

2012 Cost-of-Living Adjustments

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The IRS issued news release IR-2011-103 on October 20, 2011, containing the cost-of-living adjustments (COLAs) for 2012. COLAs affect the administration of IRAs and employer-sponsored retirement plans, and the deferral limits for 401(k) plans, 403(b) plans, 457(b) governmental plans, and SIMPLE plans. Note that many of the plan limitations will change for 2012 because the increase in the cost-of-living index met the statutory thresholds that trigger their adjustment.

The Social Security Administration has also issued its benefit increases for 2012, which include an increase in the adjusted taxable wage base.

Following are the limitations for 2012.

Employer-Sponsored Retirement Plans

Cost-of-Living Adjustments		
	2012	2011
Annual Additions Limit	\$50,000	\$49,000
Compensation Cap	\$250,000	\$245,000
Defined Benefit Limit	\$200,000	\$195,000
Highly Compensated Employee (HCE)	\$115,000	\$110,000
Key Employee Officer Amount	\$165,000	\$160,000
Minimum Compensation for SEP Plans	\$550	\$550
402(g) Salary Deferral Limit	\$17,000	\$16,500
Catch-Up Contribution Limit	\$5,500	\$5,500
SIMPLE Salary Deferral Limit	\$11,500	\$11,500
SIMPLE Catch-Up Contribution Limit	\$2,500	\$2,500
Taxable Wage Base	\$110,100	\$106,800

Traditional and Roth IRA Plans

Annual limitations for IRA contributions, modified adjusted gross income (MAGI) limits for IRA contribution deductibility and Roth IRA eligibility, and MAGI limits for those seeking an income tax credit for retirement saving contributions have slightly different indices than those used for determining COLAs for employer plans. Some adjustments have been made for 2012.

The IRS news release did not increase the Traditional/Roth IRA contribution limit for 2012, which currently is \$5,000 (plus \$1,000 for catch-up contributions, which are not subject to COLAs). The 2012 COLAs are as follows. Note that there are some changes in the MAGI limits.

2012 Cost-of-Living Adjustments

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*"When chill November's surly blast
make fields and forest bare."*

—Robert Burns


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Traditional IRA Deduction MAGI Ranges

- ◆ Single active participant: \$58,000–\$68,000 (\$56,000–\$66,000 for 2011)
- ◆ Married active participant filing a joint income tax return: \$92,000–\$112,000 (\$90,000–\$110,000 for 2011)
- ◆ Married active participant filing a separate income tax return: \$0–\$10,000
- ◆ Spouse of an active participant: \$173,000–\$183,000 (\$169,000–\$179,000 for 2011)

Roth IRA Contribution MAGI Ranges

- ◆ Single individual: \$110,000–\$125,000 (\$107,000–\$122,000 for 2011)
- ◆ Married individual filing a joint income tax return: \$173,000–\$183,000 (\$169,000–\$179,000 for 2011)
- ◆ Married individual filing a separate income tax return: \$0–\$10,000

Saver's Tax Credit

The indexed adjusted gross income limits associated with the saver's income tax credit for IRA contributions and deferrals in retirement plans have been increased and are listed below.

2012 Adjusted Gross Income*						Applicable percentage
Joint return		Head of household		All other cases		
Over	Not over	Over	Not over	Over	Not over	
	\$34,500		\$25,875		\$17,250	50
34,500	37,500	25,875	28,125	17,250	18,750	20
37,500	57,500	28,125	43,125	18,750	28,750	10
57,500		43,125		28,750		0

*Adjusted gross income includes foreign earned income and income from Guam, American Samoa, North Mariana Islands, and Puerto Rico.



Test Your Knowledge – Answers to Last Month's Puzzle

Thank you to everyone who participated in last month's crossword puzzle. Five winners were randomly drawn from correct responses Ascensus received before the deadline and each will receive one free Ascensus blanket.

Congratulations to the winners!

Gina Fenwick

Cedar Point Federal Credit Union

Sara Karr

American Bank of the North

Eva Kreps

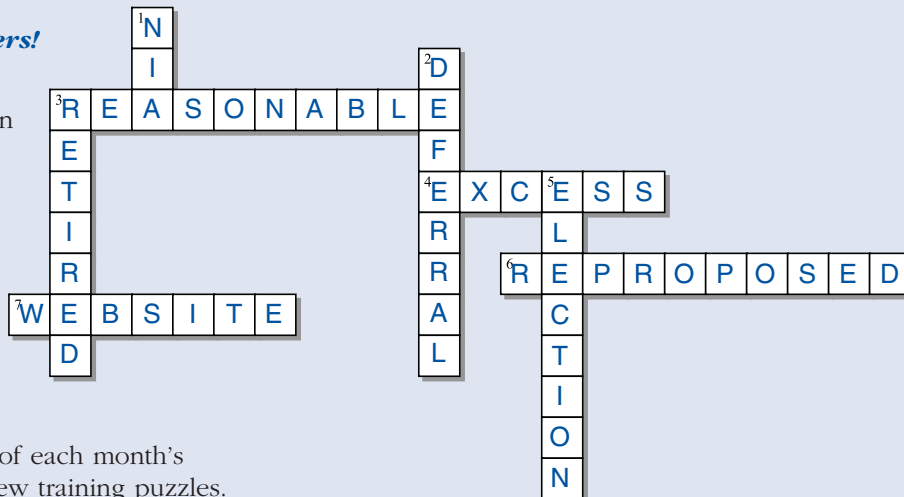
First Merchants Trust Company

Daniella McChesney

Adams Bank & Trust

Nancy Williams

ViewPoint Bank



Be sure to check the last page of each month's *Retirement Plans Bulletin* for new training puzzles.

Guidance on the Second Restatement Cycle for Pre-Approved Plan Documents

UNIVERSAL

On October 5, 2011, the IRS released Revenue Procedure (Rev. Proc.) 2011-49. Rev. Proc. 2011-49 amends IRS Rev. Proc. 2007-44, which established a program consisting of six-year restatement cycles for qualified retirement plans established using prototype and volume submitter plan documents (collectively called pre-approved plan documents). Under Rev. Proc. 2007-44, document sponsors of pre-approved plans must submit applications for opinion and advisory letters for new plan documents during a specified time frame within a six-year cycle. The first six-year cycle began in 2005 and generally ended in 2010. The resulting plan documents reflected legislative, regulatory, and other technical changes through 2004 and became known as the “EGTRRA” plan documents. “EGTRRA” is an acronym derived from the major piece of legislation reflected in the revised plan documents—the Economic Growth and Tax Relief Reconciliation Act of 2001.

Second Six-Year Cycle Begins

The second six-year cycle began on February 1, 2011, and the plan submission process ends on January 31, 2012. In other words, the submission period for plan document providers to apply for opinion and advisory letters on their own behalf and on behalf of pre-approved document sponsors that use their plans will end on January 31, 2012. The IRS will have approximately two years from January 31, 2012, to review and approve pre-approved plans and issue approval letters.

Revisions to EGTRRA plan documents will include those technical changes that generally became effective during the period beginning in 2005 and ending in 2010. The Pension Protection Act of 2006 (PPA) provided the most significant changes to retirement plans during this period of time and so this cycle is being called the “PPA restatement.” Other major items that will be addressed in PPA plan documents include

- ◆ final regulations under IRC Section 415,
- ◆ the Heroes Earnings Assistance and Relief Tax Act of 2008,
- ◆ the Worker, Retiree, and Employer Recovery Act of 2009, and
- ◆ guidance related to in-plan Roth rollovers.

A “Cumulative List” of changes in legislation, regulations, and other guidance that the IRS will consider when reviewing and approving PPA plan documents for the current cycle is provided in IRS Notice 2010-90 (<http://www.irs.gov/pub/irs-drop/n-10-90.pdf>).

In addition to the Cumulative List, pre-approved plan document providers will also be updating their plan documents based on the IRS’ sample plan language provided in its Listing of Required Modifications and Information Packages (LRMs) (http://www.irs.gov/pub/irs-tege/dc_lrm1011.pdf; http://www.irs.gov/pub/irs-tege/coda_lrm1011.pdf) and Rev. Proc. 2011-49 (<http://www.irs.gov/pub/irs-drop/rp-11-49.pdf>). The LRMs contain sample plan language that may (and in some cases must) be used when writing the PPA plan documents.

Rev. Proc 2011-49 also modifies and supersedes Revenue Procedure 2005-16 and details the broad provisions outlining pre-approved plans and the submission process for the plan documents.

Pre-Approved Provisions

Rev. Proc. 2011-49 makes many changes to the requirements of pre-approved plan documents. Most notable among them involve multiple employer plans. Employers that wish to establish a multiple employer plan using an EGTRRA pre-approved plan document are required to use a volume submitter plan. The prohibition against using a PPA prototype plan document has now been removed, allowing multiple employer plans to be established using PPA prototype plan documents upon IRS approval. (Multiemployer plans must still use an individually designed document.)

Guidance on Restatement Cycle

Continued on Page 4

In addition, the list of features or plan types that may *not* be included in pre-approved plans has been expanded to include combined defined benefit and 401(k) plans, commonly referred to as “DB/k” plans, “hybrid” defined benefit plans, and pension and annuity plans that provide for medical and other benefits to retired employees.

Amendment and Ongoing Maintenance

Rev. Proc. 2011-49 clarifies and updates a number of issues relating to the IRS’ interim amendment requirements, including specifying the documentation needed for amendments adopted by pre-approved document sponsors on behalf of their adopting employers.

Plan document providers who adopt an interim amendment on behalf of their employer plan clients will need to document that adoption and will need to provide the date of adoption to their employer plan clients along with a copy of the interim amendment. The requirement applies only to interim amendments that are adopted at the plan document provider level and that do not require a signature by the employer. This new requirement is effective for any interim amendments adopted on or after **October 31, 2011**. If a plan document provider has adopted the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) amendment by October 31, 2011, there is nothing further to do at this time to meet this requirement.

Remedial Amendment Cycle

Once PPA plan documents are approved by the IRS, employers will have approximately two years to restate their current plans onto the PPA plan documents to complete the IRS’ second six-year cycle and to avoid having to enter the IRS’ correction program. The IRS will provide the exact PPA restatement deadline in future guidance.

Effective Date

Rev. Proc. 2011-49 is effective October 31, 2011. While the majority of the rules contained in the revenue procedure deal only with the new PPA plan documents, there are several provisions that will affect the way existing EGTRRA plans are maintained. These items will be described in more detail upon further analysis. ❖

What You Need To Do

With the IRS submission deadline of January 31, 2012, your organization should contact Ascensus as soon as possible so that you are included in the submission to the IRS.

By contacting an Ascensus representative now, you can

- ◆ discuss your current document,
- ◆ receive information on what you need to submit to Ascensus, and
- ◆ register to be on our contact list for future information and educational opportunities with Ascensus.

While the actual restatement may seem a long way off, you have only a short time to ensure that your organization will continue to have compliant qualified plan documents.

Contact Ascensus Today

Contact your Ascensus Sales Representative today at 800-346-3860
or email us at sales.support@ascensus.com.



Bits n' Pieces

Reposted at the IRS website are several previously issued 2011 tax year forms that are used to report transactions involving employer retirement plans, IRAs, health savings accounts (HSAs), medical savings accounts (MSAs), and Coverdell education savings accounts (ESAs). Also posted are draft versions of several 2012 forms that have not yet been officially released.

Reposted 2011 forms

The 2011 forms listed immediately below were issued during the first quarter of 2011. Upon examination of the new postings, the change we find is in the instructions on the forms. Page one on each form, titled "Attention," has a modified reference to the penalty that may be assessed against an information return preparer for failure to file a machine-scannable form. The instructions on the forms released early in 2011 identify a \$50 per return penalty that may be assessed. The newly released versions state that "A penalty may be imposed for filing forms that can't be scanned." See part O in the current *General Instructions for Certain Information Returns* for more information about penalties."

It appears that this change—referring to the detailed separate instructions, rather than identifying a \$50-per-failure penalty—will lead preparers to distinguish between the tiered penalty structure for Form 1099-R failures and the \$50 per form penalty for failures associated with other forms, such as those in the 5498 series and other 1099 series forms.

The reposted 2011 forms may be accessed as follows.

2011 Form 1099-R	http://www.irs.gov/pub/irs-pdf/f1099r.pdf
2011 Form 1099-Q	http://www.irs.gov/pub/irs-pdf/f1099q.pdf
2011 Form 1099-SA	http://www.irs.gov/pub/irs-pdf/f1099sa.pdf
2011 Form 5498	http://www.irs.gov/pub/irs-pdf/f5498.pdf
2011 Form 5498-SA	http://www.irs.gov/pub/irs-pdf/f5498sa.pdf
2011 Form 5498-ESA	http://www.irs.gov/pub/irs-pdf/f5498e.pdf

Draft Form Postings

Following are several draft version IRS forms, released for comment as they are being finalized.

2010 Form 8955-SSA	http://www.irs.gov/pub/irs-dft/f8955ssa--dft.pdf <i>(IRS was late releasing both the 2009 and 2010 forms and instructions)</i>
2010 Form 8955-SSA Instructions	http://www.irs.gov/pub/irs-dft/i8955ssa--dft.pdf
2012 Form 5498	http://www.irs.gov/pub/irs-dft/f5498--dft.pdf
2012 Form 5498-ESA	http://www.irs.gov/pub/irs-dft/f5498e--dft.pdf
2012 Form 1099-R	http://www.irs.gov/pub/irs-dft/f1099r--dft.pdf
2012 Form 1099-Q	http://www.irs.gov/pub/irs-dft/f1099q--dft.pdf
2012 Form 1042-S	http://www.irs.gov/pub/irs-dft/f1042s--dft.pdf



Thanksgiving Wishes

The associates of Ascensus wish you a happy Thanksgiving. The offices at Ascensus, including the *800 Consulting* service, will be closed on Thursday, November 24, 2011, in celebration of the holiday. The offices will reopen for business on Friday, November 25, 2011.

Resource Solutions

Updated for 2012!

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 - Individual(k) Plans
 - Self-Directed Investments
 - Retirement Plan Rollovers
 - Inheriting an IRA
 - 403(b) Plans
 - IRA and QRP Distributions
 - Catch-Up Contributions



Call your Ascensus Sales Representative today at 800-346-3860 option 3, suboption 2, to order.

References



A Blueprint for Success

Customize your internal IRA and HSA training program to meet the needs of your team with the Ascensus *IRA* and *HSA Training Organizers*. These comprehensive toolkits are designed to accommodate all learning styles and help you efficiently train your staff on IRA and HSA fundamentals, even if you are not an expert.

- ◆ #3915 *HSA Training Organizer*
- ◆ #9915 *IRA Training Organizer*

Build Your Knowledge Base

Provide your clients more efficient quality service by making these tools part of your IRA and savings plan knowledge base.

- ◆ #650 *Desktop Guide to Coverdell ESAs*
- ◆ #652 *Desktop Guide to HSAs*
- ◆ #886 *IRA Fact Book*
- ◆ #889 *Forms Handbook*

Support Your Structure

Stay in compliance and support your knowledge base with these comprehensive tools.

- ◆ #909 *IRA Compliance*
- ◆ #926 *IRA Reference Service*
- ◆ #936 *Qualified Plan Reference Service*
- ◆ #3909 *HSA Compliance & Operations*
- ◆ *eResource Center*
- ◆ *Retirement Plans Bulletin*

Trusts, Estates, and Inherited IRAs

Most people who establish an IRA name a spouse, child, or other individuals as beneficiaries. When the original IRA owner dies, the beneficiaries become owners of the IRA. Sometimes, however, an entity other than a person inherits the IRA assets, either by being named beneficiary or by default under the terms of the IRA document.

Although charities or other nonindividuals can be named as IRA beneficiaries, the two most common nonindividual beneficiaries are trusts and estates of deceased IRA owners. If an estate becomes an IRA beneficiary, either by being specifically named or by an IRA document default, the IRA assets may become part of the estate probate process of determining the ultimate disposition of the assets. This could vary depending on the jurisdiction.

Trusts are generally established either to limit tax consequences or to control the disposition of a deceased person's assets after death. Too often, an IRA owner fails to seriously consider the consequences of naming or not naming certain beneficiaries, and IRA assets that could have passed unimpeded to beneficiaries end up in an estate or a trust.

It is becoming increasingly common to see requests made to the IRS by trust or estate beneficiaries who wish to be permitted to establish inherited IRAs for IRA assets they have inherited through a trust or estate. They want to essentially rewrite the history of the IRA and be given options similar to those that would have been theirs if the IRA owner had named them as direct IRA beneficiaries. Individuals do this by applying to the IRS for a private letter ruling (PLR) which, if granted, may approve the action that a taxpayer wishes to make.

Typical Trust or Estate Beneficiary Treatment

The rules governing the options of IRA beneficiaries date to 2002, when the IRS released the final required minimum distribution (RMD) regulations. In simplest terms, the options for beneficiary distributions are generally based on life expectancy or the "five-year rule." The latter, available only when an IRA owner dies before his required beginning date (RBD) for taking RMDs, has but one requirement: all assets must be distributed from the IRA before December 31 of the fifth year following the year of the IRA owner's death. The five-year rule is available to either a trust or an estate beneficiary, with such distributions paid directly to the trust or estate, not to the individuals who are its ultimate recipient-beneficiaries.

The life expectancy form of IRA payout is available in some circumstances for either a trust or an estate. If the trust is a qualified trust, the life expectancy of the oldest trust beneficiary can be used to determine the rate of IRA payout to the trust. (See the sidebar accompanying this article; see also the June 2010 *Retirement Plans Bulletin* article "Can You Trust a Beneficiary?") Here again, such distributions are normally payable to the trust and not to the individuals who are its ultimate recipient-beneficiaries.

To add still another IRA payout twist, if the original IRA owner dies after his RBD, then *either* an estate or a trust can use the deceased IRA owner's life expectancy to determine a rate of payout from the IRA to that trust or estate. Note that the payout is made to that trust or estate, and not made directly to the estate's or trust's beneficiaries.

Why Request IRA Beneficiary Status?

There are practical reasons why the beneficiaries of an IRA-funded trust or estate might ask the IRS to be allowed to establish inherited IRAs. Simplicity is one. If this status is granted by the IRS, there is no need for the underlying beneficiary to deal with the personal representative of the estate or with the trustee in order to receive IRA assets. Also, the privilege of transferring a beneficiary IRA from one custodian or trustee to another is reserved for the trustee or executor when a trust or estate is the direct IRA beneficiary.

Qualified Trust

To be considered a qualified trust, the trust must

- ◆ be valid under state law,
- ◆ be irrevocable upon creation of the trust or upon the grantor's death,
- ◆ have identifiable beneficiaries listed.

If the requirements are met, and the trustee of the trust timely provides the financial organization with either a copy of the trust instrument or qualifying documentation of the trust (Treas. Reg. 1.401(a)(9)-4, Q&A-6), the trust will be considered a qualified trust.

Timing may be another reason. Estate settlement is typically a short-term proposition, and few personal representatives will want to keep an estate open beyond a typical 12–18 month probate period. IRA payouts can last for many years. Some trusts are created for a particular purpose, such as those trusts that are set up to govern the transfer of assets to minors who may have reached adulthood by the time the trust's grantor dies. If an estate's or a trust's beneficiaries can be given the same status as an IRA beneficiary, there is no need to keep an estate or a trust open to receive assets from the IRA.

What the IRS Has Permitted

There is no official guidance that permits the beneficiaries of an IRA-funded estate or trust to establish inherited IRAs. It is true that the IRS has stated in PLRs that “neither the Code nor the regulations promulgated under Code section 401(a)(9) preclude the posthumous division of a deceased IRA into sub-IRAs or the distribution of such IRAs from a trust to the trust's beneficiaries.” But nowhere in the Internal Revenue Code or regulations are provisions that specifically support—or even mention—the concept of “sub-IRAs.” Nonetheless, the IRS has ruled in favor of such actions in PLRs. Two examples appear below.

Private Letter Rulings

Trust Beneficiary

PLR 200740018

Facts

- ◆ The IRA owner died before her required beginning date (RBD). Trust T (qualified trust) was the beneficiary, with two cousins (Individual B and C) as cotrustees of Trust T.
- ◆ Individual B wanted to subdivide Trust T IRA into two inherited IRAs.
- ◆ Individual B requested permission to take life expectancy payments based on Individual B's life expectancy, instead of the five-year rule.

IRS Ruling

- ◆ The IRS allowed Trust T, the named beneficiary of the IRA, to be subdivided into two sub-IRAs through a trustee-to-trustee transfer.
- ◆ The IRA was to be created for “Taxpayer A (deceased) for the benefit of Individual B, a beneficiary of Trust T.”
- ◆ Each beneficiary of the trust must receive life expectancy payments based on the eldest beneficiary (Individual B).

NOTE: See also PLRs 200634070, 200538034, 2005380031, 200538033, 200453023, 200444034, 200432028, 200432029, 200432030, and 200349009.

Estate Beneficiary

PLR 200850058

Facts

- ◆ Dad (Decedent A) died after his RBD. He named his wife (Surviving Spouse B) as beneficiary of his IRA with no contingent beneficiaries.
- ◆ Surviving Spouse B disclaimed the IRA, and the default beneficiary in the IRA X documents is Dad's estate. Dad's will named the three children, including the son (Taxpayer C), to each receive an equal share.
- ◆ Taxpayer C would like to divide the IRA into sub-IRAs by means of a trustee-to-trustee transfer and continue to use his father's remaining life expectancy based on single life expectancy (SLE), nonrecalculated.

IRS Ruling

- ◆ IRS allowed Taxpayer C's one-third interest to be transferred to a sub-IRA in the name of “Decedent A for the benefit of Taxpayer C, beneficiary thereof.”

- ◆ Revenue Ruling 78-406 states that a trustee-to-trustee transfer does not constitute a distribution. Therefore, a transfer may be accomplished by the beneficiary of an IRA of a deceased individual.
- ◆ Decedent A's estate was the beneficiary, therefore IRA X had no designated beneficiary under IRC Sec. 401(a)(9). Decedent A's remaining SLE, nonrecalculated, must be used to calculate distributions from the sub-IRA that is set up to benefit Taxpayer C.

NOTE: See also *PLR 200343030*.

What the IRS Has Not Permitted

It's important to note that, while the IRS allowed the creation of inherited IRAs for individuals who were not named direct IRA beneficiaries, the IRS did *not* allow them to stretch out payments beyond the period that could be used by the trust or estate to receive the assets. So whether the beneficiaries are paid directly, or through the trust or estate, the tax paid to the IRS is the same. Even if these distributions were paid to the estate or trust, the trustee or personal representative of the estate would file IRS Form 1041, *U.S. Income Tax Return for Estates and Trusts*, and give a Form K-1, *Beneficiary's Share of Income, Deductions, Credits, etc.*, to each of the underlying beneficiaries of the trust or estate for each share received. These underlying beneficiaries would be required to include the IRA distributions as ordinary income on their personal income tax returns, just as they now will when they receive payouts from their newly granted "inherited IRAs."

Can Anyone Do This?

The standard legend appearing on PLRs issued by the IRS states that "[t]his letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent." This means that another taxpayer cannot rely on it to take the same actions, and the IRS is not bound to arrive at a similar finding for another taxpayer. "Rely on it at your own risk" might be another way of putting it. "Don't rely on it," might be the best advice.

How to Respond to Such a Request?

If a financial organization is asked to set up inherited IRAs in trust or estate beneficiary scenarios like those described here, it may consider the following options and consult with its legal counsel.

The financial organization could take a conservative approach and only allow this transaction if an IRS PLR has been granted. (According to 2011 IRS guidance, most PLRs will cost roughly \$10,000 in filing fees.)

Or the financial organization may permit an underlying beneficiary of a trust or estate to create an inherited IRA after providing a hold harmless statement indicating that the taxpayer has sought and received competent legal and tax advice, and that the IRA custodian or trustee is acting only upon that taxpayer's direction. ♦

How to find PLRs at the IRS.gov website

Go to www.irs.gov

- Click **Tax Professionals** on middle top of page.
- Click **Newsroom** on left side under IRS Resources.
- Click **IRS Guidance** on left side.
- Click **IRS Written Determinations** in middle of page.
- Then search by PLR number, or choose a subcategory of **Required Distributions**.

<http://www.irs.gov/app/picklist/list/writtenDeterminations.html>

Number	Amount	Subject	Released
201141023	418.00-00	Treatment of Funded Welfare Benefit Plans	10/14/2011
201141022	488.00-00	Roth IRA Contributions	10/14/2011
201141021	501.00-00	Exemption From Tax on Corporations, Certain Trusts, etc. (Example) - Tax Exempt	10/14/2011
201141020	501.00-00	Organizational and Operational Tests	10/14/2011
201141019	67074.00-00	Penalty for Failure to Include Reportable Transaction Information with Return	10/14/2011
201141018	6222.00-00	Effect of Failure to Notify	10/14/2011
201141017	4281.00-00	Transportation of Persons by Air (Taxable vs. Nontaxable)	10/14/2011
201141016	7802.00-00	Delivered to Completion - Other	10/14/2011
201141015	1296.00-00	Passive Foreign Investment Company	10/14/2011
201141014	1296.00-00	Passive Foreign Investment Company	10/14/2011

QRP FOCUS



Randy Barnes, QKA
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.

QRP FOCUS ON SELF-EMPLOYMENT COMPENSATION

Q Does a self-employed individual who does not receive a Form W-2, Wage and Tax Statement, have compensation for contribution allocation purposes in a qualified retirement plan?

A A self-employed individual, whether a sole proprietor or a partner in a business entity taxed as a partnership, does not generally receive a Form W-2 like most rank-and-file employees do. A self-employed individual may, however, have earned income upon which to base a qualified retirement plan contribution. The term "earned income" means the net earnings from self-employment. Therefore, the starting point for most sole proprietors will be the income reported on Schedule C, *Profit or Loss From Business (Sole Proprietorship)*, (line 31) or Schedule C-EZ, *Net Profit From Business (Sole Proprietorship)*, (line 3), or in the case of a partner in a partnership (or other entities taxed as a partnership, like LLCs) the Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.*, line that reports "self-employment earnings (loss)," or in the case of a farmer Schedule F, *Profit or Loss From Farming*, line 36. These amounts are further modified by the adjustment required by IRC Sec. 401(c)(2). As a helpful resource that includes applicable examples, refer to IRS Publication 560, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, Section 5, for "Tables and Worksheets for the Self-Employed."

Q If a partner receives guaranteed payments from the partnership, are these guaranteed payments included in earned income?

A Yes, guaranteed payments are taken into account in calculating a partner's net earnings from self-employment. But partners should be cautioned that if they have a self-employment loss and receive guaranteed payments, the resulting net earnings from self-employment will be less than the amount of the guaranteed payments.

Q Are draws that are requested during the business tax year included in compensation?

A No. The draw that a self-employed individual takes during the year may not be representative of her actual net earnings from self-employment at the end of the business tax year. The IRS regulations do allow a partner's deferral to be calculated on a draw, assuming that a deferral election has been made by the partner and the cash advance payments reflect a reasonable estimate of the partner's earned income for the year. Note that if a partner defers on a draw and the actual net earnings from self-employment end up being less than the draw used as a base for the deferral, an operational failure may occur. Therefore, when deferring on their draws, partners should be conservative in their estimates to ensure they are not prefunding the plan in an amount in excess of what they are allowed.

Q Is there anything new for 2011 when calculating earned income?

A For 2011 only, Congress passed a "tax holiday" that reduces the employee's share of FICA, up to the taxable wage base (TWB as indexed for 2011 is \$106,800), by 2 percent. Therefore, an employee pays 5.65 percent up to the TWB, while the employer continues to pay 7.65 percent. To give self-employed individuals the same benefit, Congress reduced the self-employed tax rate for 2010 to 10.4 percent up to the TWB, plus 2.9 percent of the adjusted net earnings from self-employment.

This may seem significant except that Congress has made other adjustments that cause the impact of the "tax holiday" to be minimal. To determine the effect this change has, consult a CPA or tax professional. ♦

IRA Advisor



Christle Johnson, CIP, QKA
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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 One of our IRA owners died in 2010. I see in his file that his sister is the beneficiary and that she elected the five-year beneficiary option. She has not yet taken any distributions. Wasn't she required to start distributing all the assets before now?

A No, under the five-year rule, beneficiaries are not required to take distributions at any particular time during the five-year period, but they must deplete all the IRA assets on or before December 31 of the fifth year following the year of death. So your client has not yet violated the rules, but she must distribute all the IRA assets on or before December 31, 2015. If she does not distribute all the assets by this deadline, she will owe a 50 percent excess accumulation penalty tax to the IRS.

Q When auditing our files, I found a situation where a Traditional IRA owner died in 2010 and the nonspouse beneficiary has not yet elected a distribution option. What happens if an election is not made by the end of this year?

A Beneficiaries generally should make such elections by December 31 of the year after death. If they don't, certain defaults apply. You should first review your IRA plan agreement because it may contain specific IRA distribution options or defaults.

Treasury regulations indicate that if the Traditional IRA owner died before the required beginning date for required minimum distributions (RMDs) and the plan does not specify a different default option, then single life expectancy (SLE) payments will apply. These are annual payments, and the first distribution generally is required on or before December 31 of the year following the year of death. If the beneficiary fails to take the SLE payment by December 31, he is subject to an excess accumulation penalty tax of 50 percent of the required amount that was not distributed. But the regulations allow a waiver of the excess accumulation penalty tax if the beneficiary distributes the entire IRA balance by the end of the fifth year following the IRA owner's death.

If the IRA owner died on or after the required beginning date for RMDs, the regulations require SLE payments using the longer of the remaining life expectancy of the designated beneficiary or the remaining life expectancy of the IRA owner. If an SLE payment is not taken, the beneficiary is subject to the excess accumulation penalty tax.

Q I understand that when an IRA has multiple beneficiaries electing single life expectancy payments, we can base the payments on each beneficiary's age if we apply separate accounting. How do we establish separate accounts?

A The term "separate accounting" generally means creating a new entry on the financial organization's computer system for each beneficiary. Each entry tracks the gains and losses on that individual's assets. Once you create a new entry, you may transfer the assets from the decedent's IRA into each beneficiary's entry. Note that this is a nonreportable transaction.

Separate accounting allows the beneficiary more options and permits the financial organization to accurately report the fair market value and any distributions in the beneficiary's name and Social Security number. You do not need the beneficiary's permission nor is the beneficiary required to sign any documents to establish the separate accounts. ❖

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Test Your Knowledge

Test your knowledge of this month's edition of the *Retirement Plans Bulletin*. Decide whether each statement below is true or false. The answer key is at the bottom of the page.

True or False

- _____ 1. An IRA trust or estate beneficiary that chooses to take life expectancy payments may have the payments made payable directly to the beneficiaries of the trust or estate.
- _____ 2. The IRS does not allow IRA beneficiaries of trusts or estates to extend payments beyond the time period that could be used by the trust or estate beneficiary to receive the assets.
- _____ 3. The salary deferral limit of \$16,500 did not increase with the 2012 cost-of-living adjustments.
- _____ 4. The 2012 Roth IRA modified adjusted gross income (MAGI) ranges for determining contribution eligibility increased from 2011 for both single individuals and married individuals filing a joint federal income tax return.
- _____ 5. The qualified retirement plan submission process for plan document providers to apply for opinion and advisory letters on their own behalf and on behalf of pre-approved document sponsors that use their plans ends on January 31, 2012.
- _____ 6. According to Revenue Procedure 2011-49, employers that wish to establish a multiple employer plan using an EGTRRA pre-approved plan document are required to use a volume submitter plan.
- _____ 7. A self-employed individual who does not receive Form W-2 wages does not have compensation for purposes of allocating contributions in a qualified retirement plan.
- _____ 8. Guaranteed payments that a partner receives from a partnership are included in earned income for purposes of allocating contributions in a qualified retirement plan.
- _____ 9. Beneficiaries choosing to take life expectancy payments must take the first payment by December 31 of the fifth year following the year of death.
- _____ 10. IRA beneficiaries who do not take distributions by the required deadline are subject to an excess accumulation penalty tax of 50 percent of the amount required to be taken but not taken.

Puzzle Answers

Answer Key: 1. F, 2. T, 3. F, 4. T, 5. T, 6. T, 7. F, 8. T, 9. F, 10. T