A Guide to Retirement Plans

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Course # 8152153 - 2 CPE Credits

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Course CPE Information

Course Expiration Date
Per AICPA and NASBA Standards (S9-06), QAS Self-Study courses must include an expiration date that is ***no longer than one year from the date of purchase or enrollment***.

Field of Study
Taxes. Some state boards may count credits under different categories—check with your state board for more information.

Course Level
Overview.

Prerequisites
There are no prerequisites.

Advance Preparation
None.

Course Description
The need for effective retirement planning has never been greater. This course is essential for those who wish to attain a comfortable retirement for themselves and their clients by maximizing tax saving strategies. You'll learn about the advantages and disadvantages of different types of plans, including qualified and nonqualified deferred compensation plans, defined contribution plans, Roth IRAs, and traditional IRAs. Additional covered topics include retirement distributions, tax-free rollovers, and Roth IRA recharacterizations.

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Publication/Revision Date
September 2020

Instructional Design

This Self-Study course is designed to lead you through a learning process using instructional methods that will help you achieve the stated learning objectives. You will be provided with course objectives and presented with comprehensive information and facts demonstrated in exhibits and/or case studies. Review questions will allow you to check your understanding of the material, and a qualified assessment will test your mastery of the course.

Please familiarize yourself with the following instructional features to ensure your success in achieving the learning objectives.

Course CPE Information

The preceding section, “Course CPE Information,” details important information regarding CPE. If you skipped over that section, please go back and review the information now to ensure you are prepared to complete this course successfully.

Table of Contents

The table of contents allows you to quickly navigate to specific sections of the course.

Learning Objectives and Content

Learning objectives clearly define the knowledge, skills, or abilities you will gain by completing the course. Throughout the course content, you will find various instructional methods to help you achieve the learning objectives, such as examples, case studies, charts, diagrams, and explanations. Please pay special attention to these instructional methods, as they will help you achieve the stated learning objectives.

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

Glossary

The glossary defines key terms. Please review the definition of any words you are not familiar with.

Index

The index allows you to quickly locate key terms or concepts as you progress through the instructional material.

Qualified Assessment

Qualified assessments measure (1) the extent to which the learning objectives have been met and (2) that you have gained the knowledge, skills, or abilities clearly defined by the learning objectives for each section of the course. Unless otherwise noted, you are required to earn a minimum score of 70% to pass a course. If you do not pass on your first attempt, please review the learning objectives, instructional materials, and review questions and answers before attempting to retake the qualified assessment to ensure all learning objectives have been successfully completed.

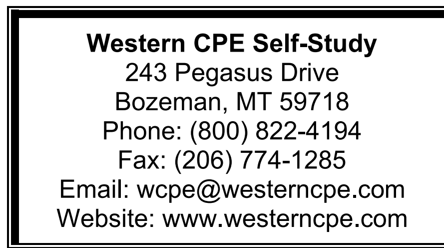
Answer Sheet

Feel free to fill the Answer Sheet out as you go over the course. To enter your answers online, follow these steps:

1. Go to www.westerncpe.com.
2. Log in with your username and password.
3. At the top right side of your screen, hover over "My Account" and click "My CPE."
4. Click on the big orange button that says "View All Courses."
5. Click on the appropriate course title.
6. Click on the blue wording that says "Qualified Assessment."
7. Click on "Attempt assessment now."

Evaluation

Upon successful completion of your online assessment, we ask that you complete an online course evaluation. Your feedback is a vital component in our future course development.



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A Quick Guide to Retirement Plans

Learning Objectives

After completing this course, you will be able to:

- Recognize the difference between qualified and nonqualified deferred compensation plans, noting the major benefits of each, compensation base, advantages and disadvantages of corporate plans, and basic ERISA compliance provisions
- Identify the basic requirements of the three forms of qualified pension plans, noting the characteristics of each form and fundamental differences that require variations in the application of certain rules
- Recognize the types of corporate defined contribution and defined benefit plans, noting their requirements and their effect on retirement benefits
- Specify the rules and requirements for self-employed Keogh plans and individual IRA plans, noting the mechanics of each, contribution rates and limits, participation rules, limitations, and rollover rules
- Note the requirements for Simplified Pension Plans (SEPs) and Savings Incentive Match (SIMPLE) plans, including applicable contribution limits, distribution, and taxation

Deferred Compensation

Qualified deferred compensation plans are the most important form of compensation used to provide retirement and separation from service benefits.

Qualified vs. Nonqualified Plans

A qualified deferred compensation plan is a plan that meets specified requirements in order to obtain special tax treatment. In general, qualified deferred compensation plans must satisfy the following requirements:

(i) Minimum participation standards under §410,

(ii) Nondiscrimination standards (i.e., the plan cannot discriminate in favor of highly compensated employees) under §401(a)(4),

(iii) Minimum vesting standards under §411,

(iv) Minimum funding standards (particularly, for defined benefit plans) under §412, *and*

(v) Specified limits on benefits and contributions under §415.

In addition, reporting and disclosure requirements mandated by the Employee Retirement Security Act of 1974 (ERISA) have to be met.

Major Benefit

For many employees, the retirement plan will be the primary vehicle in their employer-provided benefit program. These plans are expressly approved by the

government and are significant wealth building devices. Historically, the employer considered pension plan benefits a "gift" to the employee. Unfortunately, the current thinking of many employees is that such benefits are a "right."

Current Deduction

Qualified deferred compensation allows the employer to have a tax deduction every time the employer puts money aside for the employee's retirement. "Funding" the retirement plan through the use of a trust or similar arrangement does this.

Timing of Deductions

A contribution to a qualified plan is generally deductible in the employer's taxable year when paid. However, §404(a)(6)[1] provides that an employer is deemed to have made a contribution to the plan as of its year-end, if the contribution is made on account of such year and is made by the due date of its tax return including extensions. A special rule is provided for CODAs.

Compensation Base

As a general rule, qualified plan benefits or contributions may not be based on imputed salary or nonqualified deferred compensation arrangements. Therefore, an employee who draws no current salary may not be included as a participant in a qualified plan. Similarly, shareholder-employees who elect to reduce their current salaries under nonqualified deferred compensation contracts may suffer the disadvantages of reduced contribution limits for qualified plan purposes.

Salary Reduction Amounts

Contributions to a money purchase pension plan, however, may be based on a salary reduction where the reduced amount was used to purchase a tax-deferred annuity for the employee of a tax-exempt employer. The IRS has also ruled that the amount of salary reduction under a §401(k) plan may be counted as compensation for purposes of determining benefits under a defined benefit plan.

Corporate Plans

Advantages

For a small closely held company that can operate in the corporate form, a qualified corporate pension, or profit-sharing plan generally is the best vehicle for deferring income until retirement. The principal advantages fall into two categories—current and deferred.

Current

The current benefits are:

(1) The employer corporation obtains a current deduction for the amounts paid or accruable to the qualified plan (§404(a));

[1] Section 404(h)(1)(B) provides the same treatment for SEPs.

(2) The employee does not recognize income currently on contributions made by his or her employer even though the benefits may be nonforfeitable and fully vested (§402(a) & §403(a));

(3) Employee benefit trust accumulates tax-free (see §501(a).

Deferred

Among the deferred tax advantages are:

(1) Lump-sum distributions from a qualified employee benefit plan are eligible for favorable five (or in some cases still ten) year income averaging treatment (§402(e)); *and*

Note: The Small Business Job Protection Act of 1996 repealed five-year averaging.

(2) Certain distributions may be rolled over tax-free into an IRA.

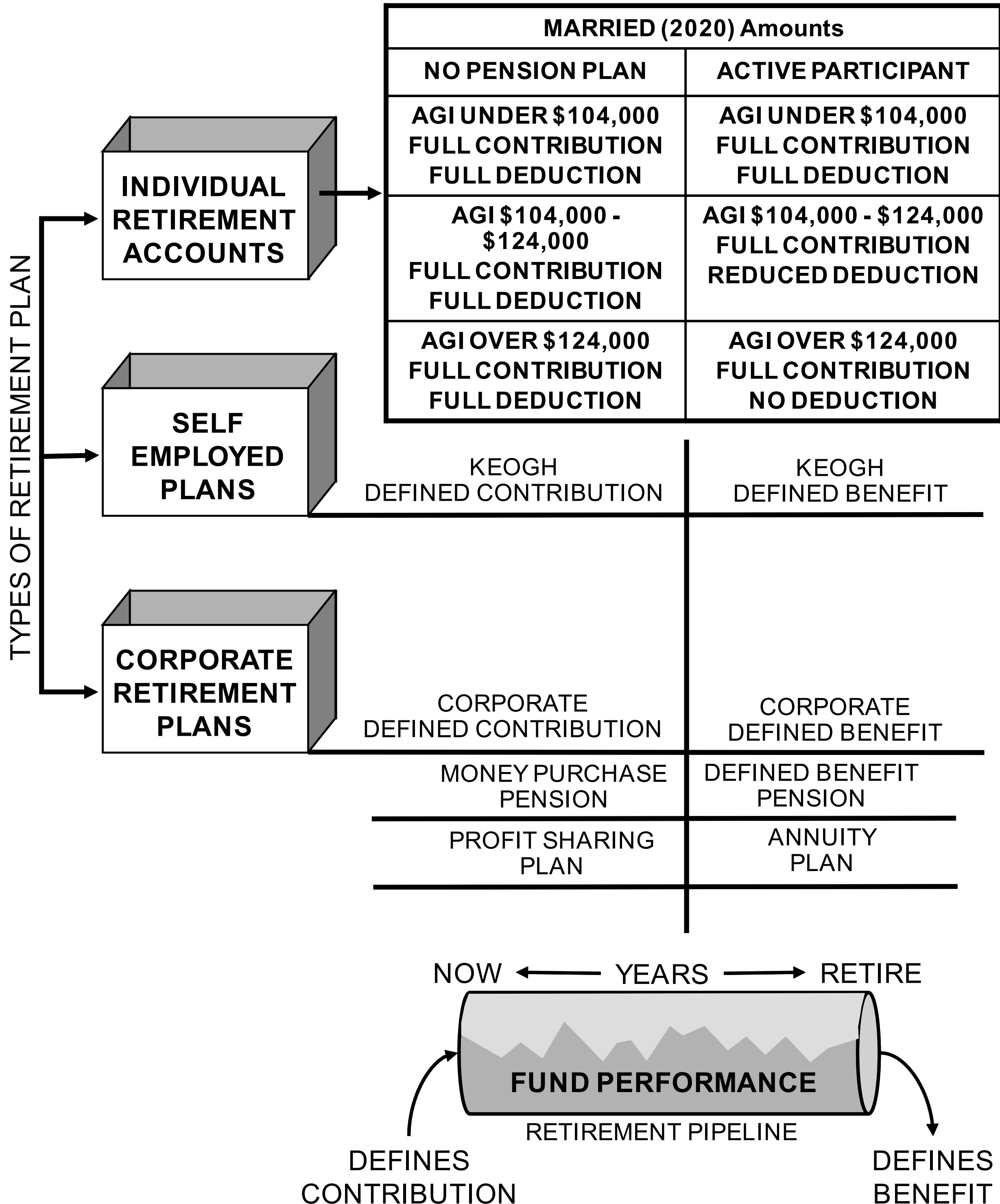
Disadvantages

There are two principal disadvantages of a qualified corporate plan.

Employee Costs

For a closely held corporation, it is often the cost to the shareholder-employee of covering rank and file employees. Generally, the objective of qualified retirement plans of closely held companies is to provide the greatest benefit to the controlling shareholders/executives.

Retirement Plans



Comparison with IRAs & Keoghs

Qualified corporate plans permit substantially larger contributions than an IRA. Formerly, corporate plans also exceeded Keogh plans as well, but effective 1984, such plans are essentially equal in terms of benefits.

As a result of TEFRA (Tax Equity and Fiscal Responsibility Act of 1982) maximum benefits were reduced, the early retirement age was raised, new rules were enacted for corporate and noncorporate plans, and restrictions were established for "top heavy" plans.

Basic ERISA Provisions

ERISA consists of four main sections (Titles):

Title I is primarily concerned with all types of retirement and welfare benefit programs. Health insurance, group insurance, deferred compensation plans, etc. must all be considered from the standpoint of the Department of Labor regulations. Reporting and disclosure requirements are provided for under Title I, which requires that detailed plan summaries be provided to all plan participants and beneficiaries. Similarly, any plan amendments must also be reported to the participants and beneficiaries. All participants must also receive copies of the plan's financial statement from the annual report, as well as an annual statement of accrued and vested benefits.

Title II covers only qualified retirement plans and tax-deferred annuities, primarily from a federal tax standpoint.

Title III involves jurisdiction, administration, enforcement, and the enrollment of actuaries.

Title IV outlines the requirements for plan termination insurance. Because of the complexity and length of these provisions (the DOL it seems, feels obligated to equal or exceed the standards of administrative confusion which have been so competently laid out by the IRS), we will attempt only to cursorily cover some of the provisions commonly affecting qualified plans.

ERISA Reporting Requirements

ERISA imposes a large paperwork burden in connection with any qualified retirement plan. This burden includes preparing reports that must be sent to the IRS, plan participants, plan beneficiaries, the Department of Labor, and the Pension Benefit Guaranty Corporation. When a qualified plan is first installed, the IRS approval of the plan is usually sought.

In addition, the Department of Labor must receive a plan description when the plan is first installed (plus additional reports every time the plan is amended). Most plans must file an annual report that includes financial statements (certified by a Certified Public Accountant), schedules, an actuarial statement (certified by an enrolled actuary), and other information. Participants and

beneficiaries are required to receive a summary plan description and a summary annual plan report from the plan.

Moreover, participants and beneficiaries are entitled to receive, on request, statements concerning certain benefit information.

Fiduciary Responsibilities

The fiduciary responsibilities of plan administration are also detailed by Title I. A federal prudent man investment rule is imposed on fiduciaries and adequate portfolio diversification is normally required. Any person who exercises any discretionary control or authority over the management of a plan, or any authority over the management of the plan's assets is a fiduciary. Therefore, while plan trustees are clearly fiduciaries, other not-so-obvious persons may also be so classified by ERISA and, therefore, be liable for losses if they violate their fiduciary duties. The law defines a "party-in-interest" as an administrator, officer, fiduciary, employer, trustee, custodian and legal counsel, as well as certain other parties.

Bonding Requirement

All fiduciaries, except certain banks, must be bonded. The amount of the bond must not be less than 10% of the amount of funds handled or $1,000, whichever is greater, or generally, not more than $500,000. Plans covering only partners and their spouses, or a sole shareholder, or a sole proprietor and spouse, are not subject to the bonding requirements.

Prohibited Transactions

There are also several prohibited transactions that fiduciaries are forbidden to engage in with party-in-interest. However, the Department of Labor may grant a specific exemption to any of these prohibited transactions based upon disclosure and proof of the benefit to the plan. These prohibited transactions are as follows:

(1) A sale, exchange, or lease of property between the plan and a party-in-interest;

(2) A loan or other extension of credit between the plan and a party-in-interest;

(3) The furnishing of goods, services, or facilities between the plan and a party-in-interest;

(4) A transfer of plan assets to a party-in-interest or a transfer that is for the use and benefit of a party-in-interest; *and*

(5) An acquisition by the plan of employer securities or real estate that is in violation of ERISA §407(a).

Loans

This important exception to the prohibited transaction rules permits qualified plans to make loans to plan participants. Any such loans must be made in accordance with specific provisions in the plan and must provide for a reasonable interest rate and adequate security. Loans must be made available on a nondiscriminatory basis. That is to say, they must be made available to all plan participants on a reasonably equivalent basis.

A loan from a qualified plan to a plan participant or beneficiary is treated as a taxable distribution unless:

(1) The loan must be repaid within five years (except for certain home loans), *and*

(2) The loan does not exceed the lesser of (a) $50,000, or (b) the greater of $10,000 or ½ of the participant's accrued benefit under the plan.

The $50,000 limit for qualified plan loans is reduced where the participant has an outstanding loan balance during the one-year period ending on the day before the date of any new loan (§72(p)(2)(A)(i)). In addition, except as provided in regulations, a plan loan must be amortized in substantially level payments, made not less frequently than quarterly, over the term of the loan (§72(p)(2)(C)).

Formerly, the above exceptions to the prohibited transaction rules did not apply to plan loans to owner-employees.

However, since 2002, the rules relating to plan loans made to owner employees (other than the owner of an IRA) are eliminated. Thus, the general statutory exception applies to such transactions.

Employer Securities

With the exception of profit sharing and pre-ERISA money purchase pension plans, pension plans may not acquire or hold qualifying employer securities or real property in the plan in excess of 10% of the fair market value of all of the plan's assets.

In addition, ERISA imposes restrictions on the investment of retirement plan assets in employer stock or employer real property (ERISA §407). Under these restrictions, a retirement plan may hold only a "qualifying" employer security. Under the Pension Act, in order to satisfy the plan qualification requirements of the Code and the vesting requirements of ERISA certain defined contribution plans are required to provide diversification rights with respect to amounts invested in employer securities.

Such a plan is required to permit applicable individuals to direct that the portion of the individual's account held in employer securities be invested m alternative investments. An applicable individual includes:

(1) any plan participant, *and*

(2) any beneficiary who has an account under the plan with respect to which the beneficiary is entitled to exercise the rights of a participant

Thus, participants must now be allowed to immediately diversify any employee contributions or elective contributions invested in employer securities. For employer contributions, participants must be able to diversify out of employer stock after they have been in the plan for three years.

Excise Penalty Tax

Where a disqualified person participates in a prohibited transaction, an initial nondeductible excise tax equal to 5% of the amount of the transaction is imposed on such person. An additional tax equal to 100% of the transaction amount is imposed if the transaction is not corrected within the correction period that is 90 days from the notice of deficiency, plus any extensions.

PBGC Insurance

Defined benefit pension plans may be subject to the plan termination insurance requirements of the Pension Benefit Guarantee Corporation (PBGC). The basic purpose is to guarantee payment of vested plan benefits at the time of termination of a plan where the plan's assets are insufficient to pay such benefits.

Sixty-Month Requirement

The PBGC guarantees the plan benefits to the extent that a plan has been in existence for 60 months at the time of plan termination. This 60-month requirement allows for a phase-in of 20% per year for plans that have not been in existence for five years. The funds to be accumulated by the PBGC are derived from an annual premium to be paid for each active participant and retiree. Even fully insured plans are required to obtain PBGC coverage.

Recovery against Employer

Where the PBGC is required to pay benefits to participants, it may recover such amounts from the employer up to 30% of the employer's net worth plus additional sums. Although this contingent employer liability may be covered by special risk insurance, the premiums are substantial.

Plans Exempt from PBGC Coverage

Some plans are specifically excluded from the requirement of PBGC insurance coverage. These plans are as follows:

(a) Individual account plans, such as money purchase pension plans, target benefit plans, profit sharing plans, thrift and savings plans, and stock bonus plans;

(b) Governmental plans;

(c) A church plan which is not volunteered for coverage, does not cover the employees of a nonrelated trade or business and is not a multi-employer plan in which one or more of the employers are not churches or a convention or association of churches;

(d) Plans established by fraternal societies or other organizations described in §501(c)(8), (9) or (18) which receive no employer contributions and cover only members (not employees);

(e) A plan that has not, after the date of enactment, provided for employer contributions;

(f) Nonqualified deferred compensation plans established for a select group of management or highly compensated employees;

(g) A plan outside the United States established for nonresident aliens;

(h) A plan that is primarily for a limited group of highly compensated employees where the benefits to be paid, or the contributions to be received, are in excess of the limitations of §415;

(i) A qualified plan established exclusively for substantial owners;

(j) A plan of an international organization that is exempt from tax under the provisions of the International Organizations Immunity Act;

(k) A plan maintained only to comply with worker's compensation, unemployment compensation, or disability insurance laws;

(l) A plan established and maintained by a labor organization described in §501(c)(5) that does not, after the date of enactment, provide for employer contributions;

(m) A plan that is a defined benefit plan to the extent that it is treated as an individual account plan under §3(35)B of the Act; *or*

(n) A plan established and maintained by one or more professional service employers that has, from the date of enactment, not had more than 25 active participants. Once one of these plans has more than 25 active participants, it will remain covered even if the number of active participants subsequently falls back below 25.

Basic Requirements of a Qualified Pension Plan

There are three basic forms of qualified plans: pension plans, profit-sharing plans, and stock bonus plans. The qualification requirements for all of these plans are identical, except that certain fundamental differences in the plans require variations in the application of some rules.

Written Plan

The employer must establish and communicate to its employees a written plan (and, usually, a trust), which is valid under state law (Reg. §1.401(a)(2)).

Communication

A plan must actually be reduced to a formal written document and communicated to employees by the end of the employer's taxable year, in order to be qualified for such year. Under ERISA, a summary plan description must be furnished to participants within 120 days after the plan is established or, if later, 90 days after an employee becomes a participant (DOL Reg. §2520.104b-2(a)). The summary plan description must be written in such a manner that it will be understood by the average plan participant and must be sufficiently comprehensive in its description of the participant's rights and obligations under the plan (DOL Reg. §2520.102-2).

Trust

The assets of a qualified plan must be held in a valid trust created or organized in the United States. As an alternative, a custodial account or an annuity contract issued by an insurance company or a custodial account held by a bank (for a plan which uses IRAs) may be used (ERISA §403(b)). Under §401(f), these custodial accounts and annuity contracts will be treated as a qualified trust, and the person holding the assets of the account or contract will be treated as the trustee thereof.

Requirements

A trust is a matter of state law. In order to be a valid trust, three requirements must be met:

(i) The trust must have a corpus (property);

(ii) The trust must have a trustee; *and*

(iii) The trust must have a beneficiary.

Both the plan and the trust must be written instruments. They may, however, be two separate or one combined instrument.

Exclusive Benefit of Employees

The plan and trust must be for the exclusive benefit of employees and their beneficiaries. A qualified plan cannot be a subterfuge for the distribution of profits to shareholders. Thus, the plan cannot discriminate in favor of certain highly compensated employees.

Highly Compensated Employees

Under §414(q)(1), a "highly compensated employee" is any employee who:

(1) Was a 5% owner (as defined in §416(i)), at any time during the year or the preceding year, *or*

(2) For the preceding year, had compensation from the employer in excess of $80,000 (indexed for inflation), and, if the employer elects this condition, was in the top 20% of employees by compensation for the preceding year (§414(q)).

Participation & Coverage

The plan must cover a required percentage of employees or cover a nondiscriminatory classification of employees. The plan may not discriminate in favor of highly compensated employees.

Section 401(a)(3) requires that a plan meet the minimum participation standards of §410. Section 410 divides these participation standards into two general categories:

(i) Age and service requirements (that is, the rights of an employer to exclude certain employees on account of age or years of service), *and*

(ii) Coverage requirements, which relate to the portion of the employer's total workforce that must participate in the plan.

Age & Service

A qualified plan cannot exclude any employee from participation on account of his or her age or years of service, except for the exclusion of employees who are:

(i) Under age 21, *or*

(ii) Have less than one "year of service."

Note: In the case of a plan that provides for 100 percent vesting after no more than two years of service, it can require a two-year period of service for eligibility to participate.

An employee who has satisfied the minimum age and service requirements of the plan (if any) must actually begin participation (i.e., enter the plan) no later than the earlier of:

(i) The first day of the first plan year beginning after he or she satisfied the requirements; *or*

(ii) Six months after he or she satisfied the requirements (Reg. §1.410(a)-4(b)).

A ***year of service*** is a 12-consecutive- month period (referred to as the computation period) during which the employee has at least 1,000 "hours of service."

Hours of service include:

(i) Hours for which the employee is paid, or entitled to payment, for the performance of duties;

(ii) Hours for which the employee is paid, or entitled to payment, during periods when no duties are performed, such as vacation, illness, disability, maternity or paternity leave; *and*

Note: The plan does not have to credit the employee with more than 501 hours of service for this category.

(iii) Hours for which back pay is awarded or agreed to by the employer.

Coverage

To ensure that lower paid employees have the benefit of a retirement plan, tax law requires qualified plans to provide coverage for them. This is accomplished by *two* sets of requirements. The first set is three tests:

(i) A percentage test,

(ii) A ratio test, *and*

(iii) An average benefits test.

The second set requires a specific minimum number of covered participants.

Percentage Test

Under this test, the plan must "benefit" at least 70% of all the employees who are not highly compensated employees.

Note: This is not the same as the 70% test under pre-TRA '86 law. This test is broader, since it requires that 70% of "all nonhighly compensated employees," rather than "all employees" (which includes both highly and nonhighly compensated employees).

Ratio Test

To satisfy this test, a plan must benefit a percentage of nonhighly compensated employees that is at least 70% of the percentage of highly compensated employees benefiting under the plan.

Example

An employer has two highly compensated employees and 20 nonhighly compensated employees. If the plan covers both of the highly compensated employees (100%), it must cover at least 14 of the nonhighly compensated employees (70% of 100% = 70% required coverage). If the plan covers only one of the highly compensated employees (50%), it must cover at least seven of the nonhighly compensated employees (70% of 50% = 35% required coverage).

Average Benefits Test

A plan will meet the average benefits test if:

(i) The plan meets a nondiscriminatory classification test (using the §414(q) definition of highly compensated employees); *and*

(ii) The average benefit percentage of nonhighly compensated employees, considered as a group, is at least 70% of the average benefit percentage of the highly compensated employees, considered as a group.

The classification test is met for a plan year if the classification system is reasonable and established under objective business criteria that identify the employees who benefit under the plan. This classification must meet a safe and unsafe harbor range that compares the percentage of nonhighly compensated employees to the percentage of highly compensated employees benefiting under the plan.

Numerical Coverage

The second set of requirements was added to the Code to eliminate discrimination in favor of highly compensated employees through the use of multiple plans. Section 401(a)(26) provides that a trust will not be qualified unless it benefits the lesser of:

(i) 50 employees; *or*

(ii) 40% of "all employees."

Thus, each plan must have a minimum number of employees covered, without regard to any designation of another plan.

The additional participation rules of §401(a)(26) only apply to defined benefit plans. A defined benefit plan does not meet the §401(a)(26) rules unless it benefits the *lesser* of:

(i) 50 employees, *or*

(ii) The *greater* of:

(a) 40% of all employees of the employer, *or*

(b) 2 employees (one employee if there is only one employee).

Related Employers

An employer could attempt to circumvent the coverage requirements of §410(b) by operating its business through multiple entities. Because of this potential abuse, certain related employers are treated as a single employer for purposes of the coverage tests. That is, all employees of each entity in the group are used in computing the percentage or classification tests.

The related employers that fall into this classification are:

(i) Trades or businesses under common control (both parent-subsidiary and brother-sister forms),

(ii) Affiliated service groups, *and*

(iii) Leased employee arrangements.

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

1. One of the deferred tax advantages of a corporate retirement plan is that:

   a. The employee benefit trust accumulates tax-free.
   b. Certain distributions may be rolled over tax-free into an IRA.
   c. The employer corporation obtains a deduction for the amounts paid or accruable to the qualified plan.
   d. The employee does not recognize income on contributions made by the employer even though the benefits may be nonforfeitable and fully vested.

2. Your C corporation is growing and you wanted to offer a qualified retirement plan. However, you are concerned as to your potential responsibilities in managing the plan assets. In this case, you would consult:

   a. Title I under Employee Retirement Security Act of 1974.
   b. The Small Business Job Protection Act of 1996.
   c. The Tax Equity and Fiscal Responsibility Act of 1982.
   d. Section 404(a)(6) of the IRC.

3. Which of the following plans is most likely included in Pension Benefit Guarantee Corporation (PBGC) insurance coverage?

   a. A government plan.
   b. A plan established by a fraternal society.
   c. A defined benefit plan.
   d. A qualified plan established exclusively for substantial owners.

Vesting

Vesting refers to the percentage of accrued benefit to which an employee would be entitled if they left employment prior to attaining the normal retirement age under the plan. Vesting represents that portion of the employee's benefit that is nonforfeitable.

Section 401(a)(7) requires a plan to meet the rules under §411, regarding vesting standards. These vesting standards contain three classes of vesting:

(i) Full and immediate vesting;

(ii) Minimum vesting under §411(a)(2); *and*

(iii) Compliance with §401(a)(4) nondiscrimination requirements.

Full & Immediate Vesting

Under §411(a), a participant's normal retirement benefit derived from employer contributions must be nonforfeitable upon the attainment of normal retirement age, regardless of where the employee happens to fall on the plan's vesting schedule at normal retirement age.

Section 411(a)(1) requires that a participant must be fully vested at all times in the accrued benefit derived from the employee's own contributions to the plan. This requirement applies regardless of whether the employee contributions are voluntary or mandatory.

Section 411(d)(3) requires that a qualified plan provide that accrued benefits become nonforfeitable for participants who are affected by a complete or partial termination of, or a discontinuance of contributions to, a plan.

Minimum Vesting

For employer contributions, plans have historically had to meet the requirements of two minimum vesting schedules:

1. Five-Year Cliff Vesting. Under this schedule, participants who have completed five years of service with the employer must receive a 100% nonforfeitable claim to employer-derived benefits. Thus, the schedule is as follows:

Completed Years of Service	Nonforfeitable Percentage
1-4	0%
5	100%

2. Three-to-Seven Year Graded Vesting. This schedule is graded in a similar fashion to the old five-to-15 year graded schedule, except, of course, that it provides a more rapid rate of vesting. The schedule is:

Completed Years of service	Nonforfeitable Percentage
1-2	0%
3	20%
4	40%
5	60%
6	80%
7	100%

Note: The general rules for counting years of service for vesting are similar to those for participation. However, three important differences exist. First, all years of service after the attainment of age 18 (rather than age 21) must be counted. Years of service before age 18 may be disregarded. Second, contributory plans (those with mandatory employee contributions) may disregard any years of service in which an employee failed to make a contribution. Finally, years of service during which the employer did not maintain the plan or a predecessor plan may be disregarded.

In the case of matching contributions (as defined in §401(m)(4)(A)), plans had to meet the requirements up to minimum vesting schedules:

1. Three-Year Cliff Vesting. Under this schedule, participants who have completed three years of service with the employer must receive a 100% nonforfeitable claim to employer-derived benefits.

2. Two-to-Six Year Graded Vesting. This schedule is graded in a similar fashion to the old five-to-15 year graded schedule, except, of course, that it provides a more rapid rate of vesting. The schedule is:

Completed Years of Service	Nonforfeitable Percentage
2	20%
3	40%
4	60%
5	80%
6	100%

However, the expedited vesting schedule that applied to employer matching contributions was extended to all employer contributions to defined contribution plans by the Pension Protection Act of 2006 (§411(a)(2)).

As a result, for plan years after 2006, a defined contribution plan (e.g., profit-sharing and §401(k) plans) must vest all employer contributions according to the schedule that, before 2007, applied only to employer matching contributions. For example, if a defined contribution plan used cliff vesting, accrued benefits derived from all employer contributions must now vest with the participant after three years of service. Likewise, if a defined contribution plan used graduated vesting, all employer contributions must now vest with the participant at the rate of 20% per year, beginning with the second year of service.

Nondiscrimination Compliance

Even if a plan adopts one of the statutory vesting schedules, it may still discriminate in favor of highly compensated employees in practice. If the IRS determines either that there has been a "pattern of abuse" under the plan or that there is reason to believe that there will be an accrual of benefits or forfeitures tending to discriminate in favor of highly compensated employees, it can require a more accelerated vesting schedule under §411(d)(1).

Contribution & Benefit Limits

Section 401(a)(16) requires a plan to comply with §415 limitations for contributions and benefits. These limitations set the maximum amounts that the employer may provide under the plan. A plan must include provisions to ensure that these limitations are never exceeded for any participant; otherwise, the entire plan will become disqualified for the year.

The limitations imposed on both defined contribution and defined benefit plans are based on the participant's compensation. However, there is a maximum dollar amount of compensation that may be considered. Initially set at $200,000, it was decreased by OBRA '93 to $150,000. In 2020, it is set to $285,000.

Defined Benefit Plans (Annual Benefits Limitation) - §415

A defined benefit plan may not provide "annual benefits" in excess of the lesser of:

(i) A dollar limit of $160,000 (subject to COLAS) ((§415(b)(1)(A)); *or*

(ii) 100% of the participant's average annual compensation for the three consecutive years in which their compensation was the highest (§415(b)(1)(B)).

The $160,000 limit is subject to cost of living adjustments. In 2020 plan years, this amount is $230,000.

The annual benefit means a benefit payable annually at the participant's social security retirement age in the form of a straight-life annuity, with no ancillary

benefits, under a plan to which employees do not contribute and under which the employee makes no rollover contributions.

Note: Employee contributions, whether mandatory or voluntary, are considered to be a separate defined contribution plan to which the limitations thereon apply.

Defined Contribution Plans (Annual Addition Limitation) - §415

A defined contribution plan's "annual additions" to a participant's account for any limitation year may not exceed the lesser of:

(i) $57,000 in 2020 (or, if greater, one-fourth of the defined benefit dollar limitation) (§415(c)(1)(A)).; *or*

(ii) 100% of the participant's compensation (§415(c)(1)(B)).

Annual additions include employer contributions, including contributions made at the election of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee (§415(c)(2)).

Limits on Deductible Contributions - §404

To be deductible, a contribution to a qualified plan must be an ordinary and necessary expense of carrying on a trade, business or other activity engaged in for the production of income. In addition, a contribution may not be deducted unless it is actually paid into the plan.

1. Defined contribution plans: For profit-sharing, stock bonus, simplified employee pension, and money purchase pension plans, deductible contributions are limited to 25% of the compensation otherwise paid or accrued during the taxable year to plan beneficiaries (§404(a)(3)(A)).

2. Defined benefit plans: An employer is permitted to use either one of two methods for determining the minimum deductible annual contribution to a defined benefit pension plan:

a. The level funding method (§404(a)(1)(A)(ii)), *or*

b. The normal cost method (§404(a)(1)(A)(iii)).

Note: However, if the annual contribution necessary to satisfy the minimum funding standard provided by §412(a) is greater than the amount determined under either of the above two, the limit may be increased to that amount.

As to the maximum deductible annual contribution (subject to a special rule for plans with more than 100 participants), the employer may not deduct an amount that exceeds the full funding limitation determined under the minimum funding rules (§412).

3. Combination plans: Where any employee is the beneficiary under both a defined benefit and a defined contribution plan of the employer, deductible

contributions are limited to 25% of the compensation otherwise paid or accrued during the taxable year to plan beneficiaries (§404(a)(9)).

Basic Types of Corporate Plans

Under ERISA, qualified corporate retirement plans are one of two basic types:

(1) Defined contribution plans, *or*

(2) Defined benefit plans.

Although defined benefit plans offer several advantages, defined contribution plans are frequently better to start with and are generally more practical for the small corporation.

Defined Benefit

Mechanics

Generally, a defined benefit plan attempts to specify benefit levels for employees. Once benefit levels are established, contributions are determined based upon actuarial calculations.

The employer bears the risk of the investment program used by the employee benefit trust that administers the plan's assets. If that program causes the plan assets to fall below the amount actuarially necessary to pay the defined benefits then the employer must make additional contributions.

Although contributions may vary based on the investment program, such plans are a fixed obligation of the corporation and contributions must be made annually to the plan regardless of the company's profits.

Defined Benefit Pension

The primary form of the defined benefit plan is the defined benefit pension plan. A defined benefit pension plan must provide for the payment of definitely determinable benefits to the employees over a period of years after retirement. In short, it guarantees a monthly income for a participant at retirement age. Benefits are measured by years of service with the employer, years of participation in the plan, percent of average compensation, or a combination thereof. In addition, most defined benefit pension plans pay Pension Benefit Guaranty Corporation premiums to ensure that participant's guaranteed benefits will always be paid at retirement.

Defined Contribution

Mechanics

In defined contribution plans, an individual account is established for each employee. The total vested amount of each employee's account at termination or retirement will be the amount available to provide each covered employee with a benefit. The employer defines or fixes the annual cost rather than defining the

benefit it wants to have its employees to receive. Contributions to the employee's account are based on a formula that is usually expressed as a percentage of the employee's salary.

Discretion

Contributions need not be mandatory as exampled by profit sharing plans that are in this category. Considerable discretion by the board of directors is permitted without jeopardizing the qualification of the plan. (Reg. §1.401-1(b)(1)(ii)). The key is that there is no exact benefit. The procedure is not one of defining benefits and then determining the contributions necessary to fund it. Benefits are the result of the contributions made to the plan and the investment performance (or lack thereof) of the employee benefits trust that administers the plan's assets. As a result, the participant/employee bears the risk of the investment program and benefits are directly dependent upon it.

Types of Defined Contribution Plans

There is a variety of defined contribution plans:

Profit Sharing

A profit sharing plan is a defined contribution plan under which the plan may provide, or the employer may determine, annually, how much will be contributed to the plan out of profits or otherwise. As a result profit sharing plans cannot provide determinable benefits. However, distributions can occur prior to retirement.

Requirements for a Qualified Profit Sharing Plan

A profit sharing plan is a vehicle through which an employer may share some of his or her profits[2] with his or her employees. We will discuss profit sharing plans of the deferred type only (i.e., payment is to be made to the participant in a future taxable year). Since each participant is credited with a share of the allocated profits and the gains or losses thereon, ultimate benefits are unknown. In this respect, profit sharing plans are similar to money purchase pension plans and are generally more suitable where the employees (or shareholder-employees) are under age 45.

Eligibility

The eligibility requirements for profit sharing plans are generally more liberal than those of pension plans. A maximum age provision is not permissible, however; this poses no great cost problem since actuarial funding is not required.

In addition, since employer contributions are not required to be made out of current or accumulated profits or earnings, these plans may be

[2] TRA 86 provides that a contribution to a qualified profit sharing plan does not require that the employer have current or accumulated earnings or profits.

established by private, nonprofit organizations and presumably, by local governments as well.

Deductible Contribution Limit

Since 2002, the maximum annual deduction is 25% of the aggregate gross compensation of all plan participants. Contribution and some credit carry-overs are also permitted.

Substantial & Recurrent Rule

Keep in mind the "substantial and recurrent" rule. Generally, the IRS will expect a contribution of some sort to be made if there are profits. However, a contribution need not be made in every plan year. If contributions are not made on a fairly consistent basis, the IRS may claim that the plan has been discontinued and require full vesting to the participants.

Money Purchase Pension

A money purchase plan is a pension plan but, nevertheless, it is categorized as a defined contribution plan. The employer contributes a fixed amount each year based upon a percentage of each employee's compensation. The employee's benefits are the amount of total contributions to the plan plus (or minus) investment gains (or losses).

Profit Sharing & Money Purchase Pension Plans	
Planholder	Corporations S corporations Nonprofit organizations Partnerships Sole proprietorships (i.e., self-employed)
Eligibility **Requirements**	**The employer must include employees who have:**
	Reached age 21 Completed 2 years of service if 100% vesting is elected or completed 1 year of service if a vesting schedule is elected
	The plan must also meet certain coverage and participant requirements.
Contribution Limits	**Profit Sharing**: Maximum *deductible* amount is 25% of total eligible participant compensation. Employer contributions are discretionary and can be based on, but are not limited to profits. **Money Purchase:** Maximum *deductible* amount is 25% of total eligible participant compensation. Employer must contribute a predetermined percentage each year. Contributions are mandatory regardless of profits. **Combination Plans:** Combined Money Purchase Pension and Profit Sharing Plans are subject to a single maximum *deductible*

	limit of 25% of compensation. **Annual Additions Maximum:** Annual additions to any participant's account may not exceed 100% of compensation, or $57,000 (in 2020), if less. Minimum Employer Contribution may be required if plan primarily benefits key employees.
Deadlines For Establishment & Contributions	**Establishment:** On or before the last day of the employer's fiscal year, for the year in which the deduction is taken. **Funding:** On or before the date the employer's federal income tax return is due, plus extensions. **Pension Plans:** Must be funded no later than 8½ months after the plan year-end, even if the deadline for deduction purposes is later. **Filings:** Each year there are assets in the plan, a 5500 series tax form should be filed with the IRS no later than the last day of the 7th month following the plan year end (except for certain "one participant" plans with $250,000 or less in assets).
Distributions	**Earliest (without 10% tax penalty):**
	Death Permanent disability Attainment of age 59½ Distribution to pay for deductible medical expenses Separation from service and age 55 Plan termination and age 59½ Separation from service and periodic payments based on a life expectancy formula that cannot be modified for at least 5 years or until attainment of age 59½, if later Payments made to an alternate payee because of a divorce settlement as required by a Qualified Domestic Relations Order Profit Sharing Plans Only (if plan permits): In-service withdrawal and age 59½. Hardship withdrawal and age 59½
	Latest (without 50% excise tax penalty):
	April 1 of the calendar year following the year in which the participant reaches age 72.
Tax Treatment on Distribution	Taxed as ordinary income. Distributions from an account containing nondeductible voluntary contributions must consist of a nontaxable portion and a taxable portion. **Lump-Sum Distributions:** Individuals who were age 50 on 1/1/86 can elect 10-year or 5-year averaging with limited capital gain treatment. Thus, averaging is not realistically available unless the individual was born before 1935.

Cafeteria Compensation Plan

Under a "cafeteria" or "flexible benefit plan" an employee can select from a package of employer provided benefits, some of which may be taxable and

others not taxable. Employer contributions under a written plan are normally excluded from the employee's gross income to the extent that nontaxable benefits are selected (§125(b)).

Section 401(k) Plans

This is an arrangement whereby an employee will not be taxed currently for amounts contributed by an employer to an employee trust, even though the employee could have elected under the plan to receive the contribution in cash. Section 401(k) has several requirements:

(1) It must be a qualified profit-sharing or stock bonus plan;

(2) Each employee can elect to receive cash or to have an employer contribution made to the employee trust;

(3) Benefits are not distributable to an employee earlier than age 59½, termination of service, death, disability, or hardship;

(4) Each employee's accrued benefit under the plan is fully vested; *and*

(5) There is no discrimination in favor of highly paid employees.

Section 401(k) Plans	
Planholder	Corporations S corporation Partnerships Sole proprietorships (i.e., self-employed)
Eligibility Requirements	**Employees who meet age & service requirements.** **The employer must include employees who have:**

	Reached age 21 Completed 2 years of service if 100% vesting is elected or completed 1 year of service if a vesting schedule is elected
	The plan must also meet certain coverage and participant requirements. Employees who have completed 1 year of service must be eligible to make salary deferral contributions.
Contribution Limits	**Maximum Deductible Amount:** Maximum *deductible* amount is 25% of total eligible participant compensation. This amount includes employer basic, employer match and salary deferral. Employer contributions are discretionary and can be based on, but not limited to, profits. **Maximum Salary Deferral Amount:** Not to exceed $19,500 (in 2020) and is included in the maximum contribution limit. Subject to a special anti-discrimination test. **Nondeductible Voluntary Contributions** are included in the maximum contribution limit. Subject to a special anti-discrimination test. **Combination Plans:** Combined Money Purchase Pension and 401(k) Plans are subject to a single maximum deductible limit of 25% of compensation. **Annual Additions Maximum:** Annual additions to any participant's account may not exceed 100% of compensation, or $57,000 (in 2020), if less. Minimum Employer Contribution may be required if plan primarily benefits key employees.

Deadlines For Establishment & Contributions	**Establishment:** On or before the last day of the employer's fiscal year, for the year in which the deduction is taken. **Funding:** On or before the date the employer's federal income tax return is due, plus extensions. **Filings:** Each year there are assets in the plan, a 5500 series tax form should be filed with the IRS no later than the last day of the 7th month following the plan year end (except for certain "one participant" plans with $250,000 or less in assets).
Distributions	**Earliest (without 10% tax penalty):**
	Death Permanent disability Distribution to pay for deductible medical expenses Separation from service and age 55 Plan termination and age 59½ Separation from service and periodic payments based on a life expectancy formula that cannot be modified for at least 5 years or until attainment of age 59½, if later Payments made to an alternate payee because of a divorce settlement as required by a Qualified Domestic Relations Order In-service withdrawal and age 59½ Hardship withdrawal and age 59½
	Latest (without 50% excise tax penalty):
	April 1 of the calendar year following the year in which the participant reaches age 72.
Tax Treatment on Distribution	Taxed as ordinary income. Distributions from an account containing non-deductible voluntary contributions must consist of a non-taxable portion and a taxable portion. **Lump-Sum Distributions:** Individuals who were age 50 on 1/1/86 can elect 10-year or 5-year averaging with limited capital gain treatment. Thus, averaging is not realistically available unless the individual was born before 1935.

Employee Contributions

Sometimes an employer establishes a plan that requires employees to contribute as a condition of participation. Under pension plans, employees may be required to contribute in order to reduce the employer's cost. Profit sharing thrift plans require employees to contribute in order to receive the benefit of a matching employer contribution.

Nondeductible

In either case, the employee's contribution is not deductible. An important note is that if employee contributions are required, the plan is still not permitted to be discriminatory.

Employees may also be permitted to make voluntary contributions to the plan that are, of course, also not deductible.

Specific nondiscrimination rules apply to employers making matching contributions. These nondiscrimination rules are essentially the same as for §401(k) plans.

Plan Terminations & Corporate Liquidations

A qualified plan must be intended as permanent. If a plan is terminated within a few years of its inception for other than a valid business reason, the plan may be subject to retroactive disqualification with the resultant loss of all corporate deductions. For this reason, if a plan termination is contemplated, a favorable determination should be applied for and received from the IRS *prior* to any such termination. This permanency requirement does not impede the employer's customarily retained right to unilaterally terminate the plan or cease contributions. The termination of a plan requires that all participants be fully vested in their accrued benefits or account balances. ERISA may require specific allocations to be made upon the termination of a defined benefit plan.

Self-Employed Plans - Keogh

Although qualified plans for unincorporated businesses are now virtually equal with corporate plans, there are still sufficient differences to warrant a brief discussion of them separately from all other plans. While the federal tax consequences will undoubtedly be a consideration in the decision to incorporate, it is unlikely that the availability of a corporate retirement plan will weigh considerably as one of the considerations.

Contribution Timing

Cash basis self-employeds are now afforded the advantages of accrual basis taxpayers for purposes of making their contributions to Keogh plans. That is, a contribution may be made any time prior to the due date of the return, rather than by the close of the taxable year. This is undoubtedly of considerable benefit to those taxpayers who have set-up Keogh profit sharing plans. Prior to this change, it was virtually impossible to determine the allowable amount of the contribution by the close of the tax year since a self-employed individual does not generally know how much they will earn during a taxable year until the year is over.

However, the Keogh plan itself, as well as any related trust instruments, must be established prior to the close of the taxable year for which the first contributions are to be made.

Controlled Business

Where an owner-employee controls (either as a sole proprietor or as a more than 50% partner), one unincorporated business and participates as an owner-employee in the Keogh plan of another unincorporated business, whether or not he or she controls the second business, he or she must establish a plan for the regular employees of the business that they control with benefits or contributions similar to those which they are receiving. Therefore, if a 10% or less partner participates in a Keogh plan, they do not need to establish a similar plan for the sole proprietorship that they own.

If the individual in question controls more than one business, they must treat the controlled businesses as one for purposes of figuring the maximum contribution that they can make for themselves. An owner-employee's maximum contribution limits cannot be exceeded even though they participate in more than one plan. That is to say, participation in two plans does not double the allowable deduction.

General Limitations

Under the provisions of ERISA, all businesses that are under common control, including incorporated businesses, unincorporated businesses, estates and trusts, must be aggregated for purposes of the limitations on benefits, contributions, participation, and vesting. The regulations to §414(b) and (c) state that the percentage to be applied to determine if there is common control are 80% in the case of parent-subsidiary controlled groups and the 80% and more than 50% tests for brother-sister controlled groups.

As a result of ERISA, corporate and noncorporate employees are generally taxed alike on their distributions. An owner-employee's cost basis does not include any taxable or nondeductible term cost charges when a Keogh plan has been funded with life insurance.

The beneficiary of a deceased self-employed person or owner- employee will generally be taxed in the same manner as the deceased would have been taxed. When life insurance proceeds are paid as a death benefit, the excess of the proceeds over the policy's cash value will be tax-free.

Mechanics

Under a Keogh plan, a self-employed[3] individual (this term includes a sole proprietor and partners owning 10% or more of an interest in a partnership) is allowed to take a deduction for money he or she sets aside to provide for retirement. Such a plan is also a means of providing retirement security for the employees working for the self-employed individual.

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[3] Partners, but not owner/employees of an S corporation are considered self-employed.

Figuring Retirement Plan Deductions for Self-Employed

When figuring the deduction for contributions made to a self-employed retirement plan, compensation is net earnings from self-employment after subtracting:

(i) The deduction allowed for one-half of the self-employment tax, *and*

(ii) The deduction for contributions on behalf of the self-employed taxpayer to the plan.

This adjustment to net earnings in (ii) above is made indirectly by using a self-employed person's rate.

Self-Employed Rate

If the plan's contribution rate is a whole number (e.g., 12% rather than 12.5%), taxpayers can use the following table to find the rate that applies to them.

Self-Employed Rate Table

Plan's Rate	Self-Employed's Rate
1	.009901
2	.019608
3	.029126
4	.038462
5	.047619
6	.056604
7	.065421
8	.074074
9	.082569
10	.090909
11	.099099
12	.107143
13	.115044
14	.122807
15	.130435
16	.137931
17	.145299
18	.152542
19	.159664
20	.166667
21	.173554
22	.180328
23	.186992

24	.193548
25	.200000

If the plan's contribution rate is not a whole number (e.g., 10.5%), the taxpayer must calculate their self-employed rate using the following worksheet

Self-Employed Rate Worksheet

1. Plan contributions rate as a decimal (for example, 10% would be 0.10) $_________

2. Rate in Line 1 plus 1, as a decimal (for example, 0.10 plus 1 would be 1.10) $_________

3. Divide Line 1 by Line 2, this is the taxpayer's self-employed rate as a decimal $_________

Determining the Deduction

Once the self-employed rate is determined, taxpayers figure their deduction for contributions on their behalf by completing the following steps:

Step 1

Enter the self-employed rate from the Table or Worksheet above _________

Step 2

Enter the amount of net earnings from Line 29, Schedule C or Line 36, Schedule F $_________

Step 3

Enter the deduction for self-employment tax from Line 25, Form 1040 $_________

Step 4

Subtract Step 3 from Step 2 and enter the amount $_________

Step 5

Multiply Step 4 by Step 1 and enter the amount $_________

Step 6

Multiply $285,000 (in 2020) by the plan Contribution rate. Enter the result but not more than $57,000 (in 2020) $_________

Step 7

Enter the smaller of Step 5 or Step 6. This is the deductible contribution. Enter this amount on Line 27, Form 1040 $_________

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

4. In order to ensure compliance with the qualified plan requirements of §411(d)(3), an employer would need to see to it that:

   a. Accrued benefits to an employees' plan is not forfeited even if you stop make contributions to the plan.
   b. Their employees are entitled to make voluntary contributions and that only such contributions are fully vested.
   c. Their employees do not forfeit employer contributions to their plans upon reaching retirement age.
   d. Their company's retirement benefit plan does not favor the highest paid employees.

5. Suppose an employer, with a defined benefit plan, exceeded §415 contribution limitations for a key employee. What would be the most likely consequence for exceeding this limitation?

   a. Disqualification of the entire plan for the year.
   b. Reduction of contribution limits for the succeeding year.
   c. All employer contributions will revert to the employer.
   d. Disqualification of the plan for the plan participant in question.

Individual Plans - IRAs

The government wants to encourage everyone to save for retirement. Savings for this purpose also contributes to the formation of investment capital needed for economic growth. For many individuals, including those covered by corporate retirement plans, IRAs play an important role.

Mechanics

Any individual whether or not presently participating in a qualified retirement plan can set up an individual retirement plan (IRA) and take a deduction from gross income equal to the lesser of $6,000 (in 2020) or 100% of compensation.

Individuals age 50 and older may make additional catch-up IRA contributions. The maximum contribution limit (before application of adjusted gross income phase-out limits) for an individual who has celebrated his or her 50th birthday before the end of the tax year is increased by $500 for 2002 through 2005, and $1,000 for 2006 and later.

> **Note:** One way in which taxation of a lump sum distribution may be postponed is by transferring it within 60 days of receipt of payment into an IRA. This postpones the tax until the funds are withdrawn.

Phase-out

The taxpayer and spouse must be nonactive participants to obtain the full benefits of an IRA. If either is an active participant in another qualified plan, the deduction limitation is phased out proportionately between $104,000 and $124,000 of AGI in 2020. For single and head of household taxpayers the phase out is between $65,000 and $75,000 in 2017 (up from $64,000 and $74,000 of AGI in 2019).

Special Spousal Participation Rule - §219(g)(1)

Deductible contributions are permitted for spouses of individuals who are in an employer-sponsored retirement plan. However, the deduction is phased out for taxpayers with AGI between $196,000 and $206,000 in 2020.

<table>
<tr><th colspan="4">Individual Retirement Accounts</th></tr>
<tr><td>Planholder</td><td colspan="3">Individual taxpayer and nonworking spouse</td></tr>
<tr><td>Eligibility Requirements</td><td colspan="3">Prior to 2020, individuals under 70½ years old who have earned income. For 2020 and later, the age limit is repealed</td></tr>
<tr><td rowspan="17">Contribution Limits</td><td colspan="3">Maximum Contribution Limit:</td></tr>
<tr><td colspan="3">In 2017, $5,5002020, $6,000 per working individual
$1112,000 per married couple with a working & a non-working spouse</td></tr>
<tr><td colspan="3">Tax-Deductible Contributions - Who Qualifies:</td></tr>
<tr><td colspan="3">If neither individual nor spouse is covered by an employer-sponsored retirement plan, 100% is deductible at any income level.
If individual or spouse is covered by an employer-sponsored plan in 2020:</td></tr>
<tr><th>Adjusted Gross Income</th><th colspan="2">Contribution</th></tr>
<tr><th>Married</th><th>Tax-Deferred</th><th>Deductibility</th></tr>
<tr><td>Below $104,000</td><td>Yes</td><td>Full</td></tr>
<tr><td>$104,000 - $124,000</td><td>Yes</td><td>Partial*</td></tr>
<tr><td>Over $124,000</td><td>Yes</td><td>No</td></tr>
<tr><th>Single</th><th>Tax-Deferred</th><th>Deductibility</th></tr>
<tr><td>Below $65,000</td><td>Yes</td><td>Full</td></tr>
<tr><td>$65,000 - $75,000</td><td>Yes</td><td>Partial*</td></tr>
<tr><td>Over $75,000</td><td>Yes</td><td>No</td></tr>
<tr><td colspan="3">* Subtract $200 of deductibility for each $1,000 of income over the floor amount (round to lowest $10); $200 minimum.</td></tr>
<tr style="display:none"></tr>
<tr style="display:none"></tr>
<tr style="display:none"></tr>
<tr><td rowspan="3">Deadlines For Establishment & Contributions</td><td colspan="3">On or before tax filing deadline, not including extensions (usually April 15 or the next business day if April 15 falls on a holiday or weekend).</td></tr>
<tr><td colspan="3">Penalties:</td></tr>
<tr><td colspan="3">$50 penalty for failure to file Form 8606 to report nondeductible contributions
$100 penalty for overstating the designated amount of nondeductible contributions</td></tr>
<tr><td rowspan="4">Distributions</td><td colspan="3">Earliest (without 10% tax penalty):</td></tr>
<tr><td colspan="3">Death, Permanent disability, Attainment of age 59½: Periodic payments based on a life expectancy formula that cannot be modified for at least 5 years or until attainment of age 59½, if later. Transfer of assets from a participant’s IRA to spouse’s or former spouse’s IRA in accordance with a divorce or separation document.</td></tr>
<tr><td colspan="3">Latest (without 50% excise tax penalty):</td></tr>
<tr><td colspan="3">April 1 of the calendar year following the year in which the participant reaches age 72</td></tr>
<tr><td>Tax Treatment on Distribution</td><td colspan="3">All distributions from any type of IRA are taxed as ordinary income. Remember, however, that if the individual made nondeductible contributions, each distribution consists of a nontaxable portion and a taxable portion.</td></tr>
</table>

Spousal IRA

If a taxpayer files a joint return and their compensation is less than that of their spouse, the most that can be contributed for the year to the taxpayer's IRA is the lesser of:

(1) $6,000 in 2020 (or $7,000 in 2020 if taxpayer is 50 or older), *or*

(2) Total compensation includable in the gross income of both taxpayer and their spouse for the year, reduced by:

(a) The spouse's IRA contribution for the year to a traditional IRA, *and*

(b) Any contributions for the year to a Roth IRA on behalf of the spouse.

This means that the total combined contributions that can be made for the year to a taxpayer's IRA and their spouse's IRA can be up to $12,000 in 2020, or $13,000 in 2020 if only one spouse is 50 or older, or $14,000 in 2020 if both spouses are 50 or older.

Eligibility

Individuals can set up and make contributions to a traditional IRA if:

(1) They (or, if they file a joint return, their spouse) received taxable compensation during the year, *and*

(2) Prior to 2020, they were not age 70½ by the end of the year; however for 2020 and later, the age limit is repealed.

An individual can have a traditional IRA whether or not they are covered by any other retirement plan. However, a taxpayer may not be able to deduct all of their contributions if the taxpayer or their spouse is covered by an employer retirement plan.

Contributions & Deductions

Any employer, including a corporation, may establish an IRA plan for the benefit of some or all of its employees. Contributions may be made by the employer on an additional compensation basis or on a salary reduction plan. There is no nondiscrimination requirement with respect to the establishment, availability or funding of an IRA plan. However, employee participation in an IRA plan cannot be used as a basis for determining nondiscrimination in any other employer provided plan. Installation and trustee fees paid by the employer with respect to such plans should be deductible as ordinary and necessary business expenses. A separate accounting is required for each employee's interest in the trust, but commingling of assets is permissible for investment purposes.

Employer Contributions

Amounts contributed by an employer will be tax-deductible as additional compensation and includable in the employee's income. However, the employee will be entitled to an offsetting deduction for the contributed amounts. Employer contributions will be subject to FICA and FUTA but not to federal income tax

withholding if the employer reasonably believes that the employee will be entitled to a deduction for the contributed amounts.

Distribution & Settlement Options

In order to encourage participants to set aside funds for their retirement, tax law imposes a 10% penalty tax on "premature distributions." That is, distributions that are received by the participant prior to the attainment of age 59½. This penalty tax is imposed in addition to the participant's ordinary income tax liability. However, this penalty does not occur where the distribution is the result of the death, disability or the timely repayment of excess contributions.

Life Annuity Exemption

Distributions made prior to age 59½ are exempted from the penalty tax if they are made over a period of years based on the participant's life expectancy. Payments may also be made in the form of a joint and survivor annuity based on the participant's and the spouse's life expectancy and must be substantially equal.

Minimum Distributions

Funds cannot be kept indefinitely in a traditional IRA. Eventually they must be distributed. However, the requirements for distributing IRA funds differ, depending on whether the taxpayer is the IRA owner or the beneficiary of a decedent's IRA.

For 2020 and later, owners of traditional IRAs must start receiving distributions by April first of the year following the year in which they attained age 72 (prior law was age 70½). April 1st of the year following the year in which a taxpayer reaches age 72 is referred to as the required beginning date (RBD) - see Notice 2020-6 for more details.

> **Note:** The minimum distribution amount for the year the taxpayer attained age 72 must be received no later than April 1st of the next year. Thereafter, the required minimum distribution for any year must be made by December 31st of that later year.

If the minimum required distribution is not made, then an excise tax equal to 50% of the excess of the minimum required distribution over the amount actually distributed will be imposed on the payee.

Required Minimum Distribution

The required minimum distribution for each year is determined by dividing the IRA account balance as of the close of business on December 31st of the preceding year by the applicable distribution period or life expectancy.

2009 Waiver of Required Minimum Distribution Rules—Expired

For 2009, under the Worker, Retiree, and Employer Recovery Act, no minimum distribution was required for calendar year 2009 from individual retirement plans and employer-provided qualified retirement plans that were defined contribution plans (within the meaning of section 414(i)).

Definitions

IRA Account Balance

The IRA account balance is the amount in the IRA at the end of the year preceding the year for which the required minimum distribution is being figured. The IRA account balance is adjusted by certain contributions, distributions, outstanding rollovers, and recharacterizations of Roth IRA conversions.

Designated Beneficiary

The term "designated beneficiary" is a term of art, and basically means that the beneficiary must be a human being. Thus, an estate is not a "designated beneficiary" nor is a charity or other legal entity. If there is more than one beneficiary, then all of them must be human beings, or there is no designated beneficiary.

Note: There is an exception to this rule if each beneficiary has his or her or their own certain separate account.

If the beneficiary is a trust, and all of the beneficiaries of the trust are human beings, they will be treated as designated beneficiaries, if certain conditions are met.

Date the Designated Beneficiary Is Determined

Generally, the designated beneficiary is determined on the last day of the calendar year following the calendar year of the IRA owner's death. Any person who was a beneficiary on the date of the owner's death, but is not a beneficiary on the last day of the calendar year following the calendar year of the owner's death (because, for example, he or she disclaimed entitlement or received his or her entire benefit), will not be taken into account in determining the designated beneficiary.

Distributions during Owner's Lifetime & Year of Death after RBD

Required minimum distributions during the owner's lifetime (and in the year of death if the owner dies after the required beginning date) are based on a distribution period that generally is determined using Table III from IRS Publication 590 and set forth below. The distribution period (i.e., which table is used) is not affected by the beneficiary's age unless the sole beneficiary is a spouse who is more than 10 years younger than the owner.

Table III			
Uniform Lifetime			
For Use by Unmarried Owners, Married Owners Whose Spouses Are Not More Than 10 Years Younger, and Married Owners Whose Spouses Are Not the Sole Beneficiaries			
Age	**Distribution Period**	**Age**	**Distribution Period**
70	27.4	93	9.6
71	26.5	94	9.1
72	25.6	95	8.6
73	24.7	96	8.1
74	23.8	97	7.6
75	22.9	98	7.1
76	22.0	99	6.7
77	21.2	100	6.3
78	20.3	101	5.9
79	19.5	102	5.5
80	18.7	103	5.2
81	17.9	104	4.9
82	17.1	105	4.5
83	16.3	106	4.2
84	15.5	107	3.9
85	14.8	108	3.7
86	14.1	109	3.4
87	13.4	110	3.1
88	12.7	111	2.9
89	12.0	112	2.6
90	11.4	113	2.4
91	10.8	114	2.1
92	10.2	115 and over	1.9

Sole Beneficiary Spouse Who Is More Than 10 Years Younger

If the sole beneficiary is owner's spouse and their spouse is more than 10 years younger than the owner, use the life expectancy from Table II (Joint Life and Last Survivor Expectancy) in IRS Publication 590.

The life expectancy to use is the joint life and last survivor expectancy listed where the row or column containing the owner's age as of their birthday in the current year intersects with the row or column containing their spouse's age as of his or her birthday in the current year. To figure the required minimum distribution for the current year divide the account balance at the end of the preceding year by the life expectancy.

Distributions after Owner's Death

SECURE Act Accelerated Distribution Requirements

Effective 2020, the SECURE Act (H.R. 1994) shortens the period over which many beneficiaries of IRAs and defined contribution plans must

receive distributions of their inherited account balances. Under the SECURE Act, distributions to individual beneficiaries *other* than:

(i) the surviving spouse of the employee (or IRA owner),

(ii) disabled or chronically ill individuals,

(iii) individuals who are not more than 10 years younger than the employee (or IRA owner), or

(iv) child of the employee (or IRA owner) who has not reached the age of majority

are generally required to be distributed by the end of the tenth calendar year following the year of the employee or IRA owner's death.

For the beneficiares listed above the pre-SECURE Act rules remain in effect. Thus, with proper planning,they may spread the inherited account distribution over the beneficiary's life expectancy at the time of the decedent's death, using tables published by the IRS.

Beneficiary Is an Individual – Pre-SECURE Act

If the designated beneficiary is an individual, such as the owner's spouse or child, required minimum distributions for years after the year of the owner's death generally are based on the beneficiary's single life expectancy.

Note: This rule applies whether or not the death occurred before the owner's required beginning date.

To figure the required minimum distribution for the current year, divide the account balance at the end of the preceding year by the appropriate life expectancy from Table I (Single Life Expectancy) (For Use by Beneficiaries) in IRS Publication 590-B. Determine the appropriate life expectancy as follows.

- ***Spouse as sole designated beneficiary.*** Use the life expectancy listed in the table next to the spouse's age (as of the spouse's birthday in the current year). If the owner died before the year in which he or she reached age 72 (70½ before 2020), distributions to the spouse do not need to begin until the year in which the owner would have reached age 72 (70½ before 2020).

- ***Surviving spouse.*** If the designated beneficiary is the owner's surviving spouse, and he or she dies before he or she was required to begin receiving distributions, the surviving spouse will be treated as if he or she were the owner of the IRA.

• ***Other designated beneficiary.*** Use the life expectancy listed in the table next to the beneficiary's age as of his or her birthday in the year following the year of the owner's death, reduced by one for each year since the year following the owner's death.

A beneficiary who is an individual may be able to elect to take the entire account by the end of the fifth year following the year of the owner's death. If this election is made, no distribution is required for any year before that fifth year.

Multiple Individual Beneficiaries – Pre-SECURE Act

If as of the end of the year following the year in which the owner dies there is more than one beneficiary, the beneficiary with the shortest life expectancy will be the designated beneficiary if both of the following apply:

i. All of the beneficiaries are individuals, *and*

ii. The account or benefit has not been divided into separate accounts or shares for each beneficiary.

Beneficiary Is Not an Individual – Pre-SECURE Act

If the owner's beneficiary is not an individual (e.g., if the beneficiary is the owner's estate), required minimum distributions for years after the owner's death depend on whether the death occurred before the owner's required beginning date.

a. Death on or after required beginning date. To determine the required minimum distribution for the current year divide the account balance at the end of the preceding year by the appropriate life expectancy from Table I (Single Life Expectancy) (For Use by Beneficiaries) in IRS Publication 590-B*.* Use the life expectancy listed next to the owner's age as of his or her birthday in the year of death, reduced by one for each year since the year of death.

b. Death before required beginning date. The entire account must be distributed by the end of the fifth year following the year of the owner's death. No distribution is required for any year before that fifth year.

Trust as Beneficiary – Pre-SECURE Act

A trust cannot be a designated beneficiary even if it is a named beneficiary. However, the beneficiaries of a trust will be treated as having been designated as beneficiaries if all of the following are true:

1. The trust is a valid trust under state law, or would be but for the fact that there is no corpus.

2. The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee.

3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable from the trust instrument.

4. The IRA trustee, custodian, or issuer has been provided with either a copy of the trust instrument with the agreement that if the trust instrument is amended, the administrator will be provided with a copy of the amendment within a reasonable time, or all of the following:

(a) A list of all of the beneficiaries of the trust (including contingent and remaindermen beneficiaries with a description of the conditions on their entitlement),

(b) Certification that, to the best of the employee's knowledge, the list is correct and complete and that the requirements of (1), (2), and (3) above, are met,

(c) An agreement that, if the trust instrument is amended at any time in the future, the employee will, within a reasonable time, provide to the IRA trustee, custodian, or issuer corrected certifications to the extent that the amendment changes any information previously certified, *and*

(d) An agreement to provide a copy of the trust instrument to the IRA trustee, custodian, or issuer upon demand.

If the beneficiary of the trust is another trust and the above requirements for both trusts are met, the beneficiaries of the other trust will be treated as having been designated as beneficiaries for purposes of determining the distribution period.

Inherited IRAs – Pre-SECURE Act

The beneficiaries of a traditional IRA must include in their gross income any distributions they receive. The beneficiaries of a traditional IRA can include an estate, dependents, and anyone the owner chooses to receive the benefits of the IRA after he or she dies.

Spouse. If an individual inherits an interest in a traditional IRA from their spouse, they can elect to treat the entire inherited interest as their own IRA.

Beneficiary other than spouse. Formerly, when an individual inherited a traditional IRA from someone other than their spouse, they could not treat it as their own IRA. They could not roll over any part of it or roll any amount

over into it (§408(d)(3)(C)). In addition, they were not permitted to make any contributions to an inherited traditional IRA (§219(d)(4)).

However, the Pension Protection Act of 2006 extended the special treatment granted to spousal beneficiaries to nonspouse beneficiaries. For distributions after *2006*, nonspouse beneficiaries are allowed to roll over (in a trustee to trustee rollover) to an IRA structured for that purpose amounts inherited as a designated beneficiary. Thus, the benefits of a beneficiary other than a surviving spouse may be transferred directly to an IRA.

The IRA is treated as an inherited IRA of the nonspouse beneficiary. For example, distributions from the inherited IRA are subject to the distribution rules applicable to beneficiaries. The provision applies to amounts payable to a beneficiary under a qualified retirement plan, governmental §457 plan, or a tax-sheltered annuity.

Note: Nonspouse beneficiaries can also apply for waivers of the 60 day rollover period. In addition, this provision will benefit same-sex couples.

Estate Tax Deduction

A beneficiary may be able to claim a deduction for estate tax resulting from certain distributions from a traditional IRA. The beneficiary can deduct the estate tax paid on any part of a distribution that is income in respect of a decedent. He or she can take the deduction for the tax year the income is reported.

Post-Retirement Tax Treatment of IRA Distributions

The cost basis of a participant in an IRA account is almost always zero. Therefore, all distributions are fully taxable as ordinary income in the year in which they are received. The distribution of an annuity contract to a participant is not taxable when received. Rather, when the annuity payments begin, they will be fully taxable as ordinary income. Furthermore, the transfer of a participant's interest in an IRA plan to their former spouse under a decree of divorce or a written instrument incident to such divorce is not a taxable distribution. Thereafter, the IRA will be treated for tax purposes as being owned by the former spouse.

Income in Respect of a Decedent

Distributions to a beneficiary or estate of a deceased individual will generally be taxed in the same manner as if the participant received them. Life insurance death benefits however, will not lose their tax-exempt character. Any amounts that are taxable to the beneficiary should be regarded as income in respect of a decedent. Therefore, the beneficiary will be entitled to a deduction from gross income for any federal estate taxes attributable to the inclusion of the IRA in the decedent's gross estate.

Estate Tax Consequences

The estate tax consequences are generally nil, since the surviving spouse is usually the beneficiary and is entitled to the unlimited marital deduction. However, there were previously some interesting rules in effect which worked to exclude $100,000 of the IRA amount from the gross estate of the decedent. These rules were repealed by TEFRA and, therefore, some estate plans may need reworking to prevent the over-funding of the “by-pass trust.”

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

6. You are eligible for an individual retirement account (IRA) if you:

   a. Have completed 1 year of service and a vesting schedule is elected.
   b. Have completed 2 years of service and 100% vesting is elected.
   c. Are an individual who has earned income.
   d. Are a parent receiving child-support.

7. You are the owner of a small company and want to establish an IRA plan for your employees. You need to be aware that:

   a. You can use employee participation in the IRA as a basis to determine nondiscrimination in any other plan you may provide.
   b. You may not include the IRA as part of a compensation package.
   c. Your contributions will be subject to federal income tax withholding.
   d. You do not need to make the IRA plan available to all your employees.

8. Suppose you are age 58 and considering a current IRA distribution in the form of a life annuity. What would be the consequence?

   a. You would not be taxed on the distribution.
   b. You cannot make a withdrawal in this form until age 70½.
   c. You would be exempt from the early withdrawal penalty.
   d. You would need to make the withdrawal as a lump sum distribution.

Tax-Free Rollovers

Generally, a rollover is a tax-free distribution of cash or other assets from one retirement plan that is contributed to another retirement plan. The tax-free rollover provisions relate to all types of qualified plans, IRAs, annuities, and TSAs.

Note: A transfer of funds in a traditional IRA from one trustee directly to another, either at the taxpayer's request or at the trustee's request, is not a rollover. Since there is no distribution to the taxpayer, the transfer is tax free. Because it is not a rollover, it is not affected by the 1-year waiting period required between rollovers.

Amounts paid or distributed to an individual out of an IRA or annuity are not currently taxable if:

(1) The amount so received is reinvested into another IRA within the 60 day period allowed by law; *or*

Note: For distributions made after December 31, 2001, no hardship distribution can be rolled over into an IRA.

(2) The amount received represents the amount in the account or the value of the annuity attributable solely to a rollover contribution from a qualified corporate trust or qualified annuity plan and the amount, together with any earnings, is paid into another qualified corporate account or Keogh plan or trust within the 60 day period.

Note: Generally, a rollover is tax free only if a taxpayer makes the rollover contribution by the 60th day after the day they receive the distribution. Beginning with distributions after December 31, 2001, the IRS may waive the 60-day requirement where it would be against equity or good conscience not to do so.

Amounts not rolled over within the 60-day period do not qualify for tax-free rollover treatment. Taxpayers must treat them as a taxable distribution from either their IRA or employer's plan. These amounts are taxable in the year distributed, even if the 60-day period expires in the next year. Taxpayers may also have to pay a 10% tax on early distributions.

Rollover from One IRA to Another

Taxpayers can withdraw, tax-free, all or part of the assets from one traditional IRA if they reinvest them within 60 days in the same or another traditional IRA. Since this is a rollover, taxpayers cannot deduct the amount that they reinvest in an IRA.

Waiting Period between Rollovers

If a taxpayer makes a tax-free rollover of any part of a distribution from a traditional IRA, they cannot, within a one-year period, make a tax-free rollover of any later distribution from that same IRA. In addition, taxpayers cannot make a tax-free rollover of any amount distributed, within the same one-year period, from the IRA into which they made the tax-free rollover. The

one-year period begins on the date the taxpayer received the IRA distribution, not on the date they rolled it over into an IRA.

Partial Rollovers

If a taxpayer withdraws assets from a traditional IRA, they can roll over part of the withdrawal tax free and keep the rest of it. The amount kept will generally be taxable (except for the part that is a return of nondeductible contributions) and may be subject to the 10% tax on premature distributions.

Rollovers from Traditional IRAs into Qualified Plans

For distributions after December 31, 2001, taxpayers can roll over tax free a distribution from their IRA into a qualified plan. The part of the distribution that they can roll over is the part that would otherwise be taxable. Qualified plans may, but are not required to, accept such rollovers

Rollovers of Distributions from Employer Plans

For distributions after December 31, 2001, taxpayers can roll over both the taxable and nontaxable part of a distribution from a qualified plan into a traditional IRA. If a taxpayer has both deductible and nondeductible contributions in their IRA, they will have to keep track of their basis so they will be able to determine the taxable amount once distributions from the IRA begin.

Withholding Requirement

If an eligible rollover distribution is paid directly to a participant, the payer must withhold 20% of it. This applies even if the participant plans to roll over the distribution to a traditional IRA. This withholding can be avoided by a direct rollover.

Affected item	Result of a payment to you	Result of a direct rollover
Withholding	The payer must withhold 20% of the taxable part.	There is no withholding.
Additional tax	If you are under age 59½, a 10% additional tax may apply to the taxable part (including an amount equal to the tax withheld) that is not rolled over.	There is no 10% additional tax.
When to report as income	Any taxable part (including the taxable part of any amount withheld) not rolled over is income to you in the year paid.	Any taxable part is not income to you until later distributed to you from the IRA.

Waiting Period between Rollovers

Taxpayers can make more than one rollover of employer plan distributions within a year. The once-a-year limit on IRA-to-IRA rollovers does not apply to these distributions.

Conduit IRAs

Taxpayers can use a traditional IRA as a holding account (conduit) for assets they receive in an eligible rollover distribution from one employer's plan that they later roll over into a new employer's plan. The conduit IRA must be made up of only those assets and gains and earnings on those assets. A conduit IRA will no longer qualify if mixed with regular contributions or funds from other plans.

Keogh Rollovers

If a taxpayer is self-employed, they are generally treated as an employee for rollover purposes. Consequently, if a taxpayer receives an eligible rollover distribution from a Keogh plan (a qualified plan with at least one self-employed participant), the taxpayer can roll over all or part of the distribution (including a lump-sum distribution) into a traditional IRA.

Direct Rollovers from Retirement Plans to Roth IRAs

Amounts that have been distributed from a tax-qualified retirement plan, a tax-sheltered annuity, or a governmental §457 plan may be rolled over into a traditional IRA, and then rolled over from the traditional IRA into a Roth IRA. However, historically, distributions from such plans could not be rolled over directly into a Roth IRA. The Pension Protection Act of 2006 now allows distributions from tax-qualified retirement plans, tax-sheltered annuities, and governmental §457 plans to be rolled over directly from such plan into a Roth IRA, subject to the rules that apply to rollovers from a traditional IRA into a Roth IRA.

For example, a rollover from a tax-qualified retirement plan into a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10% early distribution tax does not apply. Similarly, an individual with AGI of $100,000 or more could not roll over amounts from a tax-qualified retirement plan directly into a Roth IRA.

Rollovers from SIMPLE IRAs

For distributions after December 31, 2001, taxpayers may be able to roll over tax free a distribution from their SIMPLE IRA to a qualified plan, a tax-sheltered annuity (§403(b) plan), or deferred compensation plan of a state or local government (§457 plan). Previously, tax-free rollovers were only allowed to other IRAs.

Rollover Individual Retirement Accounts	
Planholder	Recipients of partial or lump-sum distributions from an employer sponsored retirement plan within one taxable year. Distributions cannot be a series of periodic payments.
Eligibility **Requirements**	**Recipients of total distributions due to:**
	Separation from service* Attainment of age 59½ Termination of plan by employer Permanent disability** Death of employee (if spouse is beneficiary) Qualified Domestic Relations Order
	*Does not apply to self-employed individuals ** Does apply to self-employed individuals
	Recipients of partial distribution due to:
	Separation from service Death of employee (if spouse is beneficiary) Permanent disability
Contribution Limits	**Maximum Contribution Limit:** Up to 100% of the distribution. Employee voluntary nondeductible contributions cannot be rolled; earnings on these contributions can. The participant can keep a portion of the payout and roll over the rest.
Deadlines For Establishment & Contributions	Rollovers must be completed by the 60th day after receipt of the distribution. Rollovers from an employer-sponsored retirement plan are an irrevocable election.
Distributions	**Earliest without 10% tax penalty:**
	Death Permanent disability Attainment of age 59½ Periodic payments based on a life expectancy formula that cannot be modified for at least 5 years or until attainment of age 59 ½, if late Transfer of assets from a participant's IRA to spouse's or former spouse's IRA in accordance with a divorce or separation document.
	Latest (without 50% excise tax penalty):
	April 1 of the calendar year following the year in which the participant reaches age 72
	All distributions from any type of IRA are taxed as ordinary income. Remember, however, that if the individual made nondeductible contributions, each distribution consists of a nontaxable portion and a taxable portion.
Tax Treatment on Distribution	All distributions from any type of IRA are taxed as ordinary income. Remember, however, that if the individual made nondeductible contributions, each distribution consists of a

	nontaxable portion and a taxable portion.

Roth IRA - §408A

A Roth IRA is a special tax-free nondeductible individual retirement plan for individuals with AGI of $139,000 (in 2020) or less and married couples with AGI of $206,000 (in 2020) or less. It can be either an account or an annuity.

To be a Roth IRA, the account or annuity must be designated as a Roth IRA when it is set up. Neither a SEP-IRA nor a SIMPLE IRA can be designated as a Roth IRA.

Unlike a traditional IRA, contributions to a Roth IRA are not deductible. However, distributions from a Roth IRA are tax free if made more than five years after a Roth IRA has been established and if the distribution is:

(1) Made after age 59½, death, or disability, *or*

(2) For first-time homebuyer expenses (up to $10,000).

Eligibility

Individuals can contribute to a Roth IRA if they have taxable compensation and their modified AGI is less than:

(a) $206,000 (in 2020) for married filing jointly,

(b) $10,000 (in 2020) for married filing separately and taxpayer lived with their spouse at any time during the year, *and*

(c) $139,000 (in 2020) for single, head of household, qualifying widow(er) or married filing separately and taxpayer did not live with their spouse at any time during the year.

Contributions can be made to a Roth IRA regardless of an individual's age. Contributions can be made to a Roth IRA for a year at any time during the year or by the due date of the individual's return for that year (*not* including extensions).

Contribution Limitation

The contribution limit for Roth IRAs depends on whether contributions are made only to Roth IRAs or to both traditional IRAs and Roth IRAs.

Roth IRAs Only

If contributions are made only to Roth IRAs, taxpayer's contribution limit generally is the *lesser* of:

(1) $6,000 in 2020 or $7,000 in 2020 if you are 50 or older, *or*

(2) Taxpayer's taxable compensation.

However, if modified AGI is above a certain amount, the contribution limit may be reduced. Worksheets for determining modified adjusted gross income and this reduction are provided in the IRS Publication 590-B.

Roth IRAs & Traditional IRAs

If contributions are made to both Roth IRAs and traditional IRAs established for the taxpayer's benefit, the contribution limit for Roth IRAs generally is the same as the limit would be if contributions were made only to Roth IRAs, but then reduced by all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs.

This means that the contribution limit is the lesser of:

(1) $6,000 in 2020 or $7,000 in 2020 if taxpayer is 50 or older minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs, *or*

(2) Taxpayer's taxable compensation minus all contributions (other than employer contributions under a SEP or SIMPLE IRA plan) for the year to all IRAs other than Roth IRAs.

However, if modified AGI is above a certain amount, the contribution limit may be reduced. Worksheets for determining modified adjusted gross income and this reduction are provided in the IRS Publication 590-B.

Effect of Modified AGI on Roth IRA Contribution

IF you have taxable compensation and your filing status is:	**AND** your modified AGI is:	**THEN**:
Married Filing Jointly	Less than $196,000	You can contribute up to $6,000 in 2020 or $7,000 in 2020 if age 50 or older.
	At least $196,000 but less than $206,000	The amount you can contribute is reduced.
	$196,000 or more	You cannot contribute to a Roth IRA.
Married Filing Separately and you lived with your spouse at any time during the year	Zero (-0-)	You can contribute up to $6,000 in 2020 or $7,000 in 2020 if 50 or older.
	More than zero (-0-) but less than $10,000	The amount you can contribute is reduced.
	$10,000 or more	You cannot contribute to a Roth IRA.
Single, Head of Household, Qualifying Widow(er), or **Married Filing Separately** and you did not live with your spouse at any time during the	Less than $124,000	You can contribute up to $5,500 in 2017 or $6,500 in 2017 if age 50 or older.
	At least $124,000 but less than $139,000	The amount you can contribute is reduced.

year	$139,000 or more	You cannot contribute to a Roth IRA.

Conversions

It is possible to convert amounts from either a traditional, SEP, or SIMPLE IRA into a Roth IRA. Taxpayers may be able to recharacterize contributions made to one IRA as having been made directly to a different IRA. In addition, taxpayers can roll amounts over from one Roth IRA to another Roth IRA.

A conversion from a traditional IRA into a Roth IRA is allowable if, for the tax year the taxpayer makes a withdrawal from a traditional IRA, the taxpayer is not a married individual filing a separate return.

Note: For taxable years prior to 2010, another conversion requirement was that a taxpayer's modified AGI could not be more than $100,000.

Amounts can be converted from a traditional IRA to a Roth IRA in any of the following three ways:

1. Rollover. Taxpayer can receive a distribution from a traditional IRA and roll it over (contribute it) to a Roth IRA within 60 days after the distribution. A rollover from a Roth IRA to an employer retirement plan is not allowed.

Note: Taxpayers can withdraw all or part of the assets from a traditional IRA and reinvest them (within 60 days) in a Roth IRA. If properly (and timely) rolled over, the 10% additional tax on early distributions will not apply. Taxpayers must roll over into the Roth IRA the same property they received from the traditional IRA.

2. Trustee-to-trustee transfer. Taxpayer can direct the trustee of the traditional IRA to transfer an amount from the traditional IRA to the trustee of the Roth IRA.

3. Same trustee transfer. If the trustee of the traditional IRA also maintains the Roth IRA, taxpayer can direct the trustee to transfer an amount from the traditional IRA to the Roth IRA.

Note: Conversions made with the same trustee can be made by redesignating the traditional IRA as a Roth IRA, rather than opening a new account or issuing a new contract.

Taxpayers must include in their gross income distributions from a traditional IRA that they would have to include in income if they had not converted them into a Roth IRA.

Recharacterizations

Individuals may be able to treat a contribution made to one type of IRA as having been made to a different type of IRA. This is called recharacterizing the contribution.

To recharacterize a contribution, the contribution must be transferred from the first IRA (the one to which it was made) to the second IRA in a trustee-to-trustee transfer. If the transfer is made by the due date (including extensions) for the tax return for the year during which the contribution was made, taxpayers can elect to treat the contribution as having been originally made to the second IRA instead of to the first IRA. It will be treated as having been made to the *second* IRA on the same date that it was actually made to the first IRA. Taxpayers must report the recharacterization, and must treat the contribution as having been made to the second IRA, instead of the first IRA, on their tax return for the year during which the contribution was made.

> **Note:** If a taxpayer files their return timely without making the election, they can still make the choice by filing an amended return within six months of the due date of the return (excluding extensions).

Reconversions

Taxpayers cannot convert and reconvert an amount during the same taxable year, or if later, during the 30-day period following a recharacterization. If a taxpayer reconverts during either of these periods, it will be a failed conversion.

Taxation of Distributions

Taxpayers do not include in their gross income qualified distributions or distributions that are a return of their regular contributions from their Roth IRA(s). They also do not include distributions from their Roth IRA that they roll over tax free into another Roth IRA.

A qualified distribution is any payment or distribution from a taxpayer's Roth IRA that meets the following requirements:

(1) It is made after the five taxable year period beginning with the first taxable year for which a contribution was made to a Roth IRA set up for the taxpayer's benefit, *and*

(2) The payment or distribution is:

(a) Made on or after the date taxpayer reaches age 59½,

(b) Made because taxpayer is disabled,

(c) Made to a beneficiary or to taxpayer's estate after taxpayer's death, *or*

(d) One that meets the requirements for first-time homebuyer expenses (up to a $10,000 lifetime limit).

Taxpayers must pay a 10% additional tax on early distributions on the taxable part of any distributions that are not qualified distributions. Worksheets are provided in IRS Publication 590-B to figure the taxable part of a distribution that is not a qualified distribution.

No Required Minimum Distributions

Taxpayers are not required to take distributions from their Roth IRA at any age. The minimum distribution rules that apply to traditional IRAs do not apply to Roth IRAs while the owner is alive. However, after the death of a Roth IRA owner, certain of the minimum distribution rules that apply to traditional IRAs also apply to Roth IRAs.

If a Roth IRA owner dies, the minimum distribution rules that apply to traditional IRAs apply to Roth IRAs as though the Roth IRA owner died before his or her required beginning date. The basis of property distributed from a Roth IRA is its fair market value (FMV) on the date of distribution, whether or not the distribution is a qualified distribution.

Simplified Employee Pension Plans (SEPs)

A simplified employee pension (SEP) is a written arrangement (a plan) that allows an employer to make deductible contributions for the benefit of participating employees. The contributions are made to individual retirement arrangements (IRAs) set up for participants in the plan. Traditional IRAs set up under a SEP plan are referred to as SEP-IRAs (§408(k)).

Like an individual IRA, an employee may participate in a SEP even though he or she is also a participant in a qualified plan. A simplified employee pension plan is an IRA that meets all of the following requirements:

(a) For the calendar year, the employer contributes for each employee who has attained age 21 and who has performed any service for the employer during three of the preceding five years;

(b) Contributions must not discriminate in favor of highly compensated employees;

(c) Employer contributions may be integrated with Social Security based upon the rules for qualified defined contribution plans; *and*

(d) Each plan participant must own the IRA account or annuity and employer contributions must not be conditioned upon the retention in such plan of any amount so contributed.

(e) The employer has complete contribution flexibility since the employer is not required to contribute to the SEP each year regardless of whether or not there are profits. The amount to be contributed each year may also vary at the election of the employer so long as the contributions remain nondiscriminatory in nature.

(f) Employer contributions must be made pursuant to a written instrument and be based on a definite written allocation formula that specifies:

(i) The requirements for an employee to share in an allocation; *and*

(ii) The manner in which the amount allocated is to be computed.

The Small Business Job Protection Act of 1996 eliminated salary reduction simplified employee pension plans (SAR-SEPs) in favor of SIMPLE retirement plans. However, SAR-SEPs in effect on 12/31/96 can continue to receive salary reduction contributions and new employees can make salary reduction contributions.

Salary Reduction (SAR-SEP) & Simplified Employee Pension Plans (SEP-IRA)	
Planholder	Corporations S corporations Nonprofit organizations (SEP only) Partnerships Sole proprietorships (i.e., self-employed)
Eligibility Requirements	**The employer must include employees who have:**
	Reached age 21 Worked at least 3 or more of the last 5 preceding years Annual compensation of at least $600 (in 2020)
	SEP: All eligible employees must participate in the plan. **SAR/SEP:** Employer must have 25 or fewer eligible employees at all times during the preceding year. 50% of all eligible employees must participate in the salary reduction provision of the plan.
Contribution Limits	**SEP Maximum Contribution Limit:** Employer contributions are limited to 25% of each participant's compensation not to exceed $57,000 in 2020 (overall limit includes employer basic and salary reduction contributions). **SAR/SEP Maximum Contribution Limit:** Salary reduction contributions are limited to 25% of each participant's compensation not to exceed $19,500 (in 2020). These contributions, reported in Box 16 on the employee's W-2 Form, are subject to an anti-discrimination test. **Minimum SEP & SAR/SEP Contribution:** Minimum employer contribution of 3% may be required if certain highly compensated or key employees participate.
Deadlines For Establishment & Contributions	On or before the employer's tax filing deadline plus extensions. A SEP may be maintained on a calendar or fiscal year basis.
Distributions	**Earliest without 10% tax penalty:**
	Death Permanent disability Attainment of age 59½ Periodic payments based on a life expectancy formula that cannot be modified for at least 5 years or until attainment of age 59½, if later Transfer of assets from a participant's IRA to spouse's or former spouse's IRA in accordance with a divorce or separation document.
	Latest (without 50% excise tax penalty):
	April 1 of the calendar year following the year in which the participant reaches age 72 .
Tax Treatment on Distribution	All distributions from any type of IRA are taxed as ordinary income. Remember, however, that if the individual made nondeductible contributions, each distribution consists of a nontaxable portion and a taxable portion.

Contribution Limits & Taxation

The SEP rules permit an employer to contribute to each participating employee's SEP-IRA up to 25% of the employee's compensation or $57,000 in 2020, whichever is less. These contributions are funded by the employer.

An employer who signs a SEP agreement does not have to make any contribution to the SEP-IRAs that are set up. But, if the employer does make contributions, the contributions must be based on a written allocation formula and must not discriminate in favor of highly compensated employees.

The employer's contributions to a SEP-IRA are excluded from the employee's income rather than deducted from it. This means that, unless there are excess contributions, employees do not include any contributions in their gross income; nor do they deduct any of them.

Employees can make contributions to their SEP-IRA independent of employer SEP contributions. They can deduct them the same way as contributions to a regular IRA. However, their deduction may be reduced or eliminated because, as a participant in a SEP, they are covered by an employer retirement plan.

SIMPLE Plans

A savings incentive match plan for employees (SIMPLE plan) is a tax-favored retirement plan that certain small employers (including self-employed individuals) can set up for the benefit of their employees. Under a SIMPLE plan, employees can choose to make salary reduction contributions to the plan rather than receiving these amounts as part of their regular pay. In addition, you will contribute matching or nonelective contributions.

A SIMPLE plan can be set up in either of the following ways:

(1) Using SIMPLE IRAs (SIMPLE IRA plan), *or*

(2) As part of a §401(k) plan (SIMPLE 401(k) plan).

SIMPLE IRA Plan

A SIMPLE IRA plan is a retirement plan that uses SIMPLE IRAs for each eligible employee. Under a SIMPLE IRA plan, a SIMPLE IRA must be set up for each eligible employee.

Employers can set up a SIMPLE IRA plan if they meet both the following requirements:

(a) They meet the employee limit, *and*

(b) They do not maintain another qualified plan unless the other plan is for collective bargaining employees.

Employee Limit

Employers can set up a SIMPLE IRA plan only if they had 100 or fewer employees who received $5,000 or more in compensation from the employer for the preceding year. Under this rule, the employer must take into account all employees employed at any time during the calendar year regardless of whether they are eligible to participate. Employees include self-employed individuals who received earned income and leased employees. Once an employer sets up a SIMPLE IRA plan, they must continue to meet the 100-employee limit each year they maintain the plan.

Other Qualified Plan

The SIMPLE IRA plan generally must be the only retirement plan to which the employer makes contributions, or to which benefits accrue, for service in any year beginning with the year the SIMPLE IRA plan becomes effective. However, if the employer maintains a qualified plan for collective bargaining employees, they are permitted to maintain a SIMPLE IRA plan for other employees.

Set up

Employers can use *Form 5304-SIMPLE* or *Form 5305-SIMPLE* to set up a SIMPLE IRA plan. Each form is a model savings incentive match plan for employees (SIMPLE) plan document. Which form the employer uses depends on whether they select a financial institution or their employees select the institution that will receive the contributions.

Use Form 5304-SIMPLE if the employer allows each plan participant to select the financial institution for receiving his or her SIMPLE IRA plan contributions. Use Form 5305-SIMPLE if the employer requires that all contributions under the SIMPLE IRA plan be deposited initially at a designated financial institution.

The SIMPLE IRA plan is adopted when the employer has completed all appropriate boxes and blanks on the form and they (and the designated financial institution, if any) have signed it. Keep the original form. Do not file it with the IRS.

Contribution Limits

Contributions are made up of salary reduction contributions and employer contributions. The employer must make either matching contributions or nonelective contributions. No other contributions can be made to the SIMPLE IRA plan. These contributions, which the employer can deduct, must be made timely.

Salary Reduction Contributions

The amount the employee chooses to have the employer contribute to a SIMPLE IRA on his or her behalf cannot be more than $13,500 in 2020. These contributions must be expressed as a percentage of the employee's compensation unless the employer permits the employee to express them as a specific dollar

amount. The employer cannot place restrictions on the contribution amount (such as limiting the contribution percentage), except to comply with the $13,500 (in 2020) limit. Participants who are age 50 or over can make a catch-up contribution to a SIMPLE IRA of up to $3,000 in 2020.

Employer Matching Contributions

Employers are generally required to match each employee's salary reduction contributions on a dollar-for-dollar basis up to 3% of the employee's compensation. This requirement does not apply if the employer makes nonelective contributions.

Instead of matching contributions, employers can choose to make nonelective contributions of 2% of compensation on behalf of each eligible employee who has at least $5,000 (or some lower amount the employer selects) of compensation for the year. If the employer makes this choice, they must make nonelective contributions whether or not the employee chooses to make salary reduction contributions. Only $285,000 in 2020 of the employee's compensation can be taken into account to figure the contribution limit.

Deduction of Contributions

Employers can deduct SIMPLE IRA contributions in the tax year with or within which the calendar year for which contributions were made ends. They can deduct contributions for a particular tax year if they are made for that tax year and are made by the due date (including extensions) of the employer's federal income tax return for that year.

Distributions

Distributions from a SIMPLE IRA are subject to IRA rules and generally are includible in income for the year received. Tax-free rollovers can be made from one SIMPLE IRA into another SIMPLE IRA. However, a rollover from a SIMPLE IRA to a non-SIMPLE IRA can be made tax free only after a two-year participation in the SIMPLE IRA plan.

Early withdrawals generally are subject to a 10% additional tax. However, the additional tax is increased to 25% if funds are withdrawn within two years of beginning participation.

SIMPLE §401(k) Plan

Employers can adopt a SIMPLE plan as part of a 401(k) plan if they meet the 100-employee limit. A SIMPLE 401(k) plan is a qualified retirement plan and generally must satisfy the rules discussed applicable to such type plans. However, a SIMPLE 401(k) plan is not subject to the nondiscrimination and top-heavy rules if the plan meets the following conditions:

(1) Under the plan, an employee can choose to have the employer make salary reduction contributions for the year to a trust in an amount expressed as a

percentage of the employee's compensation, but not more than $13,500 in 2020 and participants who are age 50 or over can make a catch-up contribution of up to $3,000 in 2020;

(2) The employer must make either:

(a) Matching contributions up to 3% of compensation for the year, *or*

(b) Nonelective contributions of 2% of compensation on behalf of each eligible employee who has at least $5,000 of compensation for the year;

(3) No other contributions can be made to the trust;

(4) No contributions are made, and no benefits accrue, for services during the year under any other qualified retirement plan of the employer on behalf of any employee eligible to participate in the SIMPLE §401(k) plan; *and*

(5) The employee's rights to any contributions are nonforfeitable.

No more than $285,000 in 2020 of the employee's compensation can be taken into account in figuring salary reduction contributions, matching contributions, and nonelective contributions.

Review Questions

The review questions accompanying this course are designed to assist you in achieving the course learning objectives. The review section is not graded; do not submit it in place of your qualified assessment. While completing the review questions, it may be helpful to study any unfamiliar terms in the glossary in addition to course content. After completing the review questions, proceed to the review question answers and rationales.

9. Which of the following transactions is an example of a tax-free rollover into an IRA?

   a. You transfer funds used to pay off for basic living expenses while unemployed from one IRA on June 11, 2017, into another IRA on July 1, 2017.
   b. You transfer funds from one IRA on March 3, 2017, into another IRA on May 3, 2017.
   c. You transfer funds in a traditional IRA taken from one trustee to another on the same day.
   d. You transfer funds from one IRA on February 23, 2017, into another IRA on April 22, 2017.

10. Suppose you wanted to roll over a distribution from a qualified plan into a traditional IRA, but had already done so earlier in the year. Which following would hold true in your case?

    a. You are allowed to make another rollover.
    b. You could make another rollover once the one-year waiting period was over.
    c. You could not make another rollover unless it was a rollover involving a different type of plan.
    d. You would not be eligible for another rollover.

Review Question Answers and Rationales

Review question answer choices are accompanied by unique, logical reasoning (rationales) as to why an answer is correct or incorrect. Evaluative feedback to incorrect responses and reinforcement feedback to correct responses are both provided.

1. One of the deferred tax advantages of a corporate plan is that:

   a. The employee benefit trust accumulates tax-free. Incorrect. This is a current benefit, not a deferred benefit.
   b. Certain distributions may be rolled over tax-free into an IRA. Correct. One deferred tax advantage of a corporate plan is that certain distributions may be rolled over tax-free into an IRA.
   c. The employer corporation obtains a deduction for the amounts paid or accruable to the qualified plan. Incorrect. A current benefit of a corporate plan is that the employer corporation obtains a current deduction for the amounts paid or accruable to the qualified plan. This advantage is not a deferred benefit.
   d. The employee does not recognize income on contributions made by the employer even though the benefits may be nonforfeitable and fully vested. Incorrect. A current benefit of a corporate plan is that the employee does not recognize income currently on contributions made by his or her employer even though the benefits may be nonforfeitable and fully vested.

2. Your C corporation is growing and you wanted to offer a qualified retirement plan. However, you are concerned as to your potential responsibilities in managing the plan assets. In this case, you would consult:

   a. **Title I under Employee Retirement Security Act of 1974. Correct. The Employee Retirement Security Act of 1974 (ERISA) is divided into four sections called titles. Among the matters covered under Title I of ERISA are fiduciary responsibilities, which includes who is responsible for the management of plan assets.**
   b. The Small Business Job Protection Act of 1996. Incorrect. If you wanted answers concerning your fiduciary responsibilities in regard to qualifies retirement plans, you would not find them here. The Small Business Job Protection Act's on retirement plan operations primarily involved the repealed five-year averaging of lump-sum distributions from qualified employee benefit plans.
   c. The Tax Equity and Fiscal Responsibility Act of 1982. Incorrect. The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) reduced maximum benefits, raised the early retirement age, enacted new rules for corporate and noncorporate plans, and established restrictions for "top heavy" plans. TEFRA does not specify plan fiduciary responsibilities.
   d. Section 404(a)(6) of the IRC. Incorrect. Section 404(a)(6) governs the deductibility of contributions to qualified plans. It provides that you will be considered as having made a contribution to a qualified plan as of its year-end, if you made the contribution on account of the same year and you made it by the due date of its tax return, including extensions.

3. Which of the following plans is most likely included in Pension Benefit Guarantee Corporation (PBGC) insurance coverage?

   a. A government plan. Incorrect. Governmental plans are specifically excluded from PBGC insurance coverage.
   b. A plan established by a fraternal society. Incorrect. Plans established by fraternal societies or other organizations which receive no employer contributions and cover only members (not employees) are specifically excluded from PBGC insurance coverage.
   c. **A defined benefit plan. Correct. A defined benefit plan is included in PBGC coverage. However, a plan that is primarily for a limited group of highly compensated employees where the benefits to be paid, or the contributions to be received, are in excess of the limitations of §415 would be specifically excluded from PBGC insurance coverage.**
   d. A qualified plan established exclusively for substantial owners. Incorrect. Qualified plans established exclusively for substantial owners are specifically excluded from PBGC insurance coverage.

4. In order to ensure compliance with the qualified plan requirements of §411(d)(3), an employer would need to see to it that:

   a. Accrued benefits to an employees' plan is not forfeited even if you stop make contributions to the plan. Correct. Section 411(d)(3) requires that accrued benefits become nonforfeitable for employees participating in a qualified plan which is completely or partially terminated or discontinued.

   b. Their employees are entitled to make voluntary contributions and that only such contributions are fully vested. Incorrect. While retirement plans can be drafted to accept voluntary employee contributions, there is no requirement that voluntary contributions be made available to employees. However, §411(a)(1) does require that plan participants must be fully vested at all times in the accrued benefit derived from their own contributions to the plan (if, any), whether the contributions are voluntary or required.

   c. Their employees do not forfeit employer contributions to their plans upon reaching retirement age. Incorrect. This requirement is covered by §411(a), which provides that a plan participant's normal retirement benefit derived from employer contributions must be nonforfeitable upon the attainment of normal retirement age, no matter where the employee happens to fall on the plan's vesting schedule.

   d. Their company's retirement benefit plan does not favor the highest paid employees. Incorrect. Section 401(a)(4) mandates compliance with nondiscrimination requirements.

5. Suppose an employer, with a defined benefit plan, exceeded §415 contribution limitations for a key employee. What would be the most likely consequence for exceeding this limitation?

   a. Disqualification of the entire plan for the year. Correct. Under Section 401(a)(16), a plan is required to comply with §415 limitations for contributions and benefits, which set the maximum amounts that the employer may provide under the plan. A plan must include provisions to ensure that these limitations are never exceeded for any participant; otherwise, the entire plan will become disqualified for the year.

   b. Reduction of contribution limits for the succeeding year. Incorrect. Your failure to set up provisions to prevent you from exceeding contribution limits for one or more plan participants should not affect contributions in any succeeding year, provided, the plan is reinstated or still in existence.

   c. All employer contributions will revert to the employer. Incorrect. Qualified retirement plans are prohibited from having plan contributions revert to the employer.

   d. Disqualification of the plan for the plan participant in question. Incorrect. Failure to comply with contribution limits affects the entire plan, not just the individual for whom you contributed in excess to his or her plan.

6. You are eligible for an individual retirement account (IRAs) if you:

    a. Have completed 1 year of service and a vesting schedule is elected. Incorrect. One of the eligibility requirements for profit sharing, money purchase pension, and §401(k) plans is that you have completed 1 year of service if a vesting schedule is elected.
    b. Have completed 2 years of service and 100% vesting is elected. Incorrect. An eligibility requirement of profit sharing, money purchase pension, and §401(k) plans is that you are at least age 21 and have completed 2 years of service if 100% vesting is elected.
    c. Are an individual who has earned income. Correct. In order to be eligible for an IRA you would need to be an individual who has earned income.
    d. Are a parent receiving child-support. Incorrect. Child support, unlike alimony, is not considered earned income for purposes of IRA eligibility.

7. You are the owner of a small company and want to establish an IRA plan for your employees. You need to be aware that:

    a. You can use employee participation in the IRA as a basis to determine nondiscrimination in any other plan you may provide. Incorrect. You cannot use your employees' participation in an IRA as a basis for determining nondiscrimination in any other play you may provide.
    b. You may not include the IRA as part of a compensation package. Incorrect. Any contributions you make to an IRA are deductible as additional employee compensation.
    c. Your contributions will be subject to federal income tax withholding. Incorrect. Your contributions are subject to FICA and FUTA but not federal income tax withholding.
    d. You do not need to make the IRA plan available to all your employees. Correct. As an employer, you may establish an IRA plan for the benefit of some or all of your employees without being subject to a nondiscrimination requirement with respect to the establishment, availability or funding of the plan.

8. Suppose you are age 58 and considering a current IRA distribution in the form of a life annuity. What would be the consequence?

   a. You would not be taxed on the distribution. Incorrect. You are taxed on distributions made from a traditional IRA no matter when you take the distribution.
   b. You cannot make a withdrawal in this form until age 70½. Incorrect. You can make a withdrawal in the form of a life annuity or joint and survivor annuity at any time before age 70½.
   c. You would be exempt from the early withdrawal penalty. Correct. If you take distributions prior to age 59½, you are exempted from the penalty tax if the distributions are made over a period of years based on your life expectancy. You also may take payments in the form of a joint and survivor annuity based on your and your spouse's life expectancy.
   d. You would need to make the withdrawal as a lump sum distribution. Incorrect. There is no requirement for making the withdrawal in a lump sum under these or similar circumstances.

9. Which of the following transactions is an example of a tax-free rollover into an IRA?

   a. You transfer funds used to pay off for basic living expenses while unemployed from one IRA on June 11, 2017, into another IRA on July 1, 2017. Incorrect. As of December 31, 2001, no hardship distributions can be rolled over into an IRA. In this particular case, if you took a distribution to pay for basic living expenses while unemployed, this would be considered a hardship distribution.
   b. You transfer funds from one IRA on March 3, 2017, into another IRA on May 3, 2017. Incorrect. This transfer was made in 61 days, which is beyond the required 60-day period in which to roll over the funds.
   c. You transfer funds in a traditional IRA taken from one trustee to another on the same day. Incorrect. A transfer of funds in a traditional IRA from one trustee directly to another, either at the taxpayer's request or at the trustee's request, actually is not a rollover. However, since there is no distribution to the taxpayer, the transfer is still tax free.
   d. You transfer funds from one IRA on February 23, 2017, into another IRA on April 22, 2017. Correct. This transfer was made in 56 days, barely within the 60-day period needed for tax-free rollovers.

10. Suppose you wanted to roll over a distribution from a qualified plan into a traditional IRA, but had already done so earlier in the year. Which following would hold true in your case?

    a. You are allowed to make another rollover. Correct. You are allowed more than one rollover of employer plan distributions within a year.
    b. You could make another rollover once the one-year waiting period was over. Incorrect. The one-year waiting period applies to an IRA-to-IRA rollover.
    c. You could not make another rollover unless it was a rollover involving a different type of plan. Incorrect. The one-year waiting period does not apply to this type of rollover.
    d. You would not be eligible for another rollover. Incorrect. You are permitted to make more than one rollover. In the case of a rollover from one IRA into another, you would need to wait one year before you can make another rollover.

Glossary

This is a glossary of key terms with definitions. Please review any terms with which you are not familiar.

Adjusted gross income (AGI): Total income reduced by allowable adjustments, such as for an IRA, student loan interest, alimony and Keogh deductions. The AGI is important in determining whether various tax benefits are phased out.

Annuity: An annual payment of money by a company or individual to a person called an annuitant.

Capital gain: Gain from the disposition or exchange of a capital asset.

Deferred compensation: Funds held by an employer or put into an account for distribution to the employee at a later date.

Defined benefit plan: A retirement plan that calculates and pays fixed benefits based upon actuarial assumptions.

ERISA: The Employee Retirement Income Security Act of 1974 (ERISA) which governs the operation of most private pension plans.

Estate tax: A tax on the value of a decedent's taxable estate after deductions and credits.

FICA: Provides benefits for retired workers and their dependents as well as for disabled workers and their dependents. Also known as the Social Security tax.

Gross income: Money, goods, services, and property a person receives that must be reported on a tax return. Includes unemployment compensation and certain scholarships. It does not include welfare benefits and nontaxable Social Security benefits.

Individual retirement arrangement (IRA): A type of individual retirement arrangement using a funding arrangement of a trust or a custodial account.

Keogh plan: A form of qualified pension or profit-sharing plan for self-employed individuals.

Lump-sum distribution: Payment of an entire amount due at one time rather than in installments.

Premature distribution: A tax penalized withdrawal from a qualified retirement plan before age 59½.

Required minimum distribution: A minimum distribution that must be taken annually from a taxpayer's retirement plan in order to avoid a 50% penalty.

Self-employment tax: Similar to Social Security and Medicare taxes but for self-employed individuals.

Tax year: An annual accounting period for reporting income and keeping records.

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Qualified Assessment

A Quick Guide to Retirement Plans
Course # 8152153
Publication/Revision Date:
September 2020

Course Expiration Date

Per AICPA and NASBA Standards (S9-06), QAS Self-Study courses must include an expiration date that is ***no longer than one year from the date of purchase or enrollment***.

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1. One of your clients, Samuel, owns a small closely-held corporation and is in the process of choosing a retirement plan. Samuel wants to know a good reason why he would want to choose a qualified corporate pension plan. You explain to him that:

   a. It maximizes benefits for all employees.
   b. Its employee benefit trust accumulates earnings tax-free.
   c. It provides the greatest benefit to the controlling shareholders.
   d. It permits a lower early retirement age.

2. You are explaining ERISA requirements to one of your clients, Bob, who owns a small incorporated tool manufacturing business with 25 employees. Bob wants examples of plan transactions permitted under ERISA. You would inform him that permissible transactions include:

   a. Exchanges of property between the plan and a party-in-interest.
   b. Extensions of credit between the plan and a party-in-interest.
   c. Loans of plan funds to participants.
   d. Provisions of facilities between the plan and a party-in-interest.

3. Randy received a notice of deficiency after a disqualified person participated in an ERISA prohibited transaction but, it took him 65 days to correct the problem. Under these circumstances Randy should expect to:

   a. Pay an excise tax of 5%.
   b. Have the plan subjected to probationary restrictions for one year.
   c. Pay a penalty of 20%.
   d. Have all participant accounts vested 100%.

4. Jerry is putting in place a qualified pension plan at his company and is concerned about coverage costs. Under §401, which of the following of his employees would he be able to **EXCLUDE** from the plan?

    a. His CFO, Janet, whose salary is $95,000.
    b. Tom, a machinist who is 21 years of age.
    c. Larry, a customer service representative who has worked for the company for nine months.
    d. His CEO, Brandon, who is a 5% owner of the plan sponsor.

5. Ken is a self-employed engineering consultant. He wants to set up a Keogh plan and wants to know when he must contribute to his plan. You would explain to him that any contributions must be made:

    a. Any time before the due date of his tax return.
    b. Any time prior to the end of the taxable year.
    c. Prior to the end of the calendar.
    d. Any time before the end of the plan year.

6. Dan has selected a Keogh plan with a regular contribution rate of 12.75% for his sole proprietorship. However, since he is self-employed, you would remind him that the actual contribution rate for his Keogh plan would be:

    a. 6.375%.
    b. 11.3%.
    c. 13%.
    d. 15%.

7. Carolyn was born on November 27, 1951. In order to avoid a 50% excise tax for failure to receive a minimum distribution from her IRA, she would want to make sure she takes her first distribution by no later than:

    a. December 31, 2021.
    b. April 1, 2022.
    c. December 31, 2022.
    d. April 1, 2023.

8. Jeff has decided to participate in a traditional IRA but, has made several inaccurate assumptions concerning traditional IRAs. As his tax advisor, you would need to point out to Jeff that, among the assumptions he has made, his only accurate one is that:

    a. He is prohibited from making an early withdrawal prior to age 55.
    b. He can postpone the tax on a lump sum distribution by depositing it in an IRA within 60 days.
    c. Contributions for spouses of individuals who are in an employee-sponsored

retirement plan are nondeductible.
d. IRA participants can double their contributions when past age 50.

9. Your client, Benjamin, wants to know about the tax treatment of post-retirement IRA distributions. You would explain to him that they are taxable in the case of a:

a. Distribution of an annuity contract.
b. Transfer of a participant's interest in an IRA to a former spouse under a decree of divorce.
c. Contribution of a distribution of cash or other assets from one retirement plan to another retirement plan.
d. Distribution to a beneficiary or estate of a deceased individual.

10. Alexis wants to use a traditional IRA as a holding account for an eligible rollover distribution from her former employer's plan into her new employer's plan. As her advisor, you explain she would be able to accomplish this by means of a:

a. Conduit IRA.
b. Direct rollover.
c. SIMPLE IRA.
d. Deemed IRA.

Answer Sheet
A Quick Guide to Retirement Plans
Course # 8152153
2 CPE Credits

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1. ___	3. ___	5. ___	7. ___	9. ___
2. ___	4. ___	6. ___	8. ___	10. ___

Course Evaluation

A Quick Guide to Retirement Plans
Course # 8152153

Thank you for taking the time to fill out this course and customer experience evaluation. Your responses help us to build better courses and maintain the highest levels of service. If you have comments not covered by this evaluation, or need immediate assistance, please contact us at 800.822.4194 or wcpe@westerncpe.com.

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	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
The stated learning objectives were met.	O	O	O	O	O
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2. Were there any questions you felt were confusing or had incorrect answers listed? If so, please give the question number and a brief description of the issue:

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