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The Pension Digest

ALSO IN THIS ISSUE –

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

Competing for IRA Contributions and 401(k) Contributions

The business world is competitive. So is the political world.

Right now the stock market is not doing very well. Opportunities exist for deposit instruments.

IRAs and 401(k) plans are competing retirement plan types, but they also are interrelated. They both play an important role in the U.S. retirement system. There is more wealth held in IRAs (9.3 trillion) than in 401(k) plans (5.6 trillion). But it is not because of individuals making annual contributions into IRAs. It is because people change jobs or retire and the 401(k) funds are generally directly rolled over into an IRA. $400-$500 billion per year are withdrawn from 401(k) plans and other retirement plans and directly rolled over into IRAs.

Although the tax rules allow a person to annually make contributions to a 401(k) plan and also to an IRA most do not make both contributions. Most individuals will only make annual contributions to their 401(k) account within their employer's 401(k) plan.

There are approximately 150 million tax returns filed in the U.S. 120 million of these returns show that individuals are eligible to make an IRA contribution. Only 11% of individuals eligible to make a traditonal IRA or Roth IRA do so. The amount contributed to traditional IRAs is 22 billion.

Many Americans (110 million tax returns) are eligible to make an annual IRA contribution but choose not to.

One purpose of this article is - it is time to start competing. If you want the business (more IRA contributions), step one is to ask for them and step two is to earn them. Have a competing investment product. The same is true for pension contributions.

Our country is certainly split along differing political and economic philosophies. One group believes and argues an employer should be legally required to make pension contributions on behalf of its employees. It is not enough that the employer pays the 7.65% tax for social security and Medicare. Some states (Oregon, Illinois, California, et al) are requiring employers who don't sponsor a pension plan to establish one. Such state laws most likely will be found to violate ERISA, but time will tell. One way to help your customers will be to help them establish a plan with contributions being made with your institution rather than using the state sponsored plan.

The opposing philosophy is, an employer should have the freedom whether or not it will make pension contributions to benefit its employees. However, an employer that makes such contributions will receive tax benefits. This is current federal law. Because of these federal tax benefits and to be competitive against its competing businesses, many employers will sponsor a 401(k) plan or a SEP-IRA plan.

The second purpose of this article - no one needs to have their employer make their "pension" contribution because he or she is eligible to make an annual IRA contribution. Individuals should take

Continued on page 3

Understanding What Forms Are Needed To Establish a SEP-IRA

Jane Smith wishes to make a SEP-IRA contribution for herself. Jane is a self employed horse rider/exerciser. She had a good year and so she wants to establish a SEP and then make a $26,000 contribution to her SEP-IRA for tax year 2018.

What forms will she need to prepare?

First, as an employer (a one person business), she must establish her Simplified Employee Pension Plan (SEP). She will do so by completing and signing the IRS model form 5035-SEP. Note that she signs the form as the "employer." The financial institution does not sign this form. Jane will either obtain this form from her accountant, attorney, financial institution or she will find it on-line at the IRS website, www.irs.gov.

Second, as the employer, she will write a business check for the amount of $26,000 and she will contribute it to her SEP-IRA. A SEP-IRA is established by a person establishing a standard traditional IRA (IRS model form 5305) and then making a SEP-IRA contribution to it. For 2018 she is permitted to make a maximum SEP-IRA contribution equal to the lesser of 25% of her adjusted business earnings or $55,000.

We recently had a call from an IRA representative where the IRA software system her bank was using did not make this clear. The system gave the idea that the only form needed was the Form 5305-SEP. The system did not make it clear that the individual either needed to have an existing IRA into which the SEP-IRA contribution would be contributed or a new SEP-IRA must be established. Both forms are needed.

A SEP-IRA must exist for tax reporting reasons if an annual SEP-IRA contribution is made or a SEP-IRA rollover contribution is made. The IRS has never issued written guidance as to when a SEP-IRA is eligible to no longer be titled a SEP-IRA. Presumably, this occurs when there is no current SEP-IRA contribution and the individual instructs that the SEP-IRA funds are to be transferred into a traditional IRA. In most situations the IRA type classification on the computer system would be changed.

IRS statistics show that annual SEP-IRA contributions exceed those of annual traditional IRA contributions. A financial institution will benefit by communicating with its business customers about the benefits of SEP-IRAs.

The tax laws do not require a person who has an existing traditional IRA to set up a new SEP-IRA. Some financial institutions choose for administrative reasons to require a separate IRA, but the tax laws do not require it. If any employee would fail to have a SEP-IRA so the business did not make a SEP contribution for such employee, there would be no SEP and the expected tax benefits would not apply for the sponsoring business and other employees.

In summary, establishing a SEP is easy as long as the two steps above are completed for a one person business and the three steps are completed for a business with employees.

SEPs — The Last-Minute Retirement Plan and Tax Deduction

Definitions

SEP — SEP is the acronym for Simplified Employee Pension plan. In order to have a SEP, two requirements must be met. First, an employer must sign a SEP plan document which may be: (1) the IRS model Form 5305-SEP; (2) a SEP prototype; or (3) a SEP plan as written specifically for that employer by an attorney. The employer may be a gigantic corporation or a self employed person. Second, all eligible employees must establish (or have established for them) a SEP-IRA.

SEP-IRA — A SEP-IRA is a standard, traditional IRA established with a financial institution to which an employer has made a SEP-IRA contribution. The IRA custodian is required to report SEP-IRA contributions in box 8 on Form 5498. In all other respects, the standard, traditional IRA rules will apply to administering SEP-IRAs. Contributions to SEP-IRAs are always owned by the employee, once the funds have been contributed to the employee's SEP-IRA.

Discussion — SEP plans may be established and funded by the normal tax deadline, plus extensions. A person may come into your institution in July of 2019, and make a SEP contribution of $55,000, for tax year 2018. If an individual has the proper extension(s) a SEP contribution may be made as late as October 15 of 2019, for tax year 2018.

The Pension Digest

Competing for Contributions, Continued from page 1

responsibility and start making their own IRA contributions. Individuals should be informed regularly that they should to be making IRA contributions, especially if they don't participate in a 401(k) plan.

Here are some ideas for increasing IRA contributions.

1. A person should be able to make their annual IRA contribution on-line and people need to be informed and convinced why and how they will benefit. So, start implementing the making online of annual IRA contributions, especially Roth IRA contributions.

A person should be informed that annual contributions may be done online and the contribution is processed as a current year contribution unless instructed otherwise. The person should be informed that he or she must contact the financial institution for assistance if a rollover contribution, a SEP-IRA contribution or a transfer contribution is being made.

A person should almost always be making a Roth IRA contribution rather than making a contribution to a standard savings account. Why? A person can generally make a Roth IRA contribution and withdraw it without adverse tax consequences. For example, Margrit contributes $4,000 to her Roth in January and then in October withdraws $1200 of the $4000. She owes no income tax as she is only withdrawing her own contribution. The withdrawal of the earnings from a Roth IRA are often taxable, but earnings are withdrawn only after all contributions have been withdrawn.

2. Encourage SEP-IRA contributions. Annual contributions of $55,000 can multiply greatly if there are multiple employees making/receiving such contributions. See the adjacent article. Many employers will not want the complexity which comes with a 401(k) plan and there is certainly less liability. Refer to the October 2018 issue discussing how a small employer may be able to realize some FICA tax savings by sponsoring a SEP IRA plan.

3. Enlighten your higher income customers so that they come to understand how they will benefit by making non-deductible contributions even though they are making maximum contributions to their 401(k) plans. See articles in prior newsletters.

4. Encourage Direct Rollovers and Rollovers Into IRAs from 401(k) plans and other retirement plans. An institution must "work" or "compete" to gain rollover contributions.

Continued on page 7

Form **5305-SEP** (Rev. December 2004) Department of the Treasury Internal Revenue Service

Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement

(Under section 408(k) of the Internal Revenue Code)

OMB No. 1545-0499

Do not file with the Internal Revenue Service

.... (Name of employer) makes the following agreement under section 408(k) of the Internal Revenue Code and the instructions to this form.

Article I—Eligibility Requirements (check applicable boxes—see instructions)

The employer agrees to provide discretionary contributions in each calendar year to the individual retirement account or individual retirement annuity (IRA) of all employees who are at least ________ years old (not to exceed 21 years old) and have performed services for the employer in at least ________ years (not to exceed 3 years) of the immediately preceding 5 years. This simplified employee pension (SEP) ☐ includes ☐ **does not** include employees covered under a collective bargaining agreement, ☐ includes ☐ **does not** include certain nonresident aliens, and ☐ includes ☐ **does not** include employees whose total compensation during the year is less than $450*.

Article II—SEP Requirements (see instructions)

The employer agrees that contributions made on behalf of each eligible employee will be:

A. Based only on the first $205,000* of compensation.
B. The same percentage of compensation for every employee.
C. Limited annually to the smaller of $41,000* or 25% of compensation.
D. Paid to the employee's IRA trustee, custodian, or insurance company (for an annuity contract).

COLA Adjusted SEP Limits

In 2005	2018	2019
$450	$600	$600
$41,000	$55,000	$56,000
$205,000	$275,000	$280,000

Employer's signature and date — Name and title

Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Form

Form 5305-SEP (Model SEP) is used by an employer to make an agreement to provide benefits to all eligible employees under a simplified employee pension (SEP) described in section 408(k).

Do not file Form 5305-SEP with the IRS. Instead, keep it with your records.

For more information on SEPs and IRAs, see Pub. 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans), and Pub. 590, Individual Retirement Arrangements (IRAs).

Instructions to the Employer

Simplified employee pension. A SEP is a written arrangement (a plan) that provides you with an easy way to make contributions toward your employees' retirement income. Under a SEP, you can contribute to an employee's traditional individual retirement account or annuity (traditional IRA). You make contributions directly to an IRA set up by or for each employee with a bank, insurance company, or other qualified financial institution. When using Form 5305-SEP to establish a SEP, the IRA must be a Model traditional IRA established on an IRS form or a master or prototype traditional IRA for which the IRS has issued a favorable opinion letter. You may not make SEP contributions to a Roth IRA or a SIMPLE IRA. Making the agreement on Form 5305-SEP does not establish an employer IRA described in section 408(c).

When not to use Form 5305-SEP. Do not use this form if you:

1. Currently maintain any other qualified retirement plan. This does not prevent you from maintaining another SEP.

2. Have any eligible employees for whom IRAs have not been established.

3. Use the services of leased employees (described in section 414(n)).

4. Are a member of an affiliated service group (described in section 414(m)), a controlled group of corporations (described in section 414(b)), or trades or businesses under common control (described in sections 414(c) and 414(o)), unless all eligible employees of all the members of such groups, trades, or businesses participate in the SEP.

5. Will not pay the cost of the SEP contributions. Do not use Form 5305-SEP for a SEP that provides for elective employee contributions even if the contributions are made under a salary reduction agreement. Use Form 5305A-SEP, or a nonmodel SEP.

Note. *SEPs permitting elective deferrals cannot be established after 1996.*

Eligible employees. All eligible employees must be allowed to participate in the SEP. An eligible employee is any employee who: (1) is at least 21 years old, and (2) has performed "service" for you in at least 3 of the immediately preceding 5 years. You can establish less restrictive eligibility requirements, but not more restrictive ones.

Service is any work performed for you for any period of time, however short. If you are a member of an affiliated service group, a controlled group of corporations, or trades or businesses under common control, service includes any work performed for any period of time for any other member of such group, trades, or businesses.

Excludable employees. The following employees do not have to be covered by the SEP: (1) employees covered by a collective bargaining agreement whose retirement benefits were bargained for in good faith by you and their union, (2) nonresident alien employees who did not earn U.S. source income from you, and (3) employees who received less than $450* in compensation during the year.

Contribution limits. You may make an annual contribution of up to 25% of the employee's compensation or $41,000*, whichever is less. Compensation, for this purpose, does not include employer contributions to the SEP or the employee's compensation in excess of $205,000*. If you also maintain a salary reduction SEP, contributions to the two SEPs together may not exceed the smaller of $41,000* or 25% of compensation for any employee.

You are not required to make contributions every year, but when you do, you must contribute to the SEP-IRAs of all eligible employees who actually performed services during the year of the contribution. This includes eligible employees who die or quit working before the contribution is made.

Contributions cannot discriminate in favor of highly compensated employees. Also, you may not integrate your SEP contributions with, or offset them by, contributions made under the Federal Insurance Contributions Act (FICA).

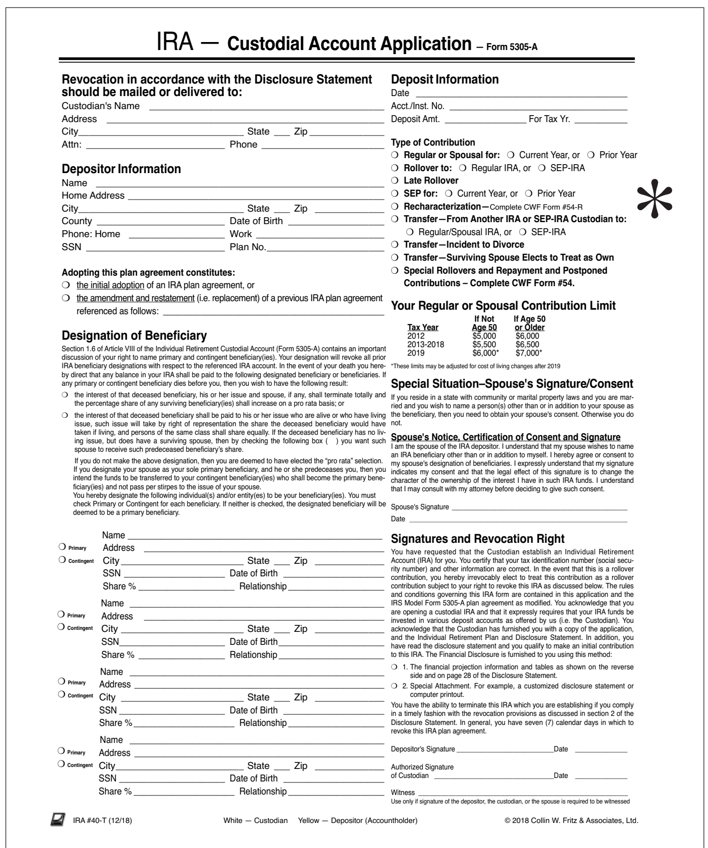
If this SEP is intended to meet the top-heavy minimum contribution rules of section 416, but it does not cover all your employees who participate in your salary reduction SEP, then you must make minimum contributions to IRAs established on behalf of those employees.

Deducting contributions. You may deduct contributions to a SEP subject to the limits of section 404(h). This SEP is maintained on a calendar year basis and contributions to the

* *For 2005 and later years, this amount is subject to annual cost-of-living adjustments. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS website at www.irs.gov.*

For Paperwork Reduction Act Notice, see page 2. Cat. No. 11825J Form **5305-SEP** (Rev. 12-2004)

IRA #700 (1/19) White Custodian Yellow Depositor Collin W. Fritz & Associates, Ltd.



IRA — Custodial Account Application – Form 5305-A

Revocation in accordance with the Disclosure Statement should be mailed or delivered to:

Custodian's Name ________
Address ________
City ________ State ___ Zip ________
Attn: ________ Phone ________

Depositor Information

Name ________
Home Address ________
City ________ State ___ Zip ________
County ________ Date of Birth ________
Phone: Home ________ Work ________
SSN ________ Plan No. ________

Adopting this plan agreement constitutes:

❍ the initial adoption of an IRA plan agreement, or
❍ the amendment and restatement (i.e. replacement) of a previous IRA plan agreement referenced as follows: ________

Designation of Beneficiary

Section 1.6 of Article VIII of the Individual Retirement Custodial Account (Form 5305-A) contains an important discussion of your right to name primary and contingent beneficiary(ies). Your designation will revoke all prior IRA beneficiary designations with respect to the referenced IRA account. In the event of your death you hereby direct that any balance in your IRA shall be paid to the following designated beneficiary or beneficiaries. If any primary or contingent beneficiary dies before you, then you wish to have the following result:

❍ the interest of that deceased beneficiary, his or her issue and spouse, if any, shall terminate totally and the percentage share of any surviving beneficiary(ies) shall increase on a pro rata basis; or

❍ the interest of that deceased beneficiary shall be paid to his or her issue who are alive or who have living issue, such issue will take by right of representation the share the deceased beneficiary would have taken if living, and persons of the same class shall share equally. If the deceased beneficiary has no living issue, but does have a surviving spouse, then by checking the following box (   ) you want such spouse to receive such predeceased beneficiary's share.

If you do not make the above designation, then you are deemed to have elected the "pro rata" selection. If you designate your spouse as your sole primary beneficiary, and he or she predeceases you, then you intend the funds to be transferred to your contingent beneficiary(ies) who shall become the primary beneficiary(ies) and not pass per stirpes to the issue of your spouse.
You hereby designate the following individual(s) and/or entity(es) to be your beneficiary(ies). You must check Primary or Contingent for each beneficiary. If neither is checked, the designated beneficiary will be deemed to be a primary beneficiary.

❍ Primary ❍ Contingent
Name ________
Address ________
City ________ State ___ Zip ________
SSN ________ Date of Birth ________
Share % ________ Relationship ________

❍ Primary ❍ Contingent
Name ________
Address ________
City ________ State ___ Zip ________
SSN ________ Date of Birth ________
Share % ________ Relationship ________

❍ Primary ❍ Contingent
Name ________
Address ________
City ________ State ___ Zip ________
SSN ________ Date of Birth ________
Share % ________ Relationship ________

❍ Primary ❍ Contingent
Name ________
Address ________
City ________ State ___ Zip ________
SSN ________ Date of Birth ________
Share % ________ Relationship ________

Deposit Information

Date ________
Acct./Inst. No. ________
Deposit Amt. ________ For Tax Yr. ________

Type of Contribution

❍ **Regular or Spousal for:** ❍ Current Year, or ❍ Prior Year
❍ **Rollover to:** ❍ Regular IRA, or ❍ SEP-IRA
❍ **Late Rollover**
❍ **SEP for:** ❍ Current Year, or ❍ Prior Year
❍ **Recharacterization**—Complete CWF Form #54-R
❍ **Transfer—From Another IRA or SEP-IRA Custodian to:** ❍ Regular/Spousal IRA, or ❍ SEP-IRA
❍ **Transfer—Incident to Divorce**
❍ **Transfer—Surviving Spouse Elects to Treat as Own**
❍ **Special Rollovers and Repayment and Postponed Contributions – Complete CWF Form #54.**

Your Regular or Spousal Contribution Limit

Tax Year	If Not Age 50	If Age 50 or Older
2012	$5,000	$6,000
2013-2018	$5,500	$6,500
2019	$6,000*	$7,000*

*These limits may be adjusted for cost of living changes after 2019

Special Situation–Spouse's Signature/Consent

If you reside in a state with community or marital property laws and you are married and you wish to name a person(s) other than or in addition to your spouse as the beneficiary, then you need to obtain your spouse's consent. Otherwise you do not.

Spouse's Notice, Certification of Consent and Signature

I am the spouse of the IRA depositor. I understand that my spouse wishes to name an IRA beneficiary other than or in addition to myself. I hereby agree or consent to my spouse's designation of beneficiaries. I expressly understand that my signature indicates my consent and that the legal effect of this signature is to change the character of the ownership of the interest I have in such IRA funds. I understand that I may consult with my attorney before deciding to give such consent.

Spouse's Signature ________
Date ________

Signatures and Revocation Right

You have requested that the Custodian establish an Individual Retirement Account (IRA) for you. You certify that your tax identification number (social security number) and other information are correct. In the event that this is a rollover contribution, you hereby irrevocably elect to treat this contribution as a rollover contribution subject to your right to revoke this IRA as discussed below. The rules and conditions governing this IRA form are contained in this application and the IRS Model Form 5305-A plan agreement as modified. You acknowledge that you are opening a custodial IRA and that it expressly requires that your IRA funds be invested in various deposit accounts as offered by us (i.e. the Custodian). You acknowledge that the Custodian has furnished you with a copy of the application, and the Individual Retirement Plan and Disclosure Statement. In addition, you have read the disclosure statement and you qualify to make an initial contribution to this IRA. The Financial Disclosure is furnished to you using this method:

❍ 1. The financial projection information and tables as shown on the reverse side and on page 28 of the Disclosure Statement.
❍ 2. Special Attachment. For example, a customized disclosure statement or computer printout.

You have the ability to terminate this IRA which you are establishing if you comply in a timely fashion with the revocation provisions as discussed in section 2 of the Disclosure Statement. In general, you have seven (7) calendar days in which to revoke this IRA plan agreement.

Depositor's Signature ________ Date ________
Authorized Signature of Custodian ________ Date ________
Witness ________
Use only if signature of the depositor, the custodian, or the spouse is required to be witnessed

IRA #40-T (12/18) White — Custodian Yellow — Depositor (Accountholder) © 2018 Collin W. Fritz & Associates, Ltd.

What Advantages Does a 401(k) Plan Have Over a SEP?

No doubt SEP-IRA plans are simple. Many farmers and other one person businesses like the simplicity. That is also why bank personnel like SEPs. A 401(k) plan is more complicated than a SEP. However, the additional complexity is not so great that a person should automatically decide he or she wants to keep the SEP and not roll the SEP-IRA funds into a new 401(k) plan. The 401(k) plan has attractive features which the SEP does not have.

What can a person do with a 401(k) plan that he or she cannot do with a SEP plan?

1. In some income situations the contributions for a person may exceed 25% of compensation. The maximum contribution under a SEP is 25% of eligible compensation. A 401(k) plan has the special rule that the employer is allowed to deduct the amount which the participants have deferred PLUS a contribution of 25% of eligible compensation. For a one person plan, this means the deductible amount may be his or her elective deferral amount of $16,500/$22,500 plus 25% of eligible compensation.
2. In general, a person may borrow up to $50,000 from his or her 401(K) plan. No loan is permissible from a SEP IRA. This loan right is quite valuable to a small business person.
3. A person may serve as the trustee of the 401(k) plan. It is impossible for an individual to be an IRA trustee, including a SEP-IRA trustee. Federal law requires a bank or other regulated corporation entity serve as the IRA custodian/trustee. There is no similar requirement for a 401(k) plan or other qualified plans.
4. An individual may make Designated Roth contributions to the 401(k) plan. This is true even if he or she is ineligible to make Roth IRA contributions because the income limits for Roth IRAs are exceeded. The individual could also "convert" non- Roth funds into the Designated Roth account. This ability to make Designated Roth contributions will be the primary reason a person will want a 401(k) plan rather than a SEP. As time goes on, more people will recognize the value of making designated Roth Contributions to a 401(k) plan. Most likely the SEP rules will never be changed to permit Roth contributions to a SEP.
5. The law imposes a very harsh penalty if a prohibited transaction takes place with respect to a SEP-IRA. The entire account balance is deemed distributed as of the first day of the year in which it occurs. The individual will have to include this amount and pay tax at his or her marginal tax rate. This rate could be as high as 36%. The funds are no longer tax deferred. In contrast, there is no forced distribution if the prohibited transaction takes place within the 401(k) plan. A 15% excise tax must be paid if the prohibited transaction occurs with respect to the 401(k) plan and the prohibited transaction must be un-done.
6. The 401(k) plan can be used to allow a person to convert after-tax dollars from another employer's 401(k) plan into a Roth IRA. The SEP cannot be so used. Example, Jane Doe has $80,000 in a 401(k) plan with employer #1. Of this $80,000, $12,000 is after-tax dollars. She directly rolls over the entire $80,000 into a traditional IRA with your institution. She establishes a 401(k) plan with your institution because she has a small business. She then rolls $68,000 from the traditional IRA into her 401(k) plan. Since the $12,000 of after-tax dollars cannot be rolled into the 401(k) plan. She is now able to convert the $12,000 in the traditional IRA to a Roth IRA and no taxes are owed since these are after-tax funds. It is assumed that if she had any other taxable money within a traditional IRA that those funds also would be rolled into the 401(k) plan.
7. Funds within a 401(k) plan are more easily protected from creditors, if needed, than funds within a SEP IRA.

The above tax benefits create strong reasons for individuals with a SEP plan to establish a 401(k) plan and then roll the SEP funds into the 401(k) plan.

Will an individual be willing to pay an annual administrative fee of $75-$500 to have these additional tax benefits? The only way an institution will find out is to ask its SEP customers. An institution need not charge an administrative fee, but one should be charged. These tax benefits are very valuable and the institution has costs which it should pass on to its users

Email Consulting Guidance – 2018 IRA Contribution Deadline April 15 or April 17?

Q-1 In between trying to get my Deficient RM D customers to make their withdrawals and getting my deceased customers taken care of before the close of day Monday, one of my IT techs wants to know the deadline for prior year contributions for 2018 so she can make sure our system is a set for 2019.

Patriots Day is on April 15th, but usually the day after Patriots Day is something also.

A1 For most U.S. taxpayers the tax filing deadline and the IRA contribution deadline for tax year 2018 is Monday April 15, 2019. However for those states which recognize Patriots Day on April 15th, the tax filing deadline will be extended to April17, 2019, due to the fact that the Emancipation Day holiday is observed on April 16th.

Patriots' Day is April 15th and the "standard" federal tax filing deadline is also April 15th.

For reasons discussed below, I believe the tax filing deadline for a Massachusetts resident is Wednesday April 17th, 2019. The Patriots' Day holiday rule changes the tax filing deadline to April 16th and the Emancipation Day holiday rule changes the deadline to April 17th.

Code section 7503 provides that a tax deadline is extended until the following business day if the original tax deadline falls on a Saturday, Sunday, or legal holiday. A legal holiday includes a legal holiday observed in Washington. D.C.

Emancipation Day in 2019 is Tuesday April 16, 2019. It is a legal holiday in the District of Columbia. It is observed on the 16th when the 16th falls on a weekday. It is observed on the 15th (preceding Friday) if the 16th falls on a Saturday and it is observed on the following Monday (17th) if the 16th falls on Sunday.

I have read that Connecticut, Florida and one other state may also now observe the Patriots' day holiday. I need to do some additional research for these non-Massachusetts states.

Email Consulting Guidance – QDRO or Transfer Incident to a Divorce

Q-1 If a QDRO is required and there are retirement plans at several.different ~providers~rs, some with Roth balances and tax deferred balances, are the parties able to designate which retirement account the QDRO will apply to and whether it be taken from Roth or tax deferred portions?

A-1 In a divorce, the two spouses will negotiate the division of their assets, including their IRAs and other retirement plan assets.

In a divorce there will either be a settlement agreement signed by both parties or if no settlement, a court order will need to define who gets/keeps the retirement assets, including IRAs. The two parties ne·ed to reach a settlement or a judge will need to define in the court order.

QDRO is a term applying to 401(k) and other retirement plans. Qualified Domestic Relations Order.

By definition a QDRO is a court order. Federal law states a person's 401(k) funds are exempt from any creditor (except the IRS), including a former spouse. However, there is a limited exception for divorce situations. If the QDRO rules are met a state court can require the transfer of 401(k) assets within the 401(k) plan from one spouse to the other spouse (the alternate payee). The alternate payee most likely will be subject to the same distribution rules applying to the participant. That is, the alternate payee may not be entitled to an immediate distribution.

A settlement agreement is not sufficient to transfer 401(k) or other pension funds from one spouse to the other spouse. There must be a QDRO.

A transfer incident to a divorce is the term used with respect to IRAs. A state court judge (or pursuant to a settlement agreement) does have the authority to have the IRA assets of one spouse transferred to the other spouse. Such a transfer is not a taxable event.

Many times accountants and attorneys use the term QDRO to include IRA transfers. They should not.

Continued on page 6

There must be a specific QDRO for each retirement plan.

With respect to IRAs, the settlement agreement or the court order must be specific with each to each IRA.

Email Consulting Guidance – HSA Contribution

Q-1 We have a customer who has an HSA but is no longer eligible to contribute to it. She wrote a check at Shopco for some glasses or some item that was not correct and returned it. Shopco refunded her money by doing an electronic credit to that account. So now the account shows a deposit which she can't do. How do we handle this?

A-1 A person who is no longer eligible to make an annual HSA contribution may be eligible to make a rollover contribution or a transfer contribution.

When did the original withdrawal take place? Is she still within her 60 day rollover period? Is she eligible to make a rollover contribution of an HSA distribution and will she so instruct?

If so, the contribution may be treated at a rollover contribution even though it came from Shopco.

If not, the contribution would an excess contribution. She can/must withdraw the excess contribution. The bank will report the contribution as a regular/annual contribution. The distribution is to be reported as the withdrawal of an excess contribution (reason code 2 in box 3 on the Form 1099-SA). Box 2 on the Form 5498-SA should be completed with 0.00 as there were no earnings related to the excess contribution.

Online HSA Contributions and Distributions- A Be Careful Subject For Both the HSA Custodian and the HSA Owner

Some financial institutions will permit HSA owners to make HSA contributions and take HSA distributions online. There are no tax laws requiring or prohibiting such online transactions. However, the HSA custodian will want to define its procedures and then communicate such procedures with its HSA owners. HSA owners will want to understand the tax consequences of their online HSA transactions.

An HSA is a tax preferred account. Most people believe it is the tax preferred account with the best tax benefits. There is tax benefit when a contribution is made to the HSA; there is a tax benefit when the contributions earn income and there is the tax benefit that the withdrawal of HSA funds is tax free as long as the distribution is used to pay a qualified medical expense.

As a tax preferred plan, the IRS requires that the HSA custodian prepare the Form 5498-SA to report the "reportable" contributions and Form 1099-SA to report the "reportable" HSA withdrawals. Such forms are prepared on a person per plan agreement basis.

The IRS takes the administrative approach that all HSA distributions are taxable and subject to the 20% penalty tax unless the individual is able to explain why the distribution is not taxable and/or why the 20% tax is not owed.

The HSA custodian has the duty to report all HSA withdrawals on an individual's Form 1099-SA with the correct reason code with two exceptions. An HSA transfer distribution is not required to be reported on the Form 1099-SA. A mistaken HSA distribution is also not required to be reported on the Form 1099-SA.

HSA software has been written to give HSA custodians the ability to code or classify a distribution as non-reportable. The HSA custodian must be careful and should understand that the use of this code must be limited.

We have had a number of calls where the HSA custo-

Continued on page 7

The Pension Digest

Online HSA Contributions,
Continued from page 6

dian is now realizing that HSA owners during 2018 made online HSA distributions which because of the coding were classified as non-reportable when in reality such distributions must be reported on the person's Form 1099-SA. A real tax reporting mess exists.

In order to code a distribution as non-reportable certain requirements must be met. There should be an HSA transfer form or the distribution check should confirm that the funds were transferred. Or, there should be paper work confirming there was a mistaken distribution by the HSA owner and that the HSA custodian is willing to accept the repayment of the mistaken distribution. The HSA custodian must define for itself when it will agree that a mistaken distribution occurred. CWF's position is– not all payments by the health plan qualify as mistaken distributions and not all refund checks related to the return of a purchased product qualify as a mistaken distribution.

The HSA custodian cannot code a distribution as non-reportable just because that is what the HSA owner (or the tax accountant wants). For example, a distribution does not become non-reportable when a person mistakenly uses their HSA debit card when they wanted to use their personal debit card. The person's withdrawal because it paid a nonmedical expense is taxable unless the person is eligible to make their once per year rollover contribution.

An HSA custodian will want to adopt and communicate with its HSA owners the following HSA procedures.

#1. All HSA contributions will be reported on the HSA owner's Form 5498-SA as an annual contribution unless the person indicates it is a rollover contribution, there is a form showing the contribution is a transfer contribution or there is a form showing the contribution is a repayment of a mistaken distribution.

#2. All HSA distributions will be reported on the HSA owner's 1099-R as a normal HSA distribution (reason code 1) unless the person indicates there was a withdrawal of an excess contribution, the withdrawal occurred when the HSA owner was disabled, there is a form showing the distribution was a transfer distribution or there is a form showing the distribution was a mistaken distribution.

HSA owner should understand that every reportable HSA distribution is to be included in their taxable income unless the person can substantiate why it is not taxable. Form 8889 must be completed. A distribution used to pay a qualified medical expense is not taxable. A distribution which is rolled over is not taxable. A mistaken distribution is not taxable. A transfer distribution is not taxable. All other distributions are taxable and subject to the 20% penalty tax unless an exception applies.

Competing for Contributions,
Continued from page 3

5. Develop a payroll deduction IRA program that can be used by your institution's business customers and also for your institution's staff. As an additional employment benefit, an employer could adopt a plan giving the employer the right to make discretionary matching Roth IRA contributions. For example, for every $500 which an employee contributes to their Roth IRA for a given year, we the employer will make a matching contribution of $50 up to a maximum of $400. The employer contribution is ordinary wage compensation for federal tax purposes.

6. Develop an IRA contribution program that can be used by your institution's business customers and also for your institution's staff. As an additional employment benefit, an employer could adopt a plan giving the employer the right to make discretionary IRA contributions. The employer contribution is ordinary wage compensation for federal tax purposes.

7. Develop a competitive IRA deposit instrument that has a long-term feature. Such IRA deposits can be used to fund the making of mortgages. In the insurance world these IRA deposit instruments are called guaranteed investment contracts. There is a sophisticated formula used to calculate the interest penalty when the longer term deposit instrument is surrendered prior to maturity. In the past the banking regulators have ruled that such investments have risks that should not be taken by banks for safety and soundness reasons. The regulators should rethink their position. The interest rate penalty provision will offer sufficient protection to the IRA custodian against those who surrender a long-term time deposit prior to maturity.

Here are some ideas for increasing 401(k) contributions and profit sharing (old Keogh) contributions.

Continued on page 8

Competing for Contributions,
Continued from page 7

1. Have a plan document ready to be adopted by your client.

2. Render plan administration services or assist the employer in retaining such services.

3. For your institution's own 401(k) plan require that such plan be written to allow as one of the investment options the purchase of your institution's sponsored time deposit.

In summary, a financial institution must be ready to compete for IRA contributions and 401(k) contributions. ·

HSA Owner's Duty to File IRS Form 8889

An HSA owner has a duty to file the Form 8889 (HSAs) in certain situations. There are special rules if a person has more than one HSA as discussed below. A person uses the Form 8889 to determine various tax consequences relating to his or her HSA. The individual reports the contributions made to his or her HSA either by an employer or personally. The individual determines what amount he or she is able to claim as a tax deduction. The individual also reports to what extent, if any, the distributions are taxable and whether or not any amount must be included in income because he or she did remain an eligible individual during a testing period.

A person must file Form 8889 if any of the following applies:

1. Contributions were made to the person's HSA for the year. These contributions could have been made by the individual, the individual's employer or another person or entity. Note: the Form 8889 must be filed even if it was only the employer who made any contributions.
2. Distributions were made from the person's HSA during the year.
3. The individual failed to remain an eligible individual and so must include certain amounts in income.
4. The individual acquired an interest in the HSA because he or she had been designated as a beneficiary and the HSA owner died.

The duty to prepare and file the Form 8889 applies even if the individual (and spouse, if married) is not required to file Form 1040 or Form 1040-NR. In this situation, the individual must prepare and file both the Form 8889 and the Form 1040/Form 1040-NR. A form 8889 must be filed for each HSA.

Example #1. An individual is the HSA owner of two or more HSAs, then he or she must complete a separate Form 8889 for each HSA.

Example #2. An individual is the beneficiary of two or more HSAs, then he or she must complete a separate Form 8889 for each HSA.

Example #3. An individual is the beneficiary of an HSA and he or she has his or her own HSA, then he or she must complete a separate Form 8889 for each HSA.

Example #4. An individual is married and has his or her own HSA and so does the spouse. A separate Form 8889 must be prepared for each spouse and each HSA.

The IRS instructions then require an individual to consolidate the multiple 8889 forms as follows. Enter "statement" at the top of each Form 8889 and complete the form as instructed. Next, complete a controlling Form 8889 combining the amounts shown on each of the statement Forms 8889. The individual is then to attach the statements to his or her tax return after completing the controlling Form 8889.

Why is it so Important to Furnish a Comprehensive HSA FMV Statement?

The obvious answer, the HSA owner and the tax preparer will use the HSA custodian's HSA statement along with other medical expense documentation to prepare their Form 8889. The individual informs the IRS what amount was contributed to their HSA and what withdrawals were made and what are the tax consequences of those withdrawals. Withdrawals used to pay qualified medical expenses are not taxed, they are tax-free. Withdrawals not used to pay a qualified medical expense must be included in the person's income and the 20% penalty is owed unless the HSA owner is age 65 or older or is disabled.

Unlike with IRAs, the IRS does not require the HSA custodian to furnish HSA owners with an HSA FMV statement. But you want to do so for customer service reasons. Furnishing it by January will allow individuals to file their tax returns soon after the IRS opens the tax filing season.