

Who Can Contribute?

UNIVERSAL

April 15th is rapidly approaching, and April 15th is THE deadline for contributions. Traditional IRAs, Roth IRAs, Coverdell education savings accounts (ESAs), and health savings accounts (HSAs) all have an April 15th contribution deadline that excludes any tax extensions. Financial organization personnel can be a little confused with so many different types of plans and so many different types of clients making contributions. Although an account owner must determine whether he is eligible to make a contribution, account administrators should review eligibility requirements for different types of contributions to be able to offer some assistance.

Traditional IRAs

To be eligible to make a Traditional IRA contribution, an individual must satisfy two requirements. First, an individual must be under age 70½. This requirement means that an individual can no longer make contributions to a Traditional IRA for the tax year in which he attains age 70½ or any later years. Remember that an individual attains 70½ exactly six months after his 70th birthday. If an individual attains age 70½ at any time in 2008, he may no longer make a Traditional IRA contribution for 2008. The individual, however, may still make a carryback contribution in 2008 for 2007, the last year he was age-eligible.

The second requirement for Traditional IRA contribution eligibility is that the taxpayer receives compensation (generally income earned in exchange for services performed). Earned income includes wages from an employer or net business income from a business if the individual is self-employed. The earned income requirement may be satisfied by either the IRA holder or, if married and filing a joint federal income tax return, by a spouse. If an individual questions whether income is considered "compensation" for purposes of making an IRA contribution, she should seek the advice of a competent tax professional. Some helpful hints for defining compensation are found in Revenue Procedure 91-18, which gives a safe harbor definition of compensation for purposes of making an IRA contribution. According to the revenue procedure, IRA holders can rely on compensation shown on Form W-2, *Wages and Tax Statement*, in the *Wages, tips, other compensation* box (Box 1 on the 2007 form), subtracting any amounts shown in the *Nonqualified plans* box (Box 11 on the 2007 form), as income eligible for making an IRA contribution.

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*"Live out of your imagination,
not your history."*

—Stephen Covey


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P.O. Box 979, Brainerd, MN 56401
www.ascensus.com

The eligibility to make a Traditional IRA contribution and the eligibility to deduct that contribution are two different issues. See the March 2007 *Retirement Plans Bulletin* article “Eligibility and Deductibility: There is a Difference” for more information on an IRA holder’s ability to take a deduction for a Traditional IRA contribution.

NOTE: If the two eligibility requirements (being under age 70½ and having compensation) are satisfied, the maximum amount that an IRA holder may contribute for 2007 is *the lesser of* the statutory limit of \$4,000 (\$5,000 if the individual is age 50 or older), or 100 percent of eligible earned income. The statutory limit increases to \$5,000 for 2008, plus the additional catch-up contribution of \$1,000 for those who are 50 or older in the contribution year.

Roth IRAs

The eligibility requirements for making Roth IRA contributions have a different focus than those for a Traditional IRA. Congress did not want to make Roth IRAs available to those individuals with large incomes. Therefore, the eligibility requirements are based primarily on a Roth IRA holder’s modified adjusted gross income (MAGI). The instructions for determining MAGI based on tax filing information can be found in IRS Publication 590, *Individual Retirement Arrangements (IRAs)*. Generally, MAGI for Roth IRA purposes is based on the taxpayer’s adjusted gross income from Form 1040 (line 38) or 1040A (line 22) with a few modifications.

As with the Traditional IRA, the Roth IRA rules require the IRA holder to have earned income from services performed that is equal to or greater than the amount of the contribution. Next, the Roth IRA holder’s MAGI cannot exceed certain statutory limits. The MAGI limit is determined by the marital status of the holder.

- ◆ For 2007, single individuals with MAGI of \$99,000 (\$101,000 for 2008) or less can make the maximum Roth contribution. If an individual’s MAGI is between \$99,000 and \$114,000 (\$101,000 to \$116,000 for 2008), the individual can make a reduced contribution. With MAGI over \$114,000 (\$116,000 for 2008), the individual cannot make a Roth IRA contribution.
- ◆ Married couples who file a joint tax return and who have MAGI of \$156,000 (\$159,000 for 2008) or less are each eligible for a full Roth contribution. If the MAGI is between \$156,000 and \$166,000 (\$159,000 to \$169,000 for 2008), each spouse can make a reduced contribution.

With MAGI over \$166,000 (\$169,000 for 2008), neither spouse is permitted to make a Roth IRA contribution.

- ◆ A married couple that files separate tax returns has little chance of making a contribution. If an individual’s MAGI is over \$10,000, the individual cannot make a Roth IRA contribution.

NOTE: If the MAGI eligibility requirements are satisfied, the maximum amount that a Roth IRA holder may contribute for 2007 is *the lesser of* the statutory limit of \$4,000 (\$5,000 if the individual is age 50 or older), or 100 percent of eligible earned income. The statutory limit increases to \$5,000 for 2008, plus the additional catch-up contribution of \$1,000 for those who are 50 or older in the contribution year.

Coverdell Education Savings Accounts

Unlike Traditional and Roth IRAs (for which contribution eligibility is determined based on criteria that apply to the contributor alone) ESAs base contribution eligibility on criteria that apply to two or more individuals: the designated beneficiary (the child) and the contributor(s). Designated beneficiaries generally must be younger than age 18 to be eligible to receive contributions in an ESA. Contributors, in contrast, can be any age and do not have to have earned income to be eligible to contribute to an ESA.

If a contributor does have earned income, however, her income must fall under certain limits to meet eligibility requirements. Any individual whose MAGI does not exceed \$95,000 for single filers, or \$190,000 for joint filers, can make a full contribution to an ESA. Single filers whose MAGIs are between \$95,000 and \$110,000, and joint filers whose MAGIs are between \$190,000 to \$220,000, may only make partial contributions. Filers whose MAGIs exceed these limits cannot make contributions, but other eligible contributors can always contribute to the designated beneficiary’s ESA because any number of contributors can contribute to an ESA for the same designated beneficiary. Nonindividuals, such as businesses, may also make contributions to an ESA and do not fall under any income or profit restrictions. Furthermore, contributions made to a 529 plan, IRA, or employer-sponsored retirement plan have no effect on contribution eligibility or amounts that can be contributed to ESAs.

NOTE: If the ESA eligibility requirements are satisfied, a contributor can make a maximum \$2,000 contribution for each designated beneficiary.

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Health Savings Accounts

Anyone can make an HSA contribution for an HSA owner, including the HSA owner or the HSA owner's employer. The eligibility requirements that an individual must meet to receive a contribution to an HSA are really the eligibility requirements to have an HSA in the first place. To be eligible, an individual must be covered under a high deductible health plan (HDHP). Additionally, an individual cannot be covered under any other health plan that is not an HDHP, cannot be entitled to benefits under Medicare, and cannot be eligible to be claimed as a dependent on another person's tax return. Eligibility is determined on the first day of each month, so if an individual obtains coverage mid-month, he will not be HSA-eligible until the first day of the following month.

Individuals may make a full-year contribution no matter which month in the year they become eligible if an HSA owner maintains eligibility throughout the "testing period." The testing period runs from the last month of the initial eligibility year through the end of the 12-month period following that month.

NOTE: The maximum HSA contribution that an HSA owner can receive from all sources is based on the type of HDHP coverage that the HSA owner has—single or family. The 2007 contribution limits are \$2,850 (\$2,900 for 2008) for an individual who has single coverage and \$5,650 (\$5,800 for 2008) for family coverage. Eligible individuals who are age 55 and older in the contribution year may also make additional HSA contributions (catch-up contributions) of \$800 for 2007 and \$900 for 2008.

A Few Simple Questions

As mentioned earlier, the contributor is responsible for determining eligibility to make a contribution. Financial organizations may, however, be prepared with a few questions to assist the contributor. Generally, if the contributor answers "yes" to the questions, she will be eligible to make the contribution.

Traditional IRA Holder

- ◆ Did (or will) you receive any salary or eligible compensation during the tax year for which the contribution is made?
- ◆ Will you be under age 70½ at the end of the tax year for which the contribution is made?

Roth IRA Holder

- ◆ Did (or will) you receive any salary or eligible compensation during the tax year for which the contribution is made?

- ◆ Did (or will) you (and your spouse, if applicable) earn less than the maximum permitted MAGI during the tax year for which the contribution is made?

ESA Contributor

- ◆ Is the designated beneficiary under age 18 at the time that the contribution is made?
- ◆ Did (or will) you (and your spouse, if applicable) earn less than the maximum permitted MAGI during the tax year for which the contribution is made?

HSA Contributor

- ◆ Is the HSA owner covered by an HDHP?

For eligibility, the following answers must be "no"

- ◆ Is the HSA owner covered by any other health plan that is not an HDHP and that provides coverage for any benefit that is covered under the HDHP (with limited exceptions)?
- ◆ Is the HSA owner enrolled in Medicare?
- ◆ Is the HSA owner eligible to be claimed as a dependent on another person's tax return?

Ascensus Can Help

If a financial organization wishes to assist clients in determining contribution eligibility, it may want to turn to Ascensus for help. Ascensus offers eligibility forms and brochures explaining contribution eligibility. Call Ascensus customer service at 800-346-3860, option 2, or visit the website at www.ascensus.com for more information.

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Good Friday Closing

The offices of Ascensus, including the *800 Consulting* service, will be closed on Friday, March 21, 2008, in observance of Good Friday. The offices and all services will reopen on Monday, March 24, 2008.



Let's Get Rolling: Part I

UNIVERSAL

Rollovers certainly are one of the most popular, and definitely one of the most confusing, methods of moving money between retirement plans. A rollover is a tax-free, reportable movement of cash or other assets from one retirement savings vehicle to another. It sounds simple enough, but just when financial organizations are sure that they have mastered the rules and restrictions, Congress or the IRS introduces something new or allows something different.

In the past, rollovers were available to IRA holders, employer-sponsored plan participants, and spouse beneficiaries. Now certain rollovers, with their own special rules, are also available to nonspouse beneficiaries. This three-part article will lead financial organizations on a review of who can perform rollovers, where distributions can roll over to, and what rules must be followed to accomplish the transaction. Part I examines rollovers originating in IRA plans and made by IRA holders. Plan participants rolling assets from employer-sponsored plans will be discussed in the April *Retirement Plans Bulletin* in Part II. Part III, in May, will explore the beneficiary (both spouse and nonspouse) distribution option to move inherited plan assets (IRA or employer-sponsored plan) through a rollover.

This diagram gives a brief overview of the rollover transactions discussed in the current and upcoming articles.

IRA Holder Rollovers

A rollover begins as a reportable distribution of the assets from a Traditional IRA (including a Traditional IRA holding SEP employer contributions), Roth IRA, or SIMPLE IRA. Although the IRA holder likely has a destination in mind, he does have a choice of where to roll over those assets.

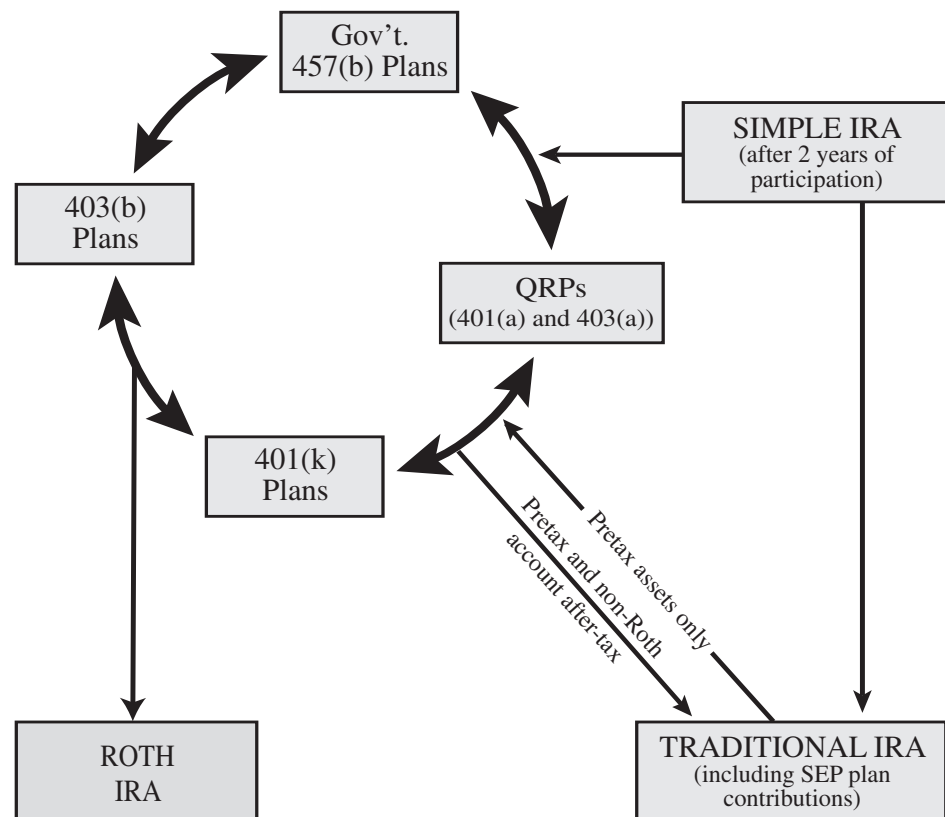
NOTE: The movement of existing assets, other than a current-year contribution, from a Traditional IRA to a Roth IRA is a conversion, not a rollover, and will not be discussed in this article.

IRA to IRA

IRA rollovers may occur between Traditional IRAs, Roth IRAs or between Traditional and SIMPLE IRAs (with certain restrictions). An IRA holder must be aware of and comply with the regulations that govern this movement in order to retain the tax-deferred status of the assets. For example, within 60 days of receipt of the assets, the IRA holder must contribute the assets into another IRA to complete a rollover contribution. Additionally, an IRA holder is allowed to take only one distribution from any one IRA and roll it over within a 12-month period.

Sixty-Day Rule

The individual generally has 60 days from the day she receives the distribution to complete the rollover. Day one is the day after she receives the distribution. Usually,



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no exceptions apply to the 60-day time period. For certain rollovers related to failed attempts to purchase a first-time home, however, this period is extended to 120 days. In cases where the 60-day period expires on a Saturday, Sunday, or legal holiday, IRC Sec. 7503 allows an IRA holder to execute the rollover on the following business day. And the IRS may waive the 60-day time limit for rollovers resulting from hardship, casualty, disaster, or other events beyond the reasonable control of the distribution recipient.

One Rollover Per Year Rule

For each IRA an individual owns, he is allowed to roll over one IRA distribution every 12 months. In addition, according to IRS Publication 590, *Individual Retirement Arrangements (IRAs)*, IRA holders may not roll over the same IRA assets more than once within one 12-month period, which begins on the date of distribution. For certain rollovers related to failed attempts to purchase a first-time home, however, the 12-month rule does not apply.

Irrevocable Rollover Designation

Since March 20, 1986, any time that assets are rolled into an IRA, the IRA holder must sign a designation indicating that the contribution is a nonrevocable rollover contribution. This designation is also required when the assets are coming from an employer-sponsored retirement plan.

SIMPLE IRA

Savings incentive match plan for employees of small employers (SIMPLE) IRA plans may be rolled over to other SIMPLE IRAs at any time, without penalty. SIMPLE IRA assets also may be rolled, after a two-year participation period, into Traditional IRAs, qualified plans (under 401(a) or 403(a)), 403(b) plans, and governmental 457(b) plans). The two-year period begins with the first day SIMPLE IRA plan contributions are deposited in the individual's SIMPLE IRA.

SIMPLE IRA distributions taken within the two-year period are subject to a 25 percent early distribution penalty. But if the SIMPLE IRA holder is age 59½ or older or can claim any other exemption from the early distribution penalty that applies to SIMPLE IRA plans, the 25 percent penalty does not apply.

Note that SIMPLE IRA assets may not be distributed and rolled over into a Traditional IRA or an employer-sponsored plan within the first two years of participation, even if one of the exceptions to the early distribution penalty under IRC Sec. 72(t) applies. The two-year waiting period does not apply for SIMPLE IRA-to-SIMPLE IRA rollovers.

Employer-sponsored plan assets and Traditional and Roth IRA assets may not be rolled over to SIMPLE IRAs. The only assets that a SIMPLE IRA can hold are other SIMPLE IRA plan assets.

IRA to Employer-Sponsored Plan

Beginning in 2002, any pretax assets held in Traditional IRAs can be rolled into 401(a) or 403(a) qualified plans, 403(b) plans, or governmental 457(b) plans. If a distribution includes both pretax and after-tax amounts, the portion that is rolled over is treated as consisting first of pretax amounts. IRA holders may not roll over after-tax (nondeductible) contributions from an IRA to a qualified plan, 403(b), or governmental 457(b) plan. Individuals who satisfy the two-year period for SIMPLE IRAs may roll SIMPLE IRA assets to a qualified plan, a 403(b) plan, or a governmental 457(b) plan.

Some IRA administrators may still remember that before 2002, only employer-sponsored plan assets that had rolled into a "conduit IRA" were eligible to roll from a Traditional IRA back into an employer-sponsored plan. A conduit IRA is an IRA that holds only rolled over assets from an employer-sponsored plan and no other assets. A conduit IRA generally serves as a temporary "holding tank" for distributed retirement plan assets preserving the tax-deferred status of the assets, and allowing an individual to later roll over the assets back into another employer-sponsored retirement plan. Because of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA), now any Traditional IRA assets, even those that originated as regular contributions, may be rolled over to an employer-sponsored plan that will accept them.

Next Month...

The *Retirement Plans Bulletin* will continue the examination of the who, where, and how of rollovers in the April edition. Next month's article will discuss employer-sponsored plan participants and their rollover options.

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Collecting Delinquent Contributions

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The Department of Labor's Employee Benefits Security Administration (EBSA) representatives have been reading the fine print in the employer retirement plans that they are reviewing. One significant find has resulted in the release of a Field Assistance Bulletin, FAB 2008-01. EBSA is concerned that plan documents sometimes state that financial organizations serving as plan trustees do not have any responsibility to monitor or collect delinquent employer and employee contributions. Additionally, the documents often do not assign this responsibility to another trustee or fiduciary and, sometimes, are completely silent about the issue. EBSA is concerned that no one is assigned to pursue these plan claims, although ERISA requires that it be done. This is the issue that EBSA addresses in FAB 2008-01.

Who Is Responsible?

ERISA requires that every plan be established using a "written instrument." Fiduciaries that administer the plan are named in that "instrument." Certain plan fiduciaries have the ability to name plan trustees, and EBSA is clear that a plan trustee is the entity typically responsible for enforcing any claim against a retirement plan. When an employer fails to make a required or timely contribution to a plan, the contribution becomes delinquent (e.g., failing to timely deposit withheld employee deferrals). The plan now has a claim against the employer and that claim is a plan asset.

The employer may properly assign the duty to pursue the claim and collect the delinquent contributions. According to ERISA, a discretionary plan trustee, a directed trustee, or an investment manager must be responsible for the collection. When multiple trustees are holding plan assets, the duty may be assigned to just one of the trustees.

If a trustee responsible for enforcing claims is not properly named, then any fiduciary with the authority to hire and monitor trustees must make sure that this duty is assigned or it may be responsible for any resulting plan losses. Additionally, if a plan trustee that is not directly responsible for overseeing contributions is aware that no one else has been assigned this task, it must take remedial action or risk co-fiduciary liability.

Action Check

Finally, the FAB does discuss various correction methods available to the trustee/fiduciary. EBSA notes that the trustee/fiduciary must make a decision on a correction procedure based on the facts and circumstances of the failure.

Plan sponsors and employers should check plan documents to make sure that plan responsibilities have been properly assigned and agreed to.

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Thank You Fall Forum Attendees



The 23rd annual *Fall Forum* series is over, but the memories of this exceptional event live on. Ascensus and the staff of the *Retirement Plans Bulletin* would like to thank all the individuals who attended *Fall Forum* this year and who contributed to the excellence of the nation's foremost retirement plan conference. Across the country, retirement plan professionals are making daily use of the information and training they received at *Fall Forum* regarding Traditional and Roth IRAs, SEP and SIMPLE plans, health savings accounts (HSAs), Coverdell education savings accounts (ESAs), 401(k) plans, 403(b) plans, and 457(b) plans.

The retirement plan industry is constantly changing to incorporate new legislation and new IRS and Department of Labor regulations. Financial organizations that are at the top of the industry make sure they budget each year for ongoing education to keep up with industry trends and rule changes. Planning has already begun for the most comprehensive educational opportunity for 2008. Make sure you plan ahead to attend the *Fall Forum* location of your choice.

Chicago, IL
Hyatt Regency Chicago
September 8-10, 2008

San Antonio, TX
Hyatt Regency San Antonio
September 22-24, 2008

Baltimore, MD
Baltimore Marriott Waterfront Hotel
October 13-15, 2008

San Diego, CA
Manchester Grand Hyatt San Diego
November 10-12, 2008

Please call Ascensus customer service at 800-346-3860, or visit our website, www.ascensus.com, for more information or to make reservations.

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Sole Proprietor Plan Calendar: March

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Sole proprietors are approaching the April 15 tax return due date and are focusing on wrapping up their 2007 tax years. This includes figuring out how much they will contribute to their retirement plans. Last month, we discussed the contribution deduction limit for sole proprietors, which is generally 25 percent of compensation. Going hand-in-hand with the deduction limit is the contribution limit for 2007, which is the lesser of 100 percent of compensation or \$45,000 (IRC Sec. 415 limit). But how does a sole proprietor know exactly what his compensation is for calculating his qualified retirement plan contribution or deduction limit?

Compensation for Plan Deduction Limit

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) amended the IRC Sec. 404(a) compensation definition that is used to calculate an employer's maximum deductible contribution to a qualified retirement plan. Elective deferrals are now included in the compensation used to calculate the maximum deductible contribution. Once the maximum deductible contribution is determined (using aggregate compensation that includes elective deferrals), the actual contribution amount should exclude the aggregate elective deferral amount.

Compensation for Self-Employed Individuals

Determining an unincorporated, self-employed individual's compensation for contribution purposes is trickier than determining compensation for common-law employees. The starting point for identifying compensation for contribution purposes on behalf of a self-employed individual is to determine the individual's earned income or net earnings from self-employment. Depending on the individual's type of self-employment, he will use one of the following forms to determine his net earnings for a specific year.

- ◆ A sole proprietor must file a Schedule C, *Profit or Loss From Business*, (an attachment to IRS Form 1040) to report the net earnings from his business during the year.
- ◆ Farmers file a Schedule F, *Profit or Loss From Farming*, (an attachment to IRS Form 1040) to report net income from farming.

Once an individual has determined his net earnings from self-employment, he must make several adjustments to this amount before he can determine the plan contribution.

Contribution Calculation

QRPs and SEP Plans

The self-employed individual who maintains an Individual(k) or SEP plan must subtract one-half of her self-employment taxes and adjust the net earnings amount to factor out plan contributions that will be made on her own behalf (IRC Sec. 401(c)(2)(A)(vi)). The resulting figure is often referred to as the individual's adjusted net business income (ANBI).

Once an individual has determined her ANBI for the plan year, she may generally determine the contribution to be made on her own behalf by applying the plan's allocation formula to her ANBI or the IRC Sec. 401(a)(17) compensation cap (whichever is less) in the same manner as it is applied to common-law employees' wages. The compensation cap is \$225,000 for 2007 and \$230,000 for 2008.

Step 1: Determine the net business income (NBI) from line 31, "Net profit or (loss)," of the employer's 2007 Schedule C or line 36, "Net farm profit or (loss)," of the 2007 Schedule F.

Step 2: Modify the NBI by subtracting one-half of the employer's self-employment (SE) tax as determined on the employer's Schedule SE, *Self-Employment Tax*.

Step 3: Calculate the adjusted NBI (ANBI) by dividing the modified NBI (from Step 2) by one (1) plus the desired contribution percentage (expressed as a decimal, e.g., $1 + 25\% = 1.25$).

Step 4: To determine the amount of the contribution, multiply the contribution percentage by the *lesser of* the ANBI (from Step 3) or the compensation cap.

EXAMPLE: Olivia, a sole proprietor, wants to make a 25% contribution to her profit sharing plan for 2007. Olivia's NBI from her Schedule C is \$300,000. From her Schedule SE, Olivia determines that one-half of her SE tax is \$9,411.

Step 1: Determine NBI

$$\text{NBI} = \$300,000$$

Step 2: Modify NBI by subtracting one-half of SE tax.

$$\$300,000 - \$9,411 = \$290,589$$

Step 3: Calculate ANBI by dividing modified NBI by one plus the contribution percentage of 25%.

$$\$290,589 \div 1.25 = \$232,471$$

Step 4: Multiply 25% by the *lesser* of the ANBI of \$232,471 or the 2007 compensation cap of \$225,000.

$$.25 \times \$225,000 = \$56,250$$

Even though Olivia's 25% calculation results in a \$56,250 contribution, the law limits the maximum 2007 contribution to \$45,000. So, \$45,000 (plus deferrals) is the most that Olivia can contribute to her plan account for 2007.

SIMPLE IRA Plans

The contribution calculation for a sole proprietor maintaining a SIMPLE IRA plan is different from the above steps for profit sharing (Individual(k)) and SEP plans. The compensation definition for sole proprietors with SIMPLE IRA plans is defined as net earnings from self-employment under IRC Sec. 1402(a), without regard to deductions that apply for the employer's own SIMPLE IRA plan contribution for the year (IRC Sec. 408(p)(6)(A)(ii)). The IRC Sec. 401(a)(17) compensation cap (\$225,000 for 2007) only applies to SIMPLE plans when the employer chooses to make the two percent nonelective contribution to all eligible employees.

Step 1 is the same as the calculation for Individual(k) and SEP plans.

Step 1: Determine the net profit from line 31 of the employer's 2007 Schedule C or line 36 of the 2007 Schedule F.

Step 2: Determine one-half the contribution rate for the Old Age Survivors and Disability Insurance (OASDI) plus the portion of Medicare that represents the Hospital Insurance (HI) rate.

$$\frac{\text{OASDI} + \text{HI}}{2}$$

According to the *2006 OASDI Trustees Report*, for 1990 and later years, the OASDI rate is 12.4 and the HI rate is 2.9.

$$\frac{12.4 + 2.9}{2} = \frac{15.3}{2} = 7.65$$

Step 3: Multiply the net profit from Step 1 by the percentage determined in Step 2.

Step 4: Subtract the result of Step 3 from the amount determined in Step 1. The result is the compensation on which the self-employed individual will base his SIMPLE IRA contribution.

Step 5: Determine the maximum matching contribution based on the adjusted compensation and the amount deferred.

Step 6: Add deferrals and matching contributions.

EXAMPLE: Drew, age 40, owns his own business, maintains a SIMPLE IRA plan, and has elected to make a 3% matching contribution for 2007. Drew's income from line 31 of his IRS Schedule C is \$50,000. To calculate the compensation for determining his 2007 SIMPLE IRA plan contribution, Drew follows these steps.

Step 1: Determine Schedule C compensation: \$50,000

Step 2: $15.3\% \div 2 = 7.65\%$

Step 3: $\$50,000 \times 7.65\% = \$3,825$

Step 4: $\$50,000 - \$3,825 = \$46,175$

Step 5: Determine matching contribution:
 $\$46,175 \times 3\% = \$1,385$

Step 6: Drew's maximum 2007 SIMPLE IRA plan contribution would be \$10,500 (deferral) + \$1,385 (3% match on \$46,175) for a total contribution of \$11,885.

Employer matching contributions for sole proprietors are not treated as elective deferrals and therefore need not be aggregated with their deferral amounts. Without this provision, sole proprietors would be required to aggregate their deferrals and employer matching contributions, which would limit them to the maximum SIMPLE IRA plan deferral limit.

Summary

Although tax advisors and accountants are typically responsible for calculating contribution amounts for unincorporated sole proprietors, financial organization personnel that understand how contributions are calculated can provide a better customer service to sole proprietor clients who have questions about their retirement plans. Financial organizations assisting sole proprietors with these questions can also find helpful information in the IRS' Publication 560, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, available on the IRS website: www.irs.gov.

QRP FOCUS



Eric Malone
FEATURED CONSULTANT

Please send topics for Ascensus' QRP Focus column to the following address: Editor, *Retirement Plans Bulletin*, Ascensus, Inc., P.O. Box 979, Brainerd, MN 56401. The editor does not guarantee that questions will appear in the column and regrets that no personal responses can be sent.

FOCUS ON ADP/ACP TESTING EXCESSES

Q What is the deadline to have average deferral percentage (ADP) and average contribution percentage (ACP) test excesses removed from a 401(k) plan to avoid the 10 percent employer excise tax?

A For 2007 plan years, ADP/ACP excesses must be removed by 2½ months following the plan year end to avoid the employer 10 percent excise tax. In addition, as a result of the Pension Protection Act of 2006 (PPA) and IRS proposed regulations on automatic contribution arrangements, plans that adopt a qualified automatic contribution arrangement (QACA) or an eligible automatic contribution arrangement (EACA) for 2008 plan years or later, have 6 months following the plan year end to distribute ADP/ACP excesses to avoid the 10 percent employer excise tax.

Q When are ADP/ACP excesses taxable to the participant?

A For 2007 plan years, if ADP/ACP excesses are paid out within 2½ months following the plan year end, the excess and earnings are taxable to the participant in the year deferred. If ADP/ACP excesses are paid out after 2½ months following the plan year end, the excess and earnings are taxable to the participant in the year distributed. PPA also made changes to the taxation of ADP/ACP excesses. Effective for 2008 plan years and beyond, ADP/ACP excesses are taxable in the year distributed regardless of when removed from the plan.

Q Do you have to calculate gap period earnings on ADP/ACP excesses for 2007 and later years?

A Plans must calculate and distribute gap period earnings for 2006 and 2007 plan year ADP/ACP excesses as a result of the final 401(k)/(m) regulations. PPA eliminated the gap period earning requirements for 2008 and later plan years.

Q What federal tax withholding applies to ADP/ACP excesses?

A For 2007 plan year ADP/ACP excesses that are paid out within 2½ months following the plan year end, federal withholding does not apply. For 2007 plan year ADP/ACP excesses that are paid out after 2½ months following the plan year end, 10 percent federal withholding applies, but can be waived by the participant. For 2008 plan years, 10 percent federal withholding will apply, but can be waived by the participant regardless of when the distribution occurs. Excesses for 2008 plan years are taxable in the year of distribution.

Q What if the plan fails to distribute an ADP/ACP excess within 12 months after the plan year end?

A If a plan fails to distribute an ADP/ACP excess within 12 months following the plan year end, the plan is deemed to have incurred an operational failure. The IRS outlines corrective measures for certain operational failures, such as the failure to distribute ADP/ACP excesses within 12 months after plan year end, in Revenue Procedure 2006-27.

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IRA Advisor



Tammy Schultz

FEATURED CONSULTANT
Ascensus 800 Consulting Service

Please send questions for Ascensus' IRA Advisor column to the following address: Editor, *Retirement Plans Bulletin*, Ascensus, Inc., P.O. Box 979, Brainerd, MN 56401. The editor does not guarantee that questions will appear in the column and regrets that no personal responses can be sent.

Q Our client is asking if his employer plan is eligible to be rolled to an IRA. The employer told him that the plan is qualified under 401(a). Is that plan eligible to be rolled over?

A Yes, assuming an eligible rollover distribution, the plan assets are eligible for rollover to a Traditional IRA. Eligible employer-sponsored retirement plans include qualified plans under 401(a) or 403(a), 403(b) plans, and governmental 457(b) plans.

Effective January 1, 2006, employers can incorporate a qualified Roth contribution program into their 401(k) and 403(b) plans. If the participant is eligible to take a distribution, those Roth assets may be rolled over to a Roth IRA.

Beginning with distributions made after January 1, 2008, participants can directly roll over/convert non-Roth retirement plan assets (pretax and after-tax) to Roth IRAs. The eligible employer-sponsored plans listed above qualify for this movement of assets.

Q Are conversions from Traditional IRAs to Roth IRAs subject to the 10 percent early distribution penalty?

A No, a conversion is a taxable movement of money from a Traditional or SIMPLE IRA (after completing the 2-year wait) to a Roth IRA. Even though the amount converted is generally taxable, if the IRA owner is under age 59½, he is not penalized. If the assets are not held in the Roth for five years and the IRA owner is under age 59½ (with no other exceptions), he will be penalized for the distribution of those conversion assets.

Q What is an “in-kind” distribution?

A An “in-kind” distribution occurs when the trustee/custodian distributes the actual investment (e.g., stocks, bonds, mutual funds, real estate) from the IRA instead of liquidating the assets and distributing cash. For example, Joe Smith invests his IRA contributions and earnings at ABC Bank in XYZ company stock. While the stock is held at ABC bank, it is titled “ABC Bank as trustee for Joe Smith’s IRA.” When Mr. Smith takes an in-kind distribution, the titling of the stock would change to “Joe Smith.” This distribution would be a reportable event for Mr. Smith and he would receive an IRS Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.* The value of the stock on the date of distribution is the amount reportable on the Form 1099-R.

Amounts distributed in-kind from an IRA or from a qualified retirement plan are generally eligible to be rolled over. IRS Publication 590, *Individual Retirement Arrangements (IRAs)*, states that “if property is distributed to you from an IRA and you complete the rollover by contributing property to an IRA, your rollover is tax free only if the property you contribute is the same property that was distributed to you.” This means that the same property distributed from the IRA must be rolled over to qualify as an eligible rollover. For example, if Mr. Smith (from the previous example) decides to do a rollover, he must roll over XYZ company stock. Rollovers from employer-sponsored plans do not have this requirement.

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