

Legislation Moving at a Snail's Pace

EDITORIAL

Though some lawmakers may disagree, the partisanship and distractions of an election year seem to have sapped Congress' sense of urgency. At least this seems to be the case where retirement and other savings arrangements are concerned. Significant technical corrections to the Pension Protection Act of 2006 (PPA) have been on hold since March, essentially due to one provision that has divided the House and Senate.

President Bush has allowed major bipartisan legislation providing tax benefits to military personnel to languish for weeks awaiting his signature. Enactment of H.R. 6081, the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008, was considered a foregone conclusion when it was passed by the House and Senate before Memorial Day. But the legislation was not signed until June 17, 2008.

Provisions of the HEART Act

The HEART Act contains provisions that will affect employer-sponsored retirement plans, IRAs, Coverdell education savings accounts (ESAs), and flexible spending accounts (FSAs), as described below.

Reservist Distributions

The HEART Act makes permanent the temporary PPA provision allowing penalty-free retirement plan and IRA "qualified reservist distributions," and the option to recontribute such amounts to IRAs. (See the following article on reservist distributions.)

Government Death Gratuities

Beneficiaries who receive military death benefit gratuities—paid to the survivors of military personnel killed in combat—may contribute the gratuities tax-free to Roth IRAs or Coverdell ESAs. These death benefit gratuities can be as much as \$100,000.

Differential Pay

Differential pay—the amount paid by an employer to make up the difference between pre-service civilian pay and military pay—will be counted as compensation for retirement plan benefit purposes if paid to the employee by the employer. (Employers are not required, however, to give differential pay.)

USERRA Changes

The HEART Act modifies USERRA, the Uniformed Services Employment and Reemployment Rights Act.

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"Beware of little expenses. A small leak will sink a great ship."

—Benjamin Franklin


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Effective for military-related deaths on or after January 1, 2007, an otherwise-qualified plan will not be considered qualified unless it provides that a participant's *survivors* will be entitled to any plan benefits that would have been available to them had the participant died after returning to employment. This would include such benefits as full vesting in a participant's retirement account, insurance benefits, etc.

For *benefit accrual purposes*, USERRA provisions have been modified to state that the employer may treat an individual who is *disabled or killed* while on active duty as having returned to employment, for purposes of 1) avoiding breaks in service, 2) vesting on prior benefits, 3) accrual of additional benefits, and 4) entitlement to benefits that are contingent on the employee making contributions or deferrals (e.g., employer matching contributions).

The amount of employee contributions or deferrals allowed to be made on the employee's behalf will be determined on the basis of the employee's "average actual employee contributions or elective deferrals" for the 12 month period prior to military service, or—if less—the period of continuous service with the employer.

If the employer implements any of the previously described USERRA options, all benefit accrual-related options must be treated as if required. Availability must be on "reasonably equivalent terms" for all employees.

The above provisions apply for deaths or disabilities occurring on or after January 1, 2007. Plans must be amended retroactively for these provisions on or before the last day of their 2010 plan year (2012 for government plans).

Access to FSA Assets

Under the HEART Act, active duty personnel may withdraw and use FSA assets for purposes not generally allowed by an FSA.

Technical Corrections?

The Congressional impasse on technical corrections to the Pension Protection Act of 2006 continues. After the House passed H.R. 3361 in March 2008, the bill went to the Senate for a vote that would send the legislation to President Bush for enactment. The Senate, however, has not voted on the bill.

Included here are H.R. 3361 provisions considered likely to have the greatest impact on retirement arrangements.

- ◆ Employer-sponsored retirement plans from which rollovers to IRAs are permitted would be *required* to offer nonspouse beneficiaries the option to directly

roll over inherited assets to a beneficiary IRA. This provision would take effect beginning in 2009.

- ◆ Rollovers from designated Roth accounts in 401(k) and 403(b) arrangements would not be subject to the annual income (\$100,000) and tax filing status restrictions that apply to conversions from Traditional IRAs to Roth IRAs, and which remain in effect through 2009.
- ◆ Correction of excess deferrals under IRC Sec. 402(g) would not require the calculation and inclusion of gap-period income (income from the end of the plan year to the date of distributing the excess) for 2008 and later years. PPA eliminated the need to calculate and include gap-period earnings when correcting an ADP failure, beginning in 2008, but did not address gap-period earnings with respect to correcting a 402(g) excess.
- ◆ State unemployment compensation could not be reduced for a taxpayer who rolls over retirement arrangement distributions. (PPA prescribes that such rollovers not be included as payments whose receipt requires states to reduce unemployment compensation under federal law. But without this technical correction, states may reduce unemployment compensation.)
- ◆ SAR-SEP and SIMPLE IRA plans will be included under PPA's automatic contribution arrangement rules, including provisions allowing permissible withdrawals of automatic deferrals. Such permissible withdrawal amounts returned to an employee will be disregarded for purposes of an employee's IRC Sec. 402(g) limit.
- ◆ An eligible automatic contribution arrangement (EACA) would not be required to provide a qualified default investment alternative (QDIA).
- ◆ The QDIA rules would apply not only to plan participants, but also to beneficiaries who have not made investment elections.

Effective dates

Except where specifically stated otherwise (such as with nonspouse beneficiary rollovers), these technical correction provisions would be effective as if they had been included in PPA when it was enacted in August 2006, and would be subject to the effective dates of the pertinent sections of PPA.

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Reservist Distributions Still Available?

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The Pension Protection Act of 2006 (PPA) provides for an exception to the 10 percent early distribution penalty for eligible members of a U.S. military reserve component (including National Guardsmen) who are called to active duty after September 11, 2001, and before December 31, 2007, and who take retirement-related distributions. According to PPA provisions, qualified reservist distributions may be taken from IRAs or from deferrals in IRC Sec. 401(k) or 403(b) plans, and certain pre-ERISA plans under IRC Sec. 501(c)(18) by those “ordered or called to active duty after September 11, 2001, and before December 31, 2007” [emphasis ours]. To qualify for the exception, reservists must be called to active duty for 180 or more days (or for an indefinite period) and take distributions on or after the date they receive the order or call to duty and before the close of their active duty. PPA also allows reservists to “recontribute” qualified reservist distributions to IRAs by the later of August 17, 2008, or two years after the end of the active duty period. Reservists may not take deductions for the recontributed amounts.

Recent IRS publications have described these special tax benefits as no longer available in 2008. This year’s Publication 553, *Highlights of Tax Changes*, states (page 23) that “The following provisions do not apply for 2008,” and identifies “Qualified reservist distributions” as among those that have expired. In addition, the IRS’ *2008 Instructions for Forms 1099-R and 5498* contains a similar statement. On page 1, under the subtitle “What’s New,” is text stating that “... references to the qualified reservist distribution ... have been deleted due to expiration of the provision.”

Has the tax benefit actually expired? No, according to PPA statutes as previously reviewed. Ascensus contacted the IRS about the conflicting information. An IRS representative confirmed that the PPA rules continue to govern the tax benefits, and that the rules remain available to anyone called to active duty under the stated terms and timing. Duration and timing of the call to duty determine general eligibility. For those eligible, qualifying distributions may be made at any time during the taxpayer’s period of active duty service. The repayment period for such distributions will not end before the end of the two-year period beginning when active duty ends.

Clearly, under PPA, the options to take qualified reservist distributions and to repay the amounts remain available

in 2008 and beyond for qualified reservists who were called to active duty by December 31, 2007.

Temporary Provision Made Permanent

Just before the posting of the *Retirement Plans Bulletin*, the Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008 was signed by President Bush. The HEART Act makes the qualified reservist distribution penalty exception and recontribution provisions of PPA permanent, thereby extending these tax benefits to reservists called to duty after December 31, 2007.

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2009 COLA-Indexed HSA Contribution Amounts

HSA

The IRS has issued Revenue Procedure 2008-29, providing the 2009 cost-of-living adjusted (COLA) amounts for health savings accounts (HSAs). These indexed amounts include annual contribution limits, and the annual deductible levels and out-of-pocket expense maximums for a health insurance policy to be considered an HSA-eligible high deductible health plan (HDHP).

For 2009, the annual contribution limit for an individual with self-only HDHP coverage is \$3,000. The maximum contribution for an individual with family coverage is \$5,950. The HDHP annual deductible amount for self-only coverage for 2009 cannot be less than \$1,150, nor can the annual out-of-pocket expense exceed \$5,800. For family coverage, the annual deductible increases to \$2,300, while the annual out-of-pocket expense cannot exceed \$11,600.

Financial organizations should remember that the Tax Relief and Health Care Act of 2006 (TRHCA) changed the regulations to allow annual contributions to be made at maximum statutory levels without reduction for a lower health plan deductible amount. Before TRHCA, annual contributions were limited to the lesser of the statutory maximum or the HDHP deductible amount.

See the article on Notice 2008-52 for the most recent guidance on HSA contributions under TRHCA.

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Economic Stimulus Payments Sneak Into IRAs



The IRS has issued Announcement 2008-44 and IR-2008-68, providing guidance and information on economic stimulus payments that are directly deposited to IRAs, HSAs, MSAs, Coverdell ESAs, and Sec. 529 education savings plans. If an economic stimulus payment is directly deposited into one of these accounts, and the taxpayer does not wish to make a contribution to that account, he may withdraw the amount by his income tax return due date plus extensions without incurring any tax or penalty.

The IRS generally deposited economic stimulus payments in May 2008 for taxpayers who filed their 2007 income tax returns electronically, and who provided one financial account number to receive a direct deposit of an income tax refund. Taxpayers who provided one account number will receive the economic stimulus payment by direct deposit to that same account. (If a taxpayer provided more than one account number, or no account number, the taxpayer will receive an economic stimulus check in the mail.)

Taxpayers may remove any amount less than or equal to the amount of the directly deposited stimulus payment, without incurring any tax or penalty that would otherwise be associated with the distribution. For this relief to apply, a taxpayer must remove the amount by the taxpayer's tax return due date (or by May 31 for a Coverdell ESA), or a later date if the taxpayer has a tax return filing extension.

Ann. 2008-44 acknowledges that financial organizations administering these accounts may not be able to readily distinguish the directly deposited stimulus payments from other contributions to such accounts. Therefore, the IRS advises these organizations to "report the deposit and distribution in the usual manner." Ann. 2008-44 states that instructions in the 2008 tax year Form 1040, *U.S. Individual Income Tax Return*, package will advise taxpayers how to report such distributions "in a manner that shows that the amount withdrawn is not subject to taxes or penalties."

The announcement and the news release are both available on the IRS website, www.irs.gov.

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IRA Processing: We Can Do It, You Can Relax



Managing an IRA program can be a complicated and time-consuming process for financial organizations. Ascensus understands the complexities, nuances, and regulatory compliance issues involved with operating an IRA program. We have used our technical knowledge and administration experience to create a comprehensive account administration program. Let us help manage your account processing functions so you can focus on your clients.

The *IRA Processing* service combines fast, accurate data processing with up-to-date knowledge of the latest developments in retirement accounts. Our team of experts knows what needs to be done and how to do it.

Processing services are available for

- ◆ Traditional IRAs,
- ◆ Roth IRAs,
- ◆ SIMPLE IRA plans,
- ◆ SEP plans,
- ◆ Coverdell education savings accounts (ESAs), and
- ◆ Health savings accounts (HSAs).

Processing services include

- ◆ accurate and timely filing of government reports,
- ◆ professional account activity reporting,
- ◆ regularly scheduled updates, and
- ◆ compliance with the industry rules and regulations.

Ascensus has been providing IRA processing services since 1975. Our experienced processing team members assist over 400 financial organizations and process over 100,000 individual accounts.

For additional information on how we can meet your account processing needs, please contact your Ascensus Sales Representative at 800-346-3860.

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IRS Releases Notice 2008-52



Although the Tax Relief and Health Care Act of 2006 (TRHCA) simplified the health savings account (HSA) contribution rules, applying the new rules to real-life situations has highlighted details of the new rules that need clarification. The IRS recently released Notice 2008-52 to provide additional guidance on determining an individual's maximum HSA contribution after the TRHCA changes. Notice 2008-52 has a retroactive effective date of January 1, 2007, which is the same effective date for most of the provisions created by TRHCA.

Determining HSA Contribution Limits

Beginning in January 2007, TRHCA repealed the rule that tied an individual's annual HSA contribution limit to his high deductible health plan (HDHP) deductible—simply making the annual contribution limit the same as the annual statutory limit (\$2,900 for self-only coverage and \$5,800 for family coverage for 2008). An individual must meet certain requirements, however, to be eligible to make the maximum contribution for the year.

If an individual is HSA-eligible on the first day of the last month of the individual's taxable year (December 1 for most taxpayers), the individual's HSA contribution limit for the year is the greater of

- 1 the sum of the monthly limits, which are determined separately for each month based on eligibility and the HDHP coverage on the first day of each month, plus catch-up contributions for each month if applicable; or
- 2 the statutory annual contribution limit, plus catch-up contributions if applicable.

EXAMPLE 1: Andrew, age 47, enrolls in self-only coverage on November 1, 2008, and is otherwise an eligible individual. The 2008 statutory contribution limit is \$2,900. The sum of Andrew's monthly contribution limits is \$483.33 (2/12 x \$2,900). Therefore, Andrew's annual contribution limit for 2008 is \$2,900 because it is greater than the sum of his monthly contribution limits.

See Example 2 for a scenario in which the sum of monthly limits is greater than the statutory contribution limit.

Eligibility for a Full-Year Contribution

To be eligible to make a full-year contribution under TRHCA, an individual must be HSA-eligible on the first day of the last month of the individual's taxable year

(December 1 for most people) and must remain eligible during the testing period. The testing period begins on December 1 and ends on the last day of the 12th month following that month. So, the testing period for 2008 is December 1, 2008, through December 31, 2009.

Notice 2008-52 clarifies that an individual is treated as being covered by the same HDHP coverage (self-only or family) for the entire year as the coverage held on December 1. Therefore, if an individual has family coverage on December 1, 2008, regardless of when in 2008 he became HSA-eligible or obtained self or family coverage, he is treated as an eligible individual having family HDHP coverage for all 12 months in 2008. Additionally, an individual who is HSA-eligible on December 1 of a year is considered eligible for that entire year and may increase, but not decrease, his contribution limit. For example, if an otherwise eligible individual has family coverage as of January 1, 2008, but switches to self-only coverage on December 1, 2008, he would be treated as having self-only coverage for the entire year. Without the "greater of" calculation, he would be stuck with the lower contribution limit for self-only coverage.

EXAMPLE 2: Greg, 53, enrolls in family HDHP coverage on January 1, 2008, and is otherwise an eligible individual. Greg changes to self-only HDHP coverage on September 1, 2008, and retains self-only coverage through December 31, 2008. Greg's contribution limit for 2008 is \$4,833.33 ((8/12 x \$5,800) + (4/12 x \$2,900)) because the sum of the monthly limits is greater than the statutory contribution limit for the type of coverage he had on December 1, 2008.

Failure to Remain HSA-Eligible During the Testing Period

If an individual becomes eligible on December 1, contributes to her HSA an amount that is greater than the sum of the monthly contribution limits, and ceases to remain HSA-eligible at any time during the testing period, the ineligible portion of the contribution must be included in gross income and is subject to an additional 10 percent penalty (unless the failure is due to disability or death). The amount that is included in the individual's gross income is calculated by subtracting the sum of the monthly contribution limits from the amount actually contributed.

Notice 2008-52

Continued on Page 6

The ineligible contribution amount is not required to be distributed from the HSA; in fact, should an individual distribute the ineligible contribution, additional adverse tax consequences may apply (as illustrated in Example 4). Withdrawing the ineligible contribution from the HSA will not prevent it from being included in gross income or being subject to the additional 10 percent penalty. Earnings, however, are not included in gross income or subject to the additional 10 percent penalty as long as the earnings remain in the HSA or are used for qualified medical expenses.

Notice 2008-52 clarifies two additional points. Unlike the additional 10 percent penalty tax for nonqualified distributions, the 10 percent additional penalty for an individual not remaining eligible during the testing period applies to individuals over age 65. Also, employers and financial organizations are not responsible for reporting whether an individual remains an eligible individual during the testing period.

EXAMPLE 3: Continuing Example 2, the 2008 annual contribution limit for self-only coverage—which is what Greg had on December 1, 2008—is \$2,900; however, the sum of Greg’s monthly contribution limits is \$4,833.33. So, Greg’s contribution limit for 2008 is \$4,833.33 because it is greater than the \$2,900 annual contribution limit.

The testing period for 2008 HSA contributions begins December 1, 2008, and ends on December 31, 2009. Assume that Greg ceases to be an HSA-eligible individual on January 1, 2009, and so does not maintain HSA eligibility during the testing period. Because Greg’s contribution of \$4,833.33 is not greater than the sum of monthly contribution limits that he was actually eligible for in 2008, he is not required to include the \$4,833.33 in gross income and the additional 10 percent tax does not apply.

Ineligible During Testing Period and Excess Contributions

The IRS generally imposes a six percent excise tax on HSA contributions in excess of an individual’s contribution limit for the year. Notice 2008-52 clarifies that the amount included in gross income because an individual failed to remain HSA-eligible during the testing period is not considered an excess contribution. Therefore, the amount cannot be removed as an excess contribution, nor can the 10 percent penalty be reduced to the 6 percent excise tax.

Ineligible During Testing Period and Nonqualified Distributions

Generally, an HSA distribution that is not used for qualified medical expenses is included in gross income and is subject to an additional 10 percent penalty. Notice 2008-52 clarifies that these consequences still apply regardless of whether some or all of the amount is also included in the HSA owner’s income and subject to the additional 10 percent penalty for not remaining an HSA-eligible individual during the testing period. This means that an HSA owner could be taxed and penalized twice on the same assets.

EXAMPLE 4: Holly, age 33, enrolls in self-only HDHP coverage on June 1, 2008, and contributes \$2,900 to her HSA on July 1, 2008. (Holly’s contribution limit is deemed to be the statutory contribution limit because it is greater than the sum of her monthly contribution limits ($7/12 \times \$2,900 = \$1,691.67$). But Holly only remains HSA-eligible December 1, 2008, through February 1, 2009. Because Holly fails to remain HSA-eligible through the 2008 testing period (December 1, 2008, through December 31, 2009), she must include \$1,208.33 ($\$2,900 - \$1,691.67$) in her 2009 gross income and pay the additional 10% penalty (\$120.83).

On February 2, 2009, Holly withdraws the ineligible contribution limit (\$1,208.33) from her HSA, and does not use it to pay for qualified medical expenses. Holly cannot treat the \$1,208.33 as an excess contribution. And because Holly took a nonqualified distribution, she must include the \$1,208.33 in her 2009 gross income and pay an additional 10% penalty (\$120.83).

Consequently, Holly is subject to tax and penalty twice: once for making a full-year contribution and not remaining HSA-eligible throughout the testing period, and once for withdrawing a nonqualified distribution.

Summary

The IRS continues to issue HSA guidance at a rapid pace. Not only did the IRS issue Notice 2008-52 to clarify the new HSA contribution rules, it also issued Notice 2008-51 to elaborate on qualified HSA funding distributions from Traditional or Roth IRAs—another provision created by TRHCA. Look for an in-depth article explaining Notice 2008-51 in next month’s issue of the *Retirement Plans Bulletin*.

B

Time to Take a Look at IRA Compliance **UNIVERSAL**

What better time than the slow days of summer to do some maintenance on your IRA programs. Every financial organization that offers IRAs should regularly monitor its level of compliance with IRS rules and regulations. Compliance errors can occur at any time and on the simplest transactions. Events occurring within financial organizations, such as mergers, acquisitions, or inadequate staff training, can also lead to compliance errors. Financial organizations that gamble with noncompliance may risk IRS audits, possible monetary penalties, and, ultimately, jeopardizing the tax-deferred status of their clients' IRAs.

Compliance problems often stem from repeating mistakes, which can seriously affect a financial organization's profit margin. For example, the IRS penalty for failing to provide an accurate financial disclosure is \$50 per occurrence (IRC Sec. 6693(a)). If a financial organization established 50 IRAs this year and made the same mistake in completing the financial disclosure for each of those 50 IRAs, the IRS could assess a noncompliance penalty of \$2,500.

Primary Compliance Concerns

To avoid IRS penalties, a financial organization must recognize the areas within its IRA department that are subject to scrutiny. Fines for noncompliance apply in three general areas: opening documents, withholding, and reporting.

Opening Documents

When an individual establishes an IRA, the financial organization must provide an up-to-date plan agreement and disclosure statement, which includes an accurate financial disclosure, to the individual. The plan agreement is the controlling contract of the IRA and states the terms of the IRA, such as contribution limits, investment restrictions, distribution requirements, etc. The disclosure statement provides a nontechnical explanation of IRA rules. The financial disclosure informs the IRA holder of the projected growth of the IRA assets (based on specific assumptions) as well as any fees or penalties that may be assessed against the IRA. An IRA holder must sign and date these opening documents (or sign and date an acknowledgement that he received copies of these opening documents). The financial organization should retain the signed and dated copy of the plan agreement and disclosure statement or a signed acknowledgement that the IRA holder received the documents.

The IRS provides specific guidance to financial organizations on the amending process for IRA opening docu-

ments. When legislation affects IRA rules, financial organizations generally must amend the plan agreement and the disclosure statement that were used to establish existing IRAs, as well as obtain a new plan agreement and disclosure statement to establish new IRAs. (The financial disclosure never needs to be amended.) The financial organization must retain proof that amendments were sent to IRA holders.

Chart 1 outlines the opening document requirements and the potential penalties for noncompliance.

Chart 1 – Opening Document Requirements

<i>Requirement</i>	<i>Penalty</i>
Failure to provide IRA holder with a copy of the plan agreement or disclosure statement	\$50 for each failure
Failure to provide IRA holder with a copy of an amendment to the plan agreement or disclosure statement	\$50 for each failure
Failure to provide IRA holder with a properly completed disclosure statement (financial disclosure)	\$50 for each failure

Withholding

Withholding on IRA distributions is another major compliance concern for financial organizations. IRA distributions are generally included in an IRA holder's income, so the IRS wants to ensure that the proper income taxes are paid. Therefore, the IRS has established rules for withholding a percentage of an IRA distribution as prepayment of the income tax that the IRA holder will potentially owe on any pretax assets distributed. One of the withholding compliance rules, however, requires that each IRA distribution recipient be given the option to elect to have withholding apply or to waive withholding.

To ensure that individuals are given the option to waive withholding (or to request additional withholding), the IRS requires financial organizations to provide a withholding notice to distribution recipients. This notice can be satisfied using Form W-4P, *Withholding Certificate for Pension or Annuity Payments*, or a substitute Form W-4P.

If a financial organization fails to withhold or fails to obtain a signed election of the recipient not to withhold, the financial organization will be responsible for the withholding that should have been withheld (IRC Sec. 3405(d)).

In addition to withholding the proper amount, financial organizations must provide periodic notices to IRA holders throughout the year. The timing of these notices depends on the frequency of the IRA holder's distributions. One annual notice can be provided for scheduled distributions made over a period greater than one year if the distributions occur at least quarterly. If scheduled distributions occur less frequently than quarterly, notice information is still required with each distribution. This notice must be provided within a reasonable time before each distribution, but no more than six months preceding the distribution. The individual receiving the distribution must receive the notice in enough time to sign and return an election, if the individual chooses to make an election change, before the distribution is made. Financial organizations must retain proof that these notices have been provided in a timely manner.

Once the withholding has been collected from distributions, financial organizations must remit these amounts to the IRS. To improve compliance, the IRS requires financial organizations to report withholding amounts to the IRS and to maintain certain records to generate current and future reporting.

Chart 2 lists the withholding requirements and the potential penalties for noncompliance.

Chart 2 – Withholding Requirements

Requirement	Penalty
Failure to withhold federal income tax or obtain signed election to waive withholding	Financial organization must pay the tax that should have been withheld
Failure to keep records necessary to report withholding to the IRS	\$50 for each IRA for which proper records were not kept
Failure to give notice to IRA holders of their right to waive withholding	\$10 for each failure

Reporting

Another way that the IRS maintains a checks and balances system for IRAs is through IRA transaction reporting. If a financial organization consistently files late or incorrect reports to the IRS, the IRS may assume that a financial organization has other problem areas. To lessen the chances of an IRS audit—and to avoid penalties for noncompliant reporting—financial organizations must stay up to date with IRA reporting requirements because reporting requirements can change each year. Keeping transaction forms current and correct is a financial organization's best tool for obtaining all the information necessary for generating compliant reports.

Chart 3 lists general IRA reporting deadlines and the potential penalties for noncompliance.

Chart 3 – IRA Reporting Requirements

Form	Due Date	Penalty
Fair Market Value Statement	January 31 (IRA holder or beneficiary)	\$50 for each failure
RMD Statement	January 31 (IRA holders who are age 70 ½ or older during the calendar year)	Unknown
Form 1099-R	January 31 (IRA holder or beneficiary) February 28 (IRS)	Tiered penalty – maximum \$50
Form 5498	May 31 (IRS)	\$50 for each failure
Annual Account Statement	May 31 (IRA holder or beneficiary)	\$50 for each failure

Solving the Problem

Because penalties for noncompliance can be substantial, financial organizations should analyze current IRA procedures and workflow and ensure that IRA staff understands the IRA compliance requirements. Reviewing a random sample of IRA files is a great way to determine if compliance errors have been made in the past and to discover any consistent patterns of errors. This allows trainers to hone in on problem areas for IRA staff. Last, an organization must recognize its reporting capabilities and address possible deficiencies.

Many financial organizations have compliance issues. If a financial organization is uncomfortable with its ability to complete an internal review, experienced technical consultants can be hired to conduct an on-site compliance audit. The Ascensus audit program, for example, also offers recommendations on how to streamline procedures to improve efficiency while maintaining compliance.

One of the greatest advantages of a third-party compliance audit is that, unlike an IRS audit, financial organizations will know the cost of the audit before the work begins. Whether a financial organization chooses to conduct its own audit or to bring in a third party, ensuring compliance with all the IRS' requirements will ultimately lead to substantial time savings and a more profitable product offering.

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Sole Proprietor Plan Calendar: July

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During the summer season, operations in a financial organization's retirement plans department generally slow down a bit. Many financial organizations take this opportunity to review existing plans to uncover any problems. Sometimes, an organization will find a sole proprietor plan (owner only, no employees) that no longer has a business to support it. Generally, a sole proprietor should terminate a retirement plan if the business has ceased to exist or the sole proprietor has sold the business. The method of terminating a sole proprietor plan will vary depending upon the type of plan.

Defined Contribution Plans

A defined contribution plan does not go away just because all the money is paid out. Profit sharing, money purchase pension, and Individual(k) plans of sole proprietors must follow a termination procedure.

The first step for the sole proprietor is typically to amend the plan. The IRS has often stated that a plan must be up-to-date with current law as of the termination date. A plan that terminates after the effective date of a change in law, but before the date that amendments are otherwise required for that law change, must be amended to comply with the applicable provisions of law from the date on which such provisions become effective with respect to the plan. Because the terminated plan will no longer exist on the required amendment date and, therefore, could not be amended on that date, the plan must be amended before it is terminated. (Additionally, if the plan is a money purchase pension plan, the sole proprietor must amend the plan to a zero (-0-) contribution percent effective on or before the termination date.)

Current plan documents do not contain many of the tax law changes that occurred with, and subsequent to, the Economic Growth and Tax Relief Reconciliation Act of 2001, including the provisions of the Pension Protection Act of 2006 (PPA). If an employer terminates a plan in 2008 or later, even though the general amendment deadline for PPA is 2009, he must amend the plan for PPA before terminating the plan. The sole proprietor should contact his document provider for a current amendment for his plan. The most conservative approach for a sole proprietor who wishes to terminate his plan is to ask the IRS to make a determination on the plan's qualification status by filing for a determination letter using Form 5310, *Application for Determination for Terminating Plan*.

Once the plan is up-to-date, the sole proprietor will request a distribution or rollover of the assets. (See "Let's Get Rolling; Part II" in the April *Retirement Plans Bulletin*.)

Often, a financial organization will require that a plan administrator authorize the distribution of plan assets in writing using a distribution form. The financial organization uses the form to gather the necessary information to file Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, reporting the distribution amount and any applicable withholding. Financial organizations as payers of the assets are responsible for collecting and remitting the appropriate withholding amounts (or for obtaining waivers). For example, if the assets in the plan are eligible to be rolled over to an IRA (or another qualified plan) and the sole proprietor chooses to take a distribution rather than roll over the assets, the distribution is subject to mandatory 20 percent withholding. The sole proprietor cannot waive this withholding. The employer or payer must collect and remit the withholding. (See the "QRP Focus" on distribution withholding.)

After the amendments and distributions have happened, the sole proprietor must file a final Form 5500-EZ, *Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan*, for the plan year in which all of the assets have been distributed. This report must be filed even if the sole proprietor has never filed one before. The report is due to the IRS by the last day of the seventh month following the end of the plan year. The day that the last dollar is paid out is considered the end of the plan year.

SEP and SIMPLE Plans

SEP plans are more easily terminated because the plan is IRA-based. Employer contributions through a SEP plan are made to a Traditional IRA. Those contributions immediately become regular IRA assets when contributed to the IRA. The IRA holder can take a distribution at any time, subject to the Traditional IRA rules. Consequently, the IRS has no formal termination procedure for a SEP plan. The sole proprietor simply ceases to make employer SEP plan contributions to his IRA. Because a SIMPLE IRA plan is also an IRA-based plan (albeit a SIMPLE IRA), the same procedure generally applies for sole proprietors.

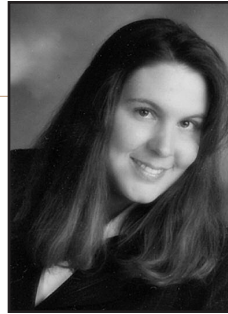
Summary

Few sole proprietors have any idea of how to terminate a retirement plan when they close up shop—or even that they must do so formally. Financial organizations can provide a valuable customer service when assisting with this operation.

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QRP FOCUS

FOCUS ON WITHHOLDING



Tammy Schultz
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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.

Q If a participant in a qualified retirement plan (QRP) elects to take a distribution from the plan, how is the federal income tax withholding determined?

A When determining the amount of federal income tax withholding, the plan administrator must first determine the type of distribution: eligible rollover distribution or noneligible rollover distribution.

An eligible rollover distribution means that the assets included in the distribution are eligible to be rolled over to another eligible retirement plan, such as an IRA. But what if, instead of rolling over the assets, the participant has decided to take a distribution? If the amount distributed from the plan is an eligible rollover distribution, the payer of the distribution must withhold 20 percent of the distribution and remit it to the IRS for prepayment of the possible tax liability. If the total amount of distributions in a calendar year is expected to be less than \$200, the payer is not required to withhold on the distribution.

An ineligible rollover distribution is an amount that cannot be rolled to an eligible retirement plan. Some of the more common distributions that are not eligible to be rolled over are required minimum distributions, hardship distributions, and certain removals of excess contributions. IRS Publication 560, *Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans)*, has a more complete list of ineligible rollover distributions. If the amounts are not eligible to be rolled over, the following withholding rules under IRC Sec. 3405(a) generally apply.

IRC Sec. 3405(a) categorizes distributions for withholding purposes as "periodic" or "nonperiodic." A periodic distribution is a "designated distribution which is an annuity or similar periodic payment" (IRC Sec. 3405(e)(2)). For periodic distributions, the payer must withhold on the distribution as if

the participant was married and claiming three withholding exemptions unless another withholding amount is elected. A nonperiodic distribution is defined as "any designated distribution that is not a periodic payment." This includes "scheduled payments" (e.g., monthly payments) that look like periodic payments, but are really just "on demand" payments, which aren't locked in contractually. The payer must withhold at a rate of 10 percent on a nonperiodic distribution unless the plan participant elects to waive out of the withholding or to withhold an amount greater than 10 percent.

Q Who is responsible for calculating and remitting withholding?

A The plan administrator is responsible for determining the amount of withholding that must be remitted to the IRS (Temp. Treas. Reg. 34.3405-1T). Treasury regulations permit the plan administrator to transfer this requirement to the payer (e.g., the trustee or custodian). The payer also will be required to remit the withheld funds and report annually to the IRS using IRS Form 945, *Annual Return of Withheld Federal Income Tax*.

Q What are the federal income tax withholding requirements if a nonspouse beneficiary takes a distribution from the plan instead of rolling over the assets to an inherited IRA?

A The Pension Protection Act of 2006 (PPA) allows beneficiaries to directly roll over inherited QRP assets to an inherited IRA. Based on IRS Notice 2007-7, though a qualified plan distribution to a nonspouse beneficiary may be eligible for rollover to an inherited IRA, the mandatory 20 percent withholding requirement of IRC Sec. 3405(c) does not apply. The nonperiodic payment withholding rules apply to a nonspouse beneficiary who takes a death distribution.

B

IRA Advisor



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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 A beneficiary of a deceased IRA holder wants to disclaim the IRA assets that he inherited. What must he do to disclaim the assets?

A According to IRC Sec. 2518, individuals may disclaim a whole or partial interest in property and then be treated as if they never had rights to that property. As a result, the individual who is disclaiming is relieved of the associated tax consequences of receiving the disclaimed property. To make a qualified disclaimer, the beneficiary must meet the requirements of IRC Sec. 2518(b):

- 1 the disclaimer must be made in writing;
- 2 the written disclaimer must be received by the IRA trustee, custodian, or issuer within nine months after the death of the IRA holder or, if later, within nine months of the date on which the beneficiary attains age 21;
- 3 the disclaiming IRA beneficiary may not accept any of the disclaimed assets or any of the benefits attributable to the disclaimed assets; and
- 4 the disclaiming beneficiary is not allowed to direct how or to whom the assets are distributed.

An IRA beneficiary that wishes to disclaim assets should work with an attorney to draft any necessary documents and to make sure that any applicable state law requirements are also met.

Q If a beneficiary disclaims, who will receive the assets in the IRA?

A Federal rules state that the disclaimed property is treated as if it had never been transferred to the person making the qualified disclaimer. (Treas. Reg. 25.2518-1(b1)) Under a "per capita" beneficiary designation, any remaining primary beneficiaries will receive a pro rata allocation of the amount disclaimed. If there are no other named primary beneficiaries, the assets will pass to the contingent beneficiaries. If there are no contingent beneficiaries, the assets will pass to the default beneficiary stated in the IRA opening document (typically the estate).

Q A deceased IRA holder had not taken her required minimum distribution (RMD) before she died this year. If her beneficiary distributes the year-of-death RMD, can the beneficiary disclaim the rest of the IRA assets?

A Revenue Ruling 2005-26 states that the beneficiary of a deceased IRA holder can disclaim the assets remaining in the IRA after taking the RMD. If the net income is distributed by September 30 of the year following the year of death, the disclaiming beneficiary will not be considered a designated beneficiary for life expectancy determination.

B

PRICING SURVEY

Rates as of week ended 6/13/08 for a \$2,000 deposit (Stated in annual percentage yield when available)

Banks and Savings and Loan Associations

	6-mo. Fixed	1-yr. Fixed	18-mo. Var.	3-yr. Fixed	5-yr. Fixed
Bank of America (Atlanta)	1.60	3.01	2.00	3.26	4.01
Bank of America (Charlotte, NC)	1.60	3.01	2.00	3.26	4.01
Bank of America (San Francisco)	1.60	3.00	2.00	3.25	4.00
Bank of America (Seattle, WA)	NA	2.75	NA	3.00	3.75
Bank One (Chicago)	1.75	1.75	NA	2.25	NA
Banknorth Connecticut (Connecticut)	2.00	3.25	3.40	NA	NA
Chase Manhattan Bank NA (NYC)	1.75	1.75	NA	2.25	NA
Citibank (NYC)	2.00	2.00	NA	3.25	3.75
Citizens Bank (Philadelphia, PA)	NA	2.50	NA	3.00	3.25
First Union Wachovia (Charlotte, NC)	1.11	1.21	NA	1.90	2.50
Guaranty Federal Bank (Dallas)	3.00	2.50	NA	3.00	3.25
KeyBank National Association (Cleveland)	1.85	1.60	1.85	2.35	4.10
MBNA America (Newark, DE)	1.60	3.01	2.00	3.26	4.01
Regions Bank (Birmingham, AL)	NA	2.40	2.22	2.70	2.90
Washington Mutual (Los Angeles)	1.25	1.25	1.50	NA	4.25
Wells Fargo Bank (San Francisco)	1.35	1.45	NA	NA	NA

NA = This specific term is not available.

MMDA for IRAs

Bank of America (Atlanta)	2.25
Bank of America (Charlotte)	2.25
Bank of America (San Francisco)	2.25
Bank of America (Seattle)	2.25
Chase Manhattan (NYC)	.20
Citibank (NYC) ¹	NA
Citizens Bank (Philadelphia)	NA
First Union Wachovia (Charlotte)	.04
KeyBank National Association (Cleveland)	.25
MBNA America (Newark, DE)	2.25
Washington Mutual (Los Angeles)	.10
Wells Fargo Bank (San Francisco)	.10

¹ New York Yield

Credit Unions

	Yield
Alliant Credit Union	2.68 ¹
Citizens Equity FCU	2.95 ^{2*}
Dearborn Federal CU	2.50 ^{3*}
Navy Federal CU	3.05 ⁴
Pentagon FCU	4.88 ⁵

* Rate, not yield

¹ Current quarter

² 1-year, \$1,000 min.

³ Variable acct. is .50%; 1-year fixed rate, \$1,000 min. is 4.91%;

2-year fixed rate, \$1,000 min. is 4.18%

⁴ 3-year certificate

⁵ 2-year is 4.76%; 3-year is 5.31%; share is 1.25%

STRIPS

(Separate Trading of Registered Interest and Principal of Securities)

Maturities	Wholesale Yield ¹
5 Year	3.70
10 Year	4.25
15 Year	4.75
20 Year	4.85
25 Year	4.80

¹ Suggested yields provided by A. G. Edwards, St. Louis, MO

Money Market Mutual Funds

	7-Day Avg. Yield	30-Day Avg. Yield
American Century Investments – Fund I	1.41	NA
Dreyfus Worldwide Dollar Money Market Fund	2.45	2.45
Federated Municipal Securities	NA	NA
Hartford Mutual	1.59	1.64
Merrill Lynch Retirement Reserves	NA	NA
Scudder Investments		
Zurich Money Market Fund	2.67	NA

Insurance Companies

	Single Premium Deferred Annuity	Flexible Premium Deferred Annuity
Beneficial Standard Life Ins. Co.	NA	NA ¹
Equitable Life Assurance	NA	NA
Hartford Life Insurance	4.10	NA
John Hancock Mutual	3.00	3.50
Massachusetts Financial	NA	6.35 ²
New York Life (NYLIAC)	3.00	3.15
Prudential Ins. Co.	NA	NA
Transamerica Life	2.00 ³	NA
Travelers Ins. Co.	NA	NA

¹ 3% interest rate bonus if initial deposit

² 5-year fixed rate, Focus 5

³ Trans 6, \$5,000 min., includes 2% bonus