachment Sequence No. 29 |
| Name of individual subject to additional tax. If married filing jointly, see instructions. Your social security number | | | | |
| Home address (number and street), or P.O. box if mail is not delivered to your home | | Apt. no. | | |
| Fill in Your Address Only if You Are Filing This Form by Itself and Not With Your Tax Return | | City, town or post office, state, and ZIP code. If you have a foreign address, also complete the spaces below (see instructions). | | If this is an amended return, check here <input type="checkbox"/> |
| Foreign country name | | Foreign province/state/country | | Foreign postal code |
| If you only owe the additional 10% tax on early distributions, you may be able to report this tax directly on Form 1040, line 59, or Form 1040NR, line 57, without filing Form 5329. See the instructions for Form 1040, line 59, or for Form 1040NR, line 57. | | | | |
| Part I Additional Tax on Early Distributions. Complete this part if you took a taxable distribution (other than a qualified disaster distribution) before you reached age 59½ from a qualified retirement plan (including an IRA) or modified endowment contract (unless you are reporting this tax directly on Form 1040 or Form 1040NR—see above). You may also have to complete this part to indicate that you qualify for an exception to the additional tax on early distributions or for certain Roth IRA distributions (see instructions). | | | | |
| 1 | Early distributions included in income. For Roth IRA distributions, see instructions | 1 | | |
| 2 | Early distributions included on line 1 that are not subject to the additional tax (see instructions). Enter the appropriate exception number from the instructions: | 2 | | |
| 3 | Amount subject to additional tax. Subtract line 2 from line 1 | 3 | | |
| 4 | Additional tax. Enter 10% (0.10) of line 3. Include this amount on Form 1040, line 59, or Form 1040NR, line 57. Caution: If any part of the amount on line 3 was a distribution from a SIMPLE IRA, you may have to include 25% of that amount on line 4 instead of 10% (see instructions). | 4 | | |

For example, Mary Doe has had a Roth IRA for 3 years. She is age 37. During 2017, she withdraws \$14,000 of which \$12,300 were her own contributions and \$1,700 were the earnings. The Roth IRA custodian will prepare the 2017 Form 1099-R to show a reason code J in box 7, \$14,000 in box 1 and a box 2a is to be left blank.

She must complete Part III of Form 8608. On line 25c she will indicate that she has taxable income of \$1,700. She will also complete line 15b of Form 1040 with \$1,700.

Because she is younger than age 59 1/2, she must complete Form 5329 to indicate she owes the 10% tax on the \$1,700 or \$170. This is reported on line 59 of Form 1040 as set forth on the next page/column.

Form 1040 2017:

| | | | |
|-----|--|-----|--|
| 57 | Self-employment tax. Attach Schedule SE | 57 | |
| 58 | Unreported social security and Medicare tax from Form: a <input type="checkbox"/> 4137 b <input type="checkbox"/> 8919 | 58 | |
| 59 | Additional tax on IRAs, other qualified retirement plans, etc. Attach Form 5329 if required | 59 | |
| 60a | Household employment taxes from Schedule H | 60a | |
| b | First-time homebuyer credit repayment. Attach Form 5405 if required | 60b | |
| 61 | Health care: individual responsibility (see instructions) Full-year coverage <input type="checkbox"/> | 61 | |
| 62 | Taxes from: a <input type="checkbox"/> Form 8959 b <input type="checkbox"/> Form 8960 c <input type="checkbox"/> Instructions; enter code(s) | 62 | |
| 63 | Add lines 56 through 62. This is your total tax ▶ | 63 | |

All Roth IRA distributions are to be reported on a person's federal income tax return. The above discussion makes clear a person who withdraws funds from a Roth IRA or receives a distribution from a Roth IRA must always report this Roth IRA distribution on their federal tax year for the tax year during which the distribution occurred. Some individuals incorrectly think that because their Roth IRA distribution is qualified and is not subject to being taxed that it need not be reported on their tax return.

Designated Roth Funds Are Eligible to Be Directly Rolled Over to a Roth IRA Or In Some Cases to a Traditional IRA

More individuals are making "Roth" contributions. The tax-free income aspect is enticing. "Roth" contributions may either be made to a Roth IRA or they may be made to a 401(k) plan which allows for designated Roth contributions.

Many employers with 401(k) plans are revising their plans to authorize a participant to make an after-tax elective deferral contribution into a designated Roth account. Many of the employees appreciate being given the opportunity to make elective deferrals to a designated Roth account along with making standard elective deferrals. In some cases the key employees of an employer are ineligible to make annual Roth IRA contributions because of the income restrictions.

When the participant is eligible for a distribution from the 401(k) plan the participant must decide if the entire balance in the designated Roth account will be directly rolled over or if only a portion will be rolled over. If distributed, the earnings portion of a designated Roth account will be tax-free only if the distribution is a qualified distribution.

Almost always the participant will instruct to directly rollover 100% of the distribution to a Roth IRA. However, with respect to the earnings portion of a Designated Roth account a participant may rollover the earnings portion to a traditional IRA rather than a Roth IRA. The person might do this to simplify their tax accounting.

The IRS in May of 2016 adopted a final regulation. The purpose of the regulation was to eliminate the requirement that a disbursement from a designated Roth account that is directly rolled over to a Roth IRA be treated as a separate distribution from any amount paid directly to the participant and therefore separately subject to the pro-rata taxation rule allocating pre-tax and after-tax amounts to each distribution. The new rule is pretax amounts are allocated first to the direct rollover rather than being allocated prorata to both distributions. Also, the participant has the right as with other non-designated accounts funds to direct the allocation of pretax and after-tax amounts to a traditional IRA and/or a Roth IRA. If the distribution of the earnings with respect to the designated Roth account would not be qualified, then the participant can choose to directly rollover such portion to a traditional IRA rather than a Roth IRA. We expect most individuals would still decide to have such earnings directly rolled over into a Roth IRA. If such earnings were distributed from the Roth IRA before the individual was eligible for a qualified distribution from the Roth IRA such earnings would be taxable.

What is one practical impact of this change?

For discussion purposes, we will assume that Jane Doe age 37 has \$4,470 in a designated Roth account. Of this amount \$4,000 is attributable to her elective deferrals and \$470 is the earnings portion. She could elect to receive \$4,000 in cash to pay-down some credit card balances and she could elect to directly rollover the \$470 into her traditional IRA so she would not be required to include the \$470 in her income. Alternatively, she could elect to directly rollover the \$4,000 into her Roth IRA and she could elect to directly rollover the \$470 into her traditional IRA so she would not be required to include the \$470 in her income.

By issuing this regulation along with the guidance in Notice 2014-54, the IRS has given an individual great flexibility in withdrawing pretax and post-tax funds from qualified plans, including 401(k) plans with designated Roth accounts. This IRS action allows an individual to simplify the tax accounting for distributions from 401(k) plans.

Statistics for SEP-IRAs and SIMPLE-IRAs

Many IRA custodians do not offer and/or promote their SEP-IRA and their SIMPLE-IRA services. They should. They are missing out on having their fair share of these contributions and account balances. Federal tax law offers these accounts as simpler alternatives to 401(k) plans and profit sharing plans. These plans do not have the administrative costs which 401(k) plans have.

The annual contributions into SEP-IRAs and SIMPLE-IRAs and the account balances in such accounts are substantial as the charts below indicate.

2015 Annual Contributions

| | Contribution Amount | Number of Contributors | Average |
|--------------------|---------------------------------|------------------------|----------|
| Roth IRAs | \$21,730,049,000 (21.7 billion) | 6,363,335 | \$3,415 |
| Traditional | \$17,692,933,000 (17.7 billion) | 4,305,106 | \$4,110 |
| SEP-IRA | \$14,696,619,000 (14.7 billion) | 1,093,512 | \$13,440 |
| SIMPLE-IRA | \$9,579,025,000 (9.6 billion) | 1,865,776 | \$5,134 |

It appears that many one person businesses will sponsor a SEP-IRA plan whereas small business with employees will sponsor a SIMPLE-IRA plan. This is understandable as the owner of the small business on average is allowed to make a smaller contribution for its employees under a SIMPLE-IRA plan than under a SEP-IRA plan and yet the owner is allowed to make a substantial contribution for himself or herself. A person under age 50 is eligible to make an elective deferral contribution each year up to a maximum of \$12,500 (plus will receive the employer's match of 3%) and a person age 50 or older is eligible to make an elective deferral contribution up to a maximum of \$15,500 (plus will receive the employer's match of 3%).

Note that the average SEP-IRA contribution for 2015 was \$13,440 and the average account balance was \$113,798.

A SEP-IRA plan or a SIMPLE-IRA plan are retirement plans and there are administrative duties which must be performed. However, a financial institution can limit its role to being the IRA custodian and it is the employer who must perform the administrative duties.

2015 Fair Market Values

| | Fair Market Value (12/31/15) | Taxpayers | Average |
|--------------------|------------------------------------|------------|-----------|
| Traditional | \$6,386,720,403,000 (6.4 trillion) | 46,431,850 | \$137,500 |
| Roth IRAs | \$625,077,216,000 (625.7 billion) | 19,248,044 | \$32,745 |
| SEP-IRA | \$364,263,654 (364.3 billion) | 3,200,957 | \$113,798 |
| SIMPLE-IRA | \$101,194,112,000 (101.2 billion) | 2,891,933 | \$34,992 |

Set forth are charts showing the SEP-IRA and SIMPLE IRA contribution information and the account balance information on the basis of the taxpayers' adjusted gross income. As one would expect, the size of a person's annual contribution and account balance increases as one's income increases.

Note the average contribution to a SEP-IRA is much larger for all compensation ranges versus a SIMPLE IRA. And the same is true for the FMVs. The average FMV of a SEP-IRA is much larger for all compensation ranges versus a SIMPLE IRA.

An IRA custodian who presently does not service many SEP-IRAs or SIMPLE-IRAs should modify its business plan to seek such IRAs.

2015 SEP-IRA Contributions

| Adjusted Gross Income | Number of Contributors | Contribution Amount | Average |
|-------------------------|------------------------|---------------------|----------|
| \$10,000 under \$50 M | 119,850 | \$533,827,000 | \$4,454 |
| \$50,000 under \$75M | 116,873 | \$781,069,000 | \$6,683 |
| \$75,000 under \$100M | 124,338 | \$810,330,000 | \$6,517 |
| \$100,000 under \$200M | 354,722 | \$4,293,137,000 | \$12,103 |
| \$200,000 under \$500M | 268,171 | \$5,373,293,000 | \$20,037 |
| \$500,000 under \$1.0MM | 64,127 | \$1,806,248,000 | \$28,167 |
| \$1,000,000 or more | 28,192 | \$913,428,000 | \$32,400 |

2015 SEP-IRA FMV

| Adjusted Gross Income | Number of Taxpayers | Contribution Amount | Average |
|-------------------------|---------------------|---------------------|-----------|
| \$10,000 under \$50 M | 470,513 | \$24,349,609,000 | \$51,751 |
| \$50,000 under \$75M | 366,672 | \$28,549,292,000 | \$77,861 |
| \$75,000 under \$100M | 386,097 | \$29,379,878,000 | \$76,095 |
| \$100,000 under \$200M | 986,000 | \$107,802,074,000 | \$112,764 |
| \$200,000 under \$500M | 654,227 | \$112,068,302,000 | \$171,299 |
| \$500,000 under \$1.0MM | 157,304 | \$34,824,468,000 | \$221,383 |
| \$1,000,000 or more | 74,076 | \$18,384,117,000 | \$248,179 |

2015 SIMPLE-IRA Contributions

| Adjusted Gross Income | Number of Contributors | Contribution Amount | Average |
|-------------------------|------------------------|---------------------|----------|
| \$10,000 under \$50 M | 363,845 | \$659,909,000 | \$1,812 |
| \$50,000 under \$75M | 311,424 | \$1,037,033,000 | \$3,330 |
| \$75,000 under \$100M | 239,698 | \$931,027,000 | \$3,384 |
| \$100,000 under \$200M | 479,250 | \$3,017,736,000 | \$6,297 |
| \$200,000 under \$500M | 211,128 | \$2,534,558,000 | \$12,005 |
| \$500,000 under \$1.0MM | 40,252 | \$604,322,000 | \$15,013 |
| \$1,000,000 or more | 15,862 | \$248,362,000 | \$15,658 |

2015 SIMPLE-IRA FMV

| Adjusted Gross Income | Number of Taxpayers | Contribution Amount | Average |
|-------------------------|---------------------|---------------------|-----------|
| \$10,000 under \$50 M | 543,794 | \$5,164,430,000 | \$9,497 |
| \$50,000 under \$75M | 485,520 | \$10,689,118,000 | \$22,016 |
| \$75,000 under \$100M | 403,616 | \$9,566,019,000 | \$23,701 |
| \$100,000 under \$200M | 740,039 | \$32,844,772,000 | \$44,382 |
| \$200,000 under \$500M | 311,050 | \$27,310,531,000 | \$20,037 |
| \$500,000 under \$1.0MM | 58,424 | \$6,942,133,000 | \$118,823 |
| \$1,000,000 or more | 22,500 | \$3,071,756,000 | \$136,522 |