IRA Fact Book

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The information addresses a wide variety of IRA topics. It will occasionally be necessary to refer to a more comprehensive text or other source to answer some questions. If you are unsure of an answer, consult a competent professional.

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The IRA Fact Book is updated regularly to incorporate new guidance issued throughout the year.

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Introduction

The *IRA Fact Book* is a concise, comprehensive reference tool that reflects the most common questions IRA administrators receive from IRA owners and from departmental colleagues. The answers are provided by Ascensus’ attorneys, CPAs, and certified IRA consultants. It may be necessary, however, to refer to more comprehensive text or other source to answer some questions. If you have questions, consult a competent professional.

The *IRA Fact Book* contains, by subject matter, the same practical topics and guidance IRA administrators face on a regular, sometimes daily, basis. It also includes some of the hard-to-answer questions that don’t always have clear answers. We’re certain you’ll use the *IRA Fact Book*—an invaluable resource tool—time and again.

The *IRA Fact Book* is not intended to be the ultimate authority on IRA issues. Ascensus has more in-depth information on IRAs available in the *IRA Reference Service* and the *IRA Compliance* manual. These two sources have been designed to include not just the basic information necessary to manage IRAs, but also the background information and IRS cites necessary to understand how and why to administer these requirements.

Hyperlinks to externally hosted forms on IRS.gov generally go to the version identified by the IRS as the most current version of the form, unless there is some instructional value to linking to a specific year’s form. When linking out to an external IRS form, please verify that you’ve reached the version you intended, in case the IRS updates its URL addresses before the next update of this manual.
Chapter 1
IRA Basics

1.1 What is an IRA?

An individual retirement arrangement (IRA) is a special domestic trust, custodial account, or annuity endorsement established to hold assets for an individual's retirement. An IRA is not a certificate of deposit, money market account, or any other type of investment.

1.2 When were IRAs created?

In 1974, Congress passed the Employee Retirement Income Security Act of 1974 (ERISA). IRAs were created by ERISA, effective January 1, 1975, as a way for individuals to save for retirement on their own. Roth IRAs were created by the Taxpayer Relief Act of 1997.

1.3 Why were Traditional IRAs originally established?

Traditional IRAs were established to supplement retirement savings, promote economic growth, and lessen the burden on social programs. At first, IRAs only were available to individuals who were not covered by a retirement plan through their employer. But IRAs now are available to even those individuals who participate in employer-sponsored retirement plans.
1.4  
**Who offers IRAs?**

IRAs may be established as individual retirement (IR) accounts or IR annuities. IR accounts are established with banks, savings and loan associations, credit unions, brokerage firms, or other organizations that can demonstrate to the Internal Revenue Service (IRS) the ability to lawfully administer the trust.

IR annuities generally are established through insurance companies using a contract and endorsement that the IRS has approved.

1.5  
**What are the benefits of having an IRA?**

All taxpayers should have a savings plan to guarantee a financially secure retirement. IRAs can be an important part of this savings plan because they provide significant income for retirement and offer tax benefits along the way.

1.6  
**What is a deemed IRA?**

A deemed IRA is a Traditional or Roth IRA established within a qualifying employer-sponsored retirement plan. Under a qualifying retirement plan, a participant may make voluntary employee contributions that are treated as IRA contributions. The contributions must be made to separate IRAs established under the employer’s plan, and must meet the requirements of Traditional or Roth IRA contributions. IRA reporting rules apply. A qualifying plan includes 401(a) and 403(a) qualified retirement plans, 403(b) plans, and governmental 457(b) plans.
Chapter 2
Establishing a Traditional IRA

Fundamentals

2.1

How are Traditional IRAs established?

A Traditional IRA is created when an individual signs an IRA plan agreement. The financial organization must give a copy of the IRA plan agreement to the individual when the IRA is established. The financial organization also must give the individual a disclosure statement, which includes a financial disclosure.

2.2

How many Traditional IRAs may an IRA owner have?

IRA owners may have more than one Traditional IRA. If an individual signs one set of opening documents and makes contributions for subsequent tax years under that same plan agreement, only one Traditional IRA exists. If an individual has more than one IRA, she must aggregate all her contributions made to Traditional and Roth IRAs for a given year to stay within specified annual contribution limits.
2.3

**Q**

**Does a financial organization’s Customer Identification Program apply to IRAs?**

**A**

All financial organizations must have in place a Customer Identification Program (CIP) that generally applies to all types of financial accounts, including IRAs. The CIP must contain reasonable procedures for verifying the identity of any person seeking to open a new account, maintaining records of the information used to verify a person’s identity, and determining whether a person appears on “terrorist lists.”

2.4

**Q**

**What should be included in an IRA owner’s file?**

**A**

At a minimum, an IRA owner’s file should include a copy of the IRA plan agreement containing the IRA owner’s signature (or acknowledgment by the IRA owner that he has received a plan agreement and disclosure statement), a beneficiary designation, any required deposit information, a copy of the IRA owner’s documentation verifying the identity (new clients only) according to CIP procedures, and a signature card (if used).

2.5

**Q**

**An IRA owner asked us if he can title his IRA in the name of his living trust. May he do that?**

**A**

No. An IRA owner may not title an IRA in the name of a living trust. IRAs may be established only for the benefit of an individual. An IRA is an individual’s trust with a financial organization generally acting as trustee for the assets. IRA owners may, however, name a living trust as an IRA beneficiary. Upon the IRA owner’s death, the IRA will pay into the trust and the trustee of the trust may disburse the assets according to the trust provisions.
2.6
Q
An individual recently asked us to establish a Traditional IRA for her four-year-old daughter. She said that her daughter had compensation as a child model. May a child have a Traditional IRA and, if so, who should sign the IRA plan agreement?

A
From a federal tax law standpoint there are no minimum age restrictions. Even children who have eligible compensation (earned income) may establish IRAs. When individuals establish IRAs, they are entering into a contract with the financial organization. In most states, there are restrictions on the ability of minors to enter into a valid contract. In some states, a contract requires the co-signature of a parent or legal guardian. Financial organizations should meet with their attorney and establish procedures to follow when a minor establishes an IRA.

2.7
Q
What is the difference between a SEP IRA and a Traditional IRA?

A
An IRA that accepts simplified employee pension (SEP) plan contributions (sometimes called a SEP IRA) is nothing more than a Traditional IRA funded by employer contributions under an employer’s SEP plan, or employee salary deferral contributions under a salary reduction SEP (SAR-SEP) plan. Once the employer or employee makes a SEP plan contribution to an IRA, the contribution becomes Traditional IRA assets subject to IRA rules and regulations.
2.8 IRA owners sometimes ask us to transfer their assets to brokerage firms or investment companies. May these types of organizations act as IRA trustees or custodians?

A Yes. Upon IRS approval, these organizations may act as nonbank trustees or custodians, thereby serving as trustee or custodian for IRAs. The IRS approval process requires the organization to submit a written application to the IRS as explained in Treasury Regulation (Treas. Reg.) 1.408-2(e). The organization must provide the IRS with satisfactory evidence that it is qualified to act as a trustee or custodian for retirement plans.

IRA Documentation

2.9 What documents are given to the IRA owner at the time a Traditional IRA is established?

A When a Traditional IRA is established, IRA owners must receive the following documents.

- IRA plan agreement
- Disclosure statement
- Financial disclosure

Beneficiary designation and deposit forms generally are filled out when the IRA is established.
2.10  
**What is a Traditional IRA plan agreement?**

A Traditional IRA plan agreement is the “contract” between the financial organization and the individual for whom the IRA is created. The Traditional IRA plan agreement may be a model Form 5305, *Traditional Individual Retirement Trust Account*, or Form 5305-A, *Traditional Individual Retirement Custodial Account*. The plan agreement also may be a prototype (which is written by a plan provider and generally submitted to the IRS for approval).

2.11  
**What is the purpose of a plan agreement?**

The IRA plan agreement provides the terms of the contract between the financial organization and the individual establishing the IRA. Some of the issues covered in the plan agreement include the contribution limits, an explanation that IRA assets are nonforfeitable, the restrictions on IRA investments, the distribution rules, the IRA owner’s responsibilities, the financial organization’s responsibilities, and additional provisions.

2.12  
**Is there a model agreement for Traditional individual retirement annuities?**

No. Form 5305, *Traditional Individual Retirement Trust Account*, and Form 5305-A, *Traditional Individual Retirement Custodial Account*, are model plan agreements only for Traditional individual retirement accounts under *Internal Revenue Code Section (IRC Sec.) 408(a)*. Currently, the IRS does not have a model plan agreement for Traditional individual retirement annuities, which are plans
created under IRC Sec. 408(b). Accordingly, the issuer of a Traditional individual retirement annuity must use a prototype. Prototype plans (generally a contract plus an IRA endorsement) usually are submitted to the IRS for approval on behalf of the financial organization sponsoring the prototype plan. In addition, IR annuity contracts must be state approved. Consequently, organizations that offer IR annuities must submit their IRA documentation to the state insurance commissioner for approval.

2.13

Q How do law changes affect IRA plan agreements?

A IRA laws change often, and law changes may affect the documents a financial organization uses to operate its IRA program. IRA owners generally should receive amendments to the plan agreement and disclosure statement when necessary for law changes.

2.14

Q I know we have to provide disclosure statements when Traditional IRAs are established. Can you explain the disclosure rules and when we must amend our disclosure statements?

A Financial organizations must provide detailed disclosure statements to individuals, along with a copy of the plan agreement (Forms 5305, Traditional Individual Retirement Trust Account, 5305-A, Traditional Individual Retirement Custodial Account, or prototype) which, together, establish the IRA. The disclosure statement must contain nontechnical language explaining IRA rules.
When individuals establish IRAs, they must be given disclosure statements that have up-to-date information. Amendments to the disclosure statement are required when a plan agreement is amended and the changes to the plan agreement affect information in the disclosure statement. There is a $50-per-IRA penalty if the financial organization fails to provide an amended disclosure statement when necessary.

2.15

What recent law changes or IRS guidance may require disclosure statement amendments?

A number of changes to IRAs took place in 2006 and later resulting from the Pension Protection Act of 2006 (PPA) that required disclosure statement amendments. More recently, the following laws and IRS guidance have made additional changes to IRAs, which may require disclosure statement amendments.

- The Bipartisan Budget Act of 2018 provided rollover relief for returns of improper IRS levies, and extended the 60-day rollover period for plan loan offset amounts due to plan termination or severance from employment.

- The Tax Cuts and Jobs Act of 2017 eliminated the ability to recharacterize Roth IRA conversions and employer-sponsored retirement plan rollovers to Roth IRAs, effective for conversions and rollovers in 2018 and later tax years. For 2017 and 2018, this legislation also reduced the AGI threshold from 10% to 7.5% for the qualified medical expense penalty exception.

- IRS Announcement 2014-15 limits the number of IRA-to-IRA rollovers to one per taxpayer per 12 months for distributions taken on or after January 1, 2015.
Financial Disclosures

2.16

Q May we use the same example in each IRA financial disclosure projection that we complete?

A No. Treas. Reg. 1.408-6(d)(4)(v) specifies that the financial projection is based upon terms no different from those of the investment used by the IRA owner to establish the IRA. A new projection is required for each IRA owner when he opens an IRA. The financial disclosure must indicate the IRA’s projected value at the end of each of the first five years and at the end of the years in which the IRA owner attains ages 60, 65, and 70.

2.17

Q What interest rate must a financial organization use in the financial disclosure when an IRA owner establishes a new IRA?

A According to the federal regulations, the interest rate used in projecting values in a financial disclosure may not be greater than the actual rate of return being paid on the initial plan investment at the time of plan establishment. It is permissible to use an interest rate in the projection that is less than the actual rate being paid on the initial IRA investment.

2.18

Q When interest rates fall, must existing IRA owners receive amended financial disclosures?

A No. The financial disclosure projection is simply a hypothetical projection of growth within the IRA. This projection of growth is based solely on the initial IRA investment. Future interest rates are not guaranteed. If properly completed, financial disclosures are not required to be amended.
2.19

**Q** We have recently changed the compounding method on our fixed rate IRA investments. Will this affect how we complete our IRA financial disclosure statements?

**A** Yes. Treas. Reg. 1.408-6(d)(4)(v)(B)(1) indicates that an IRA financial disclosure is based on an interest rate no greater than and terms no different from the actual investment used to establish an IRA. Therefore, a financial disclosure should reflect the actual or a less frequent compounding method used for the investment at the time of establishment.

2.20

**Q** What are the rules for financial disclosures on self-directed Traditional IRAs?

**A** When an individual chooses mutual funds, stocks, bonds, or similar investments as the initial investment in an IRA, a reasonable financial projection is not possible. Therefore, the rules for financial disclosures for these types of investments, which are common in self-directed IRAs, are as follows.

**Investment Options** – Provide a general description of the investments offered through the self-directed IRA program.

**Fees** – Provide a general description of the fees that the financial organization may apply to the self-directed IRA.

**Earnings** – Provide a general description of how the earnings are computed on the available investments. Include a statement that the IRA’s growth in value is neither guaranteed nor projected.

**Other** – Provide a statement disclosing any other terms or conditions that may apply to the self-directed IRA (e.g., disclose that the financial organization will debit and credit the security transactions to a settlement account).
2.21

**Q** Is a financial disclosure required when establishing a Traditional IRA with a rollover or transfer contribution?

**A** Yes. A financial disclosure is required when establishing a Traditional IRA with a rollover or transfer contribution. The process of determining the projection for a rollover or transfer is similar to the process used when establishing the IRA with a regular IRA contribution. The only difference is that the projection for IRAs established with rollovers and transfers is based on a one-time $1,000 deposit made on the first day of the year rather than on $1,000 deposits made on the first day of each year, which is used for projections for IRAs established with regular IRA contributions.

2.22

**Q** When establishing a Traditional IRA with a simplified employee pension (SEP) plan contribution, rather than a regular or rollover IRA contribution, how do I complete the financial projection portion of the IRA’s financial disclosure?

**A** Treas. Reg. 1.408-6(d)(4)(v), (vi), and (vii) contains certain contribution assumptions when establishing a Traditional IRA with either a regular or rollover IRA contribution. If establishing an IRA with a regular IRA contribution, the projection assumes that a $1,000 contribution is made on January 1 of each year. If a rollover contribution is used to establish the account, the assumption is that a single $1,000 contribution is made on January 1 of that year. No specific mention is made of IRAs established with a SEP plan contribution.
Because IRAs established with SEP plan contributions generally are expected to have additional SEP plan contributions, and because many IRA owners will make regular annual IRA contributions to IRAs that contain SEP plan contributions, Ascensus recommends completing the financial projection in the same way as for IRAs established with regular contributions, including the assumption of annual $1,000 contributions.

**IRA Beneficiary Designations**

### 2.23

**Q** Must an IRA owner name a beneficiary, and, if so, what information should a financial organization obtain regarding IRA beneficiaries?

**A** An IRA owner is not required to name a beneficiary. But financial organizations often encourage an IRA owner to name a beneficiary to guarantee that the IRA assets will pass to the individual or entity that the IRA owner prefers. Financial organizations should obtain the names, addresses, Social Security numbers, and birth dates of all IRA beneficiaries.

If an IRA owner does not name a beneficiary, the financial organization should check the terms of the IRA plan agreement and possibly state law to determine who or what entity will receive the IRA assets. IRA assets typically will pass to the deceased IRA owner’s estate if a beneficiary is not named.
2.24

Q  May an IRA owner name more than one primary beneficiary?

A  Yes. An IRA owner may name multiple primary beneficiaries. If an IRA owner names multiple beneficiaries, each beneficiary receives a portion of the decedent’s IRA balance.

An IRA owner also may name multiple contingent beneficiaries in addition to primary beneficiaries.

2.25

Q  How does the spousal consent section on the application portion of the Ascensus IRA Simplifier® apply?

A  The spousal consent is essential in community property states when an IRA owner wishes to name a beneficiary other than, or in addition to, a spouse. Community property states are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. Wisconsin’s Marital Property Act also is based on key community property principals. Alaska has also adopted community property laws, but the married couple must make an election to have these laws apply.

In the states requiring spousal consent, if the spouse has not consented to the naming of another beneficiary, the spouse generally is entitled to a portion of the IRA assets when the IRA owner dies—even if someone else is designated as beneficiary. Note that spousal consent generally is not necessary in noncommunity property states. The financial organization should check state law to see if spousal consent is recommended even though the state is not a community property state.
I’ve heard the terms “per capita” and “per stirpes” mentioned in relation to IRA beneficiary forms. What do these terms mean?

Beneficiary forms typically follow either a per capita or per stirpes design. A per stirpes designation generally requires the portion of assets that are earmarked for a deceased beneficiary to pass to that beneficiary's descendants if the beneficiary predeceases the IRA owner. These may be difficult to administer if the beneficiaries are not clearly identified on the designation form.

A per capita designation generally requires assets to pass to members of the same “class” of living beneficiaries or to specific living beneficiaries. In general, the intended recipient of the assets is explicitly named on the beneficiary form (along with an address, telephone number, and Social Security number). A per capita beneficiary designation generally terminates a primary beneficiary's interest in the IRA assets if she dies before the IRA owner, and thus, her assets do not pass to her descendants. Any other primary beneficiaries who outlive the IRA owner generally share the deceased beneficiary's portion. Ascensus’ IRA beneficiary forms are drafted following a per capita design.

May IRA beneficiaries name subsequent beneficiaries to receive payouts following the death of the initial beneficiary?

IRS rules have never prohibited beneficiaries from naming a beneficiary for their inherited IRAs or retirement accounts. But IRS rules do prohibit extending the IRA's tax-deferred status beyond that which is available to the original beneficiary. The IRS commented on this topic in a 1999 private letter ruling (PLR). PLR 199936052 indicates that
allowing a beneficiary to name a beneficiary does not violate any federal tax laws, as long as no attempt is made to extend the life expectancy beyond the original beneficiary’s life expectancy.

This PLR also caused many financial organizations to reconsider their policies on forced distributions from inherited IRAs. In the past, many of these organizations had required that the inherited IRA balance be paid immediately to the original beneficiary’s estate upon the beneficiary’s death.

Before adopting a policy of allowing IRA beneficiaries to name beneficiaries, financial organizations should carefully examine their IRA documents to determine whether document language supports beneficiaries naming beneficiaries.

2.28

Q May nonspouse beneficiaries roll over inherited assets from employer-sponsored retirement plans to “inherited” IRAs?

A Yes. The Pension Protection Act of 2006 allows nonspouse beneficiaries to directly roll over inherited assets from qualified retirement plans, governmental 457(b) plans, and 403(b) plans to inherited IRAs. IRS Notices 2008-30 and 2009-68 clarify that spouse beneficiaries may roll over assets from an employer-sponsored retirement plan to an inherited Traditional or Roth IRA.

An inherited IRA established under these provisions must identify both the deceased plan participant and the beneficiary (e.g., “Tom Smith as beneficiary of John Smith”).

If a beneficiary rolls over inherited retirement plan assets or if a beneficiary completes a trustee-to-trustee transfer of inherited IRA assets, the financial organization may use a form such as Ascensus’ Inherited IRA Simplifier® to create an inherited IRA.
Chapter 3
Traditional IRA Contributions

Funding a Traditional IRA

3.1

Q Who is eligible to make Traditional IRA contributions?

A An IRA owner must be under age 70½ and generally must have compensation from personal services rendered to contribute to a Traditional IRA (IRS Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs)). Compensation generally is what an individual earns from working (earned income). (See Question 3.25.)

3.2

Q One of our IRA owners said that the last day to make a Traditional IRA contribution for the year is December 31. Is he correct?

A No. IRC Sec. 219(f)(3) specifically permits IRA owners to make Traditional IRA contributions for any year up until their tax return due date for the year (not including extensions), generally April 15. If the deadline for filing an individual’s federal tax return falls on a Saturday, Sunday, or legal holiday, the individual will have until the following business day to make his contribution (IRC Sec. 7503).
3.3  
Q  Is a mailed IRA contribution that is postmarked on or before the deadline (generally April 15) but received after the deadline considered to have been made in a timely fashion?

A  Yes. Under IRC Sec. 7502(a), any payment delivered by U.S. mail, or an IRS-approved delivery service, after the deadline is deemed made on the postmarked date. Ascensus recommends that financial organizations accepting such contributions after April 15 save the envelope bearing the postmark in the IRA owner's file, and contact the individual to verify the tax year to which the contribution relates if it is not clear based on the documentation that is submitted with the check.

3.4  
Q  What information should the financial organization obtain when a Traditional IRA contribution is made?

A  When a Traditional IRA contribution is made, a financial organization should obtain the following information.

- The amount
- The type of contribution (i.e., regular, spousal, rollover, simplified employee pension (SEP), transfer, or recharacterization)
- The tax year for which the contribution is made
- Any necessary investment information
- The IRA owner’s signature
3.5

Q  May self-employed IRA owners contribute to a Traditional IRA if they also contribute to a SEP plan?
A  Yes. They may make Traditional IRA contributions, provided they are under age 70½ and have eligible compensation. But note that contributing to a SEP plan makes individuals active participants in an employer-sponsored retirement plan for the years in which they contribute. Their IRA contributions may or may not be fully deductible, depending on their modified adjusted gross income levels.

3.6

Q  What is the deadline for making a Traditional IRA contribution for a noncalendar-year taxpayer?
A  IRA owners have until the deadline for filing their federal tax returns to make a Traditional IRA contribution regardless of whether they file on a noncalendar-year basis. Almost all individual taxpayers, however, file on a calendar-year basis, and generally have until April 15 to make a Traditional IRA contribution.

3.7

Q  Can contributions be made to Traditional IRAs of individuals age 70½ or older?
A  Yes, but only in three situations.

1. When employers fund SEP plans, they must make a SEP plan contribution to the Traditional IRAs of employees age 70½ and older if the employees have met the plan’s eligibility requirements.
2. Traditional IRA owners age 70½ and older also may make qualifying transfers or rollovers after they turn 70½. But IRA owners may not roll over their required minimum distributions.

3. Traditional IRA owners in their 70½ year may make a prior-year contribution (a contribution made between January 1 and April 15 for the prior tax year), provided they were eligible to make a contribution for the prior tax year.

3.8

Q An employer recently asked us to establish a payroll deduction IRA program for her employees. What exactly is a payroll deduction IRA program?

A A payroll deduction IRA is simply a Traditional or Roth IRA funded with amounts voluntarily deducted directly from the IRA owner’s paycheck. An employer may establish a payroll deduction IRA program even if employees are covered by an employer-sponsored retirement plan.

If an employer wants to offer a payroll deduction program to its employees, the employer must meet certain requirements so that the program is not considered a pension plan under Title 1 of the Employee Retirement Income Security Act of 1974 (ERISA). If the employer’s payroll deduction IRA program does not follow these requirements, the program may be considered an employee pension benefit plan and subject to numerous ERISA requirements (DOL Regulation 2510.3-2(d)).

In August 2016 the DOL issued final regulations providing a safe harbor for state-mandated payroll reduction IRA programs. These programs will be exempt from ERISA if certain conditions are met.
3.9

**Q** What is the contribution limit for a Traditional IRA?

**A** An eligible individual may contribute the lesser of the annual contribution limit, or 100 percent of eligible compensation (generally, earned income) to an IRA.

<table>
<thead>
<tr>
<th>Year</th>
<th>Contribution Limit</th>
<th>Catch-up</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$5,500</td>
<td>$1,000</td>
</tr>
<tr>
<td>2019</td>
<td>$6,000</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

Also, IRA owners who are age 50 and older may make catch-up contributions of up to $1,000 annually.

The contribution limit is an aggregate limit for all Traditional and Roth IRAs. So the maximum amount that an individual may contribute to a Traditional IRA is reduced by any contributions the individual has made to other Traditional IRAs and to Roth IRAs for the same year.

3.10

**Q** Must an IRA owner have earned income to be eligible to make a catch-up contribution?

**A** Yes. Individuals age 50 and older (before the end of the applicable calendar year) may make catch-up contributions (up to $1,000 annually) to their Traditional or Roth IRAs. *Treasury Regulation (Treas. Reg.) 1.414(v)-1* confirms that the eligibility factors that apply to regular contributions also apply to catch-up contributions, including consideration of deductibility and the requirement to have eligible compensation to support the contribution.
3.11

Q May a Traditional IRA owner make an IRA contribution in 2019 for tax year 2020?

A No. Individuals must make IRA contributions for a specific year during the period beginning with the first day of the individual’s tax year (generally January 1) and ending with the tax return due date for the applicable year (excluding extensions).

3.12

Q An IRA owner has a certificate of deposit (CD) at our organization worth $5,000. This CD is not in an IRA. Can she put this CD in her Traditional IRA and treat that as an IRA contribution?

A No. IRC Sec. 408(a)(1) states that contributions to Traditional IRAs, other than rollover or transfer contributions, must be made in cash. For this purpose, cash generally means currency, check, or money order.

3.13

Q A Traditional IRA owner made his 2018 IRA contribution on April 1, 2019, but filed his federal tax return on August 15, 2019, because he had a filing extension. Does the fact that he did not file his return on or before the day he made his IRA contribution affect his 2018 IRA contribution?

A No. Traditional IRA regular contributions must be made by the IRA owner’s federal tax return due date (usually April 15) not including extensions. There is no requirement that the IRA owner actually file by the due date if an extension has been granted. Your IRA owner properly funded his IRA for 2018 before the 2018 deadline, and also properly filed his 2018 federal tax return by the tax filing extension deadline.
We have a client who is serving in the military this year, and has not made her IRA contribution yet. Do military personnel have extra time to make IRA contributions?

Yes. As noted in IRS Publication 3, Armed Forces Tax Guide, the extended deadline to complete related tax actions (including making IRA contributions) for members of the U.S. Armed Forces serving in a combat zone, qualified hazardous duty area, or contingency operation is

- 180 days after the last day an IRA owner served in the area (or, if later, the last day of qualified hospitalization because of related injuries), plus
- the number of days that remained to complete the tax action (e.g., to file an income tax return) after the IRA owner entered the combat zone.

When making an IRA contribution under a qualifying service extension, IRA owners must designate the contribution for a prior year to claim it as a deduction on the income tax return for the applicable year.

What are recontributions made by military personnel?

Qualified reservists (including National Guard personnel) on active duty for a period of at least 180 days—or for an indefinite amount of time—generally may take penalty-free distributions from IRAs and from deferrals in 401(k) plans, 403(b) plans, and certain pre-ERISA plans under IRC Sec. 501(c)(18). This applies to distributions taken between the date of the order or call to duty and the end of the active duty period.
Qualified reservists may “recontribute” these distributed amounts to IRAs within two years following the end of the active duty period.

A qualified reservist may not take a deduction for the recontributed amounts. Financial organizations should report any recontributed amounts in Boxes 14a and 14b on Form 5498, IRA Contribution Information.

**Traditional IRA Spousal Contributions**

**3.16**

**Q** What is the maximum amount an individual may contribute to a Traditional IRA as a spousal contribution?

**A**

Spousal contributions for 2019 are limited to the lesser of:

- $6,000 ($5,500 for 2018) plus an additional $1,000 if age 50 or older, or
- the couple’s combined eligible compensation reduced by any contributions made to the compensated spouse’s Traditional IRA or Roth IRA.

A couple’s maximum combined contribution amount is $12,000 for 2019 or $11,000 for 2018 ($14,000 for 2019 if both spouses are age 50 or older), assuming they have enough combined compensation to make the maximum combined IRA contribution. A couple may not contribute more than $6,000 ($7,000 if age 50 or older) to each spouse’s IRA.

Keep in mind that the maximum amount an individual may contribute to a Traditional IRA is reduced by any contributions the individual has made to other Traditional IRAs and to Roth IRAs for the same year.
3.17

Q One of my clients is an unemployed IRA owner whose husband has income and makes IRA contributions on her behalf. May her husband also make catch-up contributions for her?

A Yes. Spousal catch-up contributions are allowed for qualifying individuals. Individuals age 50 and older (before the end of the applicable year), who are otherwise eligible to make IRA contributions, may make catch-up contributions of up to $1,000 annually to Traditional or Roth IRAs.

3.18

Q This year, one of our Traditional IRA owners who is under age 70½ did not have earned income from his business. Is he eligible to make a spousal IRA contribution based upon his wife’s compensation?

A Yes. He is eligible to make a spousal contribution as long as his wife has eligible compensation and they file a joint tax return. There is no requirement for his wife to have her own IRA.

3.19

Q May my client have a joint IRA with his wife, and make both a regular contribution for himself and a spousal contribution for his wife to the joint IRA?

A No. According to IRS Publication 590-A, couples cannot both participate in the same IRA. Each spouse must have a separate IRA.
3.20

**Q** May a Traditional IRA owner age 70½ or older who is still working make a spousal contribution to his wife’s Traditional IRA if she is under age 70½ and does not work?

**A** Yes. IRS Announcement 88-80 and IRS Publication 590-A clarify that a compensated spouse age 70½ or older is eligible to make a spousal contribution for the noncompensated spouse as long as the noncompensated spouse is under age 70½. The IRA owner may contribute 100 percent of his eligible compensation up to the applicable contribution limit ($5,500 for 2018 and 6,000 for 2019, plus catch-up contributions, if eligible) to his wife’s Traditional IRA.

3.21

**Q** May an IRA owner make a spousal contribution to the Traditional IRA of his spouse who died earlier in the year?

**A** In this situation, the spouse generally is not allowed to make the contribution. The IRS has indicated that IRA owners must be alive to make contributions to their Traditional IRAs. In 1984, the IRS issued Private Letter Ruling (PLR) 8439066, which states that if an estate makes a regular or spousal contribution to the IRA of a decedent, it is considered an excess contribution. In this ruling, the IRS position was clear. A posthumous contribution is considered an excess contribution and possibly subject to a six percent penalty tax.

In 1985, the IRS issued PLR 8527083 permitting a woman who was filing a 1984 joint income tax return for the year of her husband’s death to make a spousal contribution to her own IRA based upon her deceased husband’s income. She made the contribution after his death, but it was to her own IRA, not to his. The IRS restated its position in this PLR that no contribution could be made to the husband’s IRA because he was deceased.
Although PLRs can be relied on only by the individual applying for the ruling, they are a good indication of the IRS position on such issues.

**Prior-Year Contributions**

**3.22**

**Q** What is a prior-year contribution?

**A** A prior-year contribution is a contribution made to a Traditional or Roth IRA between January 1 and April 15 for the prior tax year. Financial organizations should obtain the IRA owner’s written confirmation of the year for which the contribution is being made.

**3.23**

**Q** If an IRA owner makes a Traditional IRA contribution between January 1 and April 15 and does not designate for which year the contribution is made, should we assume the deposit is a prior-year contribution or a current-year contribution?

**A** Proposed Treas. Reg. 1.219-1(d)(2) specifically states that a contribution made by the tax return filing deadline for the taxable year is treated as made for such taxable year if the election to make a contribution for such taxable year is irrevocably specified in writing. An IRA owner who is making a prior-year contribution must provide a written irrevocable election to treat a contribution made between January 1 and April 15 as made for the prior year. Financial organizations may use a deposit form to obtain the written certification.

If the IRA owner does not specify in writing the year for which the contribution is made, the receiving financial organization must post the contribution as a current-year contribution.
3.24

**Q** May IRA owners claim Traditional IRA contributions on their tax returns if they have not made the contribution at the time of filing, but make the contribution by the contribution deadline (generally April 15)?

**A** Yes. IRA owners may claim an IRA deduction and file their tax returns before making the contribution as long as they actually make the contribution before the tax return due date. IRA owners who claim a deduction, but who do not make an IRA contribution before the tax return due date and do not timely file an amended tax return will have understated their income. In this situation, IRA owners may be subject to penalties and additional taxes.

**Eligible Compensation**

3.25

**Q** What type of income is considered eligible compensation to make a Traditional IRA contribution?

**A** Any of the following sources generally are considered eligible income for IRA contributions. Also see IRS Publication 590-A.

- Any amount shown in the *Wages, tips, other compensation* Box on Form W-2, *Wage and Tax Statement*, minus any amount shown in the *Nonqualified plans* box.
- Taxable military pay, as well as nontaxable combat pay.
- Differential wage payments (wages paid by employers to employees who are on military active duty).
- Any salary, wages, tips, professional fees, commissions, and bonuses.
• Certain net earnings from self-employment (after deducting retirement plan contributions and one-half of self-employment taxes)

**NOTE:** Before January 1, 2019, taxable alimony was also considered eligible compensation for IRA contribution purposes.

### 3.26

**Q** One of our clients is a 65-year-old, retired IRA owner who is receiving sizable dividends from stock. He also is expecting to have about $1,500 in earned income this year. He wants to contribute the maximum ($7,000) into his Traditional IRA for 2019. May he put the maximum amount into his Traditional IRA?

**A** No. Individuals may use only compensation from services rendered (earned income) to fund a Traditional IRA. Because your IRA owner only has $1,500 of earned income, he may contribute only $1,500 to his IRA.

### 3.27

**Q** If an individual owns two sole proprietorships and one business shows a net profit and the other shows a net loss, must the individual aggregate the gain and the loss to determine her earned income for purposes of making a Traditional IRA regular contribution?

**A** For sole proprietorships, business income is aggregated to determine an individual’s eligible compensation (earned income) for IRA contribution purposes. For example, if one business showed a $20,000 profit and the other business showed a $20,000 loss, the sole proprietor would have no earned income for purposes of making a Traditional IRA regular contribution.
3.28  Q  Does money contributed to a Traditional IRA have to come directly from compensation? Can it come from savings or other investment sources?

A  Although compensation either qualifies or disqualifies an individual from making Traditional IRA contributions, the actual dollars put into the IRA may come from any source. These contributions, however, must be made in cash.

3.29  Q  One of our IRA owners who has been out of work since last year recently accepted a teaching position, which begins in two months. Can she make her annual IRA contribution now, even though she won’t begin working for a few months?

A  Yes. IRC Sec. 219 requires that individuals have eligible compensation during the tax year for which they wish to make a Traditional IRA contribution. There is no requirement that individuals actually receive the eligible compensation before making a Traditional IRA contribution. If your IRA owner does not start working, and thus does not earn enough qualifying income before the end of the year, she must remove the contribution along with the earnings attributable by her tax return due date to avoid paying a six percent excess contribution penalty tax.
Active Participation

3.30

Q Is it true that an individual who is an active participant in an employer-sponsored retirement plan is not eligible to make a Traditional IRA contribution?

A Anyone who is under age 70½ and has eligible compensation may make a Traditional IRA contribution. Active participation in an employer-sponsored retirement plan does not determine who may or may not make an IRA contribution. But an individual’s status as an active participant in an employer-sponsored retirement plan may limit the deduction that the individual may take with respect to a Traditional IRA contribution. An individual’s filing status and modified adjusted gross income, as reported on Form 1040, U.S. Individual Income Tax Return, are factors in determining the deduction that the individual may take. (See Question 3.35)

3.31

Q Who is considered an active participant in an employer-sponsored retirement plan?

A A Traditional IRA owner is considered an active participant if the IRA owner (and, under certain circumstances, the spouse) is a participant in one of the following retirement plans for any part of the applicable tax year.

- A qualified pension, profit sharing, or stock bonus plan (IRC Sec. 401(a))
- A qualified annuity plan (IRC Sec. 403(a))
- A simplified employee pension (SEP) plan (IRC Sec. 408(k))
- A savings incentive match plan for employees of small employers (SIMPLE) IRA plan (IRC Sec. 408(p))
• A plan established for its employees by the United States, by a state or political subdivision thereof, or by an agency or instrumentality of any of the foregoing (not including a plan under IRC Sec. 457)

• A tax-sheltered annuity (IRC Sec. 403(b))

An individual making deductible contributions to a trust described in IRC Sec. 501(c)(18) also is considered an active participant.

3.32

Q If an IRA owner is eligible to participate in an employer’s 401(k) plan during 2019 but chooses not to, is he considered an active participant when determining the deductibility of his 2019 IRA contribution?

A Generally, no. If no contributions or forfeitures are allocated on that individual’s behalf, he is not considered an active participant for 2019. Notice 87-16 clearly states that individuals are not considered active participants merely because they are eligible to participate in an employer’s 401(k) plan. If an individual is eligible to defer compensation into an employer’s 401(k) plan but elects not to (and if no other contributions or forfeitures are allocated on that individual’s behalf), he is not considered an active participant for that year. But if his employer makes a contribution on his behalf (e.g., a profit sharing contribution) he is an active participant for that year.

Employers must indicate on an employee’s Form W-2, if the employee is an active participant.
3.33

Q An employer established a SEP plan in February 2019 and made contributions for the 2018 tax year. Are the employees who were eligible for a contribution considered active participants for IRA deduction purposes in 2018 or 2019?

A They are considered active participants for the year in which the contribution was actually made—2019. But if a plan requires contributions (e.g., money purchase pension plan), then the participants are active participants for the year for which the contribution is required.

Deductibility and Nondeductibility

3.34

Q I know that if Traditional IRA owners are active participants in an employer-sponsored retirement plan, the deductibility of their Traditional IRA contributions will then depend on their modified adjusted gross income. How does the IRS define modified adjusted gross income?

A For purposes of IRAs, modified adjusted gross income (MAGI) is adjusted gross income modified by adding back in any IRA deductions, foreign earned income exclusion, foreign housing exclusion or deduction, exclusion of qualified savings bond interest, exclusion of certain adoption expenses, any tuition and fees deductions, any student loan interest deductions, and any domestic production activities deductions.
3.35

Q What are the income thresholds for Traditional IRA deductions?

A The following chart highlights the recent IRA deductibility MAGI phase-out ranges that active participants in employer-sponsored retirement plans use to calculate their deductible IRA contributions.

<table>
<thead>
<tr>
<th>Tax Year</th>
<th>Single filer</th>
<th>Married filing joint tax return</th>
<th>Married filing separate tax return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$63,000–$73,000</td>
<td>$101,000–$121,000</td>
<td>$0–$10,000</td>
</tr>
<tr>
<td>2019</td>
<td>$64,000–$74,000</td>
<td>$103,000–$123,000</td>
<td>$0–$10,000</td>
</tr>
</tbody>
</table>

The phase-out range for a nonactive participant married to an active participant is $189,000-$199,000 for 2018 and $193,000–$203,000 for 2019.

3.36

Q An IRA owner wants to make deductible contributions to Traditional IRA #1 and nondeductible contributions to Traditional IRA #2. Is it necessary to establish separate IRAs for nondeductible contributions?

A No. The individual is not required to establish a separate Traditional IRA to receive nondeductible contributions. An individual tracks nondeductible contributions on Form 8606, Nondeductible IRAs, which is filed with an individual’s tax return.
When IRA owners who have made nondeductible Traditional IRA contributions calculate the taxable portion of an IRA distribution, they must consider the aggregate value of all their Traditional, SEP, and SIMPLE IRAs, and determine the taxable portion of a distribution accordingly on a pro rata basis.

3.37

Q

May a Traditional IRA owner make a $6,000 deductible contribution and a $6,000 nondeductible contribution for the same tax year?

A

No. The lesser of the maximum contribution amount ($6,000 for 2019 or $5,500 for 2018, plus catch-up contributions, if eligible) or 100 percent of eligible compensation (generally earned income) is the maximum aggregate contribution that an IRA owner can make for one tax year. Individuals must aggregate all contributions made to their Traditional or Roth IRAs, and stay within this limit.

3.38

Q

Because IRA owners do not claim deductions for their nondeductible Traditional IRA contributions on their tax returns, do they still need to make nondeductible contributions by the tax return deadline of April 15?

A

Yes. As with deductible Traditional IRA contributions, individuals only have until their tax return due date (not including extensions) to make nondeductible contributions.

IRA owners must report nondeductible contributions on IRS Form 8606, Nondeductible IRAs, at the same time that they file a federal tax return.
3.39

Q A husband and wife, who are both active participants in retirement plans, are each eligible to deduct $3,750 of their $6,000 Traditional IRA contributions for 2019. May they make a $6,000 deductible contribution to the wife’s IRA and a $1,500 deductible contribution to the husband’s IRA?

A No. The deduction limits for a married individual who files a joint tax return with his or her spouse, when both are active participants in retirement plans, apply separately to each spouse. In the above example, the wife who deposits $6,000 to her IRA may treat only $3,750 as a deductible contribution. The husband’s $1,500 contribution is fully deductible. The total deduction on the couple’s joint tax return is $5,250 if they choose to split the contributions this way.

3.40

Q An IRA owner made a nondeductible contribution to her Traditional IRA. Now, two years later, the IRA owner has changed her mind and does not want to keep track of the nondeductible assets. May she remove nondeductible assets from her Traditional IRA after her tax return deadline, plus extensions, for the year for which the contribution was made?

A No. An IRA owner cannot simply remove the nondeductible assets. After the deadline, a Traditional IRA owner must remove the taxable and nontaxable assets according to an IRS formula found on Form 8606. IRA owners should check with their tax advisors to determine the taxable and nontaxable portions of their distributions. (See Question 7.12 for information on removing a current-year nondeductible contribution as an excess.)
3.41

Q  May an IRA owner treat a deductible Traditional IRA contribution as a nondeductible contribution?

A  Yes. Individuals who are eligible for deductions are not required to take deductions. The IRA owner may elect to make nondeductible IRA contributions by filing IRS Form 8606.

3.42

Q  If a single individual under age 50 is an active participant in a qualified retirement plan at work and has modified adjusted gross income of $65,000 for 2019, the individual’s deduction limit is $5,400. Does this mean she must contribute $6,000 to an IRA to enjoy a $5,400 deduction?

A  No. The individual in your example may contribute only $5,400 and deduct the entire $5,400 if she so chooses. Or she may contribute up to $6,000, but still deduct only $5,400.

3.43

Q  One of our IRA owners is asking for help in determining the deductibility of his Traditional IRA contribution. Is it our responsibility to assist him?

A  No. The IRA owner is solely responsible for calculating the deductibility of a Traditional IRA contribution. This is a taxation issue for him. Because of the liability inherent in doing this calculation for an IRA owner, financial organizations should refer an IRA owner to a competent tax advisor or to the instructions and fill-in worksheets in Publication 590-A, Contributions to Individual Retirement Arrangements (IRAs), for assistance.
**Miscellaneous**

3.44

**Q** What is the saver’s credit?

**A** Certain individuals may receive a nonrefundable tax credit (not to exceed $1,000) for contributions to IRAs and salary deferrals (in aggregate) under retirement plans. Eligible individuals determine their credit by multiplying the applicable percentage by their total contributions and deferrals up to $2,000. Taxpayers with modified adjusted gross income above certain limits (e.g. for joint filers, $63,000 for 2018 and $64,000 for 2019) are not eligible.

Taxpayers calculate their credit amount using Form 8880, *Credit for Qualified Retirement Savings Contributions*, which they must file with their income tax returns.

3.45

**Q** We’re still a little confused about Traditional IRA revocations. If individuals make a contribution to an existing Traditional IRA, may they revoke the contribution within seven calendar days?

**A** No. The right of revocation applies to newly established Traditional or Roth IRAs only. IRA owners may not revoke an IRA contribution made to a pre-existing IRA. If the contribution is a regular or spousal contribution (i.e., not a rollover or transfer contribution), IRA owners may withdraw that contribution as an excess contribution by withdrawing the contribution, along with the earnings attributable, by their tax return due date (including any extensions).
Chapter 4
Traditional IRA Transfers and Rollovers

Traditional IRA Transfer Basics

4.1
What is the difference between a Traditional IRA transfer and a Traditional IRA rollover?

Q
Traditional IRA transfers and rollovers are two methods of moving retirement assets between IRAs and retirement plans. With an IRA-to-IRA transfer, the assets are moved directly from one IRA to another, often from one financial organization to another, with no constructive receipt of assets by the IRA owner. In an IRA-to-IRA rollover, a financial organization distributes the IRA assets to the individual who subsequently makes a rollover contribution, if eligible, to the IRA. Note that Traditional and savings incentive match plan for employees of small employers (SIMPLE) IRA assets can be directly and indirectly rolled over to an eligible employer-sponsored retirement plan. IRA-to-IRA transfers are nonreportable transactions, whereas rollovers (including retirement plan direct rollovers) are reportable.

4.2
What documentation is required when completing a Traditional IRA transfer?

Q
Financial organizations are not required to report a Traditional IRA transfer to the IRS. But financial organizations should have adequate documentation so that each step of the transaction can be retraced if necessary. The IRS has no specific form requirements regarding transfers.
4.3

Q One of our IRA owners is an employee of the federal government. He insists that he can directly transfer certain federal pension distributions into his Traditional or Roth IRA. Is this correct?

A The federal Thrift Savings Plan (TSP) is a retirement savings plan for civilians who are employed by the United States government and members of the uniformed services. The federal government generally requires the use of Form TSP-60, Request for a Transfer Into the TSP, for Traditional IRA-to-TSP rollovers; Form TSP-60-R, Request for a Roth Transfer Into the TSP, for Roth IRA-to-TSP rollovers; and Form TSP-70, Request for Full Withdrawal, or Form TSP-77, Request for Partial Withdrawal When Separated, for TSP-to-Traditional or Roth IRA rollovers. While the forms use the general terminology of “transfers,” these transactions are reported as rollovers.

4.4

Q A surviving spouse beneficiary wants to treat her deceased husband’s Traditional IRA as her own. Should she transfer or roll over the assets?

A She may do either. If the assets are moved directly into the surviving spouse’s Traditional IRA and she does not receive the assets, the transaction is a transfer, which is not reported to the IRS. Therefore, the financial organization would not complete Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. If a check is given to the surviving spouse in her name as a beneficiary (which she could then roll over to her own IRA), the transaction is considered a rollover because a distribution actually is made to the surviving spouse beneficiary.
4.5

**Q** Can an IRA owner transfer his IRA assets to his spouse’s IRA?  

**A** No. According to IRC Sec. 408(a), an IRA is a trust created for the exclusive benefit of an individual or his beneficiaries. During the IRA owner’s lifetime, the IRA owner may transfer or roll over the Traditional IRA assets to a Traditional IRA for the benefit of that IRA owner or, under IRC Sec. 408(d)(6), to the Traditional IRA of a former or legally separated spouse. If an IRA owner attempts to roll over his Traditional IRA into someone else’s Traditional IRA, they would both incur penalties. The financial organization must treat this transaction as a distribution (early distribution if the IRA owner is under age 59½). The recipient could have an excess contribution, depending on the amount rolled over. Only after the IRA owner’s death may the IRA owner’s assets potentially be transferred (or rolled over) to the spouse beneficiary’s Traditional IRA.

4.6

**Q** An individual who is over age 70½ approached us today requesting to transfer the Traditional IRA assets she maintains at another organization to a Traditional IRA she maintains with us. What happens with her required minimum distribution for this year?  

**A** Required minimum distribution (RMD) regulations clarify that because IRA owners can aggregate RMDs from their IRAs and can distribute the aggregate amount from any IRA that they own, the transferor (sending) IRA can transfer the entire IRA balance and is not required to retain the RMD amount for the year.
Treas. Reg. 1.408-8, Q&A 8, further specifies that a transfer is not treated as a distribution by the transferor (sending) IRA. Any RMD that applies to the transferor IRA must still be satisfied. If the transferee (receiving) IRA does not receive the transfer in the same calendar year as it was sent from the transferor IRA, then the transferee IRA’s December 31 balance for the preceding year must be adjusted to include the amount of the transfer.

Transfers and Issues Incident to Divorce

4.7

Q An IRA owner’s ex-spouse brought in a qualified domestic relations order that awards both the Traditional IRA held at our financial organization and the IRA owner’s qualified retirement plan assets to the ex-spouse. I know that these apply to retirement plans, but can they also apply to IRAs?

A IRAs generally are subject to a property division according to the terms of a divorce decree or legal separation instrument. A qualified domestic relations order (QDRO) is just a domestic relations order (DRO) that has been “qualified” because it contains certain information that employers require before they can properly pay out retirement plan assets. QDROs typically are credited as stand-alone documents that usually address only retirement plan assets. But they can be integrated into a broader DRO (or decree of divorce or legal separation). So the decree could certainly contain language that deals with IRA assets. Ask your legal counsel to review the document to determine how you should proceed.
4.8

What steps should our IRA personnel take when faced with a situation involving a divorce decree that affects Traditional IRA assets?

An IRA administrator should retain in the IRA owner’s file a copy of the portion of the divorce decree that specifically directs the transfer of assets. In addition, the IRA administrator should have either a withdrawal statement or a transfer request form (as applicable, depending upon how the transaction is being handled) filled out and signed.

The IRA administrator should read the legal document carefully to note the amount awarded to the former spouse, the timing of the award, and other information pertinent to the transfer of assets. An IRA administrator may wish to refer any questions about the legal document to the financial organization’s attorney for interpretation.

4.9

The ex-spouse of one of our IRA owners presented us with a divorce decree, which specified that she was to receive the total balance of her former spouse’s Traditional IRA. The ex-spouse took a total distribution of the IRA balance. Because the assets were distributed from our IRA owner’s Traditional IRA, should we report the distribution in his name or in the name of the ex-spouse who actually received the IRA assets?

If Traditional IRA assets are distributed directly to an ex-spouse who has been awarded all or a portion of an IRA owner’s Traditional IRA pursuant to IRC Sec. 408(d)(6), the ex-spouse generally is responsible for the taxation of the assets. Thus, the financial organization reports the
distribution to the IRS on Form 1099-R in the recipient’s (i.e., the ex-spouse’s) name and Social Security number. The appropriate distribution reason code to use on Form 1099-R normally depends upon the recipient’s age: code 1, Early distribution, no known exception, if the recipient is under age 59½ or code 7, Normal, if the recipient is age 59½ or older.

4.10

Q When an individual is awarded a portion of his ex-spouse’s Traditional IRA, should we have the recipient of the assets complete a withdrawal authorization at the time of distribution?

A When a financial organization makes a Traditional IRA distribution because of divorce or legal separation, the financial organization may wish to retain a withdrawal authorization form (filled out by the ex-spouse who received the assets), including a withholding notice and election, to gather information for reporting the distribution on Form 1099-R and to prove that the proper withholding requirements have been met.

4.11

Q May an ex-spouse who is the recipient of Traditional IRA assets awarded in a divorce decree roll over or transfer the assets into her own Traditional IRA?

A The issue of “rolling over” these assets is somewhat unclear, although IRS officials have commented to Ascensus that rollovers of such assets may be possible. If the divorce decree does not specify how to move the assets, the best alternative is to have the divorce decree or separation agreement amended to specify how this transaction must take place.
IRS Publication 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*, indicates that the two common methods of “transferring” IRA assets to a former spouse are 1) changing the name on the IRA, or 2) making a transfer. Publication 590-A does not specifically address rollovers as an option, although it does provide rollover guidance relating to qualified retirement plan distributions because of divorce.

An IRS official commented to Ascensus that a distribution could be given directly to the ex-spouse or legally separated spouse pursuant to a divorce decree or separation agreement. The distribution would then be eligible for rollover, provided all the rollover rules were met. Though IRA owners cannot rely upon IRS comments as official guidance, it is an indication of how the IRS interprets a rule or regulation.

Financial organizations that choose to allow rollovers may wish to obtain a written, signed statement or a hold harmless agreement acknowledging that the financial organization informed the individual of her options, and that the client will not hold the financial organization responsible if the IRS disallows the transaction.

**Traditional IRA-to-Traditional IRA Rollovers**

4.12

Q  Are we required to use a contribution eligibility form when an IRA owner is making a rollover deposit to a Traditional IRA?

A  No. The IRS does not require a contribution eligibility form. But *Treas. Reg. 1.402(c)-2, Q&A 13*, indicates that IRA owners must make an irrevocable rollover election when they make a rollover contribution. Temporary Treas. Reg. 1.402(a)(5)-1T, Q&A 3 and 4, applies the written irrevocable election requirements to rollovers from retirement plans and from IRAs. Many financial organizations use a contribution eligibility form to both meet the irrevocable election requirement and to determine if an individual is eligible to make a rollover contribution.
4.13

Q  We’ve heard that IRA owners can roll over only one IRA distribution per year. Is this true?

A  Yes. In 2014, the IRS changed its interpretation of IRC Sec. 408(d)(3)(B), which states that an IRA owner is allowed only one rollover per 12-month period. For many years the IRS interpreted this to allow IRA owners to roll over one IRA distribution per 12-month period for every IRA that they owned. The IRS changed its interpretation of this requirement to match a U.S. Tax Court ruling in Bobrow v. Commissioner. The tax court ruled that a taxpayer is limited to one IRA rollover per 12-month period, regardless of the number or types of IRAs (Traditional, Roth, and SIMPLE IRA) that the IRA owner may have.

The IRS issued Announcements 2014-15 and 2014-32, stating that the new interpretation was effective January 1, 2015.

The 12-month rule does not apply to certain rollovers related to failed attempts to purchase a first-time home (IRC Sec. 72(t)(8)(E)). The IRS noted in a May 31, 2017, letter to the Federal Deposit Insurance Corporation that the 12-month rollover rule does not apply to IRA distributions that result from financial organization failures. This rule also does not apply to the rollover of wrongful IRS levies returned to a taxpayer, as provided by the Tax Cuts and Jobs Act of 2017.

4.14

Q  Are financial organizations responsible for making sure IRA owners do not violate the one-per-12-month rule?

A  No. Making sure that assets are not rolled over more than once per 12 months is the IRA owner’s responsibility. Many financial organizations use a contribution eligibility form to verify that the IRA owner is aware of this rule and is eligible to complete the rollover.
4.15

Q  When does the 12-month period start for purposes of the one-per-12-month rollover rule?

A  The 12-month period begins on the day the IRA distribution is received by the IRA owner. For example, based on the IRS ruling discussed in Question 4.13, if an IRA owner receives a $1,000 Traditional IRA distribution on May 3, 2019, and subsequently rolls over the assets, the IRA owner will not be eligible for another IRA rollover until May 3, 2020.

4.16

Q  An IRA owner took an early distribution from her Traditional IRA last month. She rolled over some of it back to the IRA two weeks later, and now she wants to roll over another portion of the assets. Can she do this?

A  Yes. An IRA owner can complete a rollover with a series of rollover contributions made to the IRA before the 60-day rollover period is over. The IRA owner may roll over one distribution per 12 months, but there is no limit on the number of rollover contributions that an IRA owner can make to an IRA. The total amount, however, must not exceed the distribution amount.
Q  One of our IRA owners failed to roll over his IRA distribution back into his IRA within 60 days. He insists that there is no longer a 60-day time restriction. Is he correct?

A  No. He is probably referring to a waiver of the 60-day rollover rule, which is available in limited circumstances. The IRS may waive the 60-day rollover rule in cases of casualty, disaster, or other events beyond the recipient’s reasonable control.

The 60-day period for rollovers is waived or extended under the following situations. Also see Question 4.19.

- The IRA owner provides a written self-certification that he qualifies for a waiver under rules described in Revenue Procedure 2016-47.

- For a fee of $10,000, the IRA owner may apply for an IRS private letter ruling (PLR) asking for a waiver of the 60-day limitation.

- An IRS representative may grant a waiver of the 60-day period during an examination of the taxpayer’s income tax return.

- The IRA owner qualifies for an automatic waiver due to financial organization error if he meets the requirements described in Revenue Procedure 2003-16, which would extend the 60-day period to one year.

- An IRA distribution that fails to meet a qualified first-time homebuyer penalty tax exception solely because of a delay or cancellation of the purchase or construction of the residence qualifies for a 120-day rollover period instead of the 60-day period.

- Federal disasters and certain terroristic or military actions (e.g., combat zones, hazardous duty areas) may be declared, giving affected individuals or service members an extended period to complete rollovers as defined in Revenue Procedure 2007-56.
4.18

Q  An IRA owner did not meet the 60-day deadline for completing a rollover because he misplaced his distribution check, and the 60-day time period has expired. Can the 60-day period be extended?

A  Yes. In August 2016, the IRS released Revenue Procedure 2016-47, providing a process for individuals who received distributions and missed their 60-day deadline to self-certify that they qualify for a waiver of the 60-day period. The IRA owner must complete and sign the IRS model letter included in the Revenue Procedure or a similar form, and present it to the receiving financial organization. A copy of the certification should be kept in the IRA owner’s file to be available if requested in an audit.

Individuals may use the self-certification process if they meet all of the following conditions.

• The IRS has not previously denied a rollover waiver requested by the individual.

• The rollover contribution is made to the retirement plan or IRA as soon as practicable after the reason for the delay no longer prevents an individual from making the contribution. Rollovers made within 30 days of this date are deemed to satisfy this requirement.

• The rollover contribution satisfies all requirements for a valid rollover (except the 60-day limitation).

• The failure to timely complete the rollover was due to one or more of the reasons below.
  – Financial institution error
  – Misplaced and uncashed distribution check
  – Mistakenly believing that the rollover was placed in an eligible plan or IRA
  – Severe damage to the individual’s principal residence
– Death of a family member
– Serious illness of the individual or a family member
– Incarceration of the individual
– Restrictions imposed by a foreign country
– Postal errors
– IRS levy proceeds returned to the taxpayer
– Delays by the distributing plan in providing information required to complete the rollover

4.19

Q Are there any other special circumstances when indirect rollovers may be completed beyond 60 days?

A Yes. Under a provision of the Tax Cuts and Jobs Act of 2017, if an employer-sponsored retirement plan loan is offset (treated as distributed and taxable) when a plan participant leaves employment or the plan is terminated, the offset amount can be rolled over to an IRA (or another retirement plan) by the tax return deadline, including filing extensions, for the year the loan amount was offset. See Question 8.7.

Also, under a provision of the Bipartisan Budget Act of 2018, a wrongful IRS levy of a taxpayer’s IRA or retirement plan assets that is returned to the taxpayer may be rolled over to an IRA (including a beneficiary IRA) or to a retirement plan by the tax return deadline for the year that the assets are returned (not including filing extensions). The normal limitation of one IRA rollover per 12-month period will not apply to such rollovers.
4.20

**Q** Have there been any situations in which a request for waiver of the 60-day requirement was denied?

**A** Yes. Several PLRs have been published in which the IRS denied requests for waivers of the rollover deadline. Although each case is reviewed on an individual basis, some reoccurring facts in PLRs that deny the 60-day rollover extension include instances when the IRA owner intended to use the assets as a “short-term loan” because of financial difficulties, and IRA owner ignorance of the tax consequences associated with the distribution.

The IRS also may deny self-certification of a waiver of the 60-day period during an examination of the taxpayer’s income tax return if it determines that the requirements for the waiver were not met.

4.21

**Q** May regular contributory Traditional IRA assets be commingled with rollover Traditional IRA assets?

**A** Yes. IRA owners may commingle regular contributory Traditional IRA assets with rollover Traditional IRA assets. Individuals who are eligible to use capital gains treatment or income averaging on a qualified retirement plan (QRP) distribution may wish to roll over their distribution to a conduit IRA. Rolling over QRP assets that are eligible for these special tax treatments to a conduit IRA preserves the individual’s option of using these special tax treatments at a later date if the assets are rolled back to a QRP.
4.22

Q  One of our Traditional IRA owners wants to close his IRA by taking a distribution of $3,000 and rolling it over to another financial organization within 60 days. We are going to charge an early withdrawal penalty of $100. May the Traditional IRA owner roll over $3,000 or just the $2,900 that represents the net amount received?

A  The Traditional IRA owner may roll over only $2,900. The Traditional IRA owner will receive a Form 1099-R at the end of the year reporting a distribution of $2,900.

4.23

Q  If a Traditional IRA owner receives a distribution from his Traditional IRA in November 2019 with the intent of rolling over the assets within 60 days, in what year is the distribution taxed if the IRA owner does not complete the rollover?

A  A Traditional IRA distribution is taxable for the year in which the distribution is made to the IRA owner, regardless of whether the distribution could have been rolled over in a subsequent year. If an IRA owner takes a distribution during November or December of 2019 and does not roll over the distribution to an IRA within 60 days, the distribution generally is includible in the individual’s 2019 taxable income, even though the individual could have rolled over the distribution in 2020.
4.24

Q One of our Traditional IRA owners wants to borrow money from her IRA to pay for a new car. Is this allowed?

A IRC Sec. 4975(c)(1)(B) prohibits the lending of money between a Traditional IRA and a disqualified person (e.g., the IRA owner). If IRA assets are loaned, the account ceases to be an IRA. In this case, the IRA assets are treated as having been distributed as of the first day of the tax year in which the loan occurred.

To solve a short-term cash flow problem, the IRA owner may take a distribution and use the assets for up to 60 days. There are no adverse tax consequences as long as the IRA owner rolls over the assets into an IRA within the 60-day period. This transaction is considered a Traditional IRA rollover, not a loan from the IRA.

Rollovers Between Employer-Sponsored Retirement Plans and Traditional IRAs

4.25

Q What types of employer-sponsored retirement plan assets qualify for rollover to Traditional IRAs?

A Individuals may roll over eligible assets from IRC Sec. 401(a) and 403(a) qualified retirement plans, 403(b) plans, governmental 457(b) plans, and the federal Thrift Savings Plan to Traditional and Roth IRAs. Individuals may transfer or roll over assets held in savings incentive match plan for employees of small employers (SIMPLE) IRAs (after a two-year waiting period) and those from simplified employee pension (SEP) plans (held in Traditional IRAs) to Traditional IRAs.
Effective after December 18, 2015, the Consolidated Appropriations Act of 2016 allows Traditional IRA, qualified retirement plan, 403(b) plan, and governmental 457(b) plan assets to be rolled over to SIMPLE IRAs after satisfaction of a SIMPLE IRA two-year waiting period. (See Question 10.30.)

4.26

Q What types of plans or arrangements can receive rollovers of Traditional IRA assets?

A Individuals may roll over pretax Traditional IRA assets into IRC Sec. 401(a) and 403(a) qualified retirement plans, 403(b) plans, governmental 457(b) plans, and the federal Thrift Savings Plan. Beginning after December 18, 2015, Traditional IRA assets can be rolled over to SIMPLE IRAs if the individual has participated in the employer’s SIMPLE IRA plan for two years.

4.27

Q Who is eligible to roll over assets from an employer-sponsored retirement plan to a Traditional IRA?

A Any one of the following individuals may roll over assets from a retirement plan to a Traditional IRA if the assets are considered an eligible rollover distribution as defined by IRC Sec. 402(c)(4).

- A plan participant
- A spouse beneficiary of a deceased plan participant
- A former spouse of a plan participant identified in a qualified domestic relations order (QDRO)
- A nonspouse beneficiary (to an “inherited” IRA)
What qualified retirement plan assets are eligible to be rolled over to a Traditional IRA?

Distributions that may be rolled over to Traditional IRAs from QRPs are referred to as “eligible rollover distributions.” Eligible individuals generally may roll over all distributions to a Traditional IRA unless the distribution falls under one of the following categories.

- Required minimum distributions
- Distributions that are part of a series of substantially equal periodic payments (made over single or joint life expectancy or for a specified period of 10 or more years)
- Hardship distributions
- Returns of excess contributions and excess deferrals
- Premiums paid by the plan for the cost of current life or other insurance protection for participants
- Certain loan amounts treated as taxable distributions
- Certain dividends paid on employer securities
- Permissible withdrawals from eligible automatic contribution arrangements
Q Can an IRA owner directly roll over only pretax plan assets to her Traditional IRA and only after-tax assets into her Roth IRA if she has both types of assets in her qualified retirement plan?

A Before 2015, IRS guidance indicated that a direct rollover distribution from an employer-sponsored retirement plan required a pro rata portion of pretax and after-tax assets, while an indirect rollover distribution was deemed to consist first of pretax assets. Plan participants who wanted to roll over pretax assets to a Traditional IRA and after-tax assets to a Roth IRA had to take a distribution from the plan, indirectly roll over the pretax assets to a Traditional IRA first, and then indirectly roll over the after-tax assets to a Roth IRA.

In 2014, the IRS released Notice 2014-54 to address these concerns. This notice, effective January 1, 2015, allows participants to split pretax and after-tax retirement plan assets that are directly rolled over to multiple destinations (i.e., other retirement plans or IRAs). For participants attempting to roll over pretax assets to a Traditional IRA and after-tax assets to a Roth IRA, this eliminates the need to complete two separate indirect rollovers.

In May 2016, the IRS issued final regulations affirming the allocation rules provided in Notice 2014-54.
4.30

Q  An IRA owner recently started a new job and wants to roll over all of his Traditional IRA assets into the company’s 401(k) plan. His IRA contains both pretax and after-tax assets. Can he roll over all of these assets to the 401(k) plan?

A  No. IRA owners may not roll over after-tax (or nondeductible) contributions from an IRA to an employer-sponsored retirement plan (401(a) and 403(a) qualified retirement plans, 403(b) plans, governmental 457(b) plans, and the Thrift Savings Plan). But individuals may roll over after-tax contributions held in a retirement plan to a Traditional IRA or another eligible retirement plan of the same type if the receiving plan separately accounts for after-tax amounts.

4.31

Q  The wife of one of our IRA owners recently died. The IRA owner has a 403(b) plan through his employer and an IRA with us. He wants to roll over the assets from his deceased wife’s IRA. Can he roll over the assets into either his 403(b) plan or his IRA?

A  Because he is a spouse beneficiary, he may transfer or roll over the inherited IRA assets to his own IRA, or he may roll over the pretax assets to his 403(b) plan.
4.32

**What is a direct rollover?**

Employer-sponsored retirement plan participants may either “directly” or “indirectly” roll over assets from their plan into an IRA.

For a direct rollover, eligible assets move directly from an eligible employer-sponsored retirement plan into an IRA maintained at a financial organization that the individual has chosen. To be considered a direct rollover, the check representing the eligible rollover distribution must be titled so that the distribution is negotiable only by the receiving financial organization (i.e., “XYZ Broker as Custodian of Individual Retirement Account of John S. Wright”). Both the employer of the distributing plan and the accepting organization report the direct rollover procedure to the IRS.

4.33

**What is an indirect rollover?**

An indirect rollover distribution, unlike a direct rollover, is made payable to the participant of an eligible employer-sponsored retirement plan. Any eligible rollover distribution that is not directly rolled over to an IRA or other eligible plan generally is subject to mandatory 20 percent withholding. After receiving the remaining 80 percent of the eligible rollover distribution, the plan participant generally has 60 days, beginning the day after the day the distribution is received, to roll over the plan assets into an IRA. An individual may make up the 20 percent that was withheld for federal income tax purposes out of his own pocket so that 100 percent of the eligible rollover distribution amount is deposited into the IRA. An indirect rollover, like the direct rollover, is reported by both the employer and the accepting financial organization.
4.34  
Q  Does the 20 percent mandatory withholding for retirement plan indirect rollovers apply to direct rollovers?
A  No. The 20 percent mandatory withholding applies to eligible employer-sponsored retirement plan distributions that are indirectly rolled over, but not to direct rollovers.

4.35  
Q  Does the 60-day rollover rule apply to direct rollovers?
A  No. The 60-day rollover rule does not apply to individuals who correctly complete a direct rollover from an eligible employer-sponsored retirement plan to an IRA or another eligible retirement plan. Similar to a transfer, the check issued in a direct rollover is nonnegotiable by the plan participant. In other words, the plan participant cannot cash the check and use the proceeds for her personal needs. Instead, the check is made payable to a financial organization for the benefit of the plan participant’s IRA or eligible retirement plan and must be placed directly into the new account as soon as administratively possible.

NOTE: Although the assets are nonnegotiable by the plan participant, the financial organization still reports the transaction as a rollover to the IRA or retirement plan.
4.36

Q  One of our clients rolled over assets from her retirement plan to a Traditional IRA. Her company just informed her that a subsequent amount is now available for another rollover. May she roll over this additional amount?

A  Yes, assuming the assets are eligible for rollover. There is no restriction to the number of retirement plan rollovers to IRAs. The one-per-12-month rule does not apply to distributions from qualified retirement plans.

4.37

Q  One of our IRA owners has been offered early retirement at age 55 by his employer, which he accepted. He was told that if he takes a distribution from his 401(k) plan, he is not subject to the 10 percent early distribution penalty tax because he is over age 55, but that the company will have to withhold 20 percent for federal income tax. If he chooses a direct rollover to a Traditional IRA, can he avoid the withholding?

A  Yes. The direct rollover of a retirement plan distribution to a Traditional IRA allows an individual to avoid both the 20 percent federal income tax withholding and the 10 percent early distribution penalty tax, when applicable. Your client, however, is not subject to the 10 percent early distribution penalty tax from the 401(k) plan because of a special exception in IRC Sec. 72(t). Under this exception, if an individual separates from service during or after the calendar year in which he attains age 55 and takes a
distribution from the 401(k) plan, he is not subject to the penalty tax. Once the assets are placed in a Traditional IRA, however, the IRA owner must wait until age 59½ to avoid the 10 percent early distribution penalty tax.

**4.38**

**Q** How does an employer directly roll over retirement plan assets to a Traditional IRA?

**A** An employer may mail a check directly to the financial organization, transfer the assets by wire, or allow the rollover-eligible participant or beneficiary to hand-carry a check made payable to the receiving financial organization.

**4.39**

**Q** Last month an IRA owner rolled over his retirement plan assets to his Traditional IRA. He took a distribution from the IRA a few weeks later and now wants to roll the assets back into the IRA. Will this violate the one-per-12-month rule for rollovers?

**A** IRC Sec. 408(d)(3)(B) limits the number of IRA distributions that an individual may roll over to one every 12 months. But this rule applies only to IRA-to-IRA rollovers. In this instance, the first rollover was a direct rollover from a qualified retirement plan. Because the first rollover involved a distribution from the plan and not from an IRA, that rollover is not considered when applying the one-per-12-month rule.
4.40

Q

An IRA owner presented to us a direct rollover check for $40,000 and asked if she could keep $10,000 and roll over only $30,000 into the IRA. Do we have to deposit the entire amount of the check into her Traditional IRA, or can we pay her and deposit the remaining portion of the distribution into her Traditional IRA?

A

In situations where IRA owners change their minds regarding the rollover of retirement plan assets, a financial organization has two options. These options are based on the strict IRS reporting and withholding requirements that accompany the movement of retirement plan assets.

The first option is to send the check back to the employer and state that the IRA owner has changed her mind about completing a direct rollover. The IRA owner must contact the employer to redirect the distribution. The employer may issue one check for the IRA owner and another check for the direct rollover. Another option is to deposit the direct rollover check into the Traditional IRA. The IRA owner then may take a distribution from the Traditional IRA, thereby avoiding the 20 percent mandatory withholding that is required for an eligible rollover distribution from a retirement plan. But the distribution from the Traditional IRA is taxable and the IRA owner is subject to the 10 percent early distribution penalty tax unless she has a penalty tax exception.

4.41

Q

A participant in a qualified retirement plan died. His wife, who is the primary beneficiary, took a distribution and rolled over the assets to her Traditional IRA. Whose name should we list as the owner of the Traditional IRA? When is the wife required to take required minimum distributions from the Traditional IRA?
A surviving spouse may roll over distributions of a deceased spouse’s retirement plan account into a Traditional IRA or other eligible employer-sponsored retirement plan. In this case, the financial organization generally should establish the Traditional IRA in the name of the surviving spouse. Once the surviving spouse reaches age 70½, she must begin taking required minimum distributions.

4.42

Q May an IRA owner roll over assets from a governmental 457(b) deferred compensation plan to a Traditional IRA?

A Yes. Individuals may roll over assets from a governmental 457(b) plan to a Traditional IRA (or another eligible retirement plan). But individuals cannot roll over assets from an IRC Sec. 457(f) ineligible deferred compensation plan—or any nonqualified plan—into a Traditional IRA.

4.43

Q Upon retirement, an IRA owner received a distribution from his retirement plan, which includes some nondeductible employee contributions. May an employee roll over these assets to a Traditional IRA?

A Nondeductible employee contributions in a retirement plan are after-tax contributions. Eligible individuals may roll over retirement plan after-tax and pretax assets to IRAs. Note that individuals may not roll over 401(k), 403(b), or governmental 457(b) plan designated Roth account assets, which are a type of after-tax employee contribution, to Traditional IRAs. But designated Roth account assets may be rolled over to Roth IRAs. IRA owners must track the after-tax amounts (basis) in their Traditional IRAs using IRS Form 8606, Nondeductible IRAs.
4.44

Q  May individuals roll over retirement plan assets to a SEP IRA?

A  Yes. Employer contributions under a SEP plan actually are made to an employee’s Traditional IRA. Individuals may roll over employer-sponsored retirement plan assets to Traditional IRAs that also hold SEP plan contributions.

4.45

Q  An IRA owner wants to roll over a stock certificate to his Traditional IRA at our financial organization. He received the stock as part of a qualified retirement plan distribution. May he roll over the stock to his Traditional IRA?

A  Revenue Ruling 87-77 clarifies that an individual who receives property as part of a qualified retirement plan distribution may either roll over the actual property received or sell the property and roll over the proceeds. Retaining the property and rolling over cash equal to the property’s fair market value is not permitted.

Whether your organization may accept the stock certificate depends on a number of things, such as if you have trust powers or if you have a relationship with a brokerage firm. If you are not sure if your financial organization can hold the stock certificates, check with your management or legal counsel.
4.46

**Q** An IRA owner received an eligible rollover distribution from her employer’s profit sharing plan, consisting of cash and 500 shares of XYZ mutual fund. What happens if the share price of the mutual fund changes from the time she receives the shares as a distribution and when she redeposits the shares as a rollover contribution into a Traditional IRA?

**A** The payer must report the value of the assets at the time of distribution on Form 1099-R. Because of an increase or decrease in the value of the assets, this value may differ from the value reported on the contribution Form 5498, IRA Contribution Information. The IRS does not require an explanation of the discrepancy because of a change in the fair market value between the time of distribution from the qualified retirement plan and the time of contribution to the Traditional IRA. The IRA owner may, however, attach an explanation to her Form 1040, U.S. Individual Income Tax Return, to explain the difference in the fair market values should she wish to do so.

4.47

**Q** Our IRA owner recently retired from the federal government and received a total distribution of his benefits in the U.S. Civil Service Retirement System. May he roll this over to a Traditional IRA?

**A** According to IRS Publication 721, Tax Guide to U.S. Civil Service Retirement Benefits, the only portion that is eligible for rollover from the Civil Service Retirement System account is the interest earned on certain contributions. See Publication 721 at the IRS website for more information.
4.48

Q We are assisting one of our clients in conducting a direct rollover from his qualified retirement plan to his Traditional IRA. Our client is retired and will be 70½ this year. Even though he has until April 1 of next year (his required beginning date) to take his first required minimum distribution, must he take the distribution from the retirement plan before the direct rollover distribution?

A Yes. He should remove the required minimum distribution (RMD) before he completes the direct rollover. Retirement plan distributions that individuals may roll over to a Traditional IRA are referred to as eligible rollover distributions. According to IRC Sec. 402(c)(4)(B), an amount deemed to be an RMD is not an eligible rollover distribution.

The first assets distributed from the retirement plan in a year are deemed to satisfy the RMD for that year. Only after the RMD is satisfied may an individual roll over his account balance to a Traditional IRA.

4.49

Q One of our clients recently married a Canadian citizen. His wife will be moving to the United States and is interested in bringing the assets in her Canadian retirement plan to the United States. Can she roll over these assets to an IRA she establishes in the U.S.?

A The Internal Revenue Code currently does not allow individuals to roll over assets to IRAs from retirement savings programs established in another country under another country’s tax laws. This is true regardless of whether the person in question has become a U.S. citizen.
4.50

Q A Traditional IRA owner just received a hardship distribution from her qualified retirement plan. She wants to roll over the hardship distribution to her Traditional IRA within 60 days of the distribution. Is a hardship distribution eligible to be rolled over to a Traditional IRA?

A Any hardship distribution, regardless of the contribution source, is ineligible for rollover.

4.51

Q One of our IR annuity owners has begun taking distributions from his annuity. Can he roll over these distributions to an IRA?

A If the individual retirement (IR) annuity contract has been annuitized, he cannot roll over the distributions to another IR annuity or IR account (i.e., IRA) because the distributions are considered part of a series of substantially equal periodic payments. Such payments are ineligible for rollover according to IRC Sec. 402(c)(4)(A). If the IR annuity contract has not been annuitized, the IR annuity owner may roll over the distributions to an IRA provided the distributions satisfy the general IRA rollover rules.
**Beneficiary Rollovers From Employer-Sponsored Retirement Plans**

### 4.52

**Q** An IRA owner recently inherited her husband’s qualified retirement plan assets. She is under age 59½ and would like to roll over these assets to an inherited IRA to avoid paying the 10 percent early distribution penalty tax. Is this permitted?

**A** Yes. Although spouse beneficiaries can roll over retirement plan assets to their own IRAs, they also may roll over retirement plan assets to inherited Traditional or Roth IRAs.

### 4.53

**Q** One of our clients recently inherited her father’s 401(k) plan assets. Can she roll over these assets to an IRA?

**A** Yes. Nonspouse beneficiaries of IRC Sec. 401(a) and 403(a) qualified retirement plans, 403(b) plans, governmental 457(b) plans, and the federal Thrift Savings Plan may directly roll over inherited plan assets to inherited Traditional or Roth IRAs. Beneficiaries who choose this option must establish an inherited (beneficiary) IRA. Nonspouse beneficiaries may not roll over plan assets to retirement plans or to their own IRAs.

### 4.54

**Q** What distribution options are available for nonspouse beneficiaries who roll over inherited retirement plan assets to inherited IRAs?

**A** Once a nonspouse beneficiary rolls over inherited retirement plan assets to an inherited IRA, the required beneficiary distributions generally must be paid out in the same manner
as would have been paid out under the employer-sponsored retirement plan. But a special rule permits a nonspouse beneficiary who is subject to the five-year rule under the plan to switch to the life expectancy payment method. If a nonspouse beneficiary makes this switch, the beneficiary must take the distribution from the retirement plan and roll over the remaining balance to an inherited IRA before December 31 of the year following the year of death and continue taking annual life expectancy payments from the inherited IRA, which must be calculated using the same life expectancy as was used under the plan.

4.55

Q How do we title inherited IRAs that receive inherited employer-sponsored retirement plan assets?

A Financial organizations must identify both the deceased plan participant and the beneficiary in the title of an inherited IRA (e.g., “Tom Smith as beneficiary of John Smith”).

Automatic Rollovers

4.56

Q A local employer called our financial organization to ask if we accept “automatic rollovers” from qualified retirement plans. What is an “automatic rollover”?

A A direct rollover to an IRA (IR accounts or IR annuities) is the mandatory payout option for qualified retirement plans that have a mandatory distribution (i.e., mandatory cashout) provision for assets belonging to separated employees who do not submit payout elections. This generally applies to plan assets that are eligible for rollover and that exceed $1,000 but do not exceed $5,000.
4.57

Q An employer has a mandatory cashout provision in its plan document and told us that he must have a written agreement with us to be able to roll over the assets to IRAs here. Is this true?

A Yes. Safe harbor relief for choosing the IRA provider and the initial investment depends on an employer satisfying certain conditions. One of those conditions is that the employer enters into a written agreement with the IRA provider receiving the rollover. The agreement generally must conform to the following provisions.

- The rollover assets generally must be invested to preserve principal and to provide a reasonable rate of return, even if the return is not guaranteed. Regulations state that the following types of investments will meet this requirement: money market funds, interest-bearing savings accounts, certificates of deposit, and other “stable value products.”

- A state or federally regulated financial institution must offer the product.

- Expenses charged to the IRA must not exceed the fees charged for comparable rollover IRAs that do not contain mandatory cashout rollovers.

- The terms must be enforceable by the participant.

4.58

Q The bank that I work at has a cashout provision in our retirement plan. Can our bank do an automatic rollover to an IRA that we hold as trustee?
A Yes. Prohibited Transaction Exemption (PTE) 2004-16, which was published concurrently with final regulations on automatic rollovers, provides financial organizations that have mandatory cashout provisions in their own plans certain relief so that they may automatically roll over and invest mandatory distributions into IRAs at their own organizations. A financial organization must follow the requirements outlined in regulations (DOL Regulation 2550.404a-2) along with the additional conditions found in PTE 2004-16. Some of the additional conditions in PTE 2004-16 are as follows.

- With the exception of establishment charges, financial organizations may charge fees and expenses only against the income earned by the IRA.
- The rate of return (and fees) cannot be less favorable than it is with comparable IRAs containing assets not subject to the automatic rollover rules.
- The IRA cannot pay a sales commission in connection with the acquisition of an eligible investment product for the IRA.
- The IRA providers must maintain for six years the records necessary to determine whether the conditions of the exemption have been met. The DOL, IRS, and the IRA owner must have unconditional access to the records.
Q  Can an employer initiating an automatic rollover sign a plan agreement to establish an IRA on behalf of its terminated participant?

A  According to IRS Notice 2005-5, Q&A 10, an employer may sign the IRA plan agreement and use the participant’s most recent mailing address on record with the employer to establish an IRA on the participant’s behalf. Typically, the financial organization will have the employer sign each plan agreement when the IRAs are established. Though not specifically addressed in official guidance, Ascensus recommends that the signature on the document reference the relationship of the signer to the IRA owner. For example, the signature may read, “Mary Smith, XYZ plan administrator, for John Doe, XYZ plan participant.” The financial organization should provide copies of the plan agreement and disclosure statement to the employer and send a copy to the address provided by the employer for the terminated participant.
Conduit IRAs

Q 4.60

Must a plan participant roll over qualified retirement plan assets to a conduit IRA?

A No. Rolling over retirement plan assets into a conduit IRA is optional. A conduit IRA is a Traditional IRA that holds only the assets distributed from a retirement plan. Individuals may roll over pretax assets held in IRAs to eligible retirement plans (plan permitting), regardless of whether the assets originated in a retirement plan. The preservation of capital gains and income averaging treatment that applies to retirement plan assets, however, may no longer exist if previously rolled over retirement plan assets are commingled with other IRA assets in an IRA. So conduit IRAs may be beneficial for this purpose.

To properly establish a conduit IRA, an individual must establish a separate Traditional IRA (i.e., a new plan agreement, disclosure statement, and financial disclosure, etc.) to accept the rolled over assets. Once established, if other contributions are made to a conduit IRA, it ceases to be a conduit IRA.
Chapter 5

Traditional IRA Distributions and Withholding

Required Minimum Distributions (RMDs)

5.1 When must IRA owners begin taking money out of their Traditional IRAs?

IRA owners must begin taking money out of their Traditional IRAs by April 1 of the year following the year in which they attain age 70½ (also known as the IRA owner’s required beginning date). The minimum amount that the IRA owner must distribute for a given tax year is called the required minimum distribution (RMD). Failure to remove the RMD results in an excess accumulation penalty tax equal to 50 percent of the amount that should have been withdrawn.

Individuals who have qualifying longevity annuity contracts (QLACs) in their IRAs begin RMDs on those assets at a later age that is specified in the QLAC contract (but not later than age 85). (See Question 5.24.)

5.2 Is a financial organization obligated to calculate required minimum distributions?

RMD regulations and Notice 2002-27 state that if an RMD is required to be taken from an IRA for the year, and the IRA owner is alive at the beginning of such year, the financial organization (as of December 31 of the prior year) must provide a statement to the IRA owner by January 31 of the year for which the distribution is required. The statement
either must include the amount and due date of the RMD, or indicate that an RMD is due by a certain date and that the financial organization will calculate the RMD on request.

The IRS also requires financial organizations to report to the IRS on Form 5498, *IRA Contribution Information*, if an RMD is due for an IRA owner for the following year. Financial organizations are not required to report the RMD amount to the IRS.

### 5.3

**What are we required to include in a required minimum distribution statement?**

Financial organizations are required to report to IRA owners if an RMD is due for the year and to calculate, or to at least offer to calculate, the amount. You must provide a statement to an IRA owner by January 31 of the year for which an RMD is required. You may provide this statement in conjunction with the fair market value statement, or you may send Form 5498 to IRA owners by January 31.


**Reporting Option #1** – Provide to the IRA owner a statement of the RMD amount for the calendar year and the date by which the IRA owner must distribute such amount. The financial organization may calculate the RMD assuming the IRA sole beneficiary is not a spouse more than 10 years younger than the IRA owner, and that no amounts received by the IRA after December 31 of the prior year are taken into account to adjust the IRA’s values as of December 31 of the prior year.

**Reporting Option #2** – Provide a statement to the IRA owner that indicates an RMD is required for the year, notifies the IRA owner of the date by which such RMD must be distributed, and includes an offer to provide the IRA owner, upon request, with a calculation of the RMD amount due.
Under both options, the financial organization also must inform the IRA owner that the financial organization will report to the IRS that the IRA owner is required to receive an RMD for the year.

5.4

Q Many of our IRA owners have multiple investments within each of their Traditional IRAs. Must the required minimum distribution be calculated separately on each investment and removed proportionately?

A No. An RMD is determined using the Traditional IRA’s balance as of December 31 of the preceding year, taking into account all investments within the Traditional IRA. Once determined, the IRA owner generally may remove the RMD from the investment of the IRA owner’s choice.

5.5

Q The distribution rules require a Traditional IRA owner to take the first required minimum distribution by April 1 of the year following the year in which the individual attains age 70½. Does the April 1 deadline apply to RMDs required for all subsequent years?

A No. IRA owners must take their RMDs for subsequent years on or before December 31. This means that Traditional IRA owners who delay their first RMDs until April 1 of the calendar year following the year in which they attain age 70½ must take a second distribution by December 31 of that same year. For example, Sue turned 70½ in 2018. She delayed her first RMD until April 1, 2019. She must take her second RMD by December 31, 2019. She must take all subsequent RMDs by December 31 of each year.
5.6

Q Should the December 31 Traditional IRA balance used in the RMD calculation include earnings that have accrued but have not yet been posted as of December 31?

A The December 31 Traditional IRA balance used to determine RMDs should be the same balance that is reported to the IRS on the fair market value (FMV) statement. Technically, the FMV is equal to the balance of the IRA plus any accrued, even if not yet posted, earnings. Because this definition may pose administrative and reporting problems for some organizations, an IRS spokesperson commented to Ascensus that if a financial organization cannot use this definition, the IRS may permit the organization to use another definition (such as only including posted earnings) provided that the organization applies the definition consistently.

5.7

Q An individual came into our financial organization in January 2019, established a Traditional IRA, and made a prior-year contribution for 2018. She turned age 70½ in 2019, so she must take a required minimum distribution for 2019. But she does not have a December 31, 2018, year-end balance. If there is no December 31 balance, must she take a required minimum distribution?

A No. The RMD rules do not require financial organizations to add to the December 31 balance any contributions made after the December 31 date (i.e., prior-year contributions). Because there is no December 31, 2018, account balance to calculate a 2019 RMD, a 2019 RMD is not due.
5.8 Q If a Traditional IRA owner distributes more than the RMD amount, can the excess amount be applied to reduce the required distribution for next year?
A No. A Traditional IRA owner cannot carry over amounts that exceed the RMD and use this to reduce the amount of subsequent RMDs.

5.9 Q After removing her RMD for 2018, a Traditional IRA owner took a subsequent distribution in December 2018. Now in January 2019, she wants to roll back this second distribution. We understand that RMDs may not be rolled over. May she roll over this second distribution, or must she take her 2019 required distribution before rolling over the balance?
A Treasury Regulation (Treas. Reg.) 1.408-8, Q&A 4, requires that the first amounts distributed in each distribution year are credited toward satisfying the RMD for that year. In this case, a distribution has not yet been made in 2019. The IRA owner may not use the December 2018 distribution to satisfy a subsequent year’s RMD. Only a distribution occurring in 2019 will satisfy the 2019 RMD, so the IRA owner may roll over the entire second distribution amount.

But keep in mind that a distribution in one tax year that is rolled over in a subsequent year is considered an “outstanding rollover.” According to Treas. Reg. 1.408-8, Q&A 6, the financial organization receiving the rollover should add the rollover amount into the prior December 31 balance. Therefore, if your client completes the rollover, she must add the January 2019 rollover amount to the original December 31, 2018, fair market value of the receiving IRA. She must then determine her 2019 RMD based on the increased December 31, 2018, balance.
5.10

**Q** Can a Traditional IRA owner take the sum total of all her RMDs from an IRA at another organization?

**A** If an individual has more than one Traditional IRA, she may aggregate RMD amounts and take all or some of the amounts from just one Traditional IRA. According to Notice 88-38 and Treas. Reg. 1.408-8, Q&A 9, this aggregation of RMDs is available to individuals who maintain multiple Traditional IRAs as well as to an IRA beneficiary who must take required distributions from a decedent’s Traditional IRAs. Only amounts in IRAs that an individual holds as the IRA owner may be aggregated, and only amounts that an individual holds as the beneficiary of the same decedent may be aggregated.

To aggregate RMDs, the individual must determine the RMD amount from each Traditional IRA separately. Once the individual RMD amounts are determined, a distribution representing the aggregate amount may be taken from just one or any combination of the Traditional IRAs.

5.11

**Q** Can an IRA owner satisfy his RMD for a Traditional IRA with a distribution from a Roth IRA?

**A** No. While it is true that Traditional IRA RMDs from the same IRA owner can be aggregated and taken from one Traditional IRA, the distribution regulations specify that distributions from Roth IRAs will not satisfy an RMD for a Traditional IRA (Treas. Reg. 1.408-8, Q&A 9).
5.12

Q  An IRA owner has several Traditional IRAs, one of which she maintains at our organization. If she wants to take her total RMD for all of her Traditional IRAs from her Traditional IRA with us, should we obtain all of her Traditional IRA balances as of the prior-year end and divide by the applicable distribution period?

A  No. Treasury regulations require the amounts for each IRA to be determined separately. Certain elections that affect the calculation may vary between each Traditional IRA (e.g., beneficiary designations and method of determining life expectancy). If an IRA owner aggregates his RMDs, he must calculate the required amounts separately for each Traditional IRA and then add the amounts together to obtain one total RMD amount.

5.13

Q  An IRA owner would like to aggregate his RMDs from his 401(k) plan and his Traditional IRA and remove the aggregate amount from his Traditional IRA. Is this allowed?

A  No. Although Notice 88-38 and the RMD regulations permit RMDs of separate IRAs to be aggregated and taken from one Traditional IRA, the guidance specifically states that individuals cannot satisfy RMDs from qualified retirement plans by taking a Traditional IRA distribution. So, individuals cannot satisfy Traditional IRA RMDs by taking distributions from their retirement plan accounts.
5.14

Q Last year one of our IRA owners, age 75, did not take the RMD from her Traditional IRA at our credit union. Was it our responsibility to make sure that she took the distribution in time?

A Financial organizations are not responsible for ensuring that RMDs are taken. The timely removal of RMDs is the Traditional IRA owner’s responsibility. Your client may have taken the RMD from one of her other Traditional IRAs. You should check the terms of your plan agreement, however, to see if your organization has accepted any additional responsibility regarding RMDs.

While financial organizations must send RMD statements and calculate RMDs for certain IRA owners, the actual distribution of the RMD remains each IRA owner’s responsibility.

5.15

Determining RMDs

Q How are RMDs calculated?

A RMDs generally are calculated by dividing the account balance by the applicable distribution period (life expectancy). The account balance is determined by adding to the December 31 prior year-end IRA balance any outstanding rollovers, transfers, and recharacterizations, and subtracting the value of any qualifying longevity annuity contracts. Individuals may disregard contributions and distributions made after December 31.

The distribution period is determined by using the Uniform Lifetime Table, which can be found in IRS Publication 590-B, Distributions from Individual Retirement Arrangements (IRAs), or on the IRS website. An exception to using the Uniform Lifetime Table exists if the IRA owner has named his spouse as the sole beneficiary and the spouse beneficiary
is more than 10 years younger than the IRA owner. In this case, the Joint Life Expectancy Table, also found in IRS Publication 590-B or on the IRS website, is used to determine the distribution period.

### 5.16

**Q** One of our Traditional IRA owners just turned 71. His designated beneficiary is his 38-year-old daughter. How do we determine the life expectancy to use in the RMD calculation?

**A** Individuals determine their life expectancy (or distribution period) by using the Uniform Lifetime Table in IRS Publication 590-B. The Uniform Lifetime Table is used in all cases except when a spouse, who is more than 10 years younger than the IRA owner, is the sole designated beneficiary.

In your example, the life expectancy from the Uniform Lifetime Table that corresponds to a 71-year-old is 26.5. So, 26.5 is the life expectancy factor to use in this RMD calculation.

### 5.17

**Q** An IRA owner designated a qualified trust as the beneficiary of her Traditional IRA. How do I calculate a distribution period for RMDs?

**A** In general, an IRA owner who names a qualified trust (see Question 6.19) as beneficiary may calculate the RMD in the same manner as other IRA owners—that is, by dividing the previous year’s December 31 IRA balance by the divisor found in the Uniform Lifetime Table.

But in this situation, if the spouse is the sole beneficiary of the qualified trust and is more than 10 years younger than the IRA owner, the IRA owner may use the Joint Life Expectancy Table to calculate her RMD. If the trust is not a qualified trust, however, the IRA owner must use her own age and the Uniform Lifetime Table to calculate her RMD.
5.18

Q Can a Traditional IRA owner who is over age 70½ replace his spouse beneficiary with a revocable living trust if the spouse is still alive?

A Yes. A Traditional IRA owner may change beneficiaries any time. (Community property states may require spousal consent when changing beneficiaries.) Changing beneficiaries, however, may alter the life expectancy figure that an IRA owner uses to determine RMDs.

5.19

Q A Traditional IRA owner turns age 70½ in 2019. She has designated her husband as her primary beneficiary and her sister as contingent. Her husband died in July 2019. What effect will her husband’s death have on the calculation of her 2019 RMD?

A In most IRA plan agreements (including Ascensus’ IRA Simplifier®), if the primary beneficiary dies before the IRA owner and there are no other primary beneficiaries, the contingent beneficiary becomes the new primary beneficiary. When calculating RMDs during the IRA owner’s lifetime, however, the named beneficiary usually does not come into play because the IRA owner calculates the RMD by using a distribution period found in the Uniform Lifetime Table (Treas. Reg. 1.401(a)(9)-9, Q&A 2). The only exception applies when an IRA owner’s sole beneficiary for the entire year is the spouse, who is more than 10 years younger than the IRA owner. In that case, the actual joint life expectancy of the IRA owner and the spouse beneficiary applies.
In your example, the spouse was not the sole beneficiary for the entire year. But if there is a change during the year in marital status because of divorce or death, the change in beneficiary for determining the distribution period takes effect in the year following the year of death or divorce (Treas. Reg. 1.401(a)(9)-5, Q&A 4(b)(2)).

5.20

Q One of our Traditional IRA owners turned 70 on February 11, 2019. I know that she must take her first RMD by April 1, 2020. But by that time, she will be 71. When we calculate this RMD for 2019, which age should we use to determine her life expectancy—age 70 or 71?

A When determining a Traditional IRA owner’s life expectancy for RMD purposes, always use the IRA owner’s age on her birthday in the year for which the distribution is being made. In your situation, life expectancy will be determined using age 70, the age your IRA owner turned on her birthday in her 70½ year (2019).

5.21

Q I need to determine the joint life expectancy for an IRA owner and his spouse. Where can I find the appropriate life expectancy tables to calculate his RMD?

A The life expectancy tables can be found in IRS Publication 590-B. You may obtain this IRS publication at www.irs.gov/orderforms.
5.22

Q If an IRA owner names a charity as an IRA beneficiary, how do I calculate his RMD?

A IRA owners who name an entity such as a charity as beneficiary will use the Uniform Lifetime Table to calculate the RMD while alive. An IRA owner must divide the previous year’s adjusted December 31 IRA balance (adjusted for any recharacterizations and outstanding rollovers and transfers) by a divisor from the Uniform Lifetime Table. The divisor is determined using the IRA owner’s attained age in the year for which the RMD is being calculated.

5.23

Q Must IRA owners take RMDs if they are still working?

A Yes. IRA owners who have reached their required beginning dates must remove RMDs each year, even if they are still working. A provision under the Small Business Job Protection Act of 1996 allows qualified retirement plan participants who are not more than five percent owners to delay their first RMDs until April 1 of the year following retirement. Traditional IRAs (including IRAs that hold SEP plan contributions) and savings incentive match plan for employees of small employers (SIMPLE) IRAs are not included under this special exception.
5.24 Q We’ve heard that having a QLAC may affect how IRA RMDs are calculated. What is this?
A A qualifying longevity annuity contract (QLAC) is an annuity contract that provides annuity payments to an account owner beginning at an advanced age and is purchased from an insurance company using assets in a qualified defined contribution plan, tax-sheltered 403(b) plan, eligible governmental 457(b) plan, or IRA (other than a Roth IRA).

In July 2014, the Treasury Department published final regulations addressing the purchase of QLACs within employer-sponsored retirement plans and IRAs. These regulations define the QLAC requirements, modify the RMD rules, and describe disclosures that must be provided with respect to a QLAC. The regulations apply to QLACs purchased on or after July 2, 2014.

5.25 Q How will QLACs affect RMD calculations?
A RMD calculations for IRAs generally are based on the prior year-end account balance. QLAC regulations provide an adjustment to this balance if the IRA owner purchases a QLAC. The account balance is reduced by the QLAC premium cost to arrive at the amount to use for the RMD calculation. This, in essence, eliminates the potential need to begin taking distributions from the QLAC earlier than anticipated, which would increase the cost of the annuity and reduce the account balance faster than may be necessary.
5.26

What are some of the requirements for QLAC contracts?

Some of the required provisions of a QLAC include the following items:

- Distributions must begin no later than the first day of the month following the month the contract owner attains age 85, the approximate life expectancy of an individual at retirement. The contract can provide for an earlier age.

- An annuity contract intended to be a QLAC, whether an individual or group annuity, must state this in the contract when it is issued (e.g., a contract rider or endorsement).

- The total premium amounts paid from retirement plans and IRAs to purchase one or more QLACs cannot exceed the lesser of $130,000 (indexed) or 25 percent of the account balance. The 25 percent limitation applies separately to retirement plans and IRAs, and for IRA purposes, is 25 percent of the aggregate of all IRA account balances.

- Distributions under the QLAC must satisfy the RMD regulations that apply to annuity contracts (e.g., the contract may not provide for increasing payments).

- A QLAC may contain no cash surrender or similar value and may not be a variable or indexed annuity product (though the IRS has the authority to provide exceptions through other guidance).

- Distributions to beneficiaries can come in a return of premiums or a life annuity.
Does the issuer of the QLAC have any disclosure requirements to meet?

The QLAC issuer must file an annual report with the IRS and provide a statement to the individual on whose behalf the QLAC was purchased, starting in the year of the first premium payment and ending with the earlier of such individual’s death or the attainment of age 85. In addition to noting that the contract is a QLAC, it must contain the following information.

- The name, address, and identification number of the issuer of the contract, the individual who purchases the contract, and the IRA
- The annuity start date, the amount of the annuity payable on that date, and whether the annuity start date may begin earlier
- The amount of each premium paid, along with the date of payment
- The QLAC’s fair market value as of the close of the calendar year

IRS Form 1098-Q, Qualifying Longevity Annuity Contract Information, is used to satisfy these reporting requirements.
Qualified Charitable Distributions

5.28

Q Can IRA owners donate their RMDs tax free to charitable organizations?

A IRA owners and beneficiaries who are age 70½ and older may make tax-free qualified charitable distributions (QCDs) to qualified charities. These IRA distributions are limited to $100,000 per tax year and they satisfy the IRA owner or beneficiary’s RMD for the applicable year. QCDs first became available in 2006 as a temporary provision, and finally were made permanent by the Consolidated Appropriations Act of 2016.

5.29

Q An IRA owner instructed our bank to pay his RMD to his church as a QCD. Should this be reported on Form 1099-R as a distribution to the church?

A No. While QCDs must be paid directly to the charity (e.g., by check or cash), the distribution must be reported on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., in the name and Social Security number of the IRA owner or beneficiary. For Traditional IRAs, code 7, Normal distribution, or code 4, Death, is reported in Box 7. For Roth IRAs, either code Q, Qualified distribution from a Roth IRA, or code T, Roth IRA distribution, exception applies, is reported in Box 7. IRA owners and beneficiaries claim an exemption from tax for their QCDs on their income tax returns (i.e., Form 1040, U.S. Individual Income Tax Return).
Qualified HSA Funding Distributions

5.30

Q My client wants to move some of her Traditional IRA assets into her health savings account. Is that possible?

A Yes. Individuals may take a one-time “qualified health savings account (HSA) funding distribution” from a Traditional or Roth IRA and directly move it to an HSA. The distribution amount is restricted to the annual HSA contribution limit, and such transactions reduce any regular annual contributions to the HSA for the year. If individuals do not remain HSA-eligible (for reasons other than death or disability) for 12 months following the month of the transaction, they must include the amount in income and pay a 10 percent penalty tax.

5.31

Q May individuals take more than one qualified HSA funding distribution from their IRAs?

A Individuals generally are restricted to only one qualified HSA funding distribution per lifetime. But if individuals change from self-only coverage to family coverage during the year of the rollover, thus increasing their contribution limit, they may move an additional amount that year to reflect the higher contribution limit.
IRA Withholding

5.32

Q Why should a financial organization use an IRA withdrawal authorization form for a Traditional IRA distribution?

A Financial organizations should use an IRA withdrawal authorization form to obtain distribution information that they must report to the IRS. Financial organizations also may use a withdrawal authorization form to satisfy the withholding reminder notice and election requirement for IRA distributions.

5.33

Q Are financial organizations required to withhold federal income tax from Traditional IRA distributions?

A Generally, yes. Payers must withhold at a rate of at least 10 percent from aggregate annual Traditional IRA distributions of $200 or more. The IRA owner, however, may elect not to have withholding apply in most cases.

5.34

Q How much must a financial organization withhold on a Traditional IRA distribution if the IRA owner does not waive out of withholding?

A The withholding rate depends on whether the Traditional IRA distributions are payable on demand. If the distributions are payable on demand, meaning the IRA owner can vary or stop payouts at any time, then the distributions are deemed nonperiodic. Nonperiodic distributions are subject to a withholding rate of 10 percent.
If the payouts are not payable on demand, meaning the IRA owner or beneficiary will receive a steady stream of payouts that will not change, such as annuitized distributions from an individual retirement annuity under IRC Sec. 408(b), then the distributions are deemed periodic. Periodic distributions are treated as wages and the financial organization determines the withholding by using the income tax withholding tables with the assumption that the recipient is married and has three exemptions, unless the distribution recipient chooses a different withholding rate.

5.35

Q If a Traditional IRA owner under age 59½ takes a nonperiodic distribution, must we withhold 10 percent from the distribution?

A Assuming the proper documentation is completed (IRS Form W-4P, Withholding Certificate for Pension or Annuity Payments), the IRA owner may waive withholding on her IRA distribution.

If the IRA owner does not waive withholding and there is no election on file, the financial organization must withhold at least 10 percent (more than 10 percent may be withheld if the IRA owner wishes).

Withholding from an IRA distribution is not mandatory simply because a distribution is taken by an IRA owner before age 59½. Do not confuse IRA withholding with the 10 percent early distribution penalty tax, which IRA owners report and pay when filing their tax returns.
5.36

Q  Do I have to provide a withholding notice to my Traditional IRA owners?

A  Yes. All Traditional IRA distributions of $200 or more annually (except transfers) are subject to federal income tax withholding unless the IRA owner elects not to have income tax withheld. Financial organizations must provide IRA owners with Form W-4P or a substitute Form W-4P to notify IRA owners of their right to waive withholding.

5.37

Q  Is there a penalty for failing to provide the withholding election notice?

A  Yes. Financial organizations may be assessed a $10 penalty for each failure to provide a notice of the IRA owner’s rights regarding federal withholding. The maximum penalty that may be assessed against a financial organization is $5,000 for any calendar year.

5.38

Q  Many of our Traditional IRA owners are nearing age 59½ and would like to begin taking quarterly payments from their IRAs. Must we obtain a signed withdrawal authorization form each time a distribution is made?

A  No. Traditional IRA owners may sign one withdrawal authorization form specifying the frequency with which they desire to receive payments. Such instructions generally remain in effect until your clients notify you otherwise. But you are still required to notify IRA owners of the federal income tax withholding requirements.
Individuals taking distributions quarterly or more often must receive the withholding notice at least once per 12 months and at a reasonable time before the first distribution each year. Failure to provide the notice may result in a $10 penalty for your organization for each failure to provide the notice.

5.39

**Q** When must financial organizations provide withholding notices to Traditional IRA owners?

**A** Financial organizations generally should provide withholding notices to Traditional IRA owners at the time the IRA owner requests a distribution or within six months preceding the distribution. If distributions are being made to IRA owners quarterly or more frequently, then financial organizations must provide the notice at least once per 12 months at a reasonable time before the first distribution each year.

5.40

**Q** Can a financial organization allow IRA owners to sign withholding election forms at the time their Traditional IRAs are established?

**A** Allowing IRA owners to sign a withholding election form at the same time they establish a Traditional IRA generally does not satisfy the notice requirements unless the IRA owner takes a distribution within six months of establishing the Traditional IRA. The earliest a Traditional IRA owner may sign a withholding election form, which is for distributions that are less frequently than quarterly, is six months before the distribution.
5.41

Q Must an IRA owner sign an election not to withhold when rolling over or transferring Traditional IRA assets?

A With a transfer, a taxable distribution does not occur so the withholding rules do not apply. But when a Traditional IRA owner takes a distribution for rollover purposes, a potentially taxable distribution results and, therefore, the withholding rules apply.

5.42

Q If a financial organization provides the withholding notice within a reasonable time before a Traditional IRA distribution, can it specify a time by which an IRA owner must respond to waive withholding on a distribution?

A No. IRA owners have the right to make or revoke an election regarding federal withholding at any time before a distribution.

5.43

Q One of our IRA owners is taking required minimum distributions from another financial organization, but has never taken a distribution from her Traditional IRA here. Must we provide her with a withholding notice describing her right to waive or alter the normal 10 percent income tax withholding?

A No. The withholding regulations do not require you to provide a withholding notice if distributions are not taken from an account. Your IRA owner will receive withholding notices from your organization only when she begins taking distributions from the Traditional IRA that she maintains with you.
5.44

Q A 55-year-old IRA owner is withdrawing $10,000 from her Traditional IRA. Our organization is assessing a $120 time deposit penalty. Because the IRA owner is under age 59½, she also owes a 10 percent early distribution penalty tax. She wants to withhold 10 percent on this distribution. How do we report the time deposit penalty of $120 on Form 1099-R? How much should we withhold?

A The time deposit penalty simply lowers the account balance, which means your financial organization may base the amount of withholding on $9,880 ($10,000 – $120), or you may choose to debit the time deposit penalty amount at a later date and distribute $10,000. If you take the first approach, your financial organization must report the 10 percent withholding amount of $988 in Box 4 and the distribution amount of $9,880 (this includes the amount withheld) in Box 1, Gross distribution, on Form 1099-R. The IRA owner must report a 10 percent early distribution penalty tax of $988 (based on $9,880) when she files her individual income tax return for the year of distribution.

5.45

Q If an IRA owner takes a distribution of property from a Traditional IRA and does not waive withholding, how do we withhold from the distribution?

A When an IRA owner takes a distribution of property, the IRA owner may pay the amount needed to satisfy the withholding obligation out-of-pocket. If IRA owners do not have sufficient assets to pay withholding, they must sell an amount in property from their Traditional IRA to meet the withholding requirements and then distribute the remaining property. Note that typically the IRA owner may waive withholding at the time of distribution (Temporary Treas. Reg. 35.3405-1T, F-2).
5.46

Q  If a Traditional IRA owner requests income tax withholding on his RMD, do I need to distribute the withholding amount in addition to the required amount?

A  No. The income tax withheld on the RMD counts toward satisfying the RMD requirement. For example, if Andrew has an RMD of $500 and requests to have 10 percent withheld, the financial organization distributes $500 from the IRA, retains $50 from that amount to remit to the IRS for federal income tax withholding, and provides Andrew with a check for $450. Form 1099-R will show a gross distribution of $500 in Box 1, and Box 4, Federal Income Tax Withheld, will show that $50 was withheld for federal income taxes.

5.47

Q  Are Traditional IRA distributions subject to the mandatory 20 percent withholding requirement that applies to retirement plans?

A  No. Only eligible rollover distributions from employer-sponsored retirement plans that are not directly rolled over to an IRA or to another eligible plan are subject to the mandatory 20 percent withholding.
5.48  

**Q**  
What amount must be withdrawn from a Traditional IRA if an IRA owner wants to walk away with $5,000 but requests 10 percent federal withholding?

**A**  
Financial organizations may use the following formula to compute the distribution amount an IRA owner who is applying 10 percent withholding must request to receive a specific “after withholding” amount.

\[ G = \frac{N}{0.9} \]

- \( G \) = Gross amount withdrawn
- \( N \) = Net amount the IRA owner desires to receive after 10 percent federal withholding has been taken out (e.g., $5,000)

\[ G = \frac{5,000}{0.9} \]
\[ G = 5,555.56 \]

**NOTE:** This formula must be adjusted if a different percent is elected. If, for example, an IRA owner requests 20 percent withholding, financial organizations may use the above formula by substituting .8 for .9 (i.e., 1.0 – .2 = .8), etc.

5.49  

**Q**  
May an IRA owner elect 100 percent withholding on a Traditional IRA distribution?

**A**  
Yes. The withholding regulations generally characterize all Traditional IRA distributions (other than annuity distributions from an IRC Sec. 408(b) IR annuity) as “payable upon demand” and, therefore, are deemed nonperiodic. The withholding rules state that a recipient may elect to have withholding of 10 percent or more apply to nonperiodic payments (assuming the recipient does not elect to waive
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out of federal withholding altogether). Because the regulations do not place an upper limit on the withholding percentage that an individual may elect to have applied to nonperiodic payments, IRA owners may elect to have 100 percent withheld from their IRA distributions.

5.50

What are the IRS requirements regarding electronic transmission of federal income tax withholding elections on IRA distributions?

Financial organizations wishing to provide the withholding notice electronically generally must follow the requirements outlined in Treas. Reg. 1.401(a)(21). The regulations state that any notice or election provided electronically must satisfy all the otherwise applicable requirements relating to that communication, such as the timing, content, and delivery specifications. In general, financial organizations providing notices electronically must establish an electronic system that meets the following requirements.

• The electronic system must provide the information in a manner no less understandable than if it was provided in a paper document.

• At the time that the electronic system provides the notice, the electronic transmission must alert the recipient to the significance of the information included and must provide any instructions needed to access the notice.

• The electronic system must retain an electronic record of the notice in a form that can be reproduced later.

The regulations provide two delivery methods that financial organizations may choose from to electronically deliver any notice that the Internal Revenue Code requires to be in writing. The two methods are called the “consent” method, which meets ESIGN requirements, and the “alternative” method, which is based on the regulations from 2000.
**Withholding Deposit Requirements**

5.51

Q  How does our financial organization determine how often it must deposit IRA withholding?

A  The frequency with which a payer must deposit IRA withholding depends on the payer’s depositor status. Payers may determine their depositor status by referring to the instructions to Form 945, Annual Return of Withheld Federal Income Tax. According to the instructions, an employer’s look-back period for determining depositor status is the calendar year two years before the current calendar year (Treas. Reg. 31.6302-4(c)(2)(iv)). For example, the look-back period for 2019 is 2017.

5.52

Q  What makes an organization a monthly depositor?

A  If the total tax reported during the look-back period is $50,000 or less, the depositor is considered a monthly depositor for the current calendar year. A monthly depositor must deposit collected taxes by the 15th day of the month following the month during which the taxes were collected. For example, if ABC Bank’s 2017 Form 945 shows total tax reported of $50,000 or less, ABC Bank is a monthly depositor for 2019.

5.53

Q  What makes a financial organization a semiweekly depositor?
Depositors who reported more than $50,000 in taxes withheld during the look-back period are considered semiweekly depositors for the current year. Semiweekly depositors must make deposits on Wednesday or Friday depending upon the day during which taxes are collected. Withholding collected on Wednesday, Thursday, or Friday should be deposited by the following Wednesday. Withholding collected on Saturday, Sunday, Monday, or Tuesday should be deposited by the following Friday.

5.54

Q I know Publication 15, Circular E, Employer’s Tax Guide, provides exceptions to the deposit rules for withholding. What are the exceptions?

A Publication 15 provides two exceptions to the general deposit rules: the $100,000 next-day deposit rule and the $2,500 exception.

According to the $100,000 next-day deposit rule, if a payer accumulates withheld taxes of $100,000 or more within a deposit period, the payer must deposit those taxes by the close of the next banking day following the day the $100,000 limit was met. At that point, the payer immediately becomes a semiweekly depositor and must follow the semiweekly depositor rules for the rest of the calendar year and for the following calendar year. The payer also must complete Form 945-A, Annual Record of Federal Tax Liability, for the entire year in which it became a semiweekly depositor.

A depositor who accumulates less than $2,500 in withholding during a year may wait until it files Form 945 to deposit the taxes. Depositors who are unsure if they will accumulate less than $2,500 generally should deposit under the monthly or semiweekly depositor rules, thereby avoiding a penalty for failure to deposit should the depositor accumulate more than $2,500 during the quarter.
IRS Forms 945 and 945-A

5.55

Q What is Form 945 and why does our financial organization have to file it?
A Payers must report all nonpayroll withholding on Form 945, Annual Return of Withheld Federal Income Tax. Nonpayroll withholding includes amounts withheld from IRA distributions, pensions, annuities, military retirement benefits, gambling winnings, voluntary withholding on certain government payments, and payments subject to backup withholding.

Payers file Form 945 with the IRS following the end of the calendar year in which they collect any nonpayroll withholding. Form 945 generally is due to the IRS by January 31 of the year following the year the taxes are withheld. If deposits are made on time, in full, the due date for filing Form 945 is February 10 rather than January 31. Form 945 may be filed on paper or electronically.

5.56

Q Is there ever a time that a financial organization does not have to file Form 945?
A Yes. Depositors must file Form 945 only for a calendar year in which the depositor is required to withhold federal income tax from nonpayroll payments. The organization need not file Form 945 for any year that all IRA withholding is waived and the depositor does not collect nonpayroll withholding.

5.57

Q Our financial organization is a semiweekly depositor. Is our financial organization required to complete Form 945-A?
Yes. Semiweekly depositors must file Form 945-A, *Annual Record of Federal Tax Liability*, with Form 945 to report nonpayroll withholding. Form 945-A reports the amount of nonpayroll withholding collected each day. The IRS uses Form 945-A to match the tax liability reported on the form to the deposits to determine if the withholding tax liabilities have been timely deposited. Only semiweekly depositors must file Form 945-A with Form 945; monthly depositors only have to file Form 945.

### 5.58

**What is Form 945-V?**

Form 945-V, *Payment Voucher*, is used in conjunction with Form 945 filing. Depositors must include Form 945-V when making a deposit with Form 945. Located on page 2 of Form 945, the IRS uses the completed voucher to credit the payment more promptly and accurately.

### Remitting Withholding Amounts

### 5.59

**What are the requirements for remitting federal income tax withholding to the IRS?**

Most financial organizations must deposit withholding amounts electronically through the IRS’ Electronic Federal Tax Payment System (EFTPS). Only those entities that remit less than $2,500 of withholding for a return period (one year for retirement arrangements) are allowed to use manual means. In that case, IRA withholding would be remitted with Form 945, which is filed annually.
Withholding on IRA Distributions Delivered Outside the U.S. or to Nonresident Aliens

5.60

Q Must we apply withholding on death distributions made to nonresident aliens?

A Unlike U.S. citizens or resident aliens, nonresident aliens (individuals who are not U.S. citizens or resident aliens) who take IRA distributions are subject to a 30 percent withholding requirement under IRC Sec. 1441, or an applicable rate as specified under a tax treaty.

The rules and regulations of IRC Sec. 1441 require 30 percent withholding for nonresident aliens, but allow nonresident aliens to apply a reduced rate of withholding under a U.S. tax treaty for their resident country by completing Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals). If a nonresident alien does not provide the form, financial organizations must apply the mandatory 30 percent withholding.

See the Instructions for the Requester of Forms W-8BEN, W-8BEN-E, W-8ECI, W-8EXP, and W-8IMY for instruction on the Forms W-8 series and the separate instructions for these forms at the IRS website.
5.61

Q A Traditional IRA owner, a U.S. citizen living in Sweden, requested a distribution from her IRA and wants to waive withholding. May she do that?

A Only if the IRA owner can provide you with a U.S. home address to which the distribution will be mailed, may she waive the 10 percent withholding requirement. If she does not have a U.S. home address of her own, you must withhold at a rate of 10 percent (assuming the payments are nonperiodic).

5.62

Q Is the withholding on an IRA distribution to a nonresident alien reported on Form 1099-R?

A Form 1099-R is not filed in cases where the withholding provisions of IRC Sec. 1441 rather than IRC Sec. 3405 apply. If the distribution recipient is a nonresident alien who is subject to withholding, Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding, must be sent to both the IRS and the recipient. This form is filed even if, as a result of the treaty rate, nothing is withheld.
Chapter 6
Traditional IRA Beneficiary Issues

Beneficiary Distribution Options – The Basics

6.1

Q What are the beneficiary distribution options if the IRA owner dies before the required beginning date for required minimum distributions?

A Beneficiaries should first review the plan agreement to determine the IRA distribution options because the plan agreement may limit the options available to beneficiaries. Beneficiary options allowed in Treasury regulations depend on the IRA owner’s age and whether the beneficiary is a spouse, nonspouse, or nonperson (e.g., charity, estate, or nonqualified trust). Regulations provide for the following beneficiary distribution options when the IRA owner has not yet reached his required beginning date (RBD) for required minimum distributions (RMDs).

- If the spouse is the sole primary beneficiary, the options include treating the IRA as the spouse’s own (by redesignation or transfer), distributing and rolling over the assets to the spouse’s own IRA or eligible plan, depleting the IRA within five years (five-year rule), or taking annual single life expectancy (SLE) payments, recalculated. If choosing SLE payments, distributions must begin on or before the later of December 31 following the year of the IRA owner’s death or December 31 of the year the IRA owner would have attained age 70½.
• If the financial organization does not establish separate accounting by December 31 of the year following the year of death and the primary beneficiary is a person other than the spouse or the spouse is one of multiple beneficiaries, the options include distributing and rolling over the assets to the spouse’s own IRA or eligible plan (for spouse beneficiaries only), taking distributions under the five-year rule, or taking annual SLE payments based on the oldest beneficiary’s age, nonrecalculated. If choosing SLE payments, distributions must begin on or before December 31 of the year following the year of death.

• If a beneficiary is not named or if the beneficiary is a nonperson, the only option is the five-year rule. (See Question 6.2.)

6.2

Q

What is the five-year rule?

A

Under this rule, the beneficiary can take distributions at any time and in any amount as long as the IRA assets are depleted by December 31 of the year containing the fifth anniversary of the IRA owner’s death.

6.3

Q

Could you explain the treat-as-own option that is available to a spouse beneficiary of a decedent’s IRA?

A

The term “treat-as-own” in the regulations means “redesignate (retile)” or “transfer.” Treasury Regulation (Treas. Reg.) 1.408-8, Q&A 5, indicates that the only situation in which spouse beneficiaries can elect to treat IRAs as their own through a redesignation or transfer is when a spouse beneficiary is the sole primary beneficiary of an IRA owner with an unlimited right to withdraw amounts from the IRA.
Individuals should not confuse a rollover with the treat-as-own option. Spouse beneficiaries may use the “distribute-and-roll option” when there are multiple beneficiaries and the financial organization has not established separate accounting.

6.4

What are the beneficiary distribution options if the IRA owner’s death occurs on or after the RBD for distributions?

Beneficiaries should first review the plan agreement to determine the IRA distribution options because the plan agreement may limit the options available to beneficiaries. Treasury regulations provide for the following distribution options when the IRA owner has begun required distributions before death.

- If the spouse is the sole primary beneficiary, the options include treating the IRA as the spouse’s own (by redesignation or transfer), distributing and rolling over the assets to the spouse’s own IRA or eligible plan, or taking annual distributions of SLE payments based on the longer of the designated beneficiary’s remaining life expectancy, recalculated, or the IRA owner’s single life expectancy, fixed in the year of death, nonrecalculated. SLE payments must begin by December 31 of the year following the year of the IRA owner’s death.

- If the financial organization does not establish separate accounting by December 31 of the year following the year of death and the primary beneficiary is a person other than the spouse or if the spouse is one of multiple beneficiaries, the options include distributing and rolling over the assets to the spouse’s own IRA or eligible plan (for spouse beneficiaries only), or taking annual distributions of SLE payments based on the longer of the oldest beneficiary’s remaining life expectancy,
nonrecalculated, or the IRA owner’s single life expectancy, nonrecalculated, fixed in the year of death. SLE payments must begin by December 31 of the year following the year of the IRA owner’s death.

- If a beneficiary is not named or if the beneficiary is a nonperson, the only option is taking annual distributions of SLE payments based on the IRA owner’s age in the year of death, nonrecalculated. Distributions must begin by December 31 of the year following the year of the IRA owner’s death.

6.5

**How is the designated beneficiary determined?**

An IRA owner’s designated beneficiary (i.e., the beneficiary used to determine the distribution period) is determined based on the beneficiaries designated as of the date of death, who remain beneficiaries as of September 30 of the calendar year following the year of the IRA owner’s death. If a beneficiary disclaims his interest in the IRA or takes a full distribution of his interest in the IRA before September 30 of the year following the year of death, that beneficiary is not taken into account when determining the designated beneficiary. *(Treas. Reg. 1.401(a)(9)-4, Q&A 4(a)).*  

If the designated beneficiary (the oldest beneficiary if the IRA owner names multiple beneficiaries) dies during the period between the IRA owner’s death and September 30 of the year following the year of the IRA owner’s death, that beneficiary continues to be treated as the designated beneficiary as of the September 30 determination date for determining the distribution period *(Treas. Reg. 1.401(a)(9)-4, Q&A 4(c)).*
What happens if a nonspouse IRA beneficiary does not choose a distribution option by December 31 of the year following the year of the IRA owner’s death?

Financial organizations should first review the plan agreement because the plan agreement may contain specific IRA distribution options or defaults. Treasury regulations provide that if the IRA owner dies before the RBD and the plan does not specify a different default option, then SLE payments will apply (Treas. Reg. 1.401(a)(9)-3, Q&A 4).

If SLE payments are required and the beneficiary fails to take the first SLE payment, the beneficiary is subject to an excess accumulation penalty tax of 50 percent of the amount that should have been distributed but was not. Regulations, however, 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.

When the IRA owner dies on or after the RBD, the beneficiary must take the RMD for the year of death if not already taken by the IRA owner. For years after the IRA owner’s death (if after the RBD), distributions must continue using the longer of the designated beneficiary’s remaining life expectancy or the IRA owner’s remaining life expectancy. If an RMD is not taken, the beneficiary is subject to the excess accumulation penalty tax.
6.7

**Q**
What happens if a spouse beneficiary fails to choose a distribution option following the IRA owner’s death?

**A**
Unless the plan agreement specifies otherwise, the default option for a spouse beneficiary is the same as for a nonspouse beneficiary—SLE payments. A spouse who is the sole IRA beneficiary (or who is one of multiple beneficiaries where separate accounting has been applied) also has the option of treating the inherited IRA as the spouse’s own. Additionally, spouse beneficiaries are deemed to have treated an inherited IRA as their own if they fail to remove an SLE payment or if they make a contribution to an inherited IRA. In these situations, future required distributions for the spouse beneficiary are determined based on the spouse beneficiary’s age.

6.8

**Q**
A Traditional IRA beneficiary elected a life expectancy payment from a decedent’s Traditional IRA. Who will receive the remaining assets in the Traditional IRA if that beneficiary dies? May a beneficiary designate beneficiaries? If so, how?

**A**
An IRA is a trust created for the exclusive benefit of an individual or her beneficiaries (IRC Sec. 408(a)). In general, only the IRA owner can name IRA beneficiaries. Naming a beneficiary does not violate any federal tax laws as long as the previously established payout schedule is not lengthened.
While many IRA documents in the industry do not explicitly prohibit a beneficiary from naming a beneficiary, most IRA forms drafters do not specifically design their IRA forms to accommodate such designations. Before adopting a policy of allowing IRA beneficiaries to name beneficiaries, financial organizations should carefully examine their IRA documents to determine whether language supports beneficiaries naming beneficiaries.

6.9

Q We have an IRA owner who died before beginning his RMDs. His spouse beneficiary then died the following year, before any payments were made. How do we determine the distribution period?

A If the sole designated beneficiary as of the September 30 beneficiary determination date is the IRA owner’s spouse, and the spouse beneficiary dies after the IRA owner but before distributions have begun, the five-year rule and the life expectancy rule (without the delayed starting date) are to be applied as if the spouse beneficiary were the IRA owner (Treas. Reg. 1.401(a)(9)-3, Q&A 5). Thus, the beneficiary for determining the distribution period is the beneficiary of the spouse beneficiary (i.e., successor beneficiary), if one exists. The successor beneficiary must be named as of the date of the spouse beneficiary’s death and remain a beneficiary as of September 30 of the year following the spouse beneficiary’s death. If there is no designated successor beneficiary as of the September 30 determination date, the five-year rule applies (Treas. Reg. 1.401(a)(9)-4, Q&A 4(b)).
6.10

Q What is meant by “recalculation” and “nonrecalculation” for single life expectancy payments?

A An option for a spouse beneficiary is to take SLE payments, recalculated. Recalculation simply means that in each subsequent year, the distribution is calculated using the age the spouse will become in the distribution year to find a life expectancy divisor in the Single Life Expectancy Table (Treas. Reg. 1.401(a)(9)-5, Q&A 5(c)(2)).

RMDs for nonspouse beneficiaries are based on SLE payments, nonrecalculated. For the first year, the SLE divisor is obtained from the Single Life Expectancy Table. When calculating the SLE for each subsequent year, the divisor used to calculate the prior-year SLE is reduced by one (Treas. Reg. 1.401(a)(9)-5, Q&A 5(c)(1)).

6.11

Q One of our IRA owners recently died. He named his spouse and their two children as primary beneficiaries of his account. All three wish to take life expectancy payments, but the children do not wish to base the payments on their mother’s age. Can we establish separate accounting so that each beneficiary can base the payments on his own age?

A Yes. Treas. Reg. 1.401(a)(9)-8 indicates that when there is more than one designated beneficiary and the Traditional IRA is timely divided into separate accounts for each beneficiary (separate accounting entries, not new plan agreements), minimum distributions may be calculated individually based on each beneficiary’s age. Spouse beneficiaries may then distribute and roll over their share of the assets to their own IRAs.
IRS officials have commented to Ascensus that the spouse beneficiary also may use the “treat-as-own” option if separate accounting is properly established. If the spouse beneficiary chooses to treat the IRA as his own, he must transfer the assets to a separate IRA because redesignating the existing IRA is not possible when a spouse is one of multiple beneficiaries of the same IRA.

6.12

**How do we establish separate accounts?**

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.

6.13

**Does it matter when we establish separate accounts for beneficiaries?**

Yes. You may establish separate accounting for multiple beneficiaries under an IRA at any time—whether the IRA owner died before or after the RBD. If beneficiary accounts are determined as of the IRA owner’s date of death and are established by December 31 of the year following the year of the IRA owner’s death, each beneficiary is treated as the sole beneficiary for purposes of determining beneficiary distribution options.
IRS officials commented to Ascensus that a spouse who is one of multiple beneficiaries may transfer the spouse’s portion of the decedent’s IRA to the spouse’s own IRA if separate accounts are established timely. If the financial organization does not establish separate accounts timely and the spouse is one of multiple designated beneficiaries, the only method of moving the decedent’s IRA assets to the spouse beneficiary’s own IRA is through a distribution and subsequent rollover.

If financial organizations establish separate accounts timely, each beneficiary generally may use his own single life expectancy to calculate life expectancy payments.

If financial organizations do not establish separate accounts timely, all designated beneficiaries generally must use the oldest designated beneficiary’s life expectancy to calculate life expectancy payments.

**Traditional IRA Owner Dies Before Required Beginning Date**

**6.14**

**Q** We have an IRA owner who died at age 57. His sole spouse beneficiary is age 49. The spouse beneficiary is trying to decide whether she should leave the assets in his IRA or immediately move them into her IRA. Is there any reason to leave them in the deceased’s IRA?

**A** The spouse beneficiary should be advised to see a tax professional who can counsel her on the tax implications of each choice. That said, if the spouse should need additional funds in the upcoming years, her tax advisor may suggest that she leave the assets in the deceased’s IRA. If she moves the assets to her own IRA and takes a distribution before age 59½, she will have a 10 percent early distribution penalty tax. If, however, she leaves the assets in the deceased’s IRA and takes a death distribution from it, the penalty tax is waived. Additionally, if the assets remain in
the deceased’s IRA, the spouse beneficiary may elect not to begin distributions until the deceased would have been age 70½ (although she can take distributions at any time). She will also have the option of moving the assets into her own IRA at anytime.

6.15

Q

A Traditional IRA owner died at the age of 60. His primary beneficiary is his 68-year-old sister. She wants to elect the five-year rule beneficiary option. May she use the five-year rule beneficiary option even though she will attain age 70½ in two years?

A

Yes. The fact that the nonspouse beneficiary will attain age 70½ in two years has no effect on the five-year rule beneficiary option. The availability of the five-year rule distribution option is based on the IRA owner’s age at death. Under the five-year rule, the nonspouse beneficiary must deplete the decedent’s Traditional IRA by December 31 of the fifth year, even though she will attain age 70½ during the five-year period.

6.16

Q

One of our Traditional IRA owners recently died. His spouse beneficiary chose to take life expectancy payments beginning when the deceased IRA owner would have been age 70½. May the beneficiary wait until that date even though she will attain age 70½ before that time?
Yes. The life expectancy beneficiary option available to a surviving spouse beneficiary specifically states that distributions do not have to begin until the later of December 31 of the year following death or December 31 of the year in which the deceased IRA owner would have attained age 70½. Therefore, a surviving spouse can wait until the decedent would have attained age 70½, even though the surviving spouse may be over age 70½ by that time.

6.17

Q A Traditional IRA owner died at age 50, leaving her Traditional IRA to her child, who is still a minor. As a minor, is the beneficiary restricted to any particular method of distribution?

A No. The child has the same options as those available to any other nonspouse beneficiary. The child’s guardian generally is responsible for making the election. Check your state’s laws to determine if any other specific rules regarding minors apply.

6.18

Q If a Traditional IRA owner dies in his 70½ year, but before the RBD, does he still have an RMD due for that year?

A No. The key here is the attainment of the RBD. Traditional IRA owners must begin taking RMDs by April 1 following the year they attain age 70½, the RBD (Treas. Reg. 1.401(a)(9)-2, Q&A 2). In this case, because the Traditional IRA owner died before the RBD, he had not reached mandatory distribution status. Therefore, an RMD does not exist. The beneficiary options available when an IRA owner dies before the RBD apply.
6.19

Q I’ve always understood that when a Traditional IRA owner dies before the RBD and a revocable living trust is the beneficiary, distribution to the trust must be made under the five-year rule. The attorney representing the daughter of our deceased Traditional IRA owner, who is the beneficiary of the trust, claims that distributions can be made to the trust over the daughter’s life expectancy. Is this true?

A Yes. A distribution to the trust may be made over the daughter’s life expectancy if the following requirements are met. (Treas. Reg. 1.401(a)(9)-4, Q&A 5).

- The trust must be valid under state law.
- The trust must be irrevocable, or become irrevocable upon the IRA owner’s death.
- The beneficiaries of the trust must be identifiable.
- The trustee of the trust must provide a copy of the trust instrument or qualifying documentation of the trust to the financial organization by October 31 of the year following the year of the IRA owner’s death.

The documentation also must show who the beneficiaries are as of September 30 of the year following the year of death (Treas. Reg. 1.401(a)(9)-4, Q&A 6(a)(2)(b)(1)).

NOTE: If there are multiple trust beneficiaries, the oldest beneficiary’s life expectancy must be used to determine the distribution period. The separate accounting rules are not available to trust beneficiaries (Treas. Reg. 1.401(a)(9)-4, Q&A 5(c)).
One of our clients died on his RBD. The beneficiary of his Traditional IRA is his 64-year-old spouse. She would like to treat the IRA as her own. Can she treat the entire balance as her own?

According to the RMD regulations, the spouse beneficiary can treat the IRA as her own at any time following the IRA owner’s death. If the deceased IRA owner did not satisfy his RMD before death, his spouse beneficiary must satisfy the RMD for the year of death based on the deceased IRA owner’s age. The spouse beneficiary has three options for distributing an RMD in the year of death.

1. The spouse beneficiary may transfer the entire account balance (including the RMD) to her own IRA and then distribute the RMD from the receiving IRA or another of her IRAs by December 31 of the year of death.

2. The spouse beneficiary may distribute the deceased IRA owner’s assets and roll over all the assets to her own IRA, except for the RMD (RMDs are not eligible rollover amounts).

3. The spouse beneficiary may decide not to move the IRA assets to her own IRA. If she chooses this option, she must distribute the RMD from the beneficiary account by December 31 of the year of death.

If the spouse beneficiary decides to treat the IRA as her own in a year following the year of death, she may calculate any future RMDs based on her age as the IRA owner (Treas. Reg. 1.408-8, Q&A 5).
6.21

**Q** A Traditional IRA owner recently died at age 74. His son is his IRA beneficiary. The son wants to take distributions under the five-year rule. Is this permissible?

**A** No. The five-year rule applies only when a Traditional IRA owner dies before the RBD (IRC Sec. 401(a)(9)(B)(ii)). The RBD generally is April 1 of the year following the year the IRA owner attains age 70½. In this situation, the decedent was age 74 at death and had passed his RBD. Thus, the five-year rule is not available as an election. The son’s only distribution options are to take a complete distribution of the account, SLE payments, or increased payments each year (may complete distributions in five years).

6.22

**Q** A Traditional IRA owner died after reaching his RBD. According to our procedures, we should pay his Traditional IRA balance to his estate, because he did not name a beneficiary. The personal representative of the estate is asking us not to pay out the entire account right away. Must we distribute his entire account?

**A** No. Treas. Reg. 1.401(a)(9)-5, Q&A 5(c)(3), indicates that when a beneficiary is not named, the financial organization may distribute SLE payments based on the age the IRA owner would have attained in the year of his death. Distributions must begin on or before December 31 of the year following the year of death, and these payments are nonrecalculated for subsequent years. Unless the plan agreement specifies otherwise, an immediate distribution of the total account is not required.
Traditional IRA Beneficiary Distribution Concerns

6.23

Q What happens to a Traditional IRA if the beneficiary dies before the IRA owner, and then the IRA owner dies without designating a new beneficiary?

A The Traditional IRA owner’s estate generally will receive the Traditional IRA assets unless the IRA owner named a contingent beneficiary, or the plan agreement specifies otherwise.

6.24

Q May a Traditional IRA owner specify a method of distribution that her primary beneficiary must adhere to upon the IRA owner’s death instead of allowing the beneficiary to choose from the beneficiary options specified in the Traditional IRA plan agreement?

A Yes. An IRA owner may specify that a particular distribution method be used, provided it satisfies one of the beneficiary options available under the Traditional IRA plan agreement and the requirement is made in a manner determined to be legal under state law.
One of our IRA owners recently died. This individual was divorced, but still listed his former wife rather than his current wife as his primary beneficiary for his Traditional IRA. He also specifically listed his Traditional IRA in his will as a probate asset to be bequeathed to his second wife. Neither the IRA owner nor his Traditional IRA is in a community property state. Who should receive the IRA proceeds, the first wife or the second wife?

An absolute answer, unfortunately, does not exist for this question. State law may come into play, and ultimately, a court determination may be necessary. So please consult your legal counsel for an opinion.

Some case law has favored the contract or trust provision of an IRA over a provision in a will. For example, if an IRA owner designates a beneficiary and includes all relevant information such as the name, date of birth, Social Security number, and relationship to the IRA owner, the beneficiary designation may supersede any conflicting directions found in the IRA owner’s will. Yet case law has also shown that the beneficiary designation may be found invalid because the will was created after the Traditional IRA designation, and more accurately represents the wishes of the decedent.

This situation illustrates the importance of updating beneficiary designations on a regular basis. Your organization should seek competent legal advice before paying out any IRA assets.
Q A husband and wife each have a Traditional IRA with us. They each have named the other spouse as primary beneficiary of their Traditional IRAs. Recently they died in a car accident. The husband died first and the wife died a few hours later. Who will receive the Traditional IRA balances?

A The answer to the question depends on how the applicable state statutes handle simultaneous deaths, whether the IRA owner designated a contingent beneficiary, and if the IRA owner established a will that contains a presumption of survivorship clause.

If two people die simultaneously (or very closely together in time), state law may dictate the presumed order of death when it cannot be conclusively determined. In the example above, state law may stipulate that in both cases, the spouse beneficiary is deemed to have predeceased the IRA owner.

If the primary beneficiary predeceases the IRA owner, then the balance within the Traditional IRA passes to the contingent beneficiary, if the IRA owner named one. When a contingent beneficiary is not named, then the Traditional IRA balance generally passes to the deceased IRA owner’s estate.

What happens to the assets that are payable to the estate? That depends upon a presumption of survivorship clause. This clause, when included in the will, establishes the order of death for purposes of estate distribution. The testator (creator of the will) could stipulate in this clause how to handle property in a simultaneous death situation. This clause may overcome the presumption of death spelled out in the simultaneous death statute. When there is no presumption of survivorship clause within a will or an IRA owner dies intestate (without a will) then the transferring of Traditional IRA property depends upon state law.
6.27

Q A client wishes to transfer an inherited IRA to our financial organization. We always have contended that a nonspouse beneficiary could not move an inherited IRA, but our client is insisting it can be done. May a nonspouse beneficiary do so?

A Publication 590-B, *Distributions from Individual Retirement Arrangements*, indicates that a nonspouse beneficiary may make a trustee-to-trustee transfer as long as the receiving IRA is set up and maintained in the name of the deceased IRA owner for the benefit of the beneficiary. Although some private letter rulings and Publication 590-B appear to permit such transactions, there may still be issues under state contract or trust law that are not addressed. If a nonspouse beneficiary wants to transfer a decedent’s IRA, your financial organization and, ideally, legal counsel, must determine whether it will allow such a transaction, and, if so, whether the financial organization should use a “hold harmless” agreement to facilitate this transaction.
**Q**

One of our IRA owners died this year. He had named his trust as beneficiary of his IRA, and named his wife as beneficiary of the trust. The attorney acting as trustee of the trust has instructed us to transfer the decedent’s IRA directly to the surviving spouse’s IRA. Can we do that when the trust is the named IRA beneficiary?

**A**

Treasury regulations expressly prohibit a spouse beneficiary of a trust from treating IRA assets received through the trust as the spouse’s own IRA assets. But in private letter rulings (PLRs), the IRS has allowed spouses—if they are the sole beneficiaries of the qualified trusts and if they have unlimited rights to withdraw the trust assets—to roll over the IRA assets to their own IRAs. Remember, however, that only the person who applied for the PLR may rely upon its ruling.

In the case you have presented, the trustee of the trust is an attorney, and not the spouse herself. This does not match the fact patterns of the PLRs that have granted surviving spouses who are trust beneficiaries the ability to distribute and roll over the assets to their own IRAs.

If a surviving spouse seeks to roll over IRA assets received through a trust or estate, the surviving spouse should discuss with her legal advisor whether applying for a PLR is appropriate.
6.29

Q  An IRA beneficiary has instructed us to pay out her deceased father’s IRA to his estate instead of to her, the named beneficiary. Can a beneficiary do this?

A  Beneficiaries can “disclaim” inherited IRA assets if they follow certain procedures. Beneficiaries cannot, however, dictate who will receive the disclaimed assets. If a beneficiary properly disclaims inherited IRA assets, the assets may then pass to any other primary beneficiaries named, or if the plan agreement allows, to any contingent beneficiaries named if there are no other primary beneficiaries. If an IRA owner did not name any other beneficiaries, the assets generally will pass to the decedent’s estate, but financial organizations should review the IRA plan agreement or state law to see if there are provisions addressing situations in which beneficiaries are not named.

A valid disclaimer must be

• the disclaimant’s written, irrevocable refusal to accept interest in the given property, and

• delivered to the financial organization within nine months of the date of the IRA owner’s death (or, if later, within nine months of the disclaimant attaining age 21).

The disclaimant may not receive any part of the disclaimed share before the disclaimer is effective. A beneficiary, however, may disclaim a partial interest in the IRA and accept the portion, and the income attributable, not disclaimed.

IRA administrators should not assist in the drafting or execution of a disclaimer, and should consult with legal counsel to determine if a disclaimer is valid.
**Beneficiary Reporting Issues**

6.30

Q Do financial organizations have to provide beneficiaries with an annual RMD notice?

A No. Notice 2002-27 specifically states that reporting is not required for IRAs of deceased owners. This means that financial organizations do not have to provide an annual RMD notice to beneficiaries, or notify the IRS when a beneficiary must take a minimum distribution payment from an inherited IRA. The only exception applies when a spouse beneficiary elects to treat the decedent’s IRA as the spouse’s own IRA. Because the spouse beneficiary is now the IRA owner, the normal RMD reporting requirements apply.

6.31

Q How is the distribution from a deceased IRA owner’s Traditional IRA reported when paid out to the beneficiary?

A The financial organization reports the distribution in the name and Social Security number of the beneficiary, not the deceased IRA owner. Financial organizations must use code 4, *Death*, on **Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**, to report the distribution.

6.32

Q One of our Traditional IRA owners recently died. The distribution is to be made to his estate. How should we report this?

A The IRA owner’s estate should provide your organization with a taxpayer identification number. Use this taxpayer identification number when completing the required distribution reporting on **Form 1099-R**.
6.33

Q A spouse beneficiary of a Traditional IRA rolled over the assets to his own IRA. He now wants to take a distribution of those assets. He said that we should report the distribution as a death payout (distribution code 4) and the distribution should not be subject to the IRS 10 percent early distribution penalty tax because the amount originally came from his deceased wife’s Traditional IRA. Is this correct?

A No. While it is true that amounts distributed from a decedent’s Traditional IRA to either a spouse or nonspouse beneficiary are not subject to the 10 percent early distribution penalty tax, that does not apply in this case. Once a spouse beneficiary transfers or rolls over the assets to the spouse’s own Traditional IRA, the assets become the spouse’s Traditional IRA assets and are subject to the early distribution penalty tax if the surviving spouse takes a distribution before attaining age 59½ (assuming no other penalty tax exceptions apply).

6.34

Q When I move the assets from a deceased IRA owner’s account to a beneficiary account, what distribution code should I use?
By establishing separate accounts, you are initiating separate accounting entries in an existing Traditional IRA for the benefit of beneficiaries. You should rename the subaccounts with the beneficiary and IRA owner names, such as “John Doe, beneficiary for Mary Doe’s IRA.” The original IRA remains intact. Distribution reporting is not required unless one of the beneficiaries takes a distribution. When a distribution is taken, you will report the distribution on IRS Form 1099-R in the beneficiary’s name and Social Security number, and use distribution code 4, Death, to report the distribution.

6.35

Q I’ve heard that nonspouse beneficiaries of employer-sponsored retirement plans may roll over inherited plan assets to an inherited IRA. Are the distribution requirements for these inherited IRAs similar to IRA beneficiary distribution requirements?

A Yes. The distribution requirements are the same. Notice 2007-7 provides additional guidance on this issue.

Once a nonspouse (or spouse) beneficiary rolls over inherited plan assets to an inherited IRA, the required beneficiary distributions generally must be paid out in the same manner as would have been paid out under the plan—SLE payments or distributions under the five-year rule. A special rule, however, permits a nonspouse beneficiary who is subject to the five-year rule under the plan to switch to the SLE payment method. If a nonspouse beneficiary makes this switch, the beneficiary must

- take the SLE payment from the plan and roll over the remaining balance to an inherited IRA before December 31 of the year following the death year, and
- continue taking annual SLE payments from the IRA, which must be calculated under the same life expectancy as would have been calculated under the plan.
Chapter 7
Traditional IRA Owner Penalties

Early Distribution Penalty Tax for Traditional IRAs

7.1

Q Should our Traditional IRA owner pay her IRS early distribution penalty tax to our financial organization or to the IRS?

A A Traditional IRA owner pays any early distribution penalty taxes to the IRS with the applicable year’s tax return. In some cases, the individual must complete and file Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts.

7.2

Q What exactly is the 10 percent early distribution penalty tax?

A In general, any distribution that a Traditional IRA owner must include in income before attaining age 59½ is subject to an IRS 10 percent early distribution penalty tax. (See Question 7.4 for exceptions.)
A Traditional IRA owner who is under age 59½ took an IRA distribution in 2018, which we reported on Form 1099-R using a code 1. He knows that he is responsible for paying the 10 percent early distribution penalty tax, but he is not sure how to report and pay the penalty tax. Is Form 5329 still used to report and pay this IRA penalty tax?

Individuals must use Form 5329 to report the 10 percent early distribution penalty tax in the following scenarios.

- An early distribution has been incorrectly coded on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

- An IRA owner owes an early distribution penalty tax, but distribution code 1, Early distribution, no known exception, is not shown in Box 7, Distribution code(s), of Form 1099-R.

- An exception to the early distribution penalty tax is met, but Form 1099-R does not indicate an exception or the exception does not apply to the entire distribution.

- Contributions for the year exceed the maximum contribution amount, or the six percent excess contribution penalty tax is due.

- A required minimum distribution (RMD) was not timely distributed.

In the case of your IRA owner, code 1 was correctly shown in Box 7. Assuming he is not eligible for any penalty tax exceptions, he will multiply the taxable portion of his IRA distribution by 10 percent (.10) and enter the result on the appropriate line on Form 1040, U.S. Individual Income Tax Return. He will not have to file Form 5329.
Exceptions to the 10 Percent Early Distribution Penalty Tax

7.4

Q What are the exceptions to the 10 percent early distribution penalty tax?

A The 10 percent early distribution penalty tax does not apply to the following types of distributions.

- Death of the IRA owner
- Disability of the IRA owner
- Rollovers
- Substantially equal periodic payments
- Age 59½ or older
- Certain medical expenses exceeding 7.5 percent of adjusted gross income (for 2017 and 2018 tax years—will return to 10 percent on January 1, 2019, unless further Congressional action is taken)
- Health insurance if an individual has been receiving unemployment compensation for more than 12 weeks
- Qualified higher education expenses
- Qualified first-time homebuyer expenses
- Conversions to Roth IRAs
- Distributions to satisfy an IRS levy
- Qualified reservist distributions
- Certain disaster-related distributions
7.5

What is meant by “qualified higher education expenses?”

In general, the term “qualified higher education expenses” means tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a student at an eligible education institution. If the individual is at least a half-time student, reasonable costs for such period incurred for room and board while attending such institution also are considered qualified higher education expenses.

7.6

Is there a maximum dollar amount that may be taken penalty-free from an IRA to pay for higher education expenses?

No. There is no limitation under the higher education penalty tax exception with respect to dollar amount. But individuals using this penalty tax exception must use the distribution to pay for qualified higher education expenses incurred during the tax year.

7.7

How does the IRS define a first-time home purchase distribution?

Individuals may take penalty-free distributions from IRAs to pay for qualified first-time home purchase expenses (IRC Sec. 72(t)(2)(F)). An IRA owner must use a qualified first-time homebuyer distribution before the close of the 120th day (starting the day after the IRA owner received the distribution). An IRA owner may take a distribution to pay for qualified acquisition costs for a principle residence of a first-time homebuyer who is the IRA owner, the IRA owner's spouse, or the child, grandchild, or ancestor of the IRA owner.
owner or the IRA owner’s spouse. IRC Sec. 72(t)(8)(D)(i)(I), defines a first-time homebuyer as an individual who has not owned a principle residence during the two-year period ending on the acquisition date. This penalty tax exception is subject to a lifetime limit of $10,000.

7.8

What is the substantially equal periodic payments exception to the 10 percent early distribution penalty tax?

Substantially equal periodic payments, or “72(t) payments,” are early distributions that are part of a series of substantially equal periodic payments (at least annual payments) made over the Traditional IRA owner’s life expectancy or the joint life expectancy of the IRA owner and the IRA owner’s beneficiary. The payments must continue unchanged for five years (beginning with the date of the first payment) or until the Traditional IRA owner attains age 59½, whichever is later.

Revenue Ruling (Rev. Rul.) 2002-62 provides guidance on calculating substantially equal periodic payments. Rev. Rul. 2002-62 describes three safe harbor calculation methods, and clarifies other factors involved in calculating payments. Many rules apply to substantially equal periodic payments; an IRA owner who requests this option should seek competent tax advice to establish the payout schedule as any modification of the payout schedule will result in the 10 percent early distribution penalty tax being assessed for all distributions taken under the arrangement, plus interest.

Financial organizations report payouts made under this exception to IRA owners under age 59½ as early distributions not subject to the 10 percent penalty tax, using distribution code 2, Early distribution, exception applies, on Form 1099-R.
7.9

Q

I understand that if substantially equal periodic payments are modified before the end of the required period, the 10 percent early distribution penalty tax generally is assessed retroactively, along with any interest, as if the substantially equal periodic payment option had not been used. What is considered a payment modification?

A

Under the three approved calculation methods, an individual calculates the payments with respect to an account balance as of the first valuation date. A modification of the payments will occur if, after such date, the IRA owner

- makes a contribution to the IRA—including transfer or rollover contributions,
- transfers or rolls over a portion of the account balance to another retirement plan, or
- makes an unapproved modification of the distribution amount.

In the past, failing to satisfy the minimum payout period (other than for reasons due to death or disability) also resulted in a modification of the payment arrangement, and generally subjected the IRA owner to retroactive penalties. Rev. Rul. 2002-62 provides relief for IRA owners who find themselves at risk of depleting their retirement assets prematurely. This relief states that if an individual used an acceptable method to determine the initial payment amounts, the IRA owner will not be penalized if depletion of IRA assets prevents the IRA owner from satisfying the otherwise prescribed minimum time period for the distributions. Also, Rev. Rul. 2002-62 permits a taxpayer to make a one-time election to switch to the RMD method from another method without being considered to have modified the payments.
7.10

Q One of our IRA owners established substantially equal periodic payments two years ago. He recently expressed his intent to change the calculation method. Can he change the calculation method halfway through the minimum period for taking such payments?

A Yes. As noted in Rev. Rul. 2002-62, IRA owners using either the amortization or annuitization calculation method may make a one-time switch to the RMD method, provided the change is made in a year following the year in which distributions began. This allows IRA owners who are at risk of depleting their IRAs prematurely to switch to the RMD method, thereby reducing the amount required to be distributed annually to amounts that will be proportional to future IRA balances and life expectancy. The IRS will not view the one-time switch in calculation methods as an impermissible payment modification subjecting IRA owners to penalties and interest.

The drafter of Rev. Rul. 2002-62 informed Ascensus that in a transition year an IRA owner may stop annuitization or amortization payments before receiving what would have been the entire required distribution amount, even if the distribution amount exceeds the new RMD-based calculation for that year.

Excess Contributions

7.11

Q What is the advantage of removing excess contributions before the tax filing deadline?

A IRA owners can avoid having to pay a six percent excess contribution penalty tax to the IRS if they remove excess contributions with net income attributable (NIA) by their tax filing deadline, plus extensions.
7.12

**Q**

An IRA owner said his tax preparer told him to withdraw his Traditional IRA regular contribution. According to the IRA owner, he was eligible to make a Traditional IRA contribution, but was not eligible to deduct it. What should we do?

**A**

An IRA owner may treat otherwise eligible Traditional IRA contributions made for a particular year (whether deductible or nondeductible) as excess contributions and withdraw them before the due date of that year’s tax return, plus extensions (including the October 15 automatic extension if applicable—see **Question 7.15**). To properly withdraw those contributions, the individual must follow the rules for removal of true excess contributions before the tax return due date (i.e., the individual removes the contribution and NIA).

After the IRA owner’s tax return due date, plus extensions, the IRA owner may not remove a Traditional IRA contribution as an excess simply because it was nondeductible.

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7.13

**Q**

An individual deposited a $5,500 Traditional IRA contribution in January 2019 for tax year 2018. If she removed the contribution and the net income attributable to the contribution before her tax filing deadline for 2018, for which year are the earnings taxable?

**A**

The NIA is taxable for the year in which the contribution was deposited—2019. To report that your IRA owner removed a 2018 contribution that she deposited and removed in 2019, indicate a distribution code 8, *Excess contributions plus earnings...*, on Form 1099-R. Also, the Form 1099-R instructions indicate that payers should enter code 1, *Early distribution, no known exception*, or 4, *Death*, if applicable, in addition to code 8.
7.14

Q A Traditional IRA owner who is under age 59½ discovered he had an excess contribution. Several months passed before he removed the excess contribution and the net income attributable to the excess. Does he have to pay the 10 percent early distribution penalty tax on the net income attributable if, at the time of the removal, he was over age 59½?

A No. The Traditional IRA owner will not have to pay the 10 percent early distribution penalty tax on the NIA. The penalty tax is determined at the time the IRA owner actually receives the assets. Thus, if he were over age 59½ at the time of distribution, he would not owe a 10 percent early distribution penalty tax.

7.15

Q Is there any way a Traditional IRA owner can correct an excess contribution after April 15 and still avoid the six percent excess contribution penalty tax?

A Yes. The deadline to remove excess IRA contributions with the NIA and avoid the six percent excess contribution penalty tax is the individual’s tax return due date, plus extensions. As noted in the instructions to Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, an automatic six-month extension for correcting the excess applies for IRA owners who filed their taxes timely. If IRA owners filed their income tax returns timely (generally by April 15, or by an authorized extension date), they have until October 15 to withdraw an excess IRA contribution and avoid the six percent penalty tax.
7.16

Q

One of our Traditional IRA owners, who is under age 50, made a $6,000 IRA contribution for 2019 in June 2019. Now I discovered that she had already made a $6,000 deposit in January 2019 for tax year 2019. What should she do?

A

Your Traditional IRA owner may avoid an excess contribution penalty tax by removing the excess contribution by her 2019 tax return due date, plus extensions (generally October 15 of the year following the tax year). She also must remove the NIA to this contribution.

If she waits until after her tax return due date (plus extensions), she may remove the excess $6,000 without the NIA, and pay a six percent IRS penalty tax (IRC Sec. 4973). Because the IRA owner is under age 59½ and her total contributions for the year ($12,000) exceeded the 2019 maximum contribution amount of $6,000, the distribution is taxable and subject to a 10 percent early distribution penalty tax. She may carry forward the excess contribution as a contribution for 2020 (see Question 7.18), but the six percent penalty tax will still apply for 2019.

7.17

Q

We were informed by the executor of our deceased IRA owner’s estate that just before his death, the IRA owner made an excess contribution to his Traditional IRA. Should it be corrected now?

A

Yes. It should be corrected. The financial organization should remove an excess contribution made by a decedent at the request of the executor of the decedent’s estate. The financial organization should report the correction in the estate’s name and tax identification number as a removal of
excess. Distributing an excess contribution to a decedent’s estate as soon as possible is important to avoid a six percent penalty tax on the excess amount (an excess contribution cannot be treated as a subsequent year contribution after an IRA owner’s death). Because the excess contribution is not an eligible IRA contribution, and the estate may have different beneficiaries than the IRA, the excess amount, plus NIA, belongs in the decedent’s estate rather than in his IRA.

7.18

Q One of our IRA owners discovered in 2019 that he has an excess contribution for 2018. Because he has not made a contribution for 2019, may the IRA owner use the $1,000 excess as a contribution for 2019?

A Yes. If the IRA owner does not want to withdraw the excess, he can leave the excess in the Traditional IRA, pay a six percent excess contribution penalty tax for 2018, and treat the excess as part of an eligible contribution in 2019 (providing he is eligible to make an IRA contribution).

The IRA owner must file Form 5329 with his amended 2018 tax return to pay the six percent penalty tax on the $1,000 excess for 2018. He can carry forward the $1,000 excess contribution as a 2019 regular contribution by indicating on the 2019 Form 1040, U.S. Individual Income Tax Return, that he made a $1,000 regular IRA contribution for 2019.

The financial organization will report the $1,000 excess amount with the other 2018 contributions on Form 5498, IRA Contribution Information, and will do nothing to carry forward the excess contribution for 2019.
7.19

Q Is it true that if an IRA owner does not remove an excess contribution by his tax return due date (plus extensions), there may be additional taxes and penalties when he does remove the excess?

A Yes. Additional taxes and penalties may apply. For example, for tax year 2019, if an IRA owner does not remove an excess contribution by the tax return due date (including extensions), and total IRA contributions for the year exceed $6,000 (or $7,000 if the IRA owner is eligible for a catch-up contribution), the IRA owner generally will owe a six percent penalty tax for each year it remains an excess in the IRA after December 31. The IRA owner also must treat the entire excess contribution amount as taxable income, and, if the IRA owner is under age 59½, the IRA owner also must pay an additional 10 percent penalty tax on the excess amount that is distributed. Special rules apply to excess simplified employee pension (SEP) plan contributions corrected after the tax-filing deadline (plus extensions) (IRC Sec. 408(d)(5)(A)(iii)) and excess rollover contributions caused by erroneous information (IRC Sec. 408(d)(5)(B)).
In 2018, an IRA owner indirectly rolled over $6,000 from his qualified retirement plan to his Traditional IRA. In November 2019, the IRA owner notified us that he was ineligible to make the rollover contribution because he completed the rollover after the 60-day limit had passed. How do we correct this problem?

The $6,000 ineligible rollover amount is deemed to be a regular IRA contribution for 2018, the year the rollover occurred. If the contribution amount, combined with any regular, spousal, or catch-up IRA contributions made for 2018, exceeded the IRA owner’s maximum contribution amount for 2018, the IRA owner must treat the amount in excess of the contribution limit as an excess contribution.

To correct an excess contribution after an IRA owner’s tax return due date (plus extensions), the IRA owner may either withdraw the excess or, if eligible, carry the excess forward as a regular contribution for a subsequent year. (See Question 7.18 for information on carrying an excess contribution forward.) If the IRA owner was able to carry forward the entire excess amount to 2019, he would not owe additional penalties for 2019 and later. He must pay a six percent excess contribution penalty tax for 2018. He will file Form 5329 to pay the penalty tax with his income tax return.

In addition, your financial organization must correct the 2018 Form 5498 for the year of the deposit. The corrected Form 5498 must reflect the ineligible rollover contribution ($6,000) as a regular contribution in Box 1 rather than a rollover contribution in Box 2.
What method should our financial organization use for determining the NIA to an excess contribution or recharacterization?

Financial organizations must use the method defined in Treas. Reg. 1.408-11 to calculate NIA on excess contributions and recharacterizations.

The method defined in the regulations uses a period of time to calculate NIA that begins on the day the excess was contributed, and ends on the date of distribution. The basic formula for the method is as follows.

Net Income Attributable = \[
\frac{\text{Excess Contribution} \times \text{Total Earnings}}{\text{Adjusted Opening Balance}}
\]

Total Earnings = \(\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance}\)

Computation Period = The period beginning immediately before the time the excess contribution is made, and ending on the date of distribution

Adjusted Opening Balance = The IRA’s fair market value (FMV) at the beginning of the computation period, plus the amount of any contributions made to the IRA during the computation period (including the excess contribution that is being distributed)

Adjusted Closing Balance = The IRA’s FMV at the end of the computation period, plus the amount of any distributions taken from the IRA during the computation period, minus any applicable loss of earnings penalty (e.g., investment penalty or fees)
Excess Accumulations

7.22

Q What is the 50 percent excess accumulation penalty tax?

A If an IRA owner’s distribution from a Traditional IRA during a particular year is less than the required minimum amount, the difference constitutes an excess accumulation. A 50 percent penalty tax is assessed for an excess accumulation. To pay this penalty tax, IRA owners must file Form 5329 with their Forms 1040.

IRA owners may request an exemption from the 50 percent excess accumulation penalty tax provided the excess accumulation is because of reasonable error.

7.23

Q One of our Traditional IRA owners, age 75, failed to remove his RMD last year. He recently discovered his error and wants to remove the amount as soon as possible. Will he be responsible for an IRS penalty tax? What distribution reason code should we use to report the distribution?

A If the amount distributed to an individual during a taxable year is less than the RMD for that year, the individual is subject to an excess accumulation penalty tax of 50 percent of the amount that should have been taken but was not. The individual must file Form 5329 and remit the penalty tax. (If filing Form 5329 for a prior year, your client must use that year’s version of the form.)

When removing the late RMD from your IRA owner’s Traditional IRA, you should include distribution reason code 7, Normal Distribution, on Form 1099-R.
Eight years ago, one of our Traditional IRA owners died at age 65. His daughter, who was the beneficiary, elected to take distributions from the Traditional IRA based on the five-year rule. She should have depleted the IRA three years ago, but a balance remains in the IRA. We know that the 50 percent excess accumulation penalty tax applies, but is that a one-time penalty tax, or does it apply for each year that assets remain in the Traditional IRA?

The 50 percent excess accumulation penalty tax is assessed for each year the assets remain in the Traditional IRA. For each year that passes after the year containing the fifth anniversary of the IRA owner’s death, any remaining balance in the Traditional IRA is considered an RMD. If an individual does not remove an RMD, the excess accumulation penalty tax will apply.
Chapter 8
Traditional IRA Reporting

Form 5498 Reporting

8.1

Q Are financial organizations required to do any corrective reporting when a Traditional IRA owner carries forward an excess contribution for a subsequent tax year?

A No. When IRA owners decide to carry forward their excess contributions for a following tax year, all reporting indicating that the contribution has been carried forward is done by the IRA owner when filing his income tax return, not the financial organization. For example, if an IRA owner carries forward a 2019 excess contribution as a 2020 contribution, the financial organization generates a 2019 Form 5498, IRA Contribution Information, and reports the actual amount that was contributed in 2019. The financial organization does not report the contribution carried forward for 2020 on a 2020 Form 5498.

8.2

Q Is it true that financial organizations are required to shorten taxpayer identification numbers on Forms 5498 and 1099-R?

A No. While the ability for financial organizations to truncate taxpayer identification numbers has been made permanent, it is not mandatory. Financial organizations may—but are not required to—truncate Social Security, individual taxpayer identification, or employer identification numbers only on the recipient copies of any information return, form, or report that does not require a complete identification number by
statute or any other guidance. This includes Form 5498 and Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. Note that truncated identification numbers may not be used on copies of information returns or documents provided to the IRS. To truncate means to replace the first five digits of the nine-digit number with asterisks (*) or Xs.

### 8.3

**Q**

Our bank has always used account numbers to differentiate our clients’ accounts. I just noticed that there is a box for account numbers on Form 5498. Are we required to report account numbers to the IRS?

**A**

When filing more than one Form 5498 or Form 1099-R for a recipient who has multiple accounts with a financial organization, the financial organization must provide an account number on each Form 5498 or Form 1099-R where indicated below the recipient’s information. Otherwise, the inclusion of an account number is optional.

The account number requirement pertains to accounts such as an IRA, not multiple investments, which might have identifying account numbers within an IRA.

### 8.4

**Q**

What checkbox should I check in Box 7 on Form 5498 for a Traditional IRA that is receiving SEP plan contributions?

**A**

The instructions to Form 5498 indicate that financial organizations should mark the appropriate checkbox in Box 7 to indicate the type of IRA that they are reporting information about. The instructions indicate that financial organizations should mark the “IRA” checkbox if unsure whether an arrangement is a Traditional IRA or a simplified employee pension (SEP) IRA.
8.5

How should a financial organization report to the IRS that an IRA owner has a required minimum distribution due for the year?

A The Instructions for Forms 1099-R and 5498 indicate financial organizations must check Box 11 on Form 5498 if a required minimum distribution (RMD) is due to the IRA owner for the following year (i.e., report on a 2019 Form 5498 that a 2020 RMD is due). Financial organizations are not required to report any RMD information to the IRS other than the fact that an RMD is due.

8.6

An IRA owner who was serving in Operation Iraqi Freedom recently made a $4,000 contribution to his IRA and said it was for 2018. How do we report this contribution?

A If a qualifying combat zone individual designates an IRA contribution for an earlier year, the financial organization must report the contribution on Form 5498. Financial organizations have the option of reporting such a contribution either on a form for the year for which the contribution was made or on a subsequent year's form. If you report this contribution on the form for the year for which it was made (2018), special reporting is not required. You must report the contribution in Box 1, IRA contributions, on an original 2018 Form 5498, or a corrected 2018 Form 5498 if an original was previously filed.

If reporting the contribution on the current year Form 5498 for a prior year, you must include the year for which the contribution was made, the contribution amount, and one of the following indicators.

- E013119 (or PL106-21) for Yugoslavia operations area
- E013239 for Afghanistan and associated direct support areas
- E012744 for the Arabian Peninsula areas
- PL 115-97 for the Sinai Peninsula of Egypt
When reporting for a prior year, you should enter the
• contribution amount in Box 13a,
• tax year for which the contribution is made in Box 13b, and
• applicable military operation indicator code (listed above) in Box 13c.

Financial organizations may request an automatic waiver from the requirement to file combat zone Forms 5498 electronically by submitting Form 8508, Request for Waiver From Filing Information Returns Electronically. Once the waiver is granted, financial organizations may choose from two methods of reporting contributions.

1. Report all Forms 5498 for combat zone participants on paper.
2. Report contributions made by the normal contribution due date electronically, and report contributions made after the normal contribution due date on paper. Financial organizations also may report prior-year contributions by combat zone participants electronically on a corrected Form 5498.

8.7

**Q** How are rollovers of retirement plan loan offsets due to severance from employment or plan termination reported on Form 5498?

**A** If an event that triggers a distribution (i.e., triggering event) occurs under a retirement plan at the same time as a loan default, a participant’s plan balance may be offset by the outstanding loan amount. The amount of the offset is considered an actual distribution, and generally is eligible for rollover. A provision in the Tax Cuts and Jobs Act of 2017 extends the 60-day rollover period to the tax return due date, including extensions, for individuals who have loan offsets that are due only to severance from employment or plan termination.
Rollovers of plan loan offsets due to plan termination or severance from employment are reported on Form 5498 in Box 13a, *Postponed/late contributions*, and Box 13c, *Code*. Enter the rollover amount in Box 13a, leave Box 13b blank, and enter Code “PO” in Box 13c. If the IRA owner made more than one type of postponed contribution, a separate Form 5498 should be used to report each postponed or late rollover amount.

### 8.8

**Q** What “specified assets” must be reported in Form 5498 Boxes 15a and 15b?

**A** Box 15a, *FMV of certain specified assets*, is used to report the fair market value (FMV) of certain investments held in an IRA that do not have readily available FMVs as described in the category codes for Box 15b, *Code(s)*. The Box 15b alpha codes and asset descriptions are as follows.

- **A** – Stock or other ownership interest in a corporation that is not readily tradable on an established securities market
- **B** – Short or long-term debt obligation that is not traded on an established securities market
- **C** – Ownership interest in a limited liability company or similar entity (unless the interest is traded on an established securities market)
- **D** – Real estate
- **E** – Ownership interest in a partnership, trust, or similar entity (unless the interest is traded on an established securities market)
- **F** – Option contract or similar product that is not offered for trade on an established option exchange
- **G** – Other asset the does not have a readily available FMV
- **H** – More than two types of assets (listed in A through G) are held in this IRA
Account Statements

8.9  
Q Must we generate 2018 Forms 5498 for Traditional IRA owners who do not make IRA contributions for 2018?

A If you send each IRA owner a fair market value statement by January 31, 2019 (reporting the IRA's December 31, 2018, value and identifying which information you will report to the IRS), Form 5498 need not be sent to IRA owners who had no IRA contributions of any kind for 2018. But you must send Form 5498 to the IRS by May 31, 2019, for every IRA owner.

8.10  
Q Our financial organization does not use Form 5498 as the Traditional IRA account statement. Instead, we generate a statement that looks much nicer and gives our Traditional IRA owners more information than Form 5498. Is this allowed?

A Yes. Many financial organizations prefer to give their IRA owners a customized account statement, which provides more information than Form 5498.

The account statement generally must include the following information for Traditional IRAs.

- The name, address, and identifying number of the financial organization
- The name, address, and identifying number of the IRA owner
- The amount of contributions made during the year and the calendar year for which a contribution is to be credited
• The amount of rollover contributions
• The amount of SEP or SIMPLE IRA plan contributions
• The account’s FMV at the end of the year

If Form 5498 is not used to satisfy the account statement, this language also must be included: “This information is being furnished to the Internal Revenue Service.”

**Fair Market Value Statements**

8.11

**Q** Financial organizations may send the fair market value statement, which lists a Traditional IRA owner’s year-end balance, to the IRA owner in any written format. Exactly what is meant by “any written format?”

**A** The requirements of the fair market value (FMV) statement are fulfilled if IRA owners receive something in writing, mailed by January 31, that states their December 31 IRA balances for the previous year. Note, however, that Traditional IRA owners who do not receive an account statement because no contributions were made for the year must receive a FMV report that includes a legend specifying which information from the statement the financial organization is providing to the IRS.

8.12

**Q** When sending out statements to Traditional IRA owners to report the FMV, must we print “IMPORTANT TAX INFORMATION” on the envelope?

**A** No. There are no special mailing requirements when reporting the FMV to your Traditional IRA owners.
8.13

Q Must I generate a FMV statement for an IRA owner who revoked his Traditional IRA?

A According to Revenue Procedure 91-70, if an individual establishes an IRA late in one year and revokes the IRA early in the following year, the financial organization should generate a FMV statement. For example, if an IRA existed on December 31, 2018, but was revoked within the seven calendar-day revocation period in early 2019, the financial organization must generate an FMV statement showing the IRA’s value as of December 31, 2018, for the former IRA owner. If the IRA was established and revoked before December 31, 2018, a 2018 FMV statement would not be necessary.

8.14

Q We’ve recently had trouble with our computer system, and it appears that we won’t make the May 31 deadline for Forms 5498 reporting. How do we apply for a reporting extension from the IRS?

A Treas. Reg. 1.6081-8(b) provides a 30-day automatic extension for filing certain forms, including Forms 1099-R and 5498 if a financial organization completes and files Form 8809, Application for Extension of Time to File Information Returns, on or before the date prescribed for filing the particular information return.
A filer may receive one additional 30-day extension if it submits a request before the expiration of the automatic 30-day extension (Treas. Reg. 1.6081-8(d)(2)). The request must

- be submitted on Form 8809;
- include the filer's name, address, tax identification number, telephone number, and contact name;
- include an explanation in detail as to why the additional time is needed; and
- include the filer's signature.

### Form 1099-R Reporting

**8.15**

**Q** An IRA owner closed his Traditional IRA that he had with us. His account held only $5. Do we need to complete a Form 1099-R for such a small distribution amount?

**A** No. The Small Business Job Protection Act of 1996 states that Form 1099-R is not required for IRA distributions under $10.

**8.16**

**Q** Must we calculate and report the taxable portion of a Traditional IRA distribution if both deductible and nondeductible contributions have been made?

**A** No. Financial organizations are not responsible for calculating the nontaxable portion of a distribution when both deductible and nondeductible IRA contributions have been made. IRA owners who have nondeductible basis in their IRAs use IRS Form 8606, Nondeductible IRAs, to calculate the taxable portion of any IRA distributions.
8.17

Q In January 2018, a Traditional IRA owner came in to make a prior-year contribution for 2017. Later in 2018, she discovered that her contribution was not deductible so she elected to withdraw it as an excess. Which code do I use on Form 1099-R to report that withdrawal? Do multiple codes apply for the contribution and the net income attributable?

A Individuals removing IRA excess contributions before their tax filing due date (plus extensions) generally do not have to treat the excess contribution as taxable income. The NIA, however, is always taxable in the year in which the individual makes the excess contribution, which means financial organizations must indicate whether the NIA is taxable in the current reporting year or in the prior reporting year.

If an individual removes an excess contribution in the same year the contribution was deposited (including those deposited as prior-year contributions), the financial organization must use a code 8, Excess contribution plus earnings..., in Box 7 on Form 1099-R. If an individual removes an excess contribution before the tax filing due date (plus extensions) in the year after the contribution was made, the financial organization must use a code P, Excess contributions plus earnings..., on Form 1099-R. The Instructions for Forms 1099-R and 5498 also require the use of code 1, Early distribution, no known exception, or code 4, Death, in conjunction with code 8 or P, if applicable.

In your client’s case, you should use code 8 to report the excess removal because she made a contribution in 2018 and she removed it the same year. This is true even though the contribution was a prior-year contribution for 2017.
8.18

Q An IRA owner made a Traditional IRA contribution in 2018 for 2018. After the tax filing deadline plus extensions for 2018, she found out she was ineligible to make the contribution because she had no eligible compensation. How should we report the removal of an excess contribution after the tax filing deadline?

A Use distribution code 1, Early distribution, no known exception, or code 7, Normal distribution, depending on the Traditional IRA owner’s age, to report this type of distribution unless another code is applicable (e.g., death or disability).

8.19

Q Are financial organizations required to obtain proof from IRA owners when they request a distribution under the exceptions to the early distribution penalty tax for payment of certain medical expenses, health insurance for unemployed individuals, first-time home purchases, qualified reservist distributions, or education expenses?

A No. In all these cases, the reason code for reporting is code 1, Early distribution, no known exception, on Form 1099-R. IRA owners must claim an exception to the penalty tax by filing Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, with their income tax returns. Consequently, financial organizations are relieved of any requirement to obtain proof for such requests.
8.20

How do financial organizations report qualified HSA funding distributions?

The *Instructions for Forms 1099-R and 5498* indicate that there is no special reporting for qualified HSA funding distributions. The IRS has clarified that financial organizations should report the transaction on *Form 1099-R* with the gross amount in Box 1, *Gross distribution*, and in Box 2a, *Taxable amount*. Box 2b, *Taxable amount not determined*, should be checked. Financial organizations should report Traditional IRA distributions with a code 1, *Early distribution, no known exception*, or code 7, *Normal distribution*, depending on the IRA owner’s age. Financial organizations should report Roth IRA distributions using a code J, *Early distribution from a Roth IRA*, code T, *Roth IRA distribution, exception applies*, or code Q, *Qualified distribution from a Roth IRA*, as applicable, and Box 2a should be left blank.

8.21

One of our IRA owners revoked his new IRA within seven calendar days of opening it. We processed the distribution for him, but are unsure which distribution codes are used to report it.

Financial organizations must report IRA revocations to the IRS and the IRA owner on *Form 1099-R*. Financial organizations should refer to the *Instructions for Forms 1099-R and 5498* to see how to report on *Forms 5498* and 1099-R when revocations have occurred. The reporting codes used in Box 7, *Distribution code(s)*, of Form 1099-R depend on the type of contribution made when opening the IRA, and whether the financial organization opted to return earnings on the contribution. Based on the Form 1099-R instructions, the various codes that may be used in Box 7 are as follows.
<table>
<thead>
<tr>
<th>Type of Revocation</th>
<th>Traditional IRA</th>
<th>Roth IRA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular or Spousal (without earnings)</td>
<td>8</td>
<td>J</td>
</tr>
<tr>
<td>Regular or Spousal (with earnings)</td>
<td>1 and 8 (if applicable)</td>
<td>J and 8 (if applicable)</td>
</tr>
<tr>
<td>Rollover or Transfer</td>
<td>1 or 7</td>
<td>J</td>
</tr>
<tr>
<td>Conversion to a Roth</td>
<td>N/A</td>
<td>J</td>
</tr>
</tbody>
</table>

8.22

**Q**

Our organization recently received an IRS notice of levy on one of our Traditional IRA owner’s accounts. He has asked what the tax consequences will be because this is not a voluntary distribution. Further, we would like guidance on how to report this transaction.

**A**

Your organization will issue Form 1099-R in the IRA owner’s name and Social Security number. The code you use to report the Traditional IRA distribution depends on whether the individual is age 59½ or older (code 7, Normal) or under age 59½ (code 2, Early distribution, exception applies). The IRA owner must include the distribution in his taxable income for the year, but there is no 10 percent penalty tax if he is under age 59½.

8.23

**Q**

Must a Traditional IRA owner attach Form 1099-R to her Form 1040?

**A**

The IRA owner will attach Copy B of Form 1099-R to her income tax return only if withholding was applied to her IRA distributions. If the IRA owner has elected not to withhold on IRA distributions, Copy B need not be attached.
8.24

Q An IRA owner asked for a total distribution that would close her Traditional IRA. She told us that she is going to roll over the assets into another Traditional IRA. If she specifies that she intends to roll over the assets, what distribution code should we use on Form 1099-R?

A Unless your organization makes the distribution check payable to the receiving financial organization, you have no proof that the IRA owner will roll over the IRA assets, despite your IRA owner’s stated intentions. If the distribution check is indeed made payable to the IRA owner, you must use distribution code 1, Early distribution, no known exception, or 7, Normal distribution, depending on the IRA owner’s age, to report the distribution on Form 1099-R (unless a penalty tax exception applies).

8.25

Q Two years ago, a Traditional IRA owner began taking a series of substantially equal periodic payments when he was 57 years old. When coding his distributions, we have been using distribution reason code 2. Although the IRA owner will attain age 59½ this year, we know he must continue the substantially equal periodic payments for three more years. Once the IRA owner attains age 59½, should we continue to use distribution code 2 or should we begin using distribution reason code 7?

A You should begin using code 7, Normal distribution, once the IRA owner attains age 59½. The Instructions for Forms 1099-R and 5498 state that distribution code 2 is used when a distribution is part of a series of substantially equal
periodic payments and the IRA owner has not attained age 59½. Once the IRA owner who is taking substantially equal periodic payments attains age 59½, the appropriate distribution code is 7 as long as the IRA owner does not disrupt the series of payments. As a result, the year the IRA owner attains age 59½, the financial organization may need to issue two **Forms 1099-R**—one Form 1099-R, with distribution code 2 for distributions taken before age 59½, and a second Form 1099-R with distribution code 7 for distributions taken after the IRA owner attains age 59½. Note that if the IRA owner modifies the series of payments within five years of the date of the first payment, code 1, *Early distribution, no known exception*, applies to the first modified payment, even if the individual is over age 59½.

### 8.26

**Q** When entering distribution codes on Form 1099-R to report an IRA distribution, is there ever a time two codes may be applicable?

**A** According to the 2018 *Instructions for Forms 1099-R and 5498* and IRS comment to Ascensus, when applicable, payers must enter a numeric and an alpha code. For example, when using a code P to report a distribution of an excess contribution, plus NIA, removed before a taxpayer’s tax return due date, payers also should enter code 1, *Early distribution, no known exception*, or 4, *Death*, if either applies.

According to the 2018 instructions, only three numeric combinations for Traditional IRAs are permitted: codes 8 (*Excess contributions…taxable in 2018*) and 1, 8 and 2 (*Early distribution, exception applies*), or 8 and 4. If two other numeric codes are applicable, you must file more than one **Form 1099-R**.
8.27

Q Direct rollovers from employer-sponsored retirement plans to Traditional IRAs appear similar to Traditional IRA trustee-to-trustee transfers because in both instances, the distribution check is made payable to the financial organization for the benefit of the individual’s Traditional IRA. Does this mean that, like transfers, direct rollovers are not reportable transactions?

A No. Although a direct rollover is similar to a transfer, an employer-sponsored retirement plan payer must report a direct rollover as a distribution on Form 1099-R. Once the financial organization receives the eligible rollover distribution, the financial organization must report the amount as a rollover contribution in Box 2 on Form 5498.

8.28

Q Which code should I use on Form 1099-R to report a direct rollover from a Traditional IRA to a qualified plan?

A Use code G, Direct rollover and direct payment, in Box 7, for all Traditional IRA direct rollovers to eligible 401(a) and 403(a) qualified retirement plans, 403(b) plans, and governmental 457(b) plans.
8.29
Q How do we report nonspouse beneficiary rollovers from qualified retirement plans to Traditional IRAs?
A Employers will use code G and code 4 on Form 1099-R to report a direct rollover by a nonspouse beneficiary. Financial organizations should report the rollover contribution in Box 2 on Form 5498. Forms 1099-R and 5498 should be titled to reflect both the deceased plan participant and the beneficiary (e.g., “Jane Doe as beneficiary of John Doe”).

8.30
Q Early in 2018, a Traditional IRA owner told us he was disabled in an automobile accident and that he wanted an early distribution from his Traditional IRA. What code should we use to report that distribution? What, if anything, should we get for our files?
A According to the Instructions for Forms 1099-R and 5498, financial organizations should use code 3, Disability, to report a distribution to a disabled IRA owner who is under age 59½. IRC Sec. 72(t)(2)(A)(iii) states that an IRA owner who is under age 59½ may receive penalty-free early IRA distributions if the IRA owner is disabled within the meaning of IRC Sec. 72(m)(7). This rule states that individuals are considered disabled if they are

“unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration. An individual shall not be considered to be disabled unless he or she furnishes proof of the existence thereof in such form and manner as the Secretary may require.”
Although a statement is not required by law for you to code a distribution as a disability, some financial organizations require a physician’s statement before they will code a distribution as a disability payout.

**8.31**

**What is code K used for on Form 1099-R?**

Code K, *Distribution of traditional IRA assets not having a readily available FMV*, is to be entered in Box 7, *Distribution code(s)*, of Form 1099-R when certain types of assets are distributed from IRAs. According to the IRS description of the code, these assets include stocks, short or long-term obligations, ownership interests in limited liability companies (LLCs), partnerships, trusts, or similar entities, not readily tradable on an established securities market; real estate; or option contracts or similar products not offered for trade on an established option exchange.

Depending upon the circumstances of the distribution, code K can be used in combination with codes 1, 2, 4, 7, 8, and G.

**Miscellaneous Reporting Issues**

**8.32**

**How does a time deposit penalty imposed on an early IRA distribution affect Form 1099-R reporting?**

The financial organization imposes a time deposit penalty against the IRA trust. Thus, there is no tax consequence to the IRA owner because the penalty is taken from the trust assets. The amount reported on Form 1099-R is the net amount the IRA owner actually receives after this penalty is paid.
8.33

Q  May an IRA owner pay the time deposit penalty out-of-pocket and then take a deduction for it?

A  The IRS may view this as an excess contribution. Technically, the time deposit penalty is taken from the trust assets. If the IRA owner adds assets to the IRA, the IRA owner must treat the amount as an IRA contribution, reportable on Form 5498.

8.34

Q  Our financial organization would like to start submitting reporting forms to IRA owners electronically rather than on paper. Does the IRS allow financial organizations to send reporting forms to IRA owners electronically?

A  Yes. IRS Notice 2004-10 indicates that financial organizations may submit Forms 1099-R and 5498 to recipients electronically. Financial organizations may provide the required forms electronically to IRA owners and beneficiaries if they satisfy the consent, format, posting, and notification requirements found in the General Instructions for Certain Information Returns (Forms 1096, 1097, 1098, 1099, 3921, 3922, 5498, and W-2G). For example, financial organizations must send a statement that includes specific information regarding electronic format and consent information to the recipient, and the recipient must consent to receiving the forms electronically before financial organizations can send the forms electronically. Recipients must consent electronically to show they can access the electronic format the financial organization will use to provide the forms.

Once the process is in place, financial organizations must notify recipients of any hardware or software changes before providing subsequent Forms 1099-R and 5498 electronically, and a new consent to receive the forms electronically is required after the new hardware or software is put into service.
8.35  

Q We report distributions for both IRAs and for qualified retirement plans on Form 1099-R. I understand that if we file 250 or more Forms 1099-R, we must file them electronically. For electronic purposes, does the 250 limit apply separately to IRA distributions and qualified retirement plan distributions?

A No. The electronic reporting requirements do not differentiate between Traditional IRA and qualified retirement plan distributions. The 250 limit applies per form type. If you file 250 or more of Form 1099-R you must file electronically for that form regardless of whether some of the distributions were from IRAs and some were from qualified retirement plans.

NOTE: Effective for all forms filed after December 31, 2018, proposed regulations would require organizations that file 250 or more forms in aggregate to file electronically. As of this writing, the regulations had not yet been finalized.

Corrective Reporting

8.36  

Q A Traditional IRA owner made a rollover contribution in 2017, but we failed to report the rollover contribution on the 2017 Form 5498. We are now doing the corrections for these forms. For the correction, should we complete only the rollover box?
The financial organization should include the previously reported information in addition to the newly reported rollover on a corrected 2017 Form 5498. The General Instructions for Certain Information Returns provide instructions on how to correct paper filings of Forms 1099-R and 5498.

8.37
Q We submitted a Form 1099-R with an incorrect recipient name. How can we correct this form?
A If you report on paper forms, you must prepare two forms to correct a form submitted with an incorrect recipient (or payee) name. The first Form 1099-R should report the same information the incorrect form had, but the distribution amount will be zero. Indicate that this form is a correction by marking the Corrected box at the top of the form. The second Form 1099-R should report all the correct information. This is the new original Form 1099-R so do not mark the Corrected box at the top of the form. You must submit these forms to the IRS with Form 1096, Annual Summary and Transmittal of U.S. Information Returns. See the General Instructions for Certain Information Returns for more details.

Deadlines and Penalties

8.38
Q Must we submit our forms to the IRS electronically or by paper? What are the deadlines?
According to the *General Instructions for Certain Information Returns*, if you are required to file 250 or more information returns with the IRS, you must submit them electronically. The IRS, however, encourages you to file electronically even if you file fewer than 250 returns. You may request a waiver by submitting Form 8508, *Request for Waiver From Filing Information Returns Electronically*, at least 45 days before the due date of the returns.

Form 1099-R is due to the IRS by February 28 if filing by paper or March 31 if filing electronically. Form 5498 is due to the IRS by May 31 for paper and electronic filing. But if the deadline falls on a Saturday, Sunday, or legal holiday, the forms will be considered timely-filed if filed on the following business day.

**8.39**

*Q* Our organization may have trouble getting our Forms 1099-R to the IRS by the deadline. What penalty might we face if we do not file our Forms 1099-R with the IRS by the due date?

*A* If your organization does not meet the deadline to file Forms 1099-R, the IRS could assess penalties based on a tiered-penalty structure. These penalties are subject to cost-of-living adjustments. Following are the penalties that would apply for 2018 reporting failures.

- If you file the form within 30 days of the form’s due date, the penalty is $50 per form up to an annual maximum of $547,000 ($191,000 for small businesses).
- If you file the form more than 30 days after the due date but on or before August 1, the penalty is $100 per form up to an annual maximum of $1,641,000 ($547,000 for small businesses).
- If you file the form after August 1 or do not file at all, the penalty is $270 per form up to a maximum of $3,282,500 ($1,094,000 for small businesses).
Note, however, that the Consolidated Appropriations Act of 2016 introduced a safe harbor from the application of the tiered penalties for Forms 1099-R and associated payee statement errors. If one or more dollar amounts are incorrect on a return filed with the IRS or on a payee statement furnished to a recipient, no correction of the dollar amount is required if the error does not exceed $100. And if there is an error in tax withholding, the report need not be corrected if the error does not exceed $25. A correction must be made if the recipient requests a corrected statement, and the tiered penalties would continue to apply. Detailed information can be found in the General Instructions for Certain Information Returns.
Chapter 9
Roth IRAs

Establishing Roth IRAs

9.1

What is a Roth IRA?

A Roth IRA is a type of IRA, first available January 1, 1998, where contributions are not deductible, but distributions (including earnings) can be tax-free if certain circumstances exist. This IRA is named after former Senate Finance Committee Chairman William Roth (R-Del.), who spearheaded the campaign to enact these types of IRAs.

9.2

What documents do we use to establish Roth IRAs?

The IRS has issued model documents, Forms 5305-R, Roth Individual Retirement Trust Account, and 5305-RA, Roth Individual Retirement Custodial Account, that financial organizations may use to establish Roth individual retirement accounts. The model forms are similar in content and form to the model IRS forms for establishing Traditional IRAs. Many forms providers have Roth IRA opening documents available based on the model documents, but providing additional Article IX language for the financial organization. Financial organizations also may use prototype Roth IRA opening documents to open Roth IRAs.

The IRS also has released a model document that financial organizations may use, in conjunction with an annuity contract, to establish Roth individual retirement annuities, Form 5305-RB, Roth Individual Retirement Annuity Endorsement.
9.3

Is there any IRS guidance available on prototype Roth IRA documents?

Revenue Procedure 98-59 contains the application procedures for obtaining IRS opinion letters for prototype Roth IRA documents and relays information on transitional relief granted by the IRS for users of Roth IRA unapproved prototypes.

A prototype sponsor may apply for an opinion letter for a prototype Roth IRA on Form 5306, Application for Approval of Prototype or Employer Sponsored Individual Retirement Arrangement (IRA). An IRS user fee, defined in Revenue Procedure 2018-4 or any superseding revenue procedure, must accompany the Roth IRA submission.

A prototype sponsor also may request an opinion letter for a dual-purpose Traditional/Roth IRA prototype document. A dual-purpose prototype document, however, must

- allow an IRA owner to explicitly indicate whether the IRA is a Roth IRA or a Traditional IRA, and
- require that contributions to a Roth IRA are maintained in a separate trust, custodial account, or annuity from contributions to a Traditional IRA.
Who is eligible to contribute to a Roth IRA?

To contribute to a Roth IRA, an individual (or an individual’s spouse) must have eligible compensation (i.e., earned income) equal to or greater than the amount of the Roth contribution (the maximum annual contribution is $5,500 for 2018 ($6,000 for 2019), plus catch-up contributions (if eligible). Compensation for Roth IRAs is defined the same as for Traditional IRAs. (See Question 3.25.) In addition, a person’s modified adjusted gross income (MAGI) must fall within the applicable limits for her tax filing status. Unlike a Traditional IRA, there is no age limit for making contributions to a Roth IRA.

The following table shows how MAGI and filing status affect a person’s eligibility to make a 2018 and 2019 Roth IRA contribution.
<table>
<thead>
<tr>
<th>Filing Status</th>
<th>2019 MAGI</th>
<th>Contribution eligibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>* Married filing jointly or qualifying widow/widower</td>
<td>$193,000 or less</td>
<td>May contribute up to the full annual Roth IRA contribution</td>
</tr>
<tr>
<td></td>
<td>More than $193,000 but less than $203,000</td>
<td>May contribute a reduced amount to the Roth IRA</td>
</tr>
<tr>
<td></td>
<td>$203,000 or more</td>
<td>May not contribute to a Roth IRA</td>
</tr>
<tr>
<td>Married filing separately (living with spouse for any part of the tax year)</td>
<td>$0</td>
<td>Eligible to contribute the full annual Roth IRA contribution if the individual has eligible compensation</td>
</tr>
<tr>
<td></td>
<td>Over $0 but under $10,000</td>
<td>May contribute a reduced amount to a Roth IRA</td>
</tr>
<tr>
<td></td>
<td>$10,000 or more</td>
<td>May not contribute to a Roth IRA</td>
</tr>
<tr>
<td>* Single, head of household, or married filing separately (not living with spouse for any part of the tax year)</td>
<td>$122,000 or less</td>
<td>May contribute up to the full annual Roth IRA contribution</td>
</tr>
<tr>
<td></td>
<td>More than $122,000 but less than $137,000</td>
<td>May contribute a reduced amount to a Roth IRA</td>
</tr>
<tr>
<td></td>
<td>$137,000 or more</td>
<td>May not contribute to a Roth IRA</td>
</tr>
</tbody>
</table>

*These MAGI limits are subject to cost-of-living adjustments.

The Roth IRA MAGI phase-out ranges for 2018 are as follows.
- Married filing jointly: $189,000 to $199,000
- Married filing separate: $0 to $10,000
- Single filers: $120,000 to $135,000
9.5

What are the contribution limits for a Roth IRA?

An eligible individual may contribute the lesser of the annual contribution limit, or 100 percent of eligible compensation (generally, earned income) to a Roth IRA. The maximum applies to all Traditional IRA and Roth IRA contributions made for the tax year, in aggregate. The contribution limit may be adjusted annually for cost-of-living increases.

<table>
<thead>
<tr>
<th>Year</th>
<th>Contribution Limit</th>
<th>Catch-up</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>$5,500</td>
<td>$1,000</td>
</tr>
<tr>
<td>2019</td>
<td>$6,000</td>
<td>$1,000</td>
</tr>
</tbody>
</table>

Also, IRA owners who are age 50 and older may make catch-up contributions of up to $1,000 annually.

9.6

What is the deadline for contributions to a Roth IRA?

The contribution deadline is the taxpayer’s tax return due date (usually April 15), excluding extensions. But if the tax return due date falls on a Saturday, Sunday, or legal holiday, the IRA owner has until the following business day to make her contribution.

9.7

Can spousal contributions be made to a Roth IRA?

Yes. Spousal contributions—contributions made based on a working spouse’s income—may be made to Roth IRAs.
9.8  
Q  May an individual make Roth IRA contributions after attaining age 70½?
A  Yes, as long as the individual has eligible compensation to make contributions.

9.9  
Q  What happens if an individual contributes too much to a Roth IRA?
A  If an individual contributes more than the contribution limit to a Roth IRA, she could be subject to a six percent excess contribution penalty tax (identical to the Traditional IRA excess contribution rules). If Roth IRA owners who timely remove the excess contribution with the net income attributable (NIA) to the excess amount (or treat a current-year contribution as an excess contribution) may do so with limited tax and penalty consequences, thus avoiding the six percent excess contribution penalty tax.
Roth IRA Conversions, Recharacterizations, Rollovers, Transfers

9.10

Q One of our clients has been contributing to a Traditional IRA for about 10 years. He wants to move his Traditional IRA balance to a Roth IRA. Would we do this as a rollover?

A No. This is a conversion. A Roth IRA conversion is a reportable movement of assets from a Traditional or savings incentive match plan for employees of small employers (SIMPLE) IRA to a Roth IRA. (See Question 9.34 for reporting conversions.) IRA owners must include all pretax assets that are converted to Roth IRAs in their taxable income in the year of the distribution, but the 10 percent early distribution penalty tax does not apply.

9.11

Q May anyone move their assets from a Traditional IRA to a Roth IRA?

A Yes. Anyone is eligible to convert a Traditional or SIMPLE IRA to Roth IRA.

9.12

Q May individuals age 70½ or older convert their entire Traditional IRA balances to Roth IRAs?

A No. While eligible individuals age 70½ or older may convert their Traditional IRA assets, the required minimum distribution (RMD) is not eligible for conversion. Individuals must satisfy or remove RMDs from their Traditional IRAs before converting Traditional IRA assets to Roth IRAs.
9.13  
**Q** One of our clients converted his Traditional IRA to a Roth IRA early in 2018. Now he wants to put the assets back into the Traditional IRA. Is there any method he can use to do this?

**A** No. The Tax Cuts and Jobs Act of 2017 eliminated the ability to recharacterize conversions that take place in 2018 and later tax years.

A recharacterization is a reportable movement of any current-year contribution or conversion with the NIA from one type of IRA to another type of IRA. If done correctly, recharacterizations allow IRA owners to “undo” their original contribution and act as if the contribution was made to another type of IRA. IRA owners have until their tax return due date plus extensions to complete a recharacterization (see Question 9.17 regarding recharacterization deadlines).

9.14  
**Q** May an individual roll over a distribution from an eligible employer-sponsored retirement plan to a Roth IRA?

**A** Yes. Eligible individuals may directly or indirectly roll over employer-sponsored retirement plan assets to Roth IRAs. Eligible retirement plans include 401(a) and 403(a) qualified retirement plans, 403(b) plans, governmental 457(b) plans, and the federal Thrift Savings Plan.

**NOTE:** Before 2018, these plan rollovers to Roth IRAs could be recharacterized to Traditional IRAs. The Tax Cuts and Jobs Act of 2017 eliminated this beginning in 2018.
Q 9.15

May individuals both directly and indirectly roll over designated Roth account assets to Roth IRAs?

A Yes. Designated Roth contributions are a type of after-tax employee contribution made under a 401(k) plan, 403(b) plan, governmental 457(b) plan, or the federal Thrift Savings Plan. Individuals may directly or indirectly roll over employer-sponsored retirement plan assets, including designated Roth account assets, to Roth IRAs. But individuals may not roll over Roth IRA assets to employer-sponsored retirement plans. Following are some other basic rules that apply to designated Roth account-to-Roth IRA rollovers.

- Indirect rollovers from designated Roth accounts to Roth IRAs are subject to the 60-day rollover restriction.
- If the designated Roth account distribution is subject to withholding, the Roth IRA owner may roll over the amount distributed as well as the amount withheld.
- If the rollover is part of a nonqualified distribution, the taxable portion (i.e., the earnings portion of a nonqualified distribution) is deemed rolled over first.
- Individuals may roll over designated Roth account assets to an existing Roth IRA or to a new Roth IRA. A conduit Roth IRA is not required.

In May 2016, the IRS issued final designated Roth account regulations, Treas. Reg. 1.402A-1, Q&A 5(a), that made distributions from designated Roth accounts eligible for the methodology described in Notice 2014-54 (see Question 4.29). These regulations may be relied on for designated Roth account distributions occurring on or after September 18, 2014.
9.16

**How does an IRA owner elect to recharacterize a current-year contribution?**

IRA owners generally must make an election for a recharacterization by their tax return due date plus extensions (see Question 9.17 for an exception to this deadline). Once the assets have been moved, an IRA owner may not revoke the recharacterization election. To make an election, an IRA owner must notify the financial organizations distributing the IRA (IRA 1) and the receiving IRA (IRA 2) that she is electing to treat the contribution made to IRA 1 as if it had been made to IRA 2. The notification must include:

- the type and amount of contribution to IRA 1 that is being recharacterized,
- the date on which the contribution was made to IRA 1,
- the year for which the contribution was made,
- directions to the financial organization distributing IRA 1 to directly move the contribution plus the NIA to IRA 2,
- the names of the financial organizations holding IRA 1 and IRA 2, and
- any additional information needed to complete the transaction.

Unlike Roth IRA conversions, which beginning in 2018 cannot be recharacterized, annual IRA contributions remain eligible for timely recharacterizing to the other type of IRA.
9.17
Q What is the deadline for completing a recharacterization?
A IRA owners generally have until their tax return due date plus extensions to recharacterize a current-year contribution. But individuals who file their tax returns on time (generally by April 15) receive an automatic six-month extension to complete a recharacterization (generally until October 15). If the recharacterization deadline falls on a Saturday, Sunday, or legal holiday, IRA owners have until the following business day to complete the transaction.

9.18
Q Can a Roth IRA owner recharacterize from a Roth IRA back to a SIMPLE IRA?
A IRA owners who converted amounts from a SIMPLE IRA to a Roth IRA before 2018 were allowed to recharacterize those conversion amounts plus the NIA back to a SIMPLE IRA. The recharacterization transaction in this situation mimics that of a recharacterization from a Roth IRA to a Traditional IRA. The Tax Cuts and Jobs Act of 2017 provides that SIMPLE IRA conversions to Roth IRAs made in 2018 and after can no longer be recharacterized.

9.19
Q May we conduct a rollover from a Roth IRA to another Roth IRA? If so, what rules do we follow?
A Roth IRA-to-Roth IRA rollovers follow the Traditional IRA rollover rules. That is, such rollovers are limited to one rollover per 12 months, and generally must take place within 60 days of distribution. (See Question 4.13 for information on the change to the one-per-12-month rollover rule.)
9.20

Q  Are transfers allowed from one Roth IRA to another?

A  Although not mentioned specifically in the statute, it appears that Roth IRA-to-Roth IRA transfers (identical in procedure to Traditional IRA transfers) are permitted.

Roth IRA Distributions

9.21

Q  What are the tax and penalty tax consequences of a Roth IRA distribution?

A  The tax and penalty tax consequences of a Roth IRA distribution depend upon whether the distribution is a qualified or nonqualified distribution, and the contribution source of assets taken. An individual generally may take a qualified distribution of assets from a Roth IRA tax- and penalty-free. A nonqualified distribution of Roth IRA earnings is subject to tax, and may be subject to a 10 percent early distribution penalty tax. A nonqualified distribution of conversion assets, though tax-free, may be subject to the penalty tax if taken within five years of conversion. A nonqualified distribution consisting only of contributory assets is tax- and penalty-free.
9.22
Q What constitutes a qualified distribution from a Roth IRA?
A A qualified distribution is a distribution of assets that are held in a Roth IRA for at least five taxable years (beginning with the first taxable year for which the Roth IRA owner made a Roth IRA contribution of any kind to any Roth IRA) and one of the following events occurs.
- Attainment of age 59½
- Disability
- First-time home purchase
- Death

9.23
Q How does a rollover of designated Roth account assets affect the Roth IRA five-year clock for qualified distributions?
A Similar to Roth IRA distributions, for a distribution of retirement plan designated Roth account assets to be qualified, the individual must satisfy a five-year taxable period and must attain age 59½, die, or become disabled. If the individual rolls over designated Roth account assets to a Roth IRA, the designated Roth account five-year period will not carry over to the Roth IRA. Consequently, if an individual establishes her first Roth IRA with a rollover of designated Roth account assets, the five-year period for determining qualified distributions from the Roth IRA begins with the year the assets are rolled over, even if the individual has already satisfied the five-year period applicable to the designated Roth account under the plan.
9.24

Q If a Roth IRA owner establishes a Roth IRA with a contribution and later distributes the contribution as an excess, has the five-year period for determining qualified distribution status started for this individual?

A According to Treas. Reg. 1.408A-6, Q&A 2, an individual who distributes an excess contribution in accordance with IRC Sec. 408(d)(4) does not start the five-year period. Similarly, if an initial Roth IRA contribution is made to a Roth IRA that is subsequently revoked within seven calendar days, or if an individual recharacterizes an initial Roth IRA contribution, the initial contribution does not start the five-year period.

If the initial contribution to a Roth IRA is not an excess contribution, and is not revoked or recharacterized, the five-year period does not start over if a Roth IRA owner subsequently distributes the entire Roth IRA account before making any further contributions.

9.25

Q Are we required to withhold federal taxes on Roth IRA distributions?

A Based on IRS comments to Ascensus, if it is reasonable to believe that a Roth IRA distribution is, or could be, subject to taxation, payers should apply withholding rules.

Financial organizations generally need not apply withholding if they are sure the distribution is qualified, (i.e., the IRA owner meets the five-year period and is at least age 59½, has provided proof of disability, or has died) and are reporting a code Q, Qualified distribution from a Roth IRA, on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. (See Question 9.37 for a discussion of reporting code Q.)
If a payer is at all uncertain about the taxability of the Roth IRA distribution, until there is further IRS guidance, the conservative approach is to offer the Roth IRA owner the opportunity to waive withholding on Form W-4P, Withholding Certificate for Pension or Annuity Payments, or a suitable substitute form.

9.26

Q What are “ordering rules” for Roth IRA distributions?

A The ordering rules address the order in which contributory assets, conversion (and retirement plan rollover) assets, and earnings are dispersed when a Roth IRA distribution is taken. IRA owners are responsible for tracking this.

Roth IRA assets generally are considered to be distributed in the following order.

1. Contributions

2. Conversions and retirement plan rollover assets (excluding rolled designated Roth account assets), by year, with taxable assets distributed before nontaxable assets

3. Earnings

Taxable conversion and retirement plan rollover assets are those that represented pretax assets, and thus, were taxed in the year of the distribution of the conversion or rollover. Nontaxable conversion and retirement plan rollover assets are those that represented nondeductible Traditional IRA assets or after-tax retirement plan assets (excluding designated Roth contributions), and that were, therefore, not taxable at the time of the distribution of the conversion or rollover.

Designated Roth account assets rolled over to Roth IRAs are grouped with IRA contributions or earnings, depending on whether the distribution from the retirement plan was considered qualified or nonqualified. (See Question 9.27.)
9.27

Do the ordering rules apply to designated Roth account assets that are rolled over to Roth IRAs?

Distributions of designated Roth account assets from retirement plans are grouped with Roth IRA contributions or earnings depending on whether they were qualified when rolled over.

If an individual rolls over a qualified distribution from a designated Roth account to a Roth IRA, the designated Roth account assets are treated as a regular contribution (basis) within the Roth IRA. Therefore, a distribution of these assets from the Roth IRA will be tax- and penalty-free, regardless of whether the Roth IRA has met the five-year period. If the Roth account distribution is not qualified, the individual must treat the portion of the distribution that represents designated Roth deferrals as a regular contribution in the Roth IRA, and the remaining amount (i.e., the earnings) as earnings in the Roth IRA. If the Roth IRA meets the qualified distribution requirements, all Roth assets—even rolled amounts treated as earnings—are distributed tax-free. Individuals must track these rollovers on Form 8606.
9.28

Q In light of the ordering rules, what are the tax and penalty tax consequences if a Roth IRA owner takes a nonqualified distribution?

A When IRA owners take a distribution from their Roth IRAs, the contributory basis is distributed first, and is withdrawn tax- and penalty-free, regardless of whether the distribution is qualified or nonqualified. (See Question 9.26 for the order in which Roth IRA assets are distributed.)

A nonqualified distribution of taxable conversion or plan rollover assets distributed within five years of the year of the conversion/rollover is not taxable, but is subject to a 10 percent early distribution penalty tax unless one of the exceptions under IRC Sec. 72(t) applies. A nonqualified distribution of taxable conversion or plan rollover assets withdrawn after the end of the five-year period is not taxable, nor is it subject to a 10 percent penalty tax. A nonqualified distribution of nontaxable conversion and plan rollover assets is not taxable nor is it subject to the 10 percent penalty tax.

Any portion of the distribution that represents earnings in a nonqualified distribution is taxable. And, unless the Roth IRA owner meets an exception, the earnings also are subject to a 10 percent early distribution penalty tax.

9.29

Q Do the RMD rules that apply to Traditional IRAs also apply to Roth IRAs?

A The RMD rules do not apply to Roth IRAs until the IRA owner dies. After death, the beneficiaries generally are subject to certain required distributions.
Excess Contributions

9.30

A Roth IRA owner asked us to help him remove an excess Roth IRA contribution made in 2018, but it is after his tax return due date and he did not have any filing extensions. He is eligible for a 2019 Roth IRA contribution. What are his options?

Roth IRA regulations provide that excess Roth IRA contributions not removed on or before the IRA owner’s tax return due date plus extensions following the year of contribution are deemed Roth IRA contributions for subsequent years (Treas. Reg. 1.408A-3, Q&A 7). So, unless the Roth IRA owner timely removes the excess contribution, it becomes a subsequent year contribution. The six percent excess contribution penalty tax will apply for each year the contribution remained as an excess in the Roth IRA.

If the Roth IRA owner wishes to remove the excess contribution after the tax return due date, plus extensions, he must leave the NIA in the Roth IRA. Financial organizations must report on Form 1099-R a Roth IRA excess removed after the tax return due date plus extensions as a regular distribution using either code J, Early distribution from a Roth IRA, or T, Roth IRA distribution, exception applies, depending on the individual’s age, or Q, Qualified distribution from a Roth IRA, whichever is applicable.
**Beneficiary Options**

9.31

**Q** What are a Roth IRA beneficiary’s distribution options if a Roth IRA owner dies?

**A** Beneficiaries should first review their Roth IRA plan agreement for specific IRA distribution options because the plan may limit the potential distribution options available under RMD regulations. Beneficiary options generally depend on whether the beneficiary is a spouse, nonspouse, or nonperson (e.g., charity, estate, or nonqualified trust).

Beneficiary distribution options allowed by the IRS under regulations (Treas. Reg. 1.401(a)(9)-3) are the same as those allowed for Traditional IRA beneficiaries when the IRA owner dies before the required beginning date for RMDs. (See Question 6.1 for those options.)

9.32

**Q** We use Roth IRA plan agreements that are based on the IRS model Roth IRA document. Can we apply any of the beneficiary options that are available under the distribution regulations?

**A** No. IRS model Roth IRA forms (Form 5305-R, Roth Individual Retirement Trust Account, Form 5305-RA, Roth Individual Retirement Custodial Account, and Form 5305-RB, Roth Individual Retirement Annuity Endorsement) have limited beneficiary distribution options, even though provisions in the Internal Revenue Code governing Roth IRAs have allowed options in addition to those listed in the model documents (IRC Sec. 408A(c)(5)). Beneficiaries must choose from the options available in the plan document.
The most recent version of the IRS model Roth IRA documents, dated April 2017, provides the following beneficiary options in Article V.

- If a spouse is the designated beneficiary, the spouse may treat the Roth IRA as his own, and is not required to take distributions.

- A nonspouse beneficiary may choose either the five-year rule or single life expectancy (SLE) payments.
  - Under the five-year rule, the beneficiary takes a total distribution within five years (by December 31 of the year containing the fifth anniversary of the Roth IRA owner’s death).
  - Under the SLE payment option, the beneficiary takes distributions over her own life expectancy (nonrecalculated), beginning by December 31 of the year following the year of the Roth IRA owner’s death.

If a nonspouse beneficiary does not choose an option by December 31 of the year following the Roth IRA owner’s death, SLE payments will apply.

**Roth IRA Reporting**

9.33

Q How should Form 5498 be completed for Roth IRA reporting?

A Financial organizations should report the following information (as applicable) on Form 5498, IRA Contribution Information, for Roth IRAs.

- Box 2, Rollover contributions

  Report rollovers from retirement plans and from one Roth IRA to another Roth IRA in Box 2.
• Box 3, *Roth IRA conversion amount*

Report any amounts converted from a Traditional IRA or a SIMPLE IRA to a Roth IRA, including a reconversion to a Roth IRA in Box 3.

• Box 4, *Recharacterized contributions*

Report each recharacterized amount in Box 4. If one IRA receives multiple recharacterized contributions in the same year, they must be totaled and reported on one Form 5498 in Box 4.

• Box 5, *Fair market value of account*

Enter the Roth IRA’s fair market value in Box 5.

• Box 7, *Checkboxes*

Form 5498 contains four checkboxes, which are used to indicate the type of IRA being reported. Check the box under Roth IRA when reporting information about any Roth IRA.

• Box 10, *Roth IRA contributions*

Report regular current-year Roth IRA contributions, including any prior-year contributions made through April 15.

9.34

**Q** One of our clients recently converted a Traditional IRA that was held at another financial organization to a Roth IRA held at our institution. How are conversion contributions reported?

**A** You should always report conversion contributions in Box 3, *Roth IRA conversion amount*, on Form 5498 whether they are moved directly in a trustee-to-trustee transaction or indirectly in a rollover-type transaction. Note that employer-sponsored retirement plan rollovers, for which the conversion taxation rules generally apply, are not reported in Box 3, but rather are reported in Box 2, *Rollover contribution*. Even though direct conversions may look like a nontaxable transfer or rollover
between like IRAs, they differ in that assets are moving from a Traditional IRA to a Roth IRA. Unlike transfers and rollovers, conversions are treated as distributions for tax purposes, so the IRS tracks them separately. Contribution forms that include conversion contributions as a contribution type, as well as conversion certification forms, can help financial organizations identify and properly report conversion amounts.

9.35

How are recharacterizations reported?

Financial organizations must separately report “prior-year” recharacterizations from “same-year” recharacterizations, using distinct codes in Box 7, Distribution code(s), of Form 1099-R. A prior-year recharacterization is one that occurs after the year for which the Traditional or Roth IRA contribution being recharacterized was made. (Note that before 2018, IRA conversions and retirement plan rollovers to Roth IRAs also could be recharacterized.) A same-year recharacterization occurs when the contribution that is subsequently recharacterized is made for the same year in which the recharacterization takes place. Financial organizations must issue separate Forms 1099-R for prior-year and same-year recharacterizations, and

- use code R in Box 7 to report a prior-year recharacterization, and
- use code N in Box 7 to report a same-year recharacterization.

Financial organizations may combine all prior-year recharacterizations from the same IRA, and report them in aggregate for that IRA on one Form 1099-R using code R. A similar procedure applies for same-year recharacterizations from the same IRA, however, code N applies.
Financial organizations receiving recharacterized contributions must report the contributions on Form 5498 in Box 4, Recharacterized contributions. According to the Instructions for Forms 1099-R and 5498, financial organizations must report all recharacterized contributions received by the same IRA in a single year on one Form 5498.

9.36

**How are Roth IRA distributions reported?**

Financial organizations must report Roth IRA distributions using a code T, Roth IRA distribution, exception applies, Q, Qualified distribution from a Roth IRA, or J, Early distribution from a Roth IRA, on Form 1099-R unless the distribution is because of an IRS levy or a prohibited transaction. The circumstances under which your financial organization should use these codes to report on the 2018 Form 1099-R are summarized in the following table.
<table>
<thead>
<tr>
<th>Code</th>
<th>Use when...</th>
<th>May be used with other codes?</th>
</tr>
</thead>
<tbody>
<tr>
<td>T</td>
<td>It is <em>not</em> known if the five-year holding period has been met, but the Roth IRA owner has • attained age 59½, • died, or • become disabled.</td>
<td>No</td>
</tr>
<tr>
<td>Q</td>
<td>It <em>is</em> known that the five-year holding period has been met, and the Roth IRA owner has • attained age 59½, • died, or • become disabled.</td>
<td>No</td>
</tr>
</tbody>
</table>
| J    | *Code T or Q do not apply.*

**NOTE:** Use code J if code 8, Excess contributions plus earnings … taxable in 2018, *or* P, Excess contributions plus earnings … taxable in 2017, *applies.* | Yes, codes 8 and P |
| 2    | An IRS levy occurs. | No |
| 5    | A prohibited transaction occurs. | No |

Note that both code T and code Q are restricted in their usage. For example, you may not use code T to report certain penalty tax exceptions under [IRC Sec. 72(t)](https://www.irs.gov/pub/irs-pdf/n072t.pdf), including substantially equal periodic payments, qualified medical expenses, higher education expenses, or first-time home purchases. Furthermore, you may not use code Q if the distribution is because of a first-time home purchase, even if the IRA owner satisfies the five-year holding period for a qualified distribution. As a result of these restrictions, code J has become a “catch-all” code that financial organizations must use whenever a distribution does not meet the requirements defined for code T or code Q.
Roth IRA distribution recipients who are eligible for a penalty tax exception under IRC Sec. 72(t) but who are not eligible to have the distribution reported with a code T or Q, should file Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, to claim an exception to the early distribution penalty tax.

9.37

Q How can we determine if a Roth IRA owner has indeed held a Roth IRA for more than five years for the purpose of reporting distributions using code Q?

A As a financial organization, you have several options available for determining whether a Roth IRA owner has satisfied the five-year holding period associated with a qualified distribution. Consider the following options, beginning with the most conservative approach.

1. Rely on your own data and records. If the Roth IRA has been open for at least five years at your organization, and the Roth IRA owner is age 59½ or older, has died, or is disabled, you may use code Q, Qualified distribution from a Roth IRA, on Form 1099-R to report the distribution. If the Roth IRA has been transferred or rolled over to your organization, you may wish to contact the sending organization to determine when the individual established the Roth IRA.

2. Obtain a certification form and withdrawal authorization form signed by the Roth IRA owner. You may choose to use a form on which Roth IRA owners certify that they have met both the five-year holding period requirement on the Roth IRA and a qualifying distribution reason. In addition, the Roth IRA owner should complete and sign a withdrawal form.

3. Obtain a withdrawal form only. You may choose to use only a withdrawal form for the distribution, and have the Roth IRA owner select and certify which distribution reason applies to the withdrawal.
Q: Is a financial organization responsible for determining the taxes owed for a Roth IRA distribution?

A: No. In the instructions to Form 1099-R, the IRS confirms that the financial organization is not responsible for determining the taxable amount of a Roth IRA distribution. The Roth IRA owner must compute the taxable amount (if any). The instructions direct the Roth IRA owner to Form 1040 instructions for more information on computing the taxable amount.
Chapter 10
SIMPLE IRA Plans

SIMPLE IRA Plan Basics

10.1

What is a SIMPLE IRA plan?

A savings incentive match plan for employees of small employers (SIMPLE) is a product of the Small Business Job Protection Act of 1996. Individuals can fund SIMPLE plans through IRAs or through an employer’s 401(k) plan. SIMPLE plans involve employee deferrals and mandatory employer matching or nonelective contributions, but do not require nondiscrimination testing or extensive reporting. SIMPLE plans first became available on January 1, 1997.

10.2

What are the benefits of a SIMPLE IRA plan?

Both the employer and its employees benefit from having a SIMPLE IRA plan.

Employers

• Less expensive to maintain than many other retirement plans, such as 401(k) or profit sharing plans
• Relief from fiduciary liability for investment performance
• No plan-level (Form 5500) reporting
• No nondiscrimination or coverage testing
• Employees assume part of the saving responsibility
• Employer contributions are deductible
• Possible tax credit for plan start-up costs
Employees

- A means to save for retirement
- Contributions and earnings are not taxed until distributed
- Employer also contributes on behalf of eligible employees

10.3

Q What types of businesses may establish a SIMPLE IRA plan?

A Almost any type of employer may establish a SIMPLE IRA plan (e.g., for-profit entities, tax-exempt entities, and state and local governments). But SIMPLE IRA plans are available only to small employers, and employers must satisfy certain eligibility requirements to be able to offer these plans.

10.4

Q Who is considered an eligible employer with regard to offering a SIMPLE IRA plan?

A An eligible employer generally is defined as an employer with no more than 100 employees that received at least $5,000 of compensation from the employer for the preceding calendar year (IRC Sec. 408(p)(2)(C)(i)).

10.5

Q Which employees must an employer consider when determining whether the 100-employee limitation has been exceeded?

A An employer must count all employees employed at any time during the preceding calendar year who earned $5,000 or more in compensation, regardless of whether they were eligible to participate in the plan. This includes employees who could be excluded from participation under IRC Sec. 410(b)(3), (i.e., nonresident aliens with no U.S. compensation
and union employees whose retirement benefits have been the subject of good faith bargaining). Self-employed individuals who received compensation from the employer also must be counted (Notice 98-4, Q&A B-1). The 100-employee limitation is tested based on prior-year employee census data for the current year.

10.6

Q

How does the two-year grace period apply when an employer exceeds the 100-employee limitation?

A

The two-year grace period starts in the year following the calendar year for which an employer last satisfied the 100-employee limitation. For example, if an employer had 98 employees in 2018, and 101 employees in 2019, the employer passes the 100-employee limitation for 2019 based on 2018 census data, but will fail the test in 2020. The employer will be deemed to pass the 100-employee limitation for 2020 and 2021 (the two years following the year they last passed the 100-employee limitation) (Notice 98-4, Q&A B-2). If the employer again becomes eligible within the two-year grace period because the employer reduced the number of employees to 100 or less, the employer becomes eligible again and continues to offer the plan.

10.7

Q

Who are considered eligible employees under a SIMPLE IRA plan?

A

Employers must allow employees to make SIMPLE deferral elections if they receive at least $5,000 in compensation from their employer during any two preceding years and they are reasonably expected to receive at least $5,000 in compensation in the current year (IRC Sec. 408(p)(4)(A)). Employers also may consider household workers as eligible
employees. The $5,000 requirement presumably would allow the employer to exclude certain seasonal and part-time employees. Employers also may exclude from participation employees covered by a plan through a collectively bargained agreement and nonresident aliens with no U.S. income (IRC Sec. 408(p)(4)(B)). An employer may choose less restrictive requirements.

10.8

Q One of our clients currently maintains a SEP plan. Is it possible for our client to maintain both a SEP plan and a SIMPLE IRA plan?

A No. An employer maintaining a SIMPLE IRA plan generally may not maintain other retirement plans in which employees currently accrue benefits (IRC Sec. 408(p)(2)(D)), including

- a qualified pension, profit sharing, or stock bonus plan (IRC Sec. 401(a)),
- a qualified annuity plan (IRC Sec. 403(a)),
- a simplified employee pension (SEP) plan (IRC Sec. 408(k)),
- a SIMPLE plan (IRC Sec. 408(p)),
- a plan established for its employees by the United States, by a state or political subdivision or by an agency or instrumentality of the United States or a state or political subdivision (other than a plan under IRC Sec. 457),
- a plan described in IRC Sec. 501(c)(18), or
- a tax-sheltered annuity (IRC Sec. 403(b)).
An employer currently maintaining a SIMPLE IRA plan for his employees has bought another small business that has a 401(k) plan. The purchase was effective August 1, 2019. None of his original employees are eligible to participate in the 401(k) plan until 2020. Can the employer continue to maintain the SIMPLE IRA plan for his original employees until the end of his 2019 tax year?

Yes. In fact, the employer may maintain the SIMPLE IRA plan for 2019 and 2020. An employer generally may not make contributions to a SIMPLE IRA plan if the employer maintains another qualified retirement plan. Notice 98-4, however, includes a paragraph containing two exceptions to the general rule: an employer who maintains a separate union plan, and an employer who maintains another plan as a result of an acquisition or merger. In both situations, an employer may still contribute to a SIMPLE IRA plan provided the participants of these “other plans” are excluded under the SIMPLE IRA plan. Notice 98-4, Q&A, C-1 allows the employer to exclude any employees who would not have been eligible to participate in the SIMPLE IRA plan if the acquisition had not occurred. In the case of a merger or acquisition, contributions to the SIMPLE IRA plan would be allowed for the year of merger or acquisition and the following year.
**SIMPLE IRA Plan Establishment**

10.10

**Q** How is a SIMPLE IRA plan established?

**A** Employers and employees both take part in establishing the SIMPLE IRA plan. The employer establishes the plan for the business and the employees must establish SIMPLE IRAs to receive plan contributions. The employer must complete a SIMPLE IRA plan document and retain a copy of the plan document with its business records.

The employer then must notify all eligible employees about the plan and provide them with a summary description and participation notice. The employees must make their salary reduction elections and establish their SIMPLE IRAs to receive contributions.

10.11

**Q** Can SIMPLE IRA plans be maintained on a noncalendar year?

**A** No. Employers must maintain SIMPLE IRA plans on a calendar year, even if the employer’s tax year is a noncalendar year (IRC Sec. 408(p)(6)(C)).

10.12

**Q** What is the deadline for an employer to establish a SIMPLE IRA plan?

**A** According to IRS Notice 98-4, K-1, an existing employer may establish a SIMPLE IRA plan for a tax year on any date between January 1 and October 1 of that year. According to the notice, this requirement does not apply to a new employer that comes into existence after October 1 of the year the SIMPLE IRA plan is established if the employer establishes the SIMPLE IRA plan as soon as administratively feasible after the employer comes into existence.
10.13

Q Is there a tax credit available for employers who establish a SIMPLE plan?

A Yes. An eligible small employer that establishes a SEP, SIMPLE, or other qualifying plan may receive a tax credit of up to 50 percent of the start-up costs for up to three years. A $500 credit limit applies for each of the three years. Employers use Form 8881, Credit for Small Employer Pension Plan Startup Costs, to calculate and claim the credit with the business’ tax return.

10.14

Q Does the financial organization notify employees when a SIMPLE IRA plan is established?

A No. The employer must provide employees with a summary description and a participation notice before the deferral election period each year. The deferral election period generally is 60 days immediately preceding the beginning of the plan year (generally November 2 to December 31).

The summary description includes important information about the SIMPLE IRA plan, employee elections, and procedures for distributions. Because financial organizations are involved with distribution procedures, they play a role with the employer to provide the summary description notices. (See Questions 10.36 and 10.37.) Employers also must provide eligible employees with a participation notice that provides the employer contribution amount and informs them of the opportunity to make salary reduction elections.

The summary description and participation notice are annual requirements.
**SIMPLE IRA Plan Contributions**

10.15

**Q** What are the general contribution requirements for SIMPLE IRA plans?

**A** Both employers and employees typically make contributions under the SIMPLE IRA plan. Eligible employees must be given the opportunity to defer wages under the SIMPLE IRA plan. Employers are required to make contributions each year based on one of the following three contribution formulas. An employer could

1. match employee deferrals dollar-for-dollar up to three percent of an employee’s compensation (compensation includes an employee’s deferrals),

2. make a two percent nonelective contribution to all eligible employees (even those that choose not to defer) who have at least $5,000 of compensation from the employer for the year, or

3. elect to match a lower percentage (but not lower than one percent). This option is allowed only for two years of a five-year period. Note that the five-year period includes the current year and the previous four years. If one of the years in the five-year period is a year in which the SIMPLE IRA plan was not established, the employer shall be treated as satisfying the three percent contribution requirement for that year.

If an employer decides not to match dollar-for-dollar up to three percent of compensation but elects, instead, to make a two percent nonelective contribution to all eligible employees, or elects to match a lower percentage, the employer generally must notify employees 60 days before the beginning of the plan year of the formula to be used.
**10.16**

**Q** What is the definition of compensation for purposes of making employer contributions?

**A** An employer must determine an employee’s compensation based on the definition used in its SIMPLE IRA plan document. Compensation generally means the sum of wages, tips, and other compensation subject to federal income tax withholding, plus the employee’s salary deferral contribution made under the SIMPLE IRA plan.

The definition of compensation for purposes of determining a self-employed individual’s SIMPLE IRA contribution amount is the net earnings from self-employment as determined on Form 1040 Schedule SE, before subtracting SIMPLE IRA contributions made for the self-employed individual. Because compensation is defined differently based on the type of business (e.g., sole proprietor, partnership, corporation), owners should seek competent business or tax advice to determine their eligible compensation for purposes of SIMPLE IRA contributions.

**10.17**

**Q** If an eligible employee terminates employment, must the employer make a SIMPLE IRA contribution for him?

**A** Yes. SIMPLE IRA contributions cannot be based on an employee’s employment on any particular day, such as the last day of the plan year. Regardless of the reason for termination (e.g., employee quit, is laid off, or dies), a terminated eligible employee is entitled to SIMPLE IRA plan contributions for the period of time that he is employed during the termination year.
10.18

Q What is the employee deferral limit under a SIMPLE IRA plan?

A An employee may elect to defer either a percentage of compensation, or a dollar amount. Because there is no percentage limit (like the 25 percent limit that applies to SEP plans), an employee can defer the lesser of 100 percent of compensation or the maximum annual deferral limit ($12,500, plus $3,000 if eligible for catch-up contributions, for 2018, or $13,000, plus $3,000 if eligible for catch-up contributions for 2019).

If a participant is actively deferring in two separate SIMPLE IRA plans that are maintained by two separate employers, the participant's aggregate deferral limit is subject to IRC Sec. 402(g)(1), which is $18,500 for 2018 and $19,000 for 2019, plus $6,000 if eligible for catch-up. For example, if a participant, age 30, defers $13,000 under one of her SIMPLE IRA plans in 2019, she may contribute only $6,000 under her other SIMPLE IRA plan for the same year.

10.19

Q Are employee deferrals subject to income tax?

A Tax is deferred on SIMPLE IRA contributions—both employee and employer contributions—until the year the assets are distributed from the SIMPLE IRA. But deferral amounts must be included with other wages when determining and paying Social Security, Medicare, Federal Insurance Contribution Act (FICA), Federal Unemployment Tax Act (FUTA), and Railroad Retirement Act (RRTA) taxes (if applicable).
How does the employer correct excess contributions made to SIMPLE IRA plans?

Employers generally may choose from two options—remove the excess with the employee’s consent, or leave the excess in the IRA and pay certain fees. To correct plan errors (i.e., excess contributions), employers should follow the directives under the IRS’ Employee Plans Compliance Resolution System (EPCRS), found in Revenue Procedure (Rev. Proc.) 2018-52. Correcting under any of the EPCRS programs allows the employer to continue to provide the employees with retirement benefits on a tax-favored basis.

The IRS permits employers sponsoring SIMPLE IRA plans to correct certain plan failures under one of its EPCRS correction programs: the Self-Correction Program (SCP), Voluntary Correction Program (VCP), and Audit Closing Agreement Program (Audit CAP). The proper program to use to correct plan failures depends on the type of failure. Generally, the employer will document the error and the correction procedure, and will put in place established practices and procedures to prevent the error from occurring in the future.

Employers should seek competent business or tax advice to properly correct SIMPLE IRA plan errors. Detailed information on correcting plan errors under EPCRS and a SIMPLE Plan Fix-It Guide are available at the IRS website.

How does the financial organization report the removal of excess contributions from a SIMPLE IRA plan?
Excess employer contributions may be distributed with earnings and returned to the employer with the participant’s consent. The amount distributed to the employer is not includible in the participant’s gross income and cannot be deducted by the employer. The financial organization should report the distribution on Form 1099-R in the plan participant’s name, with the gross distribution amount in Box 1, zero (0) in Box 2a, and distribution code E, Distributions under Employee Plans Compliance Resolution System (EPCRS), in Box 7.

For excess deferrals, the employer may remove the excess amount adjusted for earnings (with the participant’s consent), and return the amount to the participant. The employer must inform the participant that the distribution is not eligible for tax-free rollover treatment. The participant must include the amount distributed as income in the year of the distribution. The employer does not adjust any current or previous IRS Form W-2 of the participant. The financial organization should report the distribution on Form 1099-R in the plan participant’s name by entering the gross distribution in Boxes 1 and 2a, and code E in Box 7.

10.22

What is the deadline for an employer to contribute to a SIMPLE IRA plan?

The deadline for making employer matching or nonelective contributions to a SIMPLE IRA plan is the employer’s tax return due date, including extensions, for the year for which the contributions are being made. The Department of Labor (DOL) issued final regulations in January 2010 that provide a safe harbor for the timing of employee deferral deposits for small employers, which applies to SIMPLE IRA plans. Deferrals made under small plans—plans with fewer than 100 participants at the beginning of the plan year—would be considered timely deposited if the deferrals are deposited to the SIMPLE IRAs within seven business days after they are withheld by the employer.
Eligible small plans are not required to use the seven-business-day safe harbor, and may use the general 30-business day limitation.

**SIMPLE IRA Documents**

10.23

**Q**

What documents are available for a financial organization to offer employers who wish to establish a SIMPLE IRA plan?

**A**

The IRS has released two model documents for the employer to use to establish the SIMPLE IRA plan. Form 5305-SIMPLE, Savings Incentive Match Plan For Employees of Small Employers (SIMPLE)—for Use With a Designated Financial Institution, and Form 5304-SIMPLE, Savings Incentive Match Plan For Employees of Small Employers (SIMPLE)—Not for Use With a Designated Financial Institution. Form 5305-SIMPLE is designed to be used by financial organizations that wish to act as a designated financial institution (DFI), while Form 5304-SIMPLE is designed for financial organizations that wish to establish a non-DFI arrangement.

Financial organizations also may offer prototype SIMPLE IRA plan documents. These documents have the advantage of giving a financial organization the flexibility of acting as a DFI for some employers, but not for others.
**10.24**

**Q** What documents should an employee use to establish a SIMPLE IRA to hold SIMPLE IRA plan contributions?

**A** Employees will obtain SIMPLE IRA documents from the financial organization that will administer their SIMPLE IRAs. These documents generally are based off IRS model documents—Form 5305-S, SIMPLE Individual Retirement Trust Account, and Form 5305-SA, SIMPLE Individual Retirement Custodial Account.

If an eligible employee who is entitled to a contribution is unwilling or unable to open a SIMPLE IRA before the date on which the contribution is required to be deposited, the employer may execute the necessary documents to establish a SIMPLE IRA on the employee’s behalf.

**10.25**

**Q** When must SIMPLE IRA plan documents be updated?

**A** SIMPLE IRA plan documents periodically must be amended for law changes and new IRS guidance. Amendments also may be required when there is a merger or acquisition, a change to a different financial organization (in a DFI arrangement), or when the employer wishes to change the employee eligibility requirements. It is the employer’s responsibility to ensure that its plan is kept up to date. But financial organizations that sponsor SIMPLE IRA documents generally are responsible for providing amendments for law changes when necessary.
Designated Financial Institutions

10.26

Q  What are the responsibilities of a financial organization that agrees to act as a designated financial institution for a SIMPLE IRA plan?

A  Being named as a DFI for a SIMPLE IRA plan means the DFI must be the initial recipient of all SIMPLE IRA plan contributions under the plan. Once the SIMPLE IRA plan contributions have been deposited with the DFI, the DFI must then provide employees with at least one investment option that allows them to transfer their SIMPLE IRA assets to another financial organization of their choosing, generally without cost or penalty. Notice 98-4, Q&A J-1, explains what “without cost or penalty” means. A transfer is deemed to be made without cost or penalty if the financial organization does not impose a liquidation, transaction, redemption or termination fee, or any commission, load (whether front-end or back-end), or surrender charge or similar fee.
Q  We offer SIMPLE IRA plans to employers. We like the fact that all contributions would be made to our organization if we act as a designated financial institution, but we are concerned about the inability to charge fees if we transfer any SIMPLE IRA assets. Is there any relief from the fee limitations?

A  With the information in Notice 98-4, the DFI fee concerns have abated. In fact, there are circumstances in which financial organizations may charge fees. IRS clarifications of the fee issues include the following highlights.

- While DFIs generally may not impose transfer penalties, they may charge annual maintenance fees to SIMPLE IRAs, provided the maintenance fees are the same for all employees.

- A DFI need provide only one investment alternative from which employees may elect to transfer without cost or penalty.

- The DFI may charge fees or penalties to the employer.

- The DFI may limit employees to a 60-day period, generally before the beginning of the plan year, in which they can elect to have either all or none of their contributions for the coming plan year transferred without fee or penalty to another financial organization. If employees have not made this election, DFIs may charge appropriate fees and penalties for transfers.

- DFIs may limit employees (who have previously elected to have their assets transferred during the plan year) to one transfer request per month.
**SIMPLE IRA Portability and Distributions**

10.28

Q  Is it possible to transfer or roll over assets from a SIMPLE IRA to a Traditional IRA?

A  Yes. In certain cases, employees may transfer or may roll over SIMPLE IRA assets to Traditional IRAs. Employees must wait two years from the date of initial participation before becoming eligible to roll over SIMPLE IRA assets to a Traditional IRA (Notice 98-4, Q&A I-4). A SIMPLE IRA owner also may roll over assets to 401(a) and 403(a) qualified retirement plans, 403(b) plans, governmental 457(b) plans, and the federal Thrift Savings Plan following two years of participation in the SIMPLE IRA plan.

10.29

Q  What are the rules for converting SIMPLE IRA assets to Roth IRAs?

A  SIMPLE IRA assets can be converted to Roth IRAs after two years of participation in the SIMPLE IRA plan. When converting to a Roth IRA, the SIMPLE IRA assets are taxed as ordinary income but are not subject to the early distribution penalty tax. This type of transaction is reported to the IRS.

If done as an indirect conversion (IRA owner has receipt of the assets), the IRA owner has 60 days to complete the conversion. But the 60-day rule does not apply to direct conversions because the IRA owner does not have receipt of the assets.
10.30

Q May an individual roll over retirement plan assets to a SIMPLE IRA?

A Effective after December 18, 2015, the Consolidated Appropriations Act of 2016 allows Traditional IRA, qualified retirement plan, 403(b) plan, and governmental 457(b) plan assets to be rolled over to SIMPLE IRAs after satisfaction of the SIMPLE IRA two-year waiting period. This two-year period begins when the first contribution under the employer’s SIMPLE IRA plan is made to the IRA. The two-year period does not apply to SIMPLE IRA-to-SIMPLE IRA rollovers.

10.31

Q Does the 25 percent penalty tax apply to all SIMPLE IRA distributions?

A No. A 25 percent early distribution penalty tax applies to distributions taken by an employee within the two-year period beginning on the day on which employer contributions (including deferrals) are deposited in the individual’s SIMPLE IRA, unless the employee is age 59½ or older or can claim an exemption from the early distribution penalty tax described in IRC Sec. 72(t)(6). If an employee under age 59½ satisfies the two-year requirement, and no exception exists, a 10 percent early distribution penalty tax applies.

10.32

Q Do the early distribution penalty tax exceptions under IRC Sec. 72(t)(2) apply to SIMPLE IRAs?

A Yes. The early distribution penalty tax exceptions for IRAs apply to SIMPLE IRAs.
10.33

Q Are SIMPLE IRA owners subject to the required minimum distribution rules under IRC Sec. 401(a)(9)?

A Yes. The same required minimum distribution rules that apply to a Traditional IRA owner, apply to a SIMPLE IRA owner.

10.34

Q Can employees withdraw assets from their SIMPLE IRAs at any time?

A Yes. SIMPLE IRA assets (both employee deferrals and employer contributions) are fully vested when they are made, so SIMPLE IRA owners may distribute the assets at any time. But if distributions are taken before the SIMPLE IRA owner attains age 59½, an early distribution penalty tax applies unless the individual has a penalty tax exception.

A SIMPLE IRA owner will request distributions directly from the financial organization that holds the SIMPLE IRA; the employer generally does not get involved.

10.35

Q Are SIMPLE IRAs subject to federal income tax withholding?

A Yes. The income tax withholding rules that apply to Traditional IRAs also apply to SIMPLE IRAs. If the SIMPLE IRA distribution recipient does not make a withholding election, the financial organization must withhold 10 percent. SIMPLE IRA owners may elect to waive withholding or may elect a withholding amount of 10 percent or more. State income tax withholding also applies for some states.
As a SIMPLE IRA plan provider and a SIMPLE IRA trustee, what reporting responsibilities does our financial organization have?

A financial organization generally must prepare a summary description for employers maintaining SIMPLEs. The summary must include:

- the name and address of the employer and financial organization,
- the plan’s eligibility requirements,
- plan benefits,
- timing requirements for elections, and
- the procedures and effects of withdrawals.

According to Notice 98-4, Q&A H-1, if using the IRS model Form 5305-SIMPLE or Form 5304-SIMPLE the financial organization can satisfy the summary description requirement by providing the employer with a current copy of the model form, the instructions, the information on procedures for withdrawal, and the name and address of the financial organization. In turn, the employer must provide each SIMPLE IRA owner (employee) the summary description with the employee notification each year.

The financial organization also must provide an account statement to each individual maintaining a SIMPLE IRA. The account statement is due on January 31 each year and reports the year-end account balance and account activity. The penalty for failure to provide either the summary or the account statement is $50 each day until the financial organization provides the respective report.
10.37

Q When do we have to provide the summary description for the SIMPLE IRA to the employer?

A A financial organization’s deadline for providing the summary description depends on when the employer must give the summary description information to the employees. According to Notice 98-4, Q&A H-1(2), the financial organization must provide the summary description to the employer “early enough for the employer to meet its notification obligation” to the employees.

The employer must provide the summary description to each employee immediately before the employee’s 60-day election period, which generally is the 60-day period immediately before the beginning of the new plan year, (i.e., November 2 through December 31 of the preceding year). Because the employer generally must provide the summary description at least 61 days before the beginning of each new plan year (i.e., by November 1), the financial organization should provide the summary description to the employer at least 62 days before the beginning of each plan year (i.e., on or before October 31).

10.38

Q Are financial organizations required to report SIMPLE IRA contributions to the IRS?

A Financial organizations must report SIMPLE IRA contributions, including rollover contributions, and the fair market value of the SIMPLE IRA to the IRS on Form 5498, IRA Contribution Information. The instructions to this form require financial organizations to report SIMPLE IRA contributions made between January 1 and December 31 in Box 9 of that year’s Form 5498. A financial organization who fails to file these reports may be subject to a $50 penalty for each failure.
Employers are required to report employees’ SIMPLE IRA salary reduction contributions (including catch-up contributions) on Form W-2, Wage and Tax Statement, with code S, Employee salary reduction contributions under a section 408(p) SIMPLE plan, in Box 12. Form W-2 is provided to both the employee and the IRS.

10.39

Is there any special distribution reporting to the IRS for SIMPLE IRA distributions?

A financial organization must report SIMPLE IRA distributions on IRS Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit Sharing Plans, IRAs, Insurance Contracts, etc. The report is due to the IRA owner by January 31 and to the IRS by February 28 if filing on paper or by March 31 if filing electronically.

A financial organization generally is responsible for reporting whether a distribution to a SIMPLE IRA owner under age 59½ occurred during the two-year period beginning with initial participation in the SIMPLE IRA plan. The financial organization may prepare Form 1099-R on the basis of its own records, but may take into account other “adequately substantiated information” as to when an employee first participated in a SIMPLE IRA plan. Financial organizations should use the distribution code S, Early distribution from a SIMPLE IRA in the first 2 years, no known exception, in this case. In all other instances, Traditional IRA distribution reporting rules apply.
Other than contribution and distribution reporting, what are the financial organization's SIMPLE IRA reporting responsibilities?

Financial organizations have specific reporting responsibilities for all types of IRAs, including SIMPLE IRAs.

**Account Statement**

By January 31 following the close of each calendar year, financial organizations holding SIMPLE IRAs must provide an account statement to each SIMPLE IRA owner. The account statement must include the individual's account balance as of the close of that calendar year, and a summary of the account activity during that calendar year.

**RMD Statement**

Financial organizations must provide a required minimum distribution statement to all IRA owners who are required to take distributions for the year. The statement is due by January 31 of the year for which the distribution is required.

**Fair Market Value Statement**

Financial organizations must provide fair market value statements to SIMPLE IRA owners and beneficiaries annually. The report must show the IRA's December 31 fair market value. This statement is due by January 31. The fair market value is also reported on Form 5498.
**Plan Termination**

10.41

Q  **How should an employer terminate a SIMPLE IRA plan?**

A  The employer must notify its employees within a reasonable time before the 60-day election period (generally November 2 through December 31) that the SIMPLE IRA plan will be discontinued. The IRS suggests that employers also notify the financial organization that administers its SIMPLE IRA plan that contributions will cease for the next calendar year and the plan will terminate. Notice to the IRS is not required when an employer terminates its SIMPLE IRA plan. Note that an employer must continue operating the SIMPLE IRA plan for the entire calendar year; SIMPLE IRA plans cannot be terminated mid-year.

Employers considering terminating their SIMPLE IRA plans should consult with their legal counsel and competent tax advisors to discuss the appropriate termination procedures.

10.42

Q  **An employer notified us that it wants to terminate its SIMPLE IRA plan. Must the SIMPLE IRA assets be distributed?**

A  No. SIMPLE IRA owners may continue to save their SIMPLE IRA assets for retirement, and the assets remain subject to the IRA rules and regulations.
Chapter 11
SEP Plans

SEP Plan Basics

11.1

What is a SEP plan?

A simplified employee pension (SEP) plan is a type of retirement plan for employers that wish to establish and contribute to a retirement plan for their employees while keeping plan administration responsibilities to a minimum. SEP plan contributions are discretionary—employers can decide each year whether they will make contributions. Employers make contributions to each eligible employee’s Traditional IRA. General information on SEP plans also can be found in IRS Publication 560, Retirement Plans for Small Business.

11.2

What are the benefits of a SEP plan?

Both the employer and its employees benefit from having a SEP plan.

Employers

- Less expensive to maintain than many other retirement plans, such as a conventional 401(k) plan or a profit sharing plan
- Relief from fiduciary liability for investment performance
- No plan-level (Form 5500) reporting
- No nondiscrimination or coverage testing
- Employer contributions are deductible
- Owners receive contributions
- Possible tax credit for plan start-up costs
**Employees**

- A means to build retirement assets
- Contributions and earnings are not taxed until distributed
- Employer contributes on behalf of eligible employees

11.3

**What is a salary reduction SEP plan?**

A salary reduction SEP (SAR-SEP) plan is a type of cash or deferred arrangement that allows employees to place part of their salaries into their Traditional IRAs. Each participating employee chooses whether to receive pay in a current year or to defer it and have the money contributed by the employer to a Traditional IRA.

Before 1997, employers were able to establish SAR-SEP plans. Since January 1, 1997, the Small Business Job Protection Act of 1996 has prohibited employers from establishing new SAR-SEP plans. Employers that established SAR-SEP plans before January 1, 1997, can continue to operate their plans, and new employees hired after December 31, 1996, by an employer that maintains a SAR-SEP plan are allowed to participate in the plan.
11.4

**Q** What is the difference between SEP plans and IRAs?

**A** A SEP plan is a type of retirement plan that allows an employer to contribute to employees’ Traditional IRAs (some financial organizations call these “SEP IRAs”). SEP contributions are subject to different contribution limits than Traditional IRA contributions (see Questions 11.20 and 11.22). In addition, employers may make SEP plan contributions on behalf of eligible participants who are age 70½ or older. Once the employer makes a SEP plan contribution to an IRA, the contribution becomes an IRA asset and is subject to all the regular Traditional IRA rules and regulations.

11.5

**Q** Can an individual who is in a SEP plan also have a Roth IRA?

**A** Yes. An individual can participate in an employer-sponsored retirement plan, including a SEP plan, and also open IRAs. SEP plan contributions are made to Traditional IRAs, but are not considered regular Traditional IRA contributions.

11.6

**Q** May an employer establish a vesting schedule for a SEP plan?

**A** No. SEP plan participants must be 100 percent vested in their SEP contributions at all times.
**SEP Plan Establishment**

11.7

**Q** How is a SEP plan established?

**A** Employers and employees both take part in establishing the SEP plan. The employer establishes the plan for the business and the employees must establish Traditional IRAs to receive SEP plan contributions.

The employer must complete a SEP plan document and retain a copy of the plan document with its business records. The employer must provide information about the SEP plan to each employee. If the employer uses Form 5305-SEP, all eligible employees must receive a copy of the completed Form 5305-SEP. If a prototype SEP plan document is used, the employer must complete the instrument of adoption and each employee, whether eligible or not, must receive a copy of that information or a summary of the information. Employees also must receive a SEP disclosure explanation that explains the general SEP rules and plan provisions.

The deadline for an employer to establish a SEP plan for a particular tax year is the due date, including extensions, for filing the employer’s tax return for that year.

11.8

**Q** If self-employed individuals have no employees, may they establish a SEP plan just for themselves?

**A** Yes. Such individuals complete and sign a SEP plan agreement (Form 5305-SEP, Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement, Form 5305A-SEP, Salary Reduction Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement, or a prototype SEP plan) to establish the plan, and complete and sign an IRA plan agreement (Form 5305,
Traditional Individual Retirement Trust Account, Form 5305-A, Traditional Individual Retirement Custodial Account, or a prototype IRA) to open their IRA. Individuals may establish SEP plans for a particular tax year by signing these forms by their tax return due date (including extensions). An individual may then contribute up to 25 percent of his compensation, up to a per participant limit of $55,000 for 2018 and $56,000 for 2019, subject to cost-of-living adjustments.

11.9

Q One of our clients currently maintaining a profit sharing plan is interested in establishing a SEP plan with us. We use Form 5305-SEP as the document for establishing SEP plans at our financial organization. Is this client eligible to adopt Form 5305-SEP if she continues to maintain her profit sharing plan?

A No. Form 5305-SEP clearly states that an employer who currently maintains any other qualified retirement plan, which includes profit sharing plans, may not use the form. To adopt a SEP plan while maintaining another plan, your client will have to adopt either an individually designed SEP plan or a prototype SEP plan.

11.10

Q May a nonprofit organization have a SEP plan?

A Yes. A nonprofit organization is allowed to offer a SEP plan for its employees. Under IRC Sec. 408(k)(6)(E), however, a nonprofit organization is ineligible to offer a SEP plan with a salary reduction feature (commonly referred to as a SAR-SEP plan).
11.11

**Q** May a business with a noncalendar tax year use the Form 5305-SEP document?

**A** Yes. An employer operating a business with a noncalendar tax year may use Form 5305-SEP. But the employer must maintain the SEP plan on a calendar-year basis. This means that eligibility is determined by calendar year, compensation is determined during the calendar year ending within the employer’s tax year, and deductions are taken for the fiscal tax year within which the calendar year ends. The deadline for contributions is the tax return due date of the employer’s fiscal tax year within which the calendar year ends. Under some circumstances, the employer may find it more convenient to use a prototype or individually designed plan, which the employer may maintain on a noncalendar year to match the employer’s fiscal tax year.

11.12

**Q** What is the plan start-up tax credit?

**A** An eligible small employer that establishes a SEP, savings incentive match plan for employees of small employers (SIMPLE), or other qualifying plan may receive a tax credit of up to 50 percent of the start-up costs for up to three years. A $500 maximum credit amount applies for each of the three years. Employers use Form 8881, *Credit for Small Employer Pension Plan Startup Costs*, to calculate and claim the credit with the business’ tax return. Interested employers should discuss the credit with a competent tax advisor.
11.13

Q  With several law changes affecting IRAs over the past few years, has the IRS provided any amendment information for SEP plan documents?

A  Not recently. The IRS released a new model SEP document, (Form 5305-SEP) dated December 2004, and a new model SAR-SEP document (Form 5305A-SEP), dated June 2006. The IRS updated both model documents for increased limits. Neither document update mandated employers to amend to these updated IRS’ model documents.

Eligibility Requirements

11.14

Q  An employer wants to exclude her teenage employees from her SEP plan. Can she do this?

A  Yes. An employer may complete its plan document to require its employees to satisfy certain eligibility requirements before they receive SEP plan contributions. The most restrictive eligibility requirements permitted are described below.

- **Age** – An employer may require employees to attain age 21.
- **Service** – An employer may require employees to work (for any period of time, however short) during at least three out of the immediately preceding five years.
- **Compensation** – Employees earning less than $600 for 2018 and for 2019 in compensation from the employer may be excluded from coverage. This limitation is subject to cost-of-living adjustments.
• **Class of Employees** – Employers may exclude employees who are covered by a collective bargaining agreement where retirement benefits were negotiated as part of a good-faith bargaining process (e.g., union employees), and may exclude nonresident aliens with no U.S. income from the employer.

In your example, the employees may be excluded from the SEP plan as long as the employer has included attaining age 21 as an eligibility requirement in the plan document.

**11.15**

**Q** Must an employer make a SEP plan contribution for an employee who has met the plan’s age and service requirements but was not employed by the employer on the last day of the plan year?

**A** Yes. SEP plan requirements generally state that all eligible employees must participate in the plan. An employer must make a SEP plan contribution for each eligible employee even if that employee is not employed on the last day of the plan year.

**11.16**

**Q** An employer maintains a SEP plan on a calendar-year basis and requires employees to complete three years of service for eligibility purposes. One of the employees first worked for the employer in 2015, but was laid off that same year. The employee returned to work in 2018, and is still employed. When would this employee become eligible to participate in the SEP plan?
Assuming the employee has met all other eligibility requirements, he is eligible to participate as of January 1, 2020. A year of service, as defined for SEP plans, is any period of service during a year, no matter how much the employee worked during the year. When testing for eligibility, the employer looks at the five immediately preceding years to determine if the employee has fulfilled the three-year requirement. The three years need not be successive. The employee in question worked for the employer in 2015, 2018, and 2019. Because he completed three years of service within the past five years (2015–2019), he is eligible to participate as of the first day of the plan year following his completion of three years of service, which is January 1, 2020.

**Funding Deadlines**

11.17

Q I know the deadline for funding SEP plans is different than the deadline for Traditional IRAs. What exactly are the differences?

A Individuals can make their Traditional IRA contributions until their tax return due date, with no extensions. Employer SEP plan contributions, on the other hand, must be made by the employer’s tax return due date, including extensions.

11.18

Q I was told that an employer must have a SEP plan in place by December 31 to be eligible to make a tax-deductible contribution. Is that true?

A No. An employer has until its tax return due date, plus extensions, to establish a SEP plan and make tax deductible contributions for the previous tax year. For instance, a sole proprietor, calendar-year tax filer will have until at least April 15 to establish and fund a SEP plan for the prior year.
11.19

Q  How soon must employers deposit deferrals made under a SAR-SEP plan?

A  Regulations generally state that employers must deposit employee deferrals into the employees' IRAs as soon as the assets can be segregated from the employer's general assets, but no later than the 15th business day of the month following the month in which an employee deferral is withheld or made.

The Department of Labor (DOL), however, issued proposed regulations in 2008 and final regulations in January 2010 that provide a safe harbor for the timing of employee deferral deposits for small employers, which applies to SAR-SEP plans. Deferrals made under small plans—plans with fewer than 100 participants at the beginning of the plan year—are considered timely deposited if the deferrals are deposited to the Traditional IRA within seven business days after they are withheld by the employer. Eligible small plans are not required to use the seven-business-day safe harbor, and may use the general 15-business day limitation.

SEP Plan Contributions

11.20

Q  What is the contribution limit for SEP plans?

A  The maximum annual contribution an employer may make to a SEP plan for an employee is based on a per-participant limit of the lesser of 25 percent of an employee’s eligible compensation (reduced by deferrals to a SAR-SEP plan) or $55,000 for 2018 and $56,000 for 2019 (IRC Sec. 402(h) (2)). Compensation is capped at $275,000 for 2018 and $280,000 for 2019. The compensation cap may be increased for cost-of-living adjustments.
Employers operating SAR-SEP plans must combine the employee’s elective salary deferrals and the employer contribution to determine the per-participant limit. In addition to the compensation cap, the contribution amount the employer makes also may be affected by the highly or nonhighly compensated status of the employee, and whether the employer chooses to integrate SEP contributions with Social Security.

11.21

**Q** Must our financial organization notify employees of contributions made on their behalf?

**A** No. The employer must inform each employee, in writing, of all discretionary contributions made to the employee’s IRA. This information must be supplied by the later of January 31 of the year following the year for which the contribution is made or 30 days after the contribution is made.

11.22

**Q** What is the salary deferral limit for SAR-SEP plans?

**A** The deferral limit for SAR-SEP plans is $18,500 for 2018 and $19,000 for 2019. In addition, participants in SAR-SEP plans who are age 50 or older may make salary deferral catch-up contributions of up to $6,000 for 2018 and for 2019. These limits are subject to cost-of-living adjustments. Note that employers may not establish new SAR-SEP plans, but SAR-SEP plans established before 1997 may still exist.
What is considered compensation?

Compensation is the starting point for determining how much an employer must contribute to a participant’s SEP as defined in Treas. Reg. 1.415(c)-2(d). Employers have some latitude regarding the precise definition of compensation that they use for plan contribution purposes. If an employer does not use the definition of compensation that is selected in the plan document, excess contribution and allocation failures could occur. The Internal Revenue Code defines compensation differently for common-law employees and nonincorporated business owners.

The compensation definition for common-law employees is income received from the employer during the plan year. Employers generally use Form W-2, Wage and Tax Statement, compensation for calculating the contributions of common-law employees, but other definitions are available.

Treas. Reg. 1.415(c)-2(e)(3) indicates that the definition of compensation includes compensation earned before severance from employment but paid after severance, if paid by the later of 2½ months after the date of severance or the end of the limitation year (generally, the plan year) that includes the date of severance. This includes, for example, wages, bonuses, and commissions earned before the SEP plan participant’s final employment date.

The starting point for determining a nonincorporated business owner’s compensation for contribution purposes is the individual’s earned income or net earnings from self-employment. (See Question 11.36 for an explanation of how a nonincorporated business owner’s compensation is determined.)
11.24

One of our clients, a farmer, established a SEP plan. His wife helps him run the farm. He wants to make a SEP contribution for her. Is she eligible for a contribution just by virtue of meeting the requirements for age and service?

A To be eligible for a SEP plan contribution, the farmer’s wife must earn wages for services rendered to the business. Essentially, she must have reportable income (as described in the SEP plan document) from work performed for the farm to receive a SEP plan contribution.

11.25

May an employer who adopts a SEP plan make SEP plan contributions into an existing Traditional IRA to which she is already making the maximum annual regular IRA contributions?

A Yes. The term “SEP IRA” merely refers to a Traditional IRA that is receiving SEP plan contributions (as allowed under an employer’s SEP plan agreement, such as Form 5305-SEP, 5305A-SEP, or a prototype). There is not a special IRS document called a SEP IRA. Governed by Form 5305, 5305-A, or a prototype IRA, the Traditional IRA is eligible to receive SEP plan contributions regardless of whether it also is being used to receive regular IRA contributions.
11.26

Q  May employees age 70½ and older receive SEP plan contributions?

A  Yes. When employers make a SEP plan contribution, they must contribute to each eligible employee’s Traditional IRA (called “SEP IRAs” by some financial organizations) even if an employee is age 70½ or older (Proposed Treas. Reg. 1.219-3(b)(2)). Employees age 70½ or older may no longer make regular Traditional IRA contributions. In addition, employees age 70½ or older must withdraw required minimum distributions from their Traditional IRAs each year.

11.27

Q  An IRA owner at our organization received an employer SEP plan contribution for 2019. May he still make a regular Traditional IRA contribution for 2019?

A  Yes. The IRA owner also may make an IRA contribution, provided he had eligible compensation for the year and did not attain age 70½ in 2019. A SEP plan is an employer-sponsored retirement plan and employees receiving contributions are considered active participants. Consequently, the deductibility of your client’s regular Traditional IRA contribution may be affected, but not his eligibility to make the contribution.
11.28
Q For an employer to have a valid SEP plan, all eligible employees must have a Traditional IRA. What should an employer do if an employee refuses to establish an IRA?
A Because the plan must have 100 percent participation by all eligible employees, the employer must establish an IRA for any employee who is unwilling or unable to do so. The employer may execute any necessary documents on behalf of the employee who is entitled to a contribution (Proposed Treas. Reg. 1.408-7(d)(2)).

11.29
Q Must SEP plan contributions be made in cash?
A Yes. The funding vehicle for SEP plans is an IRA. IRC Sec. 408(a)(1) requires all IRA contributions to be made in cash, except in the case of rollover contributions. There is no alternative rule permitting noncash SEP plan contributions.

11.30
Q An employer who maintains a SEP plan with us wants to make a contribution for herself early in the plan year, but would like to delay the contribution for her employees until a later date. Is this allowed?
A Ascensus does not recommend such a practice based on our interpretation of two specific Internal Revenue Code cites. IRC Sec. 408(k)(3)(A) states that SEP plan contributions may not discriminate in favor of highly compensated employees as defined in IRC Sec. 414(q). Employers must determine contributions through a uniform, written allocation method (IRC Sec. 408(k)(5)). Presumably, contributions provided for the business owner early in the
plan year and later for the rank and file employees could be viewed as favoring the highly compensated employees because the contribution made early in the year would have a greater amount of time to accrue earnings. Ascensus’ opinion is that allocating SEP plan contributions in a uniform and nondiscriminatory manner necessitates that all contributions be made at the same time.

11.31

Q Must an employer make a SEP contribution for an employee who terminates sometime during the year?

A Yes. SEP plan contributions cannot be based on an employee’s employment on any particular day, such as the last day of the plan year. Regardless of the reason for termination (e.g., employee quit, is laid off, dies), a terminated eligible employee is entitled to SEP plan contributions for the period of time that she is employed during the termination year.

11.32

Q May an employee participate in two different SEP plans? If so, is there a maximum dollar amount an employee may receive as SEP contributions?

A Yes. An individual may participate in an unlimited number of SEP plans. The maximum amount an employer may contribute for each eligible employee as a SEP contribution is the lesser of 25 percent of eligible compensation, or $55,000 for 2018 and $56,000 for 2019. When two or more plans of separate employers are involved, the employee may receive the maximum contribution under each plan (Proposed Treas. Reg. 1.219(a)-4(a)(3)(iii)). This means, for example, that the maximum contribution for an employee who participates in two SEP plans in 2019 is $112,000 ($56,000 x 2 = $112,000), with no more than $56,000 coming from either employer.
Q

How do employers correct excess contributions made to SEP plans?

A

Employers generally may choose from two options—remove the excess with the employee’s consent or leave the excess in the IRA and pay certain fees. To correct plan errors (i.e., excess contributions), employers should follow the directives under the IRS’ Employee Plans Compliance Resolution System (EPCRS), found in Revenue Procedure (Rev. Proc.) 2018-52. Effective January 1, 2019, Rev. Proc. 2018-52 modifies and supersedes Rev. Proc. 2016-51. Correcting under any of the EPCRS programs allows the employer to continue to provide the employees with retirement benefits on a tax-favored basis.

The IRS permits employers sponsoring SEP plans to correct certain plan failures under one of its EPCRS correction programs: the Self-Correction Program (SCP), Voluntary Correction Program (VCP), and Audit Closing Agreement Program (Audit CAP). The proper program to use to correct plan failures depends on the type of failure. Generally, the employer will document the error and the correction procedure, and will put in place established practices and procedures to prevent the error from occurring in the future.

Employers should seek competent business or tax advice to properly correct SEP plan errors. Detailed information on correcting plan errors under EPCRS and a SEP Plan Fix-It Guide are available at the IRS website.
11.34

Q How does the financial organization report the removal of excess contributions to a SEP plan?

A Excess employer contributions may be distributed with earnings and returned to the employer with the participant’s consent. The amount distributed to the employer is not includible in the participant’s gross income and cannot be deducted by the employer. The financial organization should report the distribution on Form 1099-R in the plan participant’s name, with the gross distribution amount in Box 1, zero (0) in Box 2a, and distribution code E, Distributions under Employee Plans Compliance Resolution System (EPCRS), in Box 7.

11.35

Q One of our clients who is a self-employed Traditional IRA owner made a 2019 IRA contribution before discovering that it would be nondeductible because his wife is covered by a retirement plan at work and their joint income exceeds $203,000. Now he wants to establish a SEP plan and recharacterize his original Traditional IRA contribution as a SEP contribution for 2019. May he do this?

A No. While SEP plan contributions are made to Traditional IRAs, a SEP plan contribution may not be made until the employer signs the SEP plan agreement. One option available to your IRA owner is to remove the regular Traditional IRA contribution as an excess (along with the net income attributable) and then recontribute the amount after he has signed a SEP plan adoption agreement (this time treating the contribution as a SEP plan contribution).
How is a nonincorporated business owner’s compensation determined for making a SEP plan contribution?

The starting point for determining a nonincorporated (i.e., self-employed) business owner’s compensation for contribution purposes is the individual’s net earnings from self-employment. Once these amounts are determined, several adjustments must be made before a SEP plan contribution can be calculated. As a general practice, the self-employed individual subtracts half of his self-employment tax as determined on the Form 1040 Schedule SE, Self-Employment Tax, as an adjustment to net earnings. The result is referred to as “adjusted net business income (ANBI).”

Determining the amount of self-employment income and the maximum amount of SEP contributions for a nonincorporated business owner is the responsibility of the business owner, not the IRA administrator. The formula for calculating a nonincorporated business owner’s SEP plan contribution can change from year-to-year, so business owners should consult competent tax advisors to assist with these calculations.

What are the employer’s options for allocating employer contributions under a SEP plan?

The employer’s allocation options include pro rata, flat dollar, and Social Security integration. During plan establishment, the employer must determine which allocation method will be used and must comply with this method when making discretionary contributions.
**Pro Rata Method**

Under the pro rata method, contributions are not considered to be discriminatory if the contribution made for all eligible employees is the same percentage of every employee’s compensation. A percentage of compensation is the only method allowed on [IRS Form 5305-SEP](https://www.irs.gov/pub/irs-pdf/f5305sep.pdf).

Alternatively, under the pro rata method, an employer may choose to contribute a certain dollar amount that would be allocated to each eligible employee proportionately based on compensation. This method is available only with a prototype plan document.

**Flat Dollar Method**

Employers select the flat dollar method if they wish to contribute the same dollar amount to each eligible employee. This approach favors lower-paid employees because their contribution is always a higher percentage of their compensation than that of the more highly paid employees. This method is available only with a prototype plan document.

**Social Security Integration Method**

The Social Security integration method of allocating contributions, also called “permitted disparity,” is not allowed on Form 5305-SEP, but may be allowed on a prototype document. If an employer adopts a plan that uses the integration method, employer discretionary contributions do not have to be the same percentage of each eligible employee’s compensation. This disparity in SEP plan contributions is permitted because of the differing amounts employers pay into Social Security based on each employee’s wages. An employer should work with an accountant to determine contributions if using this allocation method.
11.38

Q What are our financial organization’s SEP plan reporting responsibilities?

A A financial organization has no specific reporting responsibilities for a SEP plan. It does, however, have certain responsibilities for reporting for the Traditional IRAs holding the SEP plan assets. (See Chapter 8.)

11.39

Q In 2019, we received a letter and a contribution check from an employer who has a SEP plan. In his letter, he indicated the contribution was deductible for 2018. Do we report that as a prior-year contribution?

A No. An employer operating a SEP plan has until the business’ tax return due date, plus extensions, to make a SEP contribution for a tax year. Yet, a financial organization only reports SEP contributions for a tax year that are made between January 1 and December 31 of that year. Financial organizations must report any contributions received in 2019, regardless of whether the SEP contribution was for 2018 or 2019, in Box 8 on the 2019 Form 5498. The employer deducts the contribution for the appropriate year when it files its tax return.
11.40

Q  A check was sent to our financial organization with a letter from the employer instructing us to put the contribution into a SEP IRA. We do not offer SEP plan documents, so we reported the contribution as a regular Traditional IRA contribution. Should we have sent the check back and informed the employer that we don’t offer SEPs?

A Fortunately, accepting SEP contributions into a Traditional IRA does not depend upon whether your financial organization offers SEP plan documents for employers. The employer signs the SEP plan opening documents to establish the employer’s right to make SEP contributions to a Traditional IRA. The receiving financial organization can accept SEP contributions even if it does not offer the employer documents. The financial organization just has to report the contribution as a SEP contribution on Form 5498, IRA Contribution Information. Remember that a SEP is a kind of contribution, not a kind of IRA.

You will have to correct Form 5498 to show the contribution in Box 8, SEP contributions, rather than in Box 1, IRA contributions (other than amounts in boxes 2-4, 8-10, 13a, and 14a).

11.41

Q How are SEP plan contributions made by sole proprietorships and partnerships reported to the IRS?

A Employers who maintain SEP plans report the SEP plan contributions for employees and take the tax deductions for the SEP plan contributions on their business tax returns. An employer uses Form 1040 to report and take a deduction for the SEP plan contribution made on the employer’s own behalf. The financial organization reports SEP plan contributions made to Traditional IRAs in Box 8 on Form 5498.
11.42

Q An employer that uses the services of leased employees wants to open a SEP plan for her employees. We offer the IRS model Form 5305-SEP document to clients to establish SEP plans. According to the form instructions, an employer cannot use this form to open a SEP plan if the employer uses the services of leased employees. Is there any way this employer can open a SEP plan?

A Yes. An employer who uses leased employees generally may establish a SEP plan using a prototype document or an individually designed SEP plan document. The employer should be aware that if the leased employee is not covered under a “safe harbor” plan at the leasing organization, a leased employee who meets the SEP plan eligibility requirements typically will be considered an employee of the employer for purposes of receiving SEP plan contributions.

11.43

Q Are employee deferrals under a SAR-SEP plan subject to Federal Insurance Contribution Act (FICA) and Federal Unemployment Tax Act taxes (FUTA)?

A Yes. While salary deferral contributions are not included in the employee’s gross income for federal income tax purposes, FICA and FUTA taxes must be paid on the full amount of the employee’s income, which includes deferrals.
SEP Plan Portability and Distributions

11.44

Q  May employees roll over or transfer their SEP contributions?

A  Under most circumstances, yes. Once an employer makes SEP plan contributions to an employee’s Traditional IRA, the assets become the employee’s IRA assets subject to all the rules that govern IRAs. Individuals generally may transfer or roll over these SEP IRA assets in the same manner as IRA assets resulting from regular Traditional IRA contributions. Traditional IRAs holding SEP plan assets also may be converted to Roth IRAs.

11.45

Q  May an employer who has maintained a SEP plan for several years terminate the SEP plan, establish a profit sharing plan, and roll over the assets from the employer’s SEP IRA into the profit sharing plan?

A  Yes. Individuals may roll over SEP IRAs, which actually are Traditional IRAs that receive SEP plan contributions, to qualified retirement plans under IRC Sec. 401(a) and 403(a) plans, 403(b) plans, governmental 457(b) plans, and the federal Thrift Savings Plan.
11.46

Q The Small Business Job Protection Act of 1996 states that employers may not establish SAR-SEP plans after December 31, 1996. The act does not appear to address what happens if an employer wants to move an already existing SAR-SEP plan to a new financial organization. Can an employer move a SAR-SEP plan after December 31, 1996?

A Yes. Employers may amend or restate their SAR-SEP plans onto different SAR-SEP plan documents (e.g. a prototype SAR-SEP plan document offered by the same or a different financial organization, or to the IRS model Form 5305A-SEP). The IRS considers this to be a continuation of an already existing plan rather than the establishment of a new plan.

11.47

Q Can employees withdraw assets from their Traditional IRAs that hold their SEP plan contributions at any time?

A Yes. Once SEP plan contributions are made to Traditional IRAs, the assets become subject to the general rules of Traditional IRAs (e.g., distributions, transfers, and rollovers), and may be distributed at any time. But if distributions are taken before the IRA owner attains age 59½, an early distribution penalty tax applies unless the individual has a penalty tax exception (see Question 7.4 for information on penalty tax exceptions).
11.48
Q Are SEP plan distributions from Traditional IRAs subject to federal income tax withholding?
A Yes. The income tax withholding rules that apply to Traditional IRAs also apply to those containing SEP plan assets. If the distribution recipient does not make a withholding election, the financial organization must withhold 10 percent. The IRA owner may elect to waive withholding or may elect a withholding amount of 10 percent or more. State income tax withholding also applies for some states.

*SEP Plan Termination*

11.49
Q Can an employer terminate its SEP plan at any time during the year?
A Yes. Unlike SIMPLE IRA plans, which an employer must continue to operate for the entire calendar year, an employer may terminate a SEP plan at any time. And because most SEP plan contributions are discretionary, the employer is not required to make contributions for the termination year.

The IRS has no designated procedure for terminating a SEP plan, but employers may wish to notify the employees and the financial organization that contributions will cease and the plan will terminate.

11.50
Q Is it necessary to distribute SEP plan assets when a SEP plan is terminated?
A No. SEP plan contributions that were made to a Traditional IRA remain in the Traditional IRA, and continue to be subject to all the Traditional IRA rules and regulations.
Chapter 12
Miscellaneous Concerns

Hurricane Relief

12.1

Q  What IRA-related relief has been provided for 2017 hurricane victims?

A  The Disaster Tax Relief and Airport and Airway Extension Act of 2017 (The Act), signed into law on September 29, 2017, granted substantial economic relief to individuals affected by Hurricanes Harvey, Irma, and Maria.

The IRS also issued various news releases following the hurricane disasters that extend time-sensitive deadlines for the following.

- Regular contributions
- Tax deductions
- Recharacterizations
- Required beginning date and required minimum distribution (RMD) distributions
- Excess contribution removal (with net income attributable)
- Beneficiary disclaimer deadline
- 60-day rollover period
12.2

**What are qualified hurricane distributions?**

The Disaster Tax Relief and Airport and Airway Extension Act of 2017 provided retirement plan and IRA distribution relief for victims of Hurricanes Harvey, Irma, and Maria allowing qualified individuals to take “qualified hurricane distributions.”

Individuals whose principal residence is within the presidentially declared disaster area affected by Hurricanes Harvey, Irma, and Maria and who have sustained an economic loss as a result are eligible to request qualified hurricane distribution from their IRAs. The Act states that qualified hurricane distributions are distributions taken during a specific time period.

- After August 22, 2017, and before January 1, 2019, for Hurricane Harvey (Texas and Louisiana relief areas)
- After September 3, 2017, and before January 1, 2019, for Hurricane Irma (Florida, Georgia, South Carolina, U.S. Virgin Islands, and Puerto Rico relief areas)
- After September 15, 2017, and before January 1, 2019, for Hurricane Maria (U.S. Virgin Islands, Puerto Rico, and Seminole Tribe of Florida relief areas)

An eligible retirement plan includes IRAs and retirement plans under IRC Sec. 401(a), 403(a), 403(b), and governmental 457(b) plans.
12.3

**Q** Are qualified hurricane distributions subject to the 10 percent early distribution penalty?

**A** Qualified hurricane distributions are not subject to the 10 percent early distribution penalty tax under IRC Sec. 72(t). This penalty exception applies only to the first $100,000 of qualified hurricane distributions from eligible retirement plans per individual. An eligible retirement plan includes IRAs, and retirement plans under IRC Sec. 401(a), 403(a), 403(b), and governmental 457(b) plans.

12.4

**Q** Are qualified hurricane distributions taxable?

**A** IRA owners who receive qualified hurricane distributions have the option of including the distributions in their gross income ratably over three years, beginning with the year of the distribution. Those who do not elect to pay tax over three years must include the distribution in gross income for the distribution year.

12.5

**Q** How do individuals repay qualified hurricane distributions?

**A** Within three years of receipt, individuals may repay (or roll over) qualified hurricane distributions to eligible retirement plans. The three-year period begins on the day after an individual receives a distribution. Individuals may make eligible repayment contributions in one or more deposits as long as the aggregate amount does not exceed the amount of the aggregate qualified distributions. Individuals may treat repayments made within this period as part of an eligible rollover contribution.
12.6

What IRA-related relief has been provided for California wildfire victims?

The Bipartisan Budget Act of 2018 provides relief to California wildfire victims consistent with previous legislation following major natural disasters, including the 2017 legislation for victims of Hurricanes Harvey, Irma, and Maria. The relief is provided to individuals who receive qualified wildfire distributions. A qualified wildfire distribution is a distribution to an individual whose principal residence is within the declared disaster area and who has suffered an economic loss as a result of the wildfires. The following relief is granted.

- Individuals may distribute up to $100,000 from their IRAs and employer-sponsored retirement plans.
- Qualified distributions must be received on or after October 8, 2017, and before January 1, 2019.
- Individuals may evenly spread taxation of their qualified distributions over a three-year period.
- Qualified distributions are exempt from the 10 percent early distribution penalty tax.
- Individuals may repay qualified distributions to an employer plan or IRA over a three-year period.

IRS Publication 976, Disaster Relief, provides taxpayer information on these disasters.
12.7

Q Is there any recent legislation providing other IRA-related relief for disaster victims?

A The Tax Cuts and Jobs Act of 2017 grants retirement plan relief to eligible victims of any 2016 presidentially-declared disasters. This retroactive and limited relief applies only to distributions that were made on or after January 1, 2016, and before January 1, 2018. The following relief applies.

- Qualifying distributions of up to $100,000 from employer-sponsored retirement plans and IRAs before age 59½ will not be subject to the 10 percent additional tax on early distributions.
- Repayment of qualifying distributions from retirement plans and IRAs can be made within three years.
- Distributions not repaid generally will be taxed ratably over a three-year period, unless electing otherwise.

IRS Publication 976, Disaster Relief, provides taxpayer information on these disasters.

Record Retention

12.8

Q How long must financial organizations retain closed IRA files and records?

A The requirements for retaining financial organization records, including IRA records, have evolved over the years through various laws and regulations. Federal laws and regulatory agencies that govern financial organizations provide varying requirements and recommendations for retaining financial records.
States also have laws regarding financial record retention, and these laws may be more stringent than the federal requirements. Therefore, financial organizations should check with their regulatory agencies, legal counsel, and state laws to verify the length of time that they must retain various IRA records.

Conservatively, financial organizations should retain their records for seven or more years after the last activity has occurred (e.g., IRA is closed, last report is filed), but consult with legal counsel if your financial organization chooses to retain records for a different period.

In IRS Publication 1220, Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G, the IRS recommends that payers retain copies of information returns, or be able to reconstruct the data, for at least three years from the reporting due date. Depending on a financial organization’s policies and recordkeeping systems, it may need to keep copies of information returns (e.g., Forms 1099-R and Forms 5498) to reconstruct IRA transactions. Conservatively, financial organizations may choose to retain their reporting records for as long as they keep all other IRA records.

12.9

**Q** Can a financial organization implement a policy of retaining IRA records on electronic media?

**A** Revenue Procedure 97-22, along with the Electronic Signatures in Global and National Commerce Act, allows financial organizations to maintain hard copy records, including IRA documents, in an electronic storage system. These guidelines allow for the destruction of the original hard copy records but only after testing of the system is established and conducted, and procedures are in place that ensure continued compliance with all the provisions of Revenue Procedure 97-22.
State or federal laws or regulations may require financial organizations to provide or retain IRA documents or forms in their original form. Therefore, financial organizations that store records electronically should consult tax or legal advice to determine whether they must retain hard copy documents.

**Missing IRA Owners**

12.10

**Q** For the past year, our financial organization has been attempting to contact one of our IRA owners. All the letters we have sent to the IRA owner have been returned unopened. Does the IRS still offer some type of letter forwarding program that helps locate missing individuals?

**A** No. The IRS announced in Revenue Procedure 2012-35 that the availability of the IRS letter forwarding program for IRA administrators to notify a participant who has IRA assets in the financial organization has ended. The change was effective for letter forwarding requests that were postmarked on or after August 31, 2012.

An IRA administrator may wish to consider alternatives such as

- sending correspondence by certified mail with return receipt requested to the last known address;
- contacting other possible sources who might have information on the missing individual; or
- hiring a commercial locator service.

Before May 19, 2014, the Social Security Administration (SSA) had a letter-forwarding program. That program also has been terminated. The SSA believes that widespread Internet access and other locator services allow financial organizations to find individuals without using the SSA program.
Abandoned IRAs

12.11

Q What happens when an IRA owner or beneficiary cannot be located?

A If all methods used to locate missing IRA owners or beneficiaries are exhausted, provisions under the Uniform Unclaimed Property Act (the Act) require that financial organizations report on an annual basis accounts or assets presumed to be abandoned to the state administrator or treasurer.

Section 6 of the Act provides guidance regarding whether IRAs or other bank deposits at financial organizations are considered abandoned. Most states have adopted statutes patterned after the Act. Under the Act, accounts are presumed abandoned if the account is unclaimed by the owner for three years following the date that required minimum distributions are to begin (e.g., by the required beginning date).

12.12

Q If it is clear that an IRA is abandoned by its owner, what steps does a financial organization have to take to rectify the situation?

A If a financial organization cannot locate missing IRA owners or beneficiaries, the financial organization must file a report with its state. Individual state law will prescribe what information the financial organization must include in the report. The report generally is due before November of each year, reflecting property presumed abandoned as of June 30 of the same year.

Later in the year, the state generally will publish a notice of names of persons appearing to be owners of abandoned property. This notice should appear in a newspaper circulation in the county that contains the IRA owner’s last known address and reveals information about when and how individuals may claim their property. Additionally, the state must again mail a notice to each missing IRA owner whose last known address is listed in the report.
12.13  
**Q**  How are abandoned IRAs paid to the state?

**A**  According to the Uniform Unclaimed Property Act (the Act), within six months after the final date for filing the report, financial organizations shall pay or deliver reportable abandoned property to the administrator. A financial organization generally should complete and retain a withdrawal authorization form and detail the reason for the distribution.

In most states, the government takes custody, not title, of the property. In other words, the state does not actually own the IRA or other property, but rather safeguards it until the rightful owner claims it. Under the Act, the state waits three years, then sells the property (if other than cash) to the highest bidder at a public sale. If an apparent owner subsequently makes a proper claim to the IRA, the state generally will pay over or deliver the IRA to the claimant.

12.14  
**Q**  Can a financial organization be penalized for not reporting an abandoned IRA?

**A**  Yes. A financial organization can be penalized for not reporting abandoned IRAs. Although the Uniform Unclaimed Property Act (the Act) protects financial organizations that pay over abandoned property in good faith, it also provides for criminal penalties for persons who willfully violate the Act. Failure to report abandoned property is punishable as a misdemeanor level offense. Failure to pay or deliver the property to the state is a gross misdemeanor offense.
12.15

**Q** When an abandoned IRA is forfeited to the state, are financial organizations required to report that the IRA was distributed? If so, are financial organizations required to withhold 10 percent from the distribution amount?

**A** In May 2018, the IRS released Revenue Ruling (Rev. Rul.) 2018-17, outlining the rules for withholding and reporting requirements with respect to the payment of an IRA owner’s account to a state unclaimed property fund (i.e., escheatment). Payments made in this manner are treated as includable in gross income, and so the regular IRA withholding requirements under IRC Sec. 3405(e)(10) apply. Rev. Rul. 2018-17 also states that distributing trustees must report these payments on the applicable year’s Form 1099-R, identifying the IRA owner as the recipient.

*IRA Fees*

12.16

**Q** Are we allowed to charge our IRA owners a reasonable annual maintenance fee?

**A** Yes. Some organizations charge a fee while others do not. The amount of the fee usually is dependent on the services provided.
12.17
Q May a financial organization charge a transfer fee against an IRA owner’s IRA without written consent?
A Yes. If your organization wants to charge a transfer fee or reserve the right to charge fees, this should be disclosed in the financial projection or in Article VIII of the plan agreement. If the plan agreement does not reserve the right to charge fees, your financial organization may amend it to include this right. Amendment of the plan agreement for changes like this may require the IRA owner’s written consent.

12.18
Q Our bank recently debited an IRA owner’s account for his annual IRA fee (as allowed by our plan documents). The IRA owner now says that he wanted to be billed separately for the fee. He insists that he should be allowed to reimburse his IRA out of his own pocket. Can we allow him to do this?
A Although annual fees often are paid directly from an IRA, the IRS also recognizes separate billing as a permissible alternative. You may bill him for the fee separately, outside of the IRA, but if he reimburses the IRA for a fee, it is considered a contribution to the IRA. If the IRA owner has already contributed the maximum amount to the IRA, this “repayment” will become an excess contribution to the IRA.
Conservators, Guardians, and Powers of Attorney

12.19

**Q** One of our IRA owners had a stroke and is in a coma. How may his spouse withdraw assets from his IRA to pay medical bills?

**A** The spouse should seek legal counsel. The attorney may ask the court to appoint the spouse as conservator or guardian of the IRA owner. The spouse, upon receiving appropriate legal appointment, may then withdraw the assets. Ascensus recommends that you have your organization’s legal counsel review any documents that the spouse presents to you.

12.20

**Q** What is a power of attorney?

**A** A power of attorney (POA) is a written document authorizing one person (known as the attorney-in-fact or agent) to act on behalf of another person (known as the principal or grantor). State laws dictate what a POA is allowed to do regarding the IRA. POAs often are granted by individuals who will be unavailable to conduct their financial business for a limited period of time. An individual may wish to have a family member or friend conduct her personal affairs while the individual is unable to do so. This may include authorizing someone to make contributions or take distributions from an IRA on behalf of the ill or absent individual.

12.21

**Q** We recently received a conservatorship order for an IRA owner. The order seems to give the authority for making account decisions to a relative of the IRA owner. How does this differ from a power of attorney, and how should we respond?
When an individual becomes physically or mentally incapacitated, a court may appoint a conservator (or guardian) to act on the incapacitated individual’s behalf. With a POA, the individual (grantor) will actually choose who will act on his behalf. Depending on the POA document provision, a POA may terminate if the individual becomes incapacitated. A court, however, generally appoints a guardian because an individual has become incapacitated.

You should obtain a copy of the order appointing the conservator or guardian so your legal counsel may review it to determine what authority this individual may have to direct transactions. You also should have your counsel help you set guidelines to follow when such orders are received in the future.

12.22

When is a power of attorney needed?

There may be many reasons why someone would use a POA to grant authority to another individual. For instance, a principal may simply be unavailable to conduct business or may wish to turn over certain types of transactions to a trusted expert. Often the authority to act is limited by the principal. It may be limited to a certain time period or it may be limited in scope. A nondurable POA terminates if the principal becomes legally incompetent. With a durable POA, the principal’s incompetence does not terminate the agent’s authority. Typically, the durable POA document must contain language indicating that the POA shall become (or remain) effective upon the incapacity or incompetence of the principal. Whether durable or nondurable, a properly executed power of attorney may confer broad authority to the agent.
12.23

Q  What are the duties of a financial organization with regard to a power of attorney?

A  Because attorneys-in-fact “step into the shoes” of the principal, financial organizations generally would honor the wishes of the attorney-in-fact, just as they would comply with requests by the principal. In other words, provided that the agent does not exceed the scope of the authority conferred in the POA, the financial organization must treat the agent just like the principal. Although a financial organization should not refuse to accept the authority conferred in a valid POA, it certainly should use the same diligence with an agent as with the principal. For example, if an agent requests a distribution from the principal’s IRA, the financial organization should request proper identification and documentation before the transaction takes place.

Whether dealing with a principal or an agent, financial organizations must ensure that investments are protected and that transactions are properly conducted. One way to guarantee that this is done is to obtain and follow the direction of competent legal counsel familiar with individual state requirements.

IRAs and Creditors

12.24

Q  Our financial organization received a court judgment against one of our clients who maintains a savings account and an IRA at our credit union. Because the balance in the savings account is insufficient to satisfy the client’s debt, may we distribute assets from the IRA to make up the difference?
Depending on state law, certain creditors may obtain IRA assets to satisfy a debt. Perhaps the most significant variation in state law is the limitation on which particular assets creditors may obtain. Some states specifically protect IRA assets from seizure. Other jurisdictions rely on state trust law to determine whether creditors may seize IRAs. The rationale is that only “spendthrift” trusts (set up to protect a beneficiary from spending all of the money that he is entitled to) are beyond the reach of creditors. IRAs have generally been determined not to be spendthrift trusts because the IRA owner exercises control over (and has access to) the IRA.

12.25

Can the IRS levy IRAs without court action?

The IRS generally does not need court authorization to take levy action. Before the IRS takes action, however, three legal requirements must be met.

1. The IRS must assess the tax and send the taxpayer a notice and demand for payment.

2. The taxpayer must neglect or refuse to pay the tax.

3. The IRS must send a Final Notice of Intent to Levy at least 30 days in advance of the levy.

If the IRS decides to levy against a taxpayer’s accounts, the IRS will send the financial organization a Notice of Levy.

Under a provision of the Bipartisan Budget Act of 2018, a wrongful IRS levy of a taxpayer’s IRA or employer-sponsored retirement plan assets that are returned to the taxpayer may be rolled over to an IRA (including an inherited IRA) or to a retirement plan by the tax return deadline for the year the assets are returned (not including filing extensions). The normal limitation of one IRA rollover per 12-month period will not apply to such rollovers.
**FDIC and NCUA Coverage**

12.26

**Q** What is FDIC coverage?

**A** The Federal Deposit Insurance Corporation (FDIC) insures accounts of all banks chartered by the federal government and most banks chartered by state governments. Under FDIC coverage, an individual’s IRA assets, other self-directed retirement accounts, and self-directed qualified plan accounts (e.g., owner-only qualified retirement plans or self-directed 401(k) plans) are insured separately from an individual’s other accounts at the bank.

Certain retirement accounts (including IRAs and self-directed retirement plans) generally have up to $250,000 in deposit insurance coverage. This amount is reviewed for cost-of-living adjustments every five years.

12.27

**Q** Do credit unions have FDIC coverage?

**A** No. The National Credit Union Share Insurance Fund (NCUSIF), an arm of the National Credit Union Administration (NCUA), insures federal credit union deposits. Unlike the FDIC, the NCUSIF separately insures IRAs and self-directed qualified plans that an individual has at a federal credit union. The NCUA coverage for IRAs and other accounts is $250,000.

12.28

**Q** Are IRA beneficiary accounts aggregated with an individual’s own IRAs for FDIC or NCUA coverage?

**A** An FDIC senior management specialist confirmed to Ascensus that an individual’s beneficiary account is insured separately from all other IRAs that the individual maintains at the same financial organization. This rule also applies to beneficiary accounts that have NCUA coverage.
12.29

**Is bankruptcy governed by federal or state laws?**

An individual or couple filing for bankruptcy protection may have the option to choose whether to invoke state or federal bankruptcy law exemptions. Whether an individual has the option to choose is determined under state bankruptcy law. If a choice can be made, a bankruptcy petitioner can determine (with competent legal help) how each option will affect which assets or property will be included in the bankruptcy estate that is available to creditors. Depending on the state in which a petitioner files for bankruptcy and the assets the petitioner hopes to exempt from the bankruptcy estate, there may be advantages to electing one set of exemptions—state or federal—versus the other.

12.30

**What bankruptcy protections are provided for Traditional, Roth, and SIMPLE IRAs?**

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the Act) allows debtors to claim an exemption from including qualifying assets in their bankruptcy estates regardless of whether state or federal bankruptcy exemptions are chosen for the bankruptcy estate as a whole. The Act provides the following exemptions for IRAs.

- Traditional and Roth IRAs may be exempted from an IRA owner’s bankruptcy estate up to a limit of $1 million, regardless of whether state or federal bankruptcy exemptions are chosen for the bankruptcy estate as a whole. This amount may be increased based on a review of the Consumer Price Index every three years. Effective April 1, 2016, this amount was adjusted to $1,283,025.

- SIMPLE IRA and SEP plan assets may be exempted and are not subject to a maximum amount.
Assets rolled over to IRAs from employer-sponsored retirement plans may be exempted and are not subject to a maximum amount (including SIMPLE IRA and SEP plan assets).

Whether these protections apply to inherited IRAs was an issue subject to differing opinions and court rulings. In June 2014, the U.S. Supreme Court ruled that assets in an inherited IRA are not retirement funds exempt from a debtor’s bankruptcy estate under federal law. The Supreme Court ruling in Clark v. Rameker leaves inherited IRA assets open to creditor claims in bankruptcy.

**Prohibited Transactions**

12.31

**Q** Who is a disqualified person for purposes of IRA prohibited transactions?

**A** The IRS prohibits transactions between IRAs and certain individuals known as “disqualified persons.” IRC Sec. 4975(e)(2) provides a detailed definition for this term. A disqualified person generally is the IRA owner, the trustee or custodian of the IRA, or anyone who has control over the assets or who has the ability to influence investment decisions. Members of the IRA owner’s family (i.e., a spouse, an ancestor, any lineal descendant, or any spouse of a lineal descendant) also are considered disqualified persons.

12.32

**Q** May an IRA be used as security for a loan?

**A** No. Individuals may not pledge their IRAs as security for a loan. If an IRA or any portion of an IRA were pledged as security, the amount pledged is deemed distributed to the individual. As a result, the individual must include that amount in income for the year and will be subject to a 10 percent early distribution penalty tax if under age 59½.
12.33

Q May organizations offer loans to IRA owners to help them fund IRAs?

A Yes. If an IRA owner is eligible to make an IRA contribution, the IRA owner may use a loan to fund an IRA. But the IRA owner may not use the IRA as security for a loan.

12.34

Q May a qualified retirement plan participant roll over a personal note from a qualified retirement plan loan to an IRA?

A No. Rolling over a personal note from a qualified retirement plan to an IRA is a prohibited transaction under IRC Sec. 4975(c)(1)(B). According to Technical Advice Memorandum 8849001, an attempt to roll over a personal note will result in a taxable distribution in the amount of the note and disqualification of the IRA.

12.35

Q May our financial organization offer a free gift to our prospective IRA clients as an incentive to establish an IRA or is this a prohibited transaction?

A A financial organization may offer a free gift to prospective IRA owners if certain provisions are met. The Department of Labor (DOL) issued Prohibited Transaction Class Exemption 93-1 (PTE 93-1), which allows most individuals relief from any IRS sanctions if they accept cash, property, or any other type of consideration from a financial organization for establishing or contributing to an IRA.

The incentive may be worth no more than $10 for contributions of less than $5,000 and no more than $20 for contributions of $5,000 or more.
12.36

Q Our bank offers free checking to individuals who establish and maintain IRAs with us. It has recently been brought to my attention that offering free checking may be a prohibited transaction. Is this true?

A Probably not. Early in 1993, the Department of Labor (DOL) issued PTE 93-2. Often referred to as the “banking-related services exemption,” PTE 93-2 allows IRA owners who invested in deposit accounts to receive free or discounted services from financial organizations described in IRC Sec. 408(n) (generally banks, savings and loans, and credit unions) under a relationship banking strategy without the IRA owner facing prohibited transaction concerns, providing the conditions under the exemption are met. PTE 93-2 was later expanded to include simplified employee pension (SEP) plans and, at the same time, was redesignated to PTE 93-33.

On February 7, 1997, the DOL issued PTE 97-11, permitting broker-dealers to provide free or low-cost brokerage services to their IRA, SIMPLE IRA, and SEP plan clients without the clients incurring prohibited transactions if several conditions are met. PTE 97-11 is an extension of the relief provided in PTE 97-33 to IRA owners who do business with broker-dealers.

12.37

Q What is the relationship banking class exemption?

A As originally issued, PTE 93-33 offered prohibited transaction relief only to IRA owners who invest in deposit accounts. In May of 1994, the Department of Labor amended PTE 93-33 to include IRA owners who invest in “securities for which market quotations are readily available.” The amendment expands PTE 93-33 to allow certain financial organizations to offer free or discounted
services to IRA owners who purchase investments such as stocks, bonds, and mutual funds in addition to deposit accounts. The amendment, however, specifically excludes investments in securities that a financial organization offers exclusively to IRAs and retirement plans.

12.38

Q Is there any relief from the prohibited transaction penalty?

A The Pension Protection Act of 2006 provides a statutory exemption that allows individuals to correct certain retirement plan and IRA prohibited transactions without additional penalties if done within 14 days of discovery (or within 14 days of when the transaction should have been discovered). This statutory exemption covers acts that involve the acquisition, holding, or disposition of any security or commodity that is prohibited. The exemption does not apply to company stock or real estate transactions, and does not apply in situations where the fiduciary knew or should have known that the transaction was prohibited.

To “correct” means to undo the transaction to the fullest extent possible, to make good any loss to the plan or affected account, and to restore to the plan or affected account any profits gained as a result of the prohibited transaction. If the exemption applies, no excise tax is assessed, any tax assessed is abated, and any tax collected shall be credited or refunded as a tax overpayment.
**IRA Investments**

12.39

**Q** What investments are permitted in a self-directed IRA?

**A** There are relatively few limits on the types of investments that are permissible for a self-directed IRA (SDA). An IRA, however, may not be invested in collectibles. Collectibles are defined as any work of art, rug, antique, gem, metal, stamp, coin, (except American gold and silver Eagle coins minted after September 30, 1986, and any coin issued under the laws of any state) alcoholic beverage, or any personal property as specified in other regulations (see IRC Sec. 408(m) and IRC Sec. 4975).

Nonetheless, a broad range of investments are still available, including stocks, bonds, government securities, and even real estate. Many organizations with SDA programs place additional limits on available investments. Financial organizations should clearly explain such limitations in the IRA documentation. In addition, IRA owners with SDAs should be familiar with the various prohibited transactions outlined under IRC Sec. 408(e) and IRC Sec. 4975(c).

12.40

**Q** Can a savings bond be an IRA investment?

**A** Yes. The only investments that are not allowed are collectibles as defined in IRC Sec. 408(m), life insurance contracts, and investments resulting from transactions that are prohibited, as defined in IRC Sec. 4975 concerning self-dealing.
NOTE: Although a savings bond is allowed as an IRA investment, a savings bond may not be an appropriate investment to hold in an IRA because income earned on a savings bond generally is exempt from state and local income tax. IRC Sec. 408(d)(1) states that any amount distributed from an IRA shall be included in gross income. (This does not apply to an amount that is rolled over or a return of nondeductible contributions.) Because savings bonds would be taxed when withdrawn from the IRA, the IRA owner would not receive the benefit of the tax-exempt investment.

12.41

We will soon be receiving a transfer of an existing IRA. A portion of the IRA consists of rare and valuable stamps acquired in 1980. Can we accept the stamp collections as part of the IRA transfer?

Conservatively, no. Before January 1, 1982, collectibles such as rare stamps were allowed as investments within IRAs. The Economic Recovery Tax Act of 1981 disallowed collectibles as a valid IRA investment effective for any property acquired after December 31, 1981. Any collectibles that were already held in IRAs at that time were “grandfathered” in and allowed to be retained. Because IRC Sec. 408(m) prohibits the acquisition by an IRA of collectibles after December 31, 1981, the transfer or rollover of those collectibles technically is not allowed.
12.42

Q  Can an IRA owner with a self-directed IRA direct a trustee to purchase a note issued by a business owned entirely by the IRA owner?

A  No. The purchase of the note by the IRA trustee is a prohibited transaction between the IRA and a disqualified person. The Department of Labor (DOL) ruled that a similar transaction was a prohibited transaction in that it constituted “an indirect transfer of plan assets to, or use of plan assets for the benefit of, a disqualified person under IRC Sec. 4975(c)(1)(D).”
Glossary of Terms

401(k) plan. An IRC Sec. 401(k) plan is a plan that allows participants to defer receipt of a portion of their wages under a qualified cash or deferred arrangement, which is part of a profit-sharing, stock bonus plan, or pre-ERISA money purchase pension plan.

403(b) plan. An IRC Sec. 403(b) plan is a plan that allows employees of IRC Sec. 501(c)(3) organizations and public schools to defer a portion of their wages under a cash or deferred arrangement. Eligible employers also may contribute amounts on behalf of their employees.

ACP test. See “actual contribution percentage test” in this Glossary.

ACP testing safe harbor. The IRS allows employers to automatically satisfy the ACP test if the ACP testing safe harbor requirements are satisfied.

active participant. Active participants are individuals who make or receive contributions to their retirement plan accounts or are eligible to earn retirement credits in a retirement plan for an applicable year. Active participants in certain retirement plans may be limited in the amount of IRA contributions they can deduct on their income tax returns.

actual contribution percentage test. The actual contribution percentage (ACP) test is a nondiscrimination test found in IRC Sec. 401(m), which applies only to plans that have matching or after-tax employee contributions. The test imposes limits on matching and after-tax contributions for highly compensated employees each year, based on the average percentage received by the plan’s nonhighly compensated employees.

actual deferral percentage test. The actual deferral percentage (ADP) test is a nondiscrimination test that applies to salary deferral contributions in 401(k) plans (IRC Sec. 401(k)(3)) and SAR-SEP plans (IRC Sec. 408(k)). The ADP test imposes limits on the percentage of compensation that highly compensated employees may defer into the plan each year, based on the average percentage of compensation deferred by the plan’s nonhighly compensated employees.
adoption agreement. This portion of a prototype qualified retirement plan, SEP, or SIMPLE plan document contains the options that an employer may select based on the provisions allowed in the basic plan document. The employer must complete and sign the adoption agreement to establish a qualified plan, SEP, or SIMPLE plan.

ADP test. See “actual deferral percentage test” in this Glossary.

ADP testing safe harbor. The IRS allows employers to automatically satisfy the ADP test if the ADP testing safe harbor requirements are satisfied.

ANBI. See “adjusted net business income” in this Glossary.

annual additions. This is the total dollar amount contributed in a given year to the account of a participant in a defined contribution plan, as defined in IRC Sec. 415(c). The allocations must be limited to the lesser of 100 percent of the participant’s compensation or the dollar amount in effect for the year (subject to cost-of-living adjustments).

annuity. An annuity is a contract sold by an insurance company that provides the purchaser with the option to receive a sum of money payable over life expectancy or over a fixed period of time. The contract is “annuitized” when the sum of money is converted to periodic payments.

automatic enrollment. Automatic enrollment is a retirement plan provision available to plans that include salary deferral features (e.g., IRC Sec. 401(k) or 403(b) plans) in which employers can automatically enroll their employees, if certain requirements are met.

automatic rollover. An employer must directly roll over to an IRA any mandatory distribution amounts if the plan participant’s vested balance exceeds $1,000 but does not exceed $5,000, unless directed otherwise by the plan document, plan participant, or beneficiary.

average benefits test. When a plan fails the ratio percentage test for minimum coverage testing under IRC Sec. 410(b), the average benefits test is an alternative testing method for coverage testing.
**blackout period.** A blackout period is a period of time during which the participants or beneficiaries of the plan lose the ability to direct or diversify assets, obtain loans, or receive distributions from a retirement plan. Blackout periods often occur as a result of mergers, acquisitions, spin-offs, investment changes, and recordkeeper changes.

**bonding requirement.** ERISA generally requires that persons having direct or indirect control or authority over qualified retirement plan assets be bonded by a corporate surety company to insure against fraudulent acts involving plan assets or plan operations. Certain exceptions apply.

**capital gains election.** The capital gains election is a special tax treatment that may be used with lump-sum distributions of a plan participant who was born before January 2, 1936.

**cashout.** See “mandatory distribution” in this Glossary.

**catch-all amendment.** A catch-all amendment is a full and up-to-date IRA plan agreement and disclosure statement that is sent to all existing IRA owners to make up for past failures to make required amendments. Although a catch-all amendment shows a good faith compliance effort on behalf of the financial organization, it does not guarantee that the IRS will waive penalties for past failures.

**catch-up contribution.** This is a type of contribution that individuals age 50 and older may make to Traditional IRAs, Roth IRAs, SAR-SEP and SIMPLE plans, the federal Thrift Saving Plan, and 401(k), 403(b), and governmental 457(b) plans.

**compensation cap.** The compensation cap is the maximum compensation amount under IRC Sec. 401(a)(17), subject to cost-of-living adjustments, that employers may consider for SEP, SIMPLE, qualified retirement plan, and 403(b) plan purposes.

**conduit IRA.** A conduit IRA is an IRA that contains only assets that have been rolled over from an employer-sponsored retirement plan.

**controlled group.** A controlled group is one or more business entities that are related through certain common ownership interests. When a controlled group of businesses exists, it must be treated as a single employer for SEP, SIMPLE, qualified retirement plan, and 403(b) plan testing and coverage purposes.
conversion. A conversion is a taxable movement of cash or other assets from a Traditional or SIMPLE IRA to a Roth IRA.

custodian. The custodian is a bank or savings and loan association, as defined in IRC Section 408(n), or any other entity that has the IRS’ approval to act as custodian.

Coverdell education savings account (ESA). The Coverdell education savings account (ESA), created by TRA-97, is a type of savings arrangement that is established for the benefit of a designated beneficiary (potential student) to pay for education expenses.

cross-trading. Cross-trading is the purchase or sale of a security between a plan and any other account managed by the same investment manager.

deemed IRA. Under the EGTRRA rules, a qualified employer plan may allow employees to make voluntary contributions that are treated (deemed) as being made to an IRA (either Roth or Traditional), if certain requirements are met.

default investment. A default investment is a plan investment that the employer chooses if an employee does not elect investments before making contributions to the plan (e.g., if the employee is automatically enrolled in the plan).

defined benefit plan. A defined benefit plan is an employer-sponsored retirement plan that promises a predetermined benefit for plan participants at retirement. Funding for a defined benefit plan generally is provided by the employer and is based on actuarial assumptions and calculations, which determine the contribution amount required to provide the promised future benefit.

defined contribution plan. A defined contribution plan is an employer-sponsored retirement plan that both the employer and the participants can fund and that defines the level of contributions that may be made for plan participants. The benefit a participant will receive from the plan is not guaranteed and is largely dependent on contribution levels and investment performance.
**Department of Labor (DOL).** The DOL is a federal government department that governs employee and retiree benefits and that implements labor laws that support workers’ rights.

**designated beneficiary.** The designated beneficiary is the beneficiary whose life expectancy is used to calculate RMDs. A plan participant’s designated beneficiary is determined based on the beneficiaries designated as of the date of death and who remain beneficiaries as of September 30 of the calendar year following the calendar year of the plan participant’s death.

**designated financial institution.** Under IRC Sec. 408(p)(7), a SIMPLE IRA plan document may require the employer to deposit all SIMPLE IRA plan contributions at the same financial organization. The financial organization in such a case is known as the “designated financial institution” (DFI).

**designated Roth account.** A designated Roth account is a separate account in an IRC Sec. 401(k), 403(b), governmental 457(b) retirement plan, or the federal Thrift Savings Plan (TSP) that holds designated Roth contributions and earnings attributable to Roth contributions on behalf of a plan participant.

**designated Roth contribution.** Designated Roth contributions are employee elective contributions made to an IRC Sec. 401(k), 403(b), governmental 457(b) retirement plan, or federal Thrift Savings Plan (TSP) that, unlike pretax deferrals made under the plan, are included in gross income in the year the contribution is made.

**determination letter.** A determination letter is a written statement issued by the IRS that addresses a plan’s qualified status to ensure that the specific provisions of the employer’s plan document meet the requirements necessary to be treated as a qualified retirement plan.

**DFI.** See “designated financial institution” in this Glossary.

**disclaimer.** An IRA or retirement plan beneficiary may give up the right to an interest in the inherited account by filing a qualified written disclaimer.

**EACA.** See “eligible automatic contribution arrangement” in this Glossary.
early distribution. Distributions taken from a Traditional, Roth, or SIMPLE IRA, qualified retirement plan, and 403(b) plan before the IRA owner or plan participant attains age 59½ are called “early distributions.” Early distributions generally are subject to a 10 percent IRS penalty tax (25 percent for certain SIMPLE IRA distributions) unless a penalty exception applies.

earned income. Earned income generally is the amount of income a person earns for services rendered. Earned income is considered eligible compensation for making IRA contributions and can also be considered compensation paid to self-employed individuals for IRA and retirement plan contribution purposes.

EFTPS. See “Electronic Federal Tax Payment System” in this Glossary.

Electronic Federal Tax Payment System (EFTPS). EFTPS is a federal program for making federal tax payments electronically. This includes income tax withholding from IRAs and retirement plan accounts.

eligible automatic contribution arrangement (EACA). An EACA is a plan provision under which participants who do not make a deferral election are treated as having elected to defer a percentage of their compensation if certain plan requirements are met.

eligible rollover distribution. A distribution from a qualified retirement plan, 403(b) plan, or governmental 457(b) plan that is eligible to be rolled over (either directly or indirectly) to an IRA or another eligible retirement plan is sometimes called an “eligible rollover distribution.”

Employee Benefits Security Administration (EBSA). One of several DOL agencies, EBSA protects employee benefits and encourages retirement plan compliance through programs such as the Delinquent Filer Voluntary Correction (DFVC) program, the Voluntary Fiduciary Correction Program (VFCP), and the ERISA Filing Acceptance System (EFAST). EBSA is authorized to enforce civil actions and assess monetary penalties for violations of the Title I provisions of the Employee Retirement Income Security Act of 1974 (ERISA).
Employee Plans Compliance Resolution System (EPCRS). The EPCRS is a system of plan correction programs that the IRS established to help employers who have failed to meet one or more requirements of the Internal Revenue Code to correct their plans to avoid plan disqualification.

employee stock ownership plan (ESOP). An ESOP is an employee benefit plan in which participants invest primarily in employer securities.

employer reversion. When a qualified retirement plan is terminated and excess assets remain in the plan after all the plan participants have received their payouts, the excess assets in the plan may revert to the employer. Congress imposes excise taxes on most employer reversions.

employer-sponsored IRAs. Employer-sponsored IRAs are IRA trusts under IRC Sec. 408(c) that are established by employers or certain employer associations for the exclusive benefit of employees. Employer-sponsored IRAs can be funded by either or both the employer or employee.

EPCRS. See “employee plans compliance resolution system” in this Glossary.

ESOP. See “employee stock ownership plan” in this Glossary.

excess accumulation. If the amount distributed to an individual during a taxable year is less than the required minimum distribution for the year, the individual will be subject to an excess accumulation penalty tax of 50 percent of the distribution amount that should have been taken but was not. This penalty applies to IRA owners and plan participants (and their beneficiaries).

excess aggregate contribution. 401(k) plan contributions that exceed the IRC Sec. 401(m) actual contribution percentage (ACP) test limits are excess aggregate contributions.

excess contribution. The IRA contribution amount exceeding the allowable limits is an excess contribution. For 401(k) plans, contributions that cause a plan to fail the IRC Sec. 401(k) actual deferral percentage (ADP) test are excess contributions.
**excess deferrals.** Excess deferrals are employee salary deferral contributions that exceed the annual limits allowed under IRC Sec. 402(g).

**excess nondeductible employer contribution.** Excess nondeductible contributions are employer contributions that exceed the allowable deductible amount. The Internal Revenue Code mandates a 10 percent penalty on the nondeductible contribution amount.

**fair market value.** The fair market value is the value of a Traditional, Roth, or SIMPLE IRA as of a certain date. Financial organizations must provide the December 31 fair market value to each IRA owner and to the IRS each year.

**FDIC.** See “Federal Deposit Insurance Corporation” in this Glossary.

**Federal Deposit Insurance Corporation (FDIC).** The FDIC insures deposit accounts and deposit-type investments of all banks chartered by the federal government, most banks chartered by state governments, and savings associations.

**fiduciary.** A fiduciary is someone who has discretionary authority or responsibility in administration of a plan or has discretionary authority or control for management or disposition of plan assets.

**financial disclosure.** The IRS requires that financial organizations provide certain financial disclosures to individuals who establish a Traditional IRA, Roth IRA, or SIMPLE IRA. The financial disclosure is intended to be a consumer protection device, requiring financial organizations to disclose projected earnings, early withdrawal penalties, trustee fees, and other service fees such as transfer or rollover fees.

**first-time homebuyer.** A first-time homebuyer, for purposes of the early distribution penalty tax exception, is an individual (and the individual’s spouse) who had no present ownership interest in a principal residence during the two-year period ending on the date of acquisition of the principal residence.

**fiscal year.** A fiscal year is the 12-month accounting period that constitutes the employer’s tax year.
forfeitures. When a qualified retirement plan participant who is less than 100 percent vested separates from service, the participant gives up the right to any nonvested employer contributions. These forfeited amounts are called “forfeitures.”

frozen plan. A frozen plan is one in which the employer will no longer make contributions to participants, but the distribution of assets will not be made until a later date. An employer must continue to maintain a frozen plan until all of the assets are distributed.

gap period income. Gap period income is any earning or loss that is attributable to an excess contribution and that is earned after the end of the plan year in which the excess occurred but before the excess is distributed.

governmental 457(b) plan. A governmental 457(b) plan is an eligible deferred compensation plan maintained by a governmental entity.

health savings accounts. Created by the Medicare Prescription Drug and Modernization Act of 2003, health savings accounts (HSAs) are tax-favored consumer savings arrangements for individuals and families covered by high deductible health insurance plans. HSAs are designed as a savings tool to help pay for medical expenses incurred by the HSA owner, spouse, and dependents.

HCE. See “highly compensated employee” in this Glossary.

highly compensated employee. An employee defined in IRC Sec. 414(q) is a highly compensated employee (HCE). Benefits provided to HCEs are measured when performing the ADP and ACP tests for 401(k), 403(b), and SAR-SEP plans.

income averaging. An individual who receives a lump-sum distribution from a qualified retirement plan and includes those assets in taxable income may be eligible to determine the tax liability as if the distribution had been received over a 10-year period. Only plan participants who attained age 50 before January 1, 1986 (and their beneficiaries) may be eligible.
individual retirement account. An individual retirement (IR) account is a retirement savings arrangement that must qualify under IRC Sec. 408(a). IR accounts may be established by a bank, savings and loan association, credit union, brokerage firm, or other organization that can demonstrate to the IRS the ability to lawfully administer the trust.

individual retirement annuity. An individual retirement (IR) annuity is a retirement savings arrangement that must qualify under IRC Sec. 408(b). IR annuities may be established by insurance companies.

individual retirement arrangement. An individual retirement arrangement (IRA) is an individual retirement account or an individual retirement annuity. An IRA may be a Traditional, Roth, or SIMPLE IRA.

individually designed plan. An individually designed plan is a retirement plan that has not been pre-approved by the IRS, and is drafted to meet the specific needs of a single employer or multi-employer group.

inherited IRA. Inherited IRAs are IRAs that have been inherited by IRA beneficiaries or that hold retirement plan assets that were rolled over by certain beneficiaries of eligible employer-sponsored retirement plans.

in-service distribution. Profit sharing plans may allow a plan participant to take a distribution, referred to as an “in-service distribution,” from the plan before the participant incurs a permissible triggering event.

Internal Revenue Code (IRC). The Internal Revenue Code of 1986, as amended, contains the statutes relating to federal tax law.

Internal Revenue Service (IRS). The IRS is an agency of the Department of Treasury that is headed by the Commissioner of Internal Revenue. The IRS interprets and enforces the tax laws.

involuntary cashout. See “mandatory distributions” in this Glossary.

IR annuity. See “individual retirement annuity” in this Glossary.
IRA. See “individual retirement arrangement” in this Glossary.

IRA disclosure statement. When an individual establishes an IRA, the financial organization must provide a disclosure statement that explains in nontechnical language the rules that govern the IRA.

IRC. See “Internal Revenue Code” in this Glossary.

issuer. An issuer is an insurance company that offers individual retirement annuity contracts.

Keogh plan. An owner-only retirement plan (sometimes with spouse) is sometimes called a “Keogh plan,” named after the late Congressman Eugene Keogh who in the 1960s spearheaded pension plan legislation that created the owner-only retirement plan concept.

key employee. An individual who meets any of the criteria listed in IRC Sec. 416 is a key employee. If the benefits allocated to the key employees of a qualified retirement or SEP plan exceed the allowable limits, the plan is deemed to be top-heavy.

leased employee. For plan eligibility purposes, an individual who provides services to an employer under an agreement between the employer and a leasing organization is a leased employee if the individual performs services on a full-time basis for a period of at least one year.

life expectancy. Generally, life expectancy is the number of years an individual is expected to live based on her current age. Life expectancy is most commonly used to determine the amount an individual must take as a required minimum distribution from an IRA or retirement plan.

MAGI. See “modified adjusted gross income” in this Glossary.

mandatory distribution. A mandatory distribution is a total distribution of a qualified retirement or 403(b) plan participant’s vested balance. A plan may require a mandatory distribution if a participant separates from service with a vested plan balance of $5,000 or less.

master plan. A master plan is a prototype plan document that requires all employers using the plan document to place their plan contributions in the same trust.
**matching contributions.** Matching contributions are employer contributions made to a 401(k), SIMPLE IRA, SIMPLE 401(k) plan, or 403(b) plan. Employers generally make matching contributions in relation to employee salary deferrals and employee after-tax contributions, based on the terms of the plan.

**MDIB.** See “minimum distribution incidental benefit” in this Glossary.

**minimum coverage test.** The minimum coverage tests are tests defined under IRC Sec. 410(b) that generally require that highly compensated employees (HCEs) do not receive benefit coverage that is disproportionately better than that available to non-HCEs.

**minimum distribution incidental benefit (MDIB).** Minimum distributions that are paid in the form of a life (or joint and survivor) annuity to beneficiaries of retirement plans and IR annuities are referred to as “minimum distribution incidental death benefits.”

**modified adjusted gross income (MAGI).** For purposes of IRA contribution deductions, MAGI is adjusted gross income as shown on an IRA owner’s income tax return without taking into account certain deductions and exclusions.

**money purchase pension plan.** A money purchase pension plan is a defined contribution plan with mandatory annual contributions at a set percentage, which may range from zero percent to 25 percent of compensation as chosen by the employer in the plan.

**multiemployer plan.** A multiemployer retirement plan is a collectively bargained plan that is maintained by more than one employer.

**multiple employer plan.** A multiple employer plan is either a plan maintained by two or more employers that share common ownership, but that are not part of a controlled group, or employers that share no common ownership, but participate in the same plan.

**mutual funds.** Mutual funds are groups or “pools” of stock in different companies or different industries.
National Credit Union Administration (NCUA). The NCUA insures deposit accounts (e.g., share drafts and certificates) and other interest bearing deposit-type investments, for customers of insured credit unions.

NCUA. See “National Credit Union Administration” in this Glossary.

nondeductible contribution. A Traditional IRA contribution for which an IRA owner does not claim an income tax deduction is a nondeductible contribution.

nondeductible employee contribution. Some 401(k) plans and 403(b) plans allow participants to make contributions to the plan on an after-tax or nondeductible basis. The contributions are called “nondeductible employee contributions,” and are subject to the actual contribution percentage (ACP) test.

nondiscrimination test. A qualified retirement plan and a 403(b) plan must test for nondiscrimination in three areas: 1) amount of contributions or benefits, 2) availability of benefits, rights, and features, and 3) effect of plan amendments and terminations. Broadly speaking, other required tests (e.g., the ADP test) also are considered nondiscrimination tests.

nonperiodic payment. Traditional, Roth, or SIMPLE IRA distributions that are payable on demand are treated as nonperiodic payments. Distributions from a qualified retirement plan or 403(b) plan that are not periodic payments (defined later) or corrective distributions are nonperiodic payments.

nonqualified distribution. If a distribution from a Roth IRA or a designated Roth account under a 401(k) or 403(b) plan is not a qualified distribution (see “qualified distribution”), any earnings distributed are subject to taxes and a 10 percent early distribution penalty tax (unless the individual meets a penalty tax exception).

nonrecalculation. Nonrecalculation is a method of calculating beneficiary single life expectancy payments. Under this method, a divisor from the IRS Single Life Expectancy Table is used to calculate the payment for the first beneficiary distribution year, and the divisor is reduced by one to calculate each subsequent year’s payment.
nonstandardized plan. A nonstandardized pre-approved qualified retirement plan is written to satisfy various tax qualification requirements and allows an adopting employer more latitude in setting plan eligibility criteria, definitions of compensation, etc., than a standardized plan. Document providers may also permit employers to make minor changes to post-Pension Protection Act (PPA) nonstandardized plan documents.

opinion letter. Under the IRS’ PPA and earlier opinion letter program, the IRS issues this letter to businesses that sponsor PPA master and prototype plans, stating its approval that the plan meets the Internal Revenue Code tax qualification requirements as to the form of the plan. Under a revised opinion letter program, volume submitter plans become part of the opinion letter program post-PPA.

ordering rules. Ordering rules define the order in which Roth IRA asset types are deemed to be withdrawn (contributory basis first, then conversion and rollover basis, then Roth IRA earnings).

orphan plan. The IRS considers a plan to be an orphan, or abandoned, plan if there has been no contribution or distribution activity for 12 consecutive months, the plan sponsor no longer exists, or cannot be located.

outplacement. The practice of outplacing retirement plan or IRA assets by purchasing investments at another insured depository institution, primarily for the purposes of investment diversity and increased insurance coverage, is commonly referred to as “outplacement.”

paired plans. A standardized profit sharing and a standardized money purchase pension plan that are designed to operate together using the same basic plan document.

partial termination. A partial qualified retirement plan termination occurs when a significant percentage of employees participating in a plan no longer are allowed to participate because of a plan amendment or separation from service initiated by the employer. The portion of the plan covering those employees no longer eligible to participate is deemed terminated, and such employees become 100 percent vested in their plan balances.
payer. The payer is the bank, savings and loan association, credit union, brokerage firm, insurance company, or other financial organization that holds IRA or retirement plan assets and is responsible for submitting IRA and retirement plan income tax withholding.

periodic payment. Distributions that must be made in regular installment intervals, such as annuity payments, over a period of more than one full year are periodic. The intervals may be monthly, quarterly, or annually.

permitted disparity. When using the Social Security integration method to allocate employer contributions in qualified retirement, 403(b), or SEP plans, the difference between the excess contribution percentage and the base contribution percentage may not exceed certain established limits called the “permitted disparity.” Permitted disparity also is another term for the Social Security integration method of allocating employer contributions.

plan agreement. A plan agreement is the contract between a financial organization and an IRA owner that describes the IRA’s terms and conditions, such as contribution limits, investment restrictions, distribution requirements, etc.

plan loan offset. A retirement plan loan offset is the amount an employer plan account balance is reduced (or offset) to repay a loan from the plan. The amount of the account balance that is offset against the loan is considered an actual distribution, and is eligible for rollover.

PLR. See “private letter ruling” in this Glossary.

premium. A premium is an annuitant’s contribution to an annuity. For qualified retirement plans, a premium is the amount required to be paid to purchase life insurance as a plan investment.

prior-year contribution. A Roth or Traditional IRA contribution made between January 1 and April 15 of the current year for the prior tax year is called a “prior-year contribution.”

private letter ruling. The IRS issues a private letter ruling (PLR) to address a particular tax situation of a taxpayer. Only the taxpayer requesting the ruling may rely on it.
**pro rata allocation.** Qualified retirement or SEP plans may use a pro rata allocation formula to allocate employer contributions to each eligible participant in the same percentage, based on the individual’s compensation (e.g., each participant receives a contribution that represents five percent of annual W-2 wages).

**profit sharing plan.** A profit sharing plan is a defined contribution plan, typically allowing discretionary employer contributions from zero percent to 25 percent as determined by the employer on an annual basis.

**prohibited transaction.** A prohibited transaction is a transaction between an IRA, qualified retirement plan, or 403(b) plan and a party-in-interest (referred to as a disqualified person in the IRC) that is prohibited under ERISA Sec. 406 (and IRC Sec. 4975).

**prohibited transaction exemption.** The DOL grants prohibited transaction exemptions to allow certain transactions that would otherwise be considered prohibited transactions.

**protected benefit.** A protected benefit is a plan benefit found in Treas. Reg. 1.411(d)-4 that cannot be cut back or eliminated by a discretionary plan amendment.

**prototype.** A prototype is a specially designed IRA, SEP, SIMPLE, or qualified retirement plan document sponsored by an IRS-authorized entity. Prototype document sponsors offer IRS-approved prototype plan documents to employers to adopt.

**QACA.** See “qualified automatic contribution arrangement” in this Glossary.

**QDIA.** See “qualified default investment alternative” in this Glossary.

**QDRO.** See “qualified domestic relations order” in this Glossary.

**QJSA.** See “qualified joint and survivor annuity” in this Glossary.

**QLAC.** See “qualifying longevity annuity contract” in this Glossary.

**QMAC.** See “qualified matching contribution” in this Glossary.

**QNEC.** See “qualified nonelective contribution” in this Glossary.
QOSA. See “qualified optional survivor annuity” in this Glossary.

QP or QRP. See “qualified retirement plan” in this Glossary.

QPSA. See “qualified preretirement survivor annuity” in this Glossary.

qualified automatic contribution arrangement (QACA). A QACA is an automatic enrollment feature of an employer-sponsored retirement plan that meets all of the ACA requirements (see “Automatic contribution arrangements”) as well as other contribution, eligibility, and vesting requirements. A plan that meets the QACA requirements may be exempt from ADP, ACP, and top-heavy testing.

qualified charitable distribution (QCD). A QCD is an amount withdrawn from an IRA by an individual age 70½ or older that is donated directly to a qualified charitable organization. The distributed amount, up to an annual maximum of $100,000, is excluded from the individual’s gross income.

qualified default investment alternative (QDIA). A QDIA is a default investment in a participant-directed individual account plan that must meet certain notice and investment criteria. Selecting a QDIA allows the plan fiduciary to qualify for relief from investment performance liability for selecting plan investments. QDIAs are used for participants who have not selected investments (e.g., participants who are automatically enrolled in their plan).

qualified distribution. A Roth IRA distribution is a qualified distribution if the distribution represents assets that satisfy the five-year waiting period (beginning with the first taxable year for which the Roth IRA owner made a contribution) and one of the following events occurs: attainment of age 59½, disability, first-time homebuyer expenses, or death. Retirement plan designated Roth account qualified distributions are satisfied with the same general requirements, except first-time homebuyer expenses do not apply.
**qualified domestic relations order (QDRO).** A QDRO, created by the Retirement Equity Act of 1984, is a state court domestic relations order that relates to the payment of child support, alimony, or the division of qualified retirement plan or 403(b) plan assets. Such an order must meet certain requirements to be “qualified” and thus permit payment of a participant’s benefit to an alternate payee, including the participant’s spouse, former spouse, or dependent.

**qualified hurricane distribution.** Eligible retirement plan participants and IRA owners who suffered economic loss as a result of Hurricanes Harvey, Irma, and Maria in 2017 could request qualified hurricane distributions during certain periods of time, generally before January 1, 2019.

**qualified joint and survivor annuity (QJSA).** A QJSA provides a lifetime annuity payment to a qualified retirement plan or 403(b) plan participant who separates from service. When the participant dies, periodic payments will continue to a surviving spouse in a percentage determined in the plan agreement.

**qualified matching contribution (QMAC).** QMACs are employer contributions used to cover deficiencies in the 401(k) and 401(m) (i.e., ADP and ACP) nondiscrimination tests. These contributions may be conditioned on an employee’s deferrals, are nonforfeitable, and are subject to stringent withdrawal restrictions.

**qualified nonelective contribution (QNEC).** QNECs are employer contributions used to correct deficiencies in the 401(k) and 401(m) (i.e., ADP and ACP) nondiscrimination tests. These contributions are nonelective (i.e., cannot be conditioned on an employee’s deferrals), are nonforfeitable, and are subject to stringent withdrawal restrictions.

**qualified optional survivor annuity (QOSA).** A QOSA is an annuity 1) for the life of the participant with a survivor annuity for the life of the spouse that is equal to the “applicable percentage” of the annuity amount that is payable during the joint lives of the participant and the spouse, and 2) that is the actuarial equivalent of a single annuity for the life of the participant.
**qualified preretirement survivor annuity (QPSA).** A QPSA is a life annuity paid to a surviving spouse if the qualified retirement plan or 403(b) plan participant dies before plan distributions begin.

**qualified reservist distribution.** Certain qualified reservists, including National Guardsman, called to active duty can take penalty-free distributions from IRAs and from deferrals in IRC Sec. 401(k) plans, 403(b) plans, and certain pre-ERISA plans under Sec. 501(c)(18).

**qualified retirement plan.** A qualified retirement plan is an employee benefit plan that meets the requirements of IRC Sec. 401(a) or 403(a) and thus is eligible for special tax consideration.

**qualified Roth contribution program.** A qualified Roth contribution program is a type of after-tax salary deferral arrangement that can be included in IRC Secs. 401(k), 403(b), and governmental 457(b) plans. It provides plan participants the opportunity to defer some of their wages into the plan as Roth contributions and to withdraw qualified distributions tax free.

**qualified wildfire distributions.** Eligible retirement plan participants and IRA owners whose principal residence was located in the California wildfire disaster area during any portion of the period from October 8, 2017, to December 31, 2017, and who suffered economic loss as a result of the wildfires could request qualified wildfire distributions. To qualify, the distribution must have occurred on or after October 8, 2017, and before January 1, 2019.

**qualifying longevity annuity contract (QLAC).** A QLAC is an annuity contract that provides annuity payments to an account owner beginning at an advanced age and is purchased from an insurance company using assets in a qualified defined contribution plan, tax sheltered 403(b) plan, eligible governmental 457(b) plan, or IRA (other than a Roth IRA).

**ratio percentage test.** The ratio percentage test is one of the methods of testing for minimum coverage under IRC Sec. 410(b) in a qualified retirement plan. The percentage of nonHCEs benefiting under the plan must be equal to or greater than 70 percent of the HCEs benefiting under the plan.
RBD. See “required beginning date” in this Glossary.

REA annuity requirements. The Retirement Equity Act of 1984 (REA) generally requires that distributions to certain qualified retirement plan and 403(b) plan participants and beneficiaries be made in the form of a commercial annuity unless properly waived.

REA safe harbor plans. Certain types of defined contribution plans (e.g., profit sharing plans, 401(k) plans, or 403(b) plans) may be drafted to be exempt from the REA annuity requirements. These plans must meet specified conditions to qualify for this exemption.

recalculation. Recalculation is a method of calculating beneficiary single life expectancy payments in which a new divisor is obtained from the IRS Single Life Expectancy Table each year to calculate the beneficiary payment.

recharacterization. A recharacterization is the movement of current-year contributions, plus the net income attributable (NIA), from one type of IRA to another type of IRA. Recharacterizations allow IRA owners to “undo” their original contribution and to treat the contribution as if it were made to another type of IRA.

remedial amendment period. A remedial amendment period is the time afforded to a plan to complete required plan amendments to retroactively comply with law changes.

required beginning date. For purposes of required minimum distributions, the required beginning date generally is April 1 following the year a Traditional IRA or SIMPLE IRA owner or a qualified retirement plan (QRP) or 403(b) plan participant reaches age 70½. Some exceptions apply.

required minimum distribution. Traditional and SIMPLE IRA owners and retirement plan participants generally must begin taking annual required minimum (RMDs) beginning for the year they turn age 70½. Some retirement plans may allow nonowners to delay beginning RMDs until retirement, and RMDs may begin later for balances that are part of a qualifying longevity annuity contract.
revenue procedure. The IRS issues revenue procedures to explain procedural matters or list the requirements to be followed in various IRS dealings. Revenue procedures also provide guidelines that the IRS uses in handling certain tax matters.

revenue ruling. A revenue ruling is a public IRS ruling that expresses the IRS’ views in specific situations. Individuals in an identical situation as presented in the ruling generally may rely upon these rulings.

revoked IRA. A revoked IRA is an IRA from which an individual has removed the total initial contribution within seven days of opening the IRA, thereby closing the plan.

RMD. See “required minimum distribution” in this Glossary.

rollover. A rollover is a reportable movement of cash or other assets between IRAs, between retirement plans, or between IRAs and retirement plans.

Roth IRA. A Roth IRA is a type of IRA that can receive only nondeductible (i.e., after-tax) contributions. A Roth IRA owner may be entitled to tax and penalty-free distributions, provided certain rules are met.

salary deferral. Certain types of plans (e.g., 401(k), 403(b), SIMPLE, and SAR-SEP plans) allow employees to elect to contribute part of their wages to the retirement plan rather than receiving the amount in cash.

salary reduction SEP (SAR-SEP). A SAR-SEP plan is a SEP plan that allows eligible employees to defer part of their pretax wages into IRAs rather than receiving cash. Effective January 1, 1997, employers may no longer establish new SAR-SEP plans. But SAR-SEP plans established before January 1, 1997, may continue to operate.

SAR-SEP. See “salary reduction SEP” in this Glossary.

caster’s tax credit. The saver’s credit is a nonrefundable income tax credit for contributions made to IRAs and retirement plans. Taxpayers with a limited amount of adjusted gross income may claim this credit.
savings incentive match plan for employees of small employers (SIMPLE). SIMPLE plans are simplified retirement plans for small employers, funded by employee deferrals and employer matching or nonelective contributions. A SIMPLE plan may be a SIMPLE 401(k) or SIMPLE IRA plan.

SDA. See “self-directed IRA” in this Glossary.

self-directed IRA (SDA). An SDA is a Traditional, Roth, or SIMPLE IRA that is opened at a financial organization with trust powers, a state FDIC-insured institution, a federal credit union, or a federally-chartered savings and loan or savings bank where the IRA owner is allowed a wider choice of investments within the IRA. Stocks, bonds, money-market funds, and mutual funds may all be found in a self-directed IRA at the choice of the IRA owner.

SEP. See “simplified employee pension” in this Glossary.

separate line of business (SLOB). These rules provide the criteria that an employer must meet to be eligible to treat various lines of business as qualified separate lines of business for various plan testing purposes.

SIMPLE 401(k) plan. A SIMPLE 401(k) plan is a plan with many 401(k) characteristics that operates under many of the governing rules of IRC Sec. 401(a), but incorporates the contribution, notice, vesting, and exclusive-plan rules of SIMPLE IRA plans.

SIMPLE IRA. A SIMPLE IRA is a special type of IRA to which only SIMPLE IRA plan contributions are made.

SIMPLE IRA plan. A savings incentive match plan for employees of small employers (SIMPLE) IRA plan is a retirement plan for small businesses that includes both employee and employer contributions, but does not include the same administrative burdens required for other retirement plans (e.g., nondiscrimination testing and plan-level reporting).
**SIMPLE IRA summary description.** Trustees of SIMPLE IRA plans must give an annual summary description to employers, who subsequently provide them to their employees. The summary descriptions must include the names and addresses of the employer and trustee, the plan’s eligibility requirements, plan benefits, the time and method of making employee elections, and the procedures and effects of withdrawals.

**simplified employee pension (SEP).** A SEP plan is a pension plan established by a business where contributions are deposited into participants’ Traditional IRAs and are tax-deductible by the employer. Any employer, including a sole proprietor with no employees, can establish a SEP for the benefit of all eligible employees.

**SLOB.** See “separate line of business” in this Glossary.

**SMM.** See “summary of material modifications” in this Glossary.

**Social Security integration.** Social Security integration (also called “permitted disparity”) is a method of allocating employer contributions under a qualified plan, 403(b) plan, or SEP plan based on the premise that employees with salaries above the taxable wage base (TWB) receive a smaller percentage of Social Security benefits. Therefore, additional contributions may be made to a qualified retirement plan for these employees to make up for this deficiency.

**SPD.** See “summary plan description” in this Glossary.

**spousal IRA contribution.** An IRA owner who does not have adequate compensation but whose spouse has adequate compensation may make IRA contributions based on the spouse’s income. This is commonly referred to as a “spousal IRA contribution.”

**standardized plan.** A standardized pre-approved qualified retirement plan is a plan written to satisfy various tax qualification requirements under the Internal Revenue Code and applicable revenue procedures.
substantially equal periodic payment. Substantially equal periodic payments are a series of IRA or qualified retirement plan distributions that are established according to the requirements of IRC Sec. 72(t), Notice 89-25, and Revenue Ruling 2002-62. If all requirements are satisfied, an IRA owner or plan participant who receives substantially equal periodic payments from her plan before reaching age 59½ will not be subject to the 10 percent early distribution penalty tax.

summary of material modifications (SMM). An SMM is a comprehensive, easily understood summary of any material changes made to qualified retirement plan provisions, features, or operations after adoption of the initial plan. Employers must distribute an SMM to all participants and beneficiaries within the time frame established by ERISA.

summary plan description (SPD). An SPD is a comprehensive, easily understood explanation of a retirement plan’s provisions, features, and operations. Employers must provide an SPD to all participants and beneficiaries within the time frame established by ERISA.

target benefit plan. A target benefit plan is a defined contribution plan with several characteristics of a defined benefit plan. Contributions generally are based on such factors as the employee’s age, years of service, and a projected benefit at retirement.

taxable wage base (TWB). The taxable wage base is the base salary amount, as indexed annually by the Social Security Administration, upon which the employer’s and employees’ Social Security obligation is determined.

tax-sheltered annuity (TSA). A TSA is an employer-sponsored retirement plan established under IRC Sec. 403(b). TSAs are available to certain public educational organizations and tax-exempt organizations.

Thrift Savings Plan (TSP). The Thrift Savings Plan is a type of retirement plan sponsored by the federal government. A TSP distribution may be eligible to be rolled over into an IRA or eligible retirement plan.
top-heavy plan. IRC Sec. 416 defines a top-heavy plan as a plan where the aggregate plan account assets of the key employees exceed 60 percent of the aggregate assets in the accounts of all employees.

transfer. For IRA purposes, a transfer is a tax-free, nonreportable movement of assets from one IRA to another, when the IRA owner does not have constructive receipt of the assets. For retirement plans, a transfer is a tax-free movement of assets, generally initiated by the employer, from one qualified retirement plan to another.

transmittal form. A transmittal form is a report summarizing how many forms are being submitted to the IRS. For example, IRS Transmittal Form 1096, Annual Summary and Transmittal of U.S. Information Returns, summarizes how many Forms 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., are being transmitted.

triggering event. A triggering event is an event described within the qualified retirement plan or 403(b) plan documents that generally must occur before a distribution of benefits to participants or beneficiaries may be made from the plan. Triggering events generally include attainment of normal retirement age, death, disability, plan termination, or severance from employment.

trustee. A trustee is a bank or savings and loan association, as defined in IRC Section 408(n), or any person who has the approval of the IRS to act as trustee.

TSA. See “tax-sheltered annuity” in this Glossary.

TSP. See “Thrift Savings Plan” in this Glossary.

TWB. See “taxable wage base” in this Glossary.

UBTI. See “unrelated business taxable income” in this Glossary.

unrelated business taxable income (UBTI). UBTI generally occurs when a plan receives income from 1) a plan-operated business, 2) property acquired or improved by the plan through debt financing, or 3) certain partnerships in which the plan owns an interest.
**vesting.** Vesting is the process by which benefits contributed on behalf of certain employer-sponsored retirement plan participants become nonforfeitable. The vesting percentage determines the amount available for distribution to participants upon termination of employment or any other triggering event.

**volume submitter document.** For PPA and earlier document cycles, volume submitter documents are submitted to the IRS for approval and can be adopted by numerous employers, but plan design restrictions that are normally placed on prototype documents are not applicable for volume submitter documents. For post-PPA document cycles, volume submitter plans become part of the IRS’ opinion letter program, under which nonstandardized plans contain the features of the former volume submitter plans.

**withholding.** IRA and retirement plan distributions generally are subject to withholding, which is a portion of a distribution that a financial organization or an employer withholds and sends directly to the federal, state, or local tax authority as partial payment of that individual’s tax liability for the year.