125 YEARS 1890 – 2015 STIFEL

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IRA ROLLOVERS – ONE-PER-YEAR RULE

A new IRA rollover rule went into effect January 1, 2015. Announcement 2014-15 addressed the application to Individual Retirement Accounts and Individual Retirement Annuities (collectively, "IRAs") of the one-rollover-per-year limitation of § 408(d)(3)(B) of the Internal Revenue Code (IRC) and provided transition relief for owners of IRAs. IRC Section 408(d)(3)(A)(i) provides generally that any amount distributed from an IRA will not be included in the gross income of the distributee to the extent the amount is paid into an IRA for the benefit of the distributee no later than 60 days after the distributee receives the distribution. Section 408(d)(3)(B) provides that an individual is permitted to make **only one rollover in any one-year period.**

Under the previous 60-day rollover rule, an individual with multiple IRAs was permitted to take a distribution from each of them during the year, and within 60 days of each distribution roll the assets back into the same or another IRA. Now, an IRA holder will be limited to only one indirect rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs he or she owns. The limit will apply to all of an individual's IRAs, including Traditional, Roth, SEP and SIMPLE IRAs, effectively treating them as one IRA for purposes of the limit.

Transfers

When an individual transfers assets from one IRA directly to another without taking constructive receipt of the assets (check not payable to the IRA owner), the transaction is not reportable to the IRS. Therefore, the number of transfers between IRAs within one year is not limited. A transfer may be the preferred method to move assets from one IRA to another, so as not to exceed the rollover limit. (More info on transfers in the next article: "Consider Transfer Instead of Rollover")

In addition, the one-rollover-per-year rule does not apply to:

- Conversions from Traditional, SEP, or SIMPLE IRAs to Roth IRAs
- IRA-to-qualified plan rollovers
- Qualified plan-to-IRA rollovers
- Qualified plan-to-qualified plan rollovers

Transition Rule for 2014 Distributions

The IRS made it clear that the new interpretation became effective January 1, 2015. Also, the IRS has indicated that an IRA distribution received during 2014, and properly rolled over to another IRA, will have no impact on any distributions and rollovers during 2015 involving any other IRAs owned by the same individual. This provides a fresh start for IRA owners in 2015 when applying the one-per-year rollover limit to multiple IRAs.

Example: If an individual has three traditional IRAs, IRA-1, IRA-2, and IRA-3, and in 2014 took a distribution from IRA-1 and rolled it into IRA-2, he or she could not roll over a distribution from IRA-1 or IRA-2 within a 365-day period from the 2014 distribution, but could roll over a distribution from IRA-3. This transition rule applies only to 2014 distributions and only if different IRAs were involved.

Tax Consequences

Under the basic rollover rule, any amount distributed from an IRA and subsequently rolled into an eligible plan (including an IRA) within 60 days is not subject to ordinary income. For 2015 and beyond, if a distribution is received from an IRA of previously untaxed amounts, an individual must include the amount in gross income if an IRA-to-IRA rollover was made in the preceding 12 months (unless the transition rule above applies). Note that a 10% early withdrawal penalty tax may apply on the amount the individual includes in gross income if he or she is under the age of 59½. Additionally, if the distributed amount is placed into another (or the same) IRA, the amount will likely be treated as an excess contribution and taxed at 6% per year as long as it remains in the IRA.

For complete details, see Announcement 2014-15 at the following web address: http://www.irs.gov/pub/irs-drop/a-14-15.pdf and Announcement 2014-32 at the following web address: http://www.irs.gov/pub/irs-drop/a-14-32.pdf

CONSIDER TRANSFER INSTEAD OF ROLLOVER

As outlined in the previous article, a new one-time-per-year IRA to IRA rollover rule is now in effect for 2015 and beyond. How this new rule will affect an individual's strategy for tax-free movement of IRA assets will depend on his or her knowledge of the difference between a transfer and a rollover. The details are as follows:

Transfers

If an individual intends to move assets from one IRA to another IRA, possibly the simplest method is through a transfer. The IRA holder simply instructs the custodian to transfer cash or securities in-kind from one IRA directly to the other. A transfer can be completed through either the Automated Customer Account Transfer (ACAT) system or by check or wire. IRA holders should contact the custodian to determine what documentation may be necessary to complete the transfer. Note that since the IRA holder does not take constructive receipt (check not payable to the IRA holder), a Form 1099-R is not required to report the transaction to the IRS. For this reason, IRA to IRA transfers are tax- and penalty-free transactions and are unlimited to the number allowed during a year.

Rollovers

There are two types of rollovers, which are classified as direct rollovers and indirect rollovers.

Direct Rollovers – A direct rollover is generally a tax-free, reportable movement of assets from one retirement plan to another (including IRAs). The most common form of a direct roll over is when a participant in an employer sponsored retirement plan authorizes the administrator of the plan to directly rollover assets into a receiving traditional IRA. Although this type of rollover is reportable, it is not taxable, and the number of rollovers per year is unlimited. If a pre-tax rollover is directed to a Roth IRA, this would be deemed a taxable conversion (not a rollover). If a participant has contributed to a designated Roth account, a non-taxable direct rollover may be requested and paid by a plan administrator directly to the individual's Roth IRA. Note that the numbers of direct rollovers from a designated Roth account to a Roth IRA are also unlimited for a year.

Indirect Rollovers – For indirect rollovers from qualified retirement plans, a distribution is made payable to the individual. Note that 20% federal tax will automatically be withheld from the distribution. After receipt of the assets, the individual may choose to either keep the assets, in which the entire distribution will be taxable, or the individual may roll the assets, including the 20% tax withheld, into another retirement plan or IRA within 60 days of receipt of the check. If the individual rolls the assets into an IRA, future distributions from the plan may also be rolled into an IRA, as the new one-rollover-per-year rule does not apply to distributions from qualified retirement plans.

Another type of indirect rollover occurs when an IRA holder takes a distribution from his or her IRA and within 60 calendar days rolls the assets back into the same or another IRA. As stated in the previous article, the IRA to IRA rollover option is now limited to one rollover per individual per year, regardless of the number of IRAs owned. **Because of the new rule, it may be advantageous to consider a transfer instead of a rollover in order to prevent exceeding the limit of one IRA to IRA rollover per year.**

SEP IRAs STILL AVAILABLE FOR 2014

For business owners whose tax year is based upon the calendar year, December 31, 2014, was the last day a Qualified Retirement Plan (QRP) could be established for 2014. However, employers have until the due date of their federal income tax return for the business, including extensions, to establish a SEP and make contributions to the SEP for 2014.

Contributions

The maximum amount that can be contributed for 2014 on behalf of each SEP participant is the lesser of:

- 25% of compensation (IRC Sec. 402(h) limit) up to the compensation cap of $260,000 or
- $52,000 per individual (IRC Sec. 415(c) dollar limitation)

Contributions for the self-employed

For the self-employed, a special formula must be used to calculate the maximum deductible contribution. When figuring the deductible contribution, "compensation" is the "net earnings," which take into account both of the following deductions:

1. The deductible portion of an individual's self-employment tax
2. The contributions to the SEP IRA

To accomplish this calculation, a self-employed individual must reference Chapter 5 of IRS Publication 560 - Retirement Plans for Small Business (web site: http://www.irs.gov/publications/p560/) and apply the *(Rate Table for Self-Employed)* or the *(Rate Worksheet for Self-Employed,)* whichever is appropriate. After referencing the correct table, the business owner must figure the maximum deduction by using the *(Deduction Worksheet for Self-Employed)* located in the same chapter. Note that this computation can be confusing, and it's strongly recommended that a self-employed individual seek the aid of a professional tax consultant before making final decisions.

Benefits

There are several distinct benefits associated with SEPs, such as:

1. They may be established and funded later than any other type of plan-by the business owner's tax filing deadline (plus extensions)
2. Contributions are deposited directly into eligible participant's SEP IRA accounts
3. No IRS Form 5500 reports are required
4. Little administration results in low fees
5. Discretionary contributions – contributions to a SEP are not mandatory for any particular year. An employer may change the percentage of contribution or skip it entirely for any year.
6. No fiduciary responsibility for the owner

Closing Comment

A SEP it is a very attractive plan for small business owners and it is the only plan that can be established in 2015 (deadline is tax filing date plus extensions) to take advantage of a 2014 tax deduction.

TAX CREDITS FOR PLAN SPONSORS AND PLAN PARTICIPANTS

The benefits of retirement plans for the employers who sponsor them and for the employees who contribute to them are numerous. So numerous, in fact, that many benefits go overlooked. As we enter tax season, it is important to note a couple of tax credits, one for employers and one for employees, that often go unused.

Employer's Startup Costs Tax Credit

In an effort to encourage the establishment of workplace retirement plans, the federal government offers a Startup Costs Tax Credit for employers in the first three years of the plan's existence. To qualify for the credit, the employer must have 100 or fewer employees who received at least $5,000 in compensation during the preceding year. The employer must also have at least one employee who is considered a non-highly compensated employee (for 2014, this means compensation of less than $115,000), and finally, in the three years before the employer was eligible for the credit, current employees didn't substantially receive contributions or accrued benefits in another retirement plan sponsored by the employer, a member of a controlled group that includes the employer, or a predecessor plan of the employer or the aforementioned controlled group plan.

The startup credit allowed is equal to 50% of the costs to set up, administer, and educate the employees about the plan, up to a maximum of $500 per year for each of the first three years of the plan. SEP IRAs, SIMPLE IRAs, and any type of qualified retirement plans, including 401(k)s, qualify for the tax credit. Employers can choose to start claiming the credit in the tax year before the tax year in which the plan becomes effective. The credit must be claimed using IRS Form 8881, Credit for Small Employer Pension Plan Startup Costs. For more information on the credit, see IRS Publication 560.

Saver's Credit for Employees

Even though many employees are aware of the tax advantages of participating in employer-sponsored retirement plans and IRAs, lower income individuals and families may still feel they cannot afford to contribute. To help address this issue, the Saver's Credit was created. Depending on a few factors, participants in retirement plans, including self-employed individuals, may qualify for this retirement savings contribution tax credit. Individuals must meet the following conditions:

- Must be age 18 or older
- Must not be a full-time student
- Cannot be claimed as a dependent on another's tax return
- Have an adjusted gross income as reported on Form 1040 or 1040A of less than a certain amount:

	Adjusted Gross Income		
Credit Rate	**Married Filing Jointly**	**Head of Household**	**All Other Filers***
50% of Contribution	$0 – $36,000	$0 – $27,000	$0 – $18,000
20% of Contribution	$36,001 – $39,000	$27,001 – $29,250	$18,001 – $19,500
10% of Contribution	$39,001 – $60,000	$29,251 – $45,000	$19,501 – $30,000
Not Available	More than $60,000	More than $45,000	More than $30,000

* Single, married filing separately, or qualifying widow(er)

This tax credit is in addition to the tax benefits already received for contributions made to a qualified retirement plan or IRA. The credit is equal to 50%, 20%, or 10% of the individual's retirement plan, traditional IRA, or Roth IRA contributions up to $2,000 ($4,000 if married filing jointly).

The Saver's Credit must be claimed by taxpayers using IRS Form 8880, *Credit for Qualified Retirement Savings Contributions*. For more information on the credit, see IRS Publication 590.

RETIREMENT PLAN COVERAGE RULES

A common concern among employers considering the establishment of a qualified retirement plan is the presumed obligation to provide benefits to all of their employees. This needless dread can be easily overcome by the injection of a little reality. Only employees who meet a plan's eligibility requirements may participate in the plan, and it may be that only a fraction of those employees must benefit under the plan due to "coverage" requirements.

Eligibility Requirements

Generally, an employee will become eligible for plan participation after reaching 21 years of age and completing one year of service, working at least one thousand hours in that year. Additionally, if the plan (except for 401(k) plans) has immediate vesting, a two-year service requirement may be utilized.

An employer may also exclude otherwise eligible employees who are non-resident aliens and union employees whose benefits are subject to good faith bargaining.

Coverage Requirements

A plan must pass one of two tests to determine if it is covering the required minimum number of employees: the Ratio Percentage Test or the Average Benefit Test.

Ratio Percentage Test: The Ratio Percentage Test requires that the percentage of Non-Highly Compensated Employees (NHCEs) benefitting under the plan be at least 70% of the percentage of Highly Compensated Employees* (HCEs) benefitting under the plan. "Benefitting" generally means receiving an allocation of a contribution or forfeiture, but for a 401(k) plan, it means eligibility to make a deferral, irrespective if the participant actually does so. As an example, assume a company has 2 HCEs and 20 NHCEs and all meet the plan's age and service requirements. Also assume that both HCEs benefit under the plan. Since 100% of the HCEs are benefitting, then only 70% of the NHCEs (14/20) must benefit. If all the above facts are the same, except that only 50% of the HCEs are benefitting (1/2), then only 35% (.50 x .70 = .35) of the NHCEs (7/20) must benefit.

Average Benefit Test: To pass the Average Benefit Test, a plan must pass both of its two main components: the Classification Test and the Average Benefit Percentage Test.

1. The Classification Test:

- First, it is determined whether the classification of employees who are benefitting under the plan is non-discriminatory, i.e., reasonable and based on objective criteria that identify the category of employees who benefit. For example, identifying covered employees based on job category, type of compensation, or geographic location is generally considered reasonable. Naming specific covered employees or utilizing criteria that has substantially the same effect as naming employees is not reasonable.
- In addition to the above, the classification must be non-discriminatory based on either a Safe Harbor Rule or a Facts and Circumstances Test.

The Safe Harbor Rule

Based on the "Concentration Percentage" (percentage of Non-Highly Compensated Employees (NHCEs) relative to all employees), the IRS has established Safe Harbor (SH) and Unsafe Harbor (UH) percentages. The actual IRS Table runs from 0% to 99%; four examples are noted below.

NHCE Concentration Percentage	Safe Harbor (SH) Percentage	Unsafe Harbor (UH) Percentage
0 – 60	50.00	40.00
75	38.75	28.75
85	31.25	21.25
99	20.75	20.00

- If the plan's ratio percentage (percentage of NHCEs benefitting under the plan relative to the percentage of HCEs benefitting) is equal to or greater than the SH percentage, the plan passes. If the ratio percentage is equal to or below the UH percentage, the plan fails. If the ratio percentage falls between the SH and UH percentages, then a Facts and Circumstances Test is employed.
- For example, a plan with a Concentration Percentage of 50 passes with a ratio percentage of 50 or higher or fails with a ratio percentage of 40 or lower. If the plan's ratio percentage is more than 40 and less than 50, the Facts and Circumstances Test must be used.

The Facts and Circumstances Test: The IRS will consider the underlying business reason for an employee classification, the percentage of employees benefitting under the plan, whether the covered employees' salary range is representative of the employer's workforce, and the difference between the employer's ratio percentage and employer's safe harbor percentage.

2. The Average Benefit Percentage Test

This Test is passed if the NHCEs' average benefit equals at least 70% of the HCEs' average benefit. The benefits may be tested either on a contributions or benefits basis.

By having a working understanding of the eligibility and coverage requirements, a business owner can know the truth about how many of his/her employees must benefit under a plan and potentially make better decisions regarding the establishment of a new retirement plan.

** Highly Compensated Employees include: 1) a 5% owner of the employer, or 2) an employee earning > $120,000 (2015) in the prior year (and, if employer elects, in the top 20% of employees as ranked by pay). All other employees are considered Non-Highly Compensated.*

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