STIFEL

Retirement Plans Quarterly

First Quarter 2018

TRADITIONAL AND ROTH IRA CONTRIBUTIONS FOR 2017

Even though 2017 has come to an end, contributions for 2017 may still be deposited into IRAs. This year's deadline is April 17, 2018, because the normal filing deadline of April 15 falls on Sunday and April 16 is Emancipation Day. For 2017 and 2018, the maximum contribution is limited to the lesser of an individual's earned income or $5,500. In addition, tax filers age 50 (reached by December 31, 2017) or older may contribute an additional "catch up" contribution of $1,000.

Traditional IRAs

In order to be eligible to contribute to a traditional IRA, an individual must have earned income for the year the contribution is intended and not reach the age of 70½ by December 31 of that year. In order to determine if a contribution is deductible, certain requirements must be met. The worksheets to determine traditional IRA deductibility may be found on pages 35-36 in the IRS Form 1040 Instructions booklet (website: https://www.irs.gov/pub/irs-pdf/i1040gi.pdf).

Roth IRAs

In order to be eligible to make a full $5,500 Roth IRA contribution, a single filer's modified adjusted gross income (MAGI) must be under $118,000, and for married couples filing jointly, under $186,000. A partial contribution may be made for single filers if MAGI is between $118,000 and $133,000. For married couples, a partial contribution may be made if MAGI is between $186,000 and $196,000.

Worksheets to determine Roth contribution eligibility may be found on pages 41-43 in IRS Publication 590-A (website: https://www.irs.gov/pub/irs-pdf/p590a.pdf).

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IRS FORM 8606 (NON-DEDUCTIBLE CONTRIBUTIONS)

IRS Form 8606 has multiple uses with IRAs, and it is important to be aware when it is required. Most commonly, the Form is used to track non-deductible amounts contributed to traditional IRAs and for Roth IRA conversions. However, the Form goes beyond these contributions; it also plays a part in the distribution of assets from both the traditional and Roth IRAs.

Non-deductible contributions

When any non-deductible contributions are made, an 8606 must be filed to identify the value as such. These non-deductible contributions might include traditional IRA contributions, Roth conversion amounts, or a rollover of non-deductible amounts from a Qualified Retirement Plan (QRP) to a traditional IRA. This Form will help keep track of the after-tax basis (established value of non-deductible amounts) in the traditional IRA, which is critical information when it comes time to take a distribution.

IRA distributions

Distributions from any IRA that contains after-tax amounts require the IRA holder to file an 8606. This will inform the IRS that the holder's after-tax basis has been reduced. For either a distribution or a conversion, the 8606 helps to determine the pro rata formula (ratio of deductible to non-deductible amounts held inside all IRAs) required for each distribution by defining the after-tax amount of the ratio of overall IRA holdings. When taking distributions from any traditional IRA while holding multiple IRAs, the amounts within all IRAs must be aggregated, and the ratio of total pre-tax versus after-tax of all accounts must be determined.

Roth conversions

There is also a section of the 8606 that must be completed when converting to a Roth IRA. The Form identifies any conversion amounts compared to contribution amounts inside a Roth IRA. This is important, as a Roth IRA has distribution ordering rules, where contributions must be withdrawn before any conversions are withdrawn. And, Roth IRA holders will have to complete the 8606 to determine whether any portion of their withdrawal from a Roth IRA is taxable and/or subject to the 10% early distribution penalty.

Failure

Failure to file Form 8606 can result in extra money going to Uncle Sam. If one simply does not file the Form, for whatever reason, it will trigger a $50 penalty. Overstating an after-tax amount on the 8606 will yield a $100 penalty.

Closing

Remember that while QRP administrators are required to keep track of after-tax amounts for participants, custodians of IRAs are not required to and most likely will not. That is the IRA owners' responsibility.

ROTH RECHARACTERIZATIONS ELIMINATED

One popular strategy IRA owners are permitted is the ability to convert assets from a traditional IRA to a Roth IRA, thus gaining the possibility of future tax-free growth and eliminating Required Minimum Distributions (RMDs) after reaching age 70½. However, if an IRA owner determined that the conversion was not beneficial tax-wise, he or she had until the tax-filing deadline (plus extensions) to recharacterize (reverse) the conversion and undo any conversion-related tax consequences.

On December 22, President Trump signed into law the Tax Cuts and Jobs Act of 2017 (effective January 1, 2018), which eliminates the ability to recharacterize a Roth conversion. Even though conversions will still be permitted, once an IRA owner or Qualified Retirement Plan participant converts assets into a Roth IRA, there will not be a way to reverse this action, and tax will be due on all pre-tax assets that were converted.

WHAT IS THE "BACKDOOR ROTH" IRA STRATEGY?

Roth IRAs are a unique and great way for individuals to save for retirement. Individuals make non-deductible contributions to a Roth IRA, and after five years and attaining age 59½, all withdrawals of principal and earnings are tax-free. Unfortunately, everyone is not permitted to contribute directly to a Roth IRA, as eligibility is restricted based on modified adjusted gross income (MAGI). For 2018, Roth IRA contribution eligibility is as follows:

	Individual Returns (MAGI)	Joint Returns (MAGI)
Full Contribution	‹$120,000	‹$189,000
Partial Contribution	$120,000 - $135,000	$189,000 - $199,000
No Contribution	›$135,000	›$199,000

If the MAGI is greater than these phaseout ranges, there is an alternative solution known as the "Backdoor Roth."

Mechanics of the strategy

To accomplish a "Backdoor Roth" contribution, the individual must first have no pre-tax SEP, SIMPLE, or traditional IRA assets under his or her Social Security number. This may require an individual to transfer the pre-tax assets to a Qualified Retirement Plan or convert pre-tax IRA assets to a Roth IRA, which would create a taxable event, in the year before executing the "Backdoor Roth." Once the individual's pre-tax IRA assets are eliminated, the "Backdoor Roth" is a simple two-step process:

1. Make a non-deductible contribution of $5,500 ($6,500 if age 50 or older) to a traditional IRA
2. After a short waiting period, convert the traditional IRA assets to a Roth IRA

If after the non-deductible contribution was made, the conversion is executed on a timely basis, and no other pre-tax assets remain in the IRAs, the conversion is tax-free.

Keep in mind

Although numerous individuals are implementing this strategy every day, it is important to point out that the "Backdoor Roth" strategy has never been approved or disapproved by the IRS. Also, individuals must be under the age of 70½ and have earned income to contribute to a traditional IRA. Lastly, IRS Form 8606 (Non-deductible IRAs) must be filed each year a non-deductible contribution is made or a Roth conversion is executed. While the "Backdoor Roth" could be a valuable maneuver for many high income earners, it is always recommended to consult with a CPA or qualified tax preparer for guidance.

IRAs AND TAX FORMS

While the beginning of the year is often a time for resolution and planning, it is also a dreaded time for many Americans as tax season is quickly approaching. IRA owners should be aware of the tax forms they should expect to receive from their financial institutions.

The 1099R

This form is issued to individuals who receive distributions from IRAs or Qualified Retirement Plans. In addition to reporting distributions, the 1099R shows Roth conversions and any state or federal tax withheld from IRA or plan withdrawals. The deadline for financial institutions to issue 1099R forms is January 31, 2018, for the 2017 tax year.

The 5498

The receiving custodian of a qualified plan or IRA rollover issues this to the account holder as proof that the rollover was not a taxable event. The 5498 also reports any contribution or conversion going into an IRA and typically shows the prior year's December 31 value of an IRA or plan. While a 5498 shows valuable IRA information, it is generally not issued until May 31, 2018, for the 2017 tax year and should be treated as a confirmation document.

Any other IRA-related tax forms?

1. Schedule K-1 – Issued for limited partnership investments
2. 1099Q – Distributions from Education Savings Accounts (ESAs)
3. 5498-ESA – Contributions or Rollovers into ESAs

Even though financial institutions have certain IRS deadlines for issuing tax forms, there is always a chance individuals will receive amended tax forms after the deadline.

CHANGES ON FORM 5500 FOR 2017

The Department of Labor (DOL) has released advance copies of the Annual Return/Report of Employee Benefit Plans, which is more commonly known as the Form 5500. All qualified plans, with a few exceptions, must file a Form 5500 each year and, if necessary, accompanying Schedules. In collaboration with the IRS and the Pension Benefit Guaranty Corporation (PBGC), the DOL has made some modifications to the new version of the Form 5500 that must be filed for qualified plans that existed in 2017. Below are the specific changes:

- IRS-only questions removed – Previous versions of the Form 5500 had questions which were not required to be completed by filers. These questions, including preparer information, trust information, Schedules H and I, Line 4o, and Schedule R, Part VII, regarding the IRS Compliance questions, have been removed from the Form.
- Authorized Service Provider Signatures – Authorized service providers are allowed to sign electronically, and the instructions on how to do so and what is required on the Form 5500 have been updated.
- Administrative Penalties – The maximum civil penalty amount for failure to file a complete or accurate Form 5500 has increased to $2,097 a day per the 2015 Inflation Adjustment Act. The increase is noted on the 2017 Form.
- Form 5500/5500-SF-Plan Name Change – Line 4 of the new Form 5500 has been changed to provide a field for reporting the change in the name of the plan. This line must also be filled out if the plan name had changed in years prior to 2017.
- Schedule MB – This schedule only applies to Multiemployer Defined Benefit Plans and certain Money Purchase Plans. These types of plans must include information on actuarial assumptions used. The instructions for Line 6c on Schedule MB have been updated to add mortality codes for several variants of the mortality table and to add a description of the mortality projection technique and scale.
- Form 5500-SF-Line 6c – Line 6c applies to Defined Benefit Plans only and asks if the plan is covered under the PBGC insurance program. A follow-up question has been added in 2017 that prompts the filer to enter the confirmation number from the PBGC for the year being filed. This question seeks to prevent filers from either accidentally or fraudulently claiming the plan is covered by the PBGC when it is not.

At this point, advance copies of the 2017 Form 5500 are for informational purposes only and should not be used for actual filings. For more information, see the "Changes to Note" section of the 2017 Form 5500 instructions found here: https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/reporting-and-filing/form-5500

SIMPLIFIED EMPLOYEE PENSION (SEP) IRAs STILL AVAILABLE FOR 2017

For business owners whose tax year is based upon the calendar year, December 31, 2017, was the last day a Qualified Retirement Plan (QRP) could be established for 2017. 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 2017.

Contributions

The maximum amount that can be contributed for 2017 on behalf of each SEP participant is the lesser of:

- 25% of compensation (IRC Sec. 402(h) limit) up to the compensation cap of $270,000 or
- $54,000 per individual (IRC Sec. 415(c) dollar limitation)

Contributions for the self-employed

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

1. The deductible portion of an individual's self-employment tax, and
2. The contribution 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 (website: 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 deductible contribution 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. May be established and funded by the business owner's tax filing deadline (plus extensions)
2. Contributions are deposited directly into eligible participants' SEP IRA accounts
3. No IRS Form 5500 reports are required
4. Little administration is required
5. Discretionary contributions – Contributions to a SEP are not mandatory for any particular year

Closing comment

A SEP is a very attractive plan for small business owners, and it is the only plan that can be established in 2018 to take advantage of a 2017 tax deduction.

PLAN FIDUCIARY RESPONSIBILITIES

Numerous headlines in the financial news report that large percentages of plan sponsors still believe they have no fiduciary responsibilities to their qualified retirement plans. Despite the changes brought forth by the Department of Labor surrounding fiduciary advice, there is still work to be done in educating business owners sponsoring retirement plans of their responsibility to care for the participants and their beneficiaries.

Many of the actions required to operate a qualified retirement plan involve fiduciary decisions. ERISA defines "fiduciary" not in terms of formal title but rather in functional terms of control and authority over the plan. There are some plan decisions that are technically business decisions, e.g., establishing a plan, adding certain features, terminating a plan, etc. However, when action is taken to implement these decisions, it is a fiduciary act.

The following are requirements of the fiduciary[1]:

- Acting solely in the interest of the participants and beneficiaries
- Acting exclusively with the purpose of providing benefits to plan participants and beneficiaries, and ensuring reasonable expenses are charged for services
- Fulfilling duties with care, skill, prudence, and diligence with plan matters
- Following plan documents that guide the operation of the plan
- Diversifying plan investments

The responsibility to act prudently in carrying out the functions of a retirement plan may dictate the need to involve experts to assist with investment selection/monitoring and plan administration. The IRS has put rules in place to help plan fiduciaries navigate and fulfill their responsibilities. For example, salary-reduction contributions must be separated from business assets and directed to retirement plan accounts as soon as administratively feasible, but no later than the 15th business day of the month following the date in which employees were paid.

How can liability be limited?

While there is always some level of liability involved with acting in the capacity of a plan fiduciary, there are ways to mitigate some of the potential liability. A good example of this is developing a prudent process for evaluating the investments offered to plan participants. The process can be documented through an Investment Policy Statement. Even if a fund selected for a plan's investment line-up proves to be an underperforming fund for a period of time, documenting the decision-making process to illustrate the rationale for keeping the underperforming fund will help relieve some of the liability.

Another way to limit potential liability is to allow participants to control the investments in their own retirement accounts under a plan. There are specific requirements to permit a participant-directed arrangement to remove liability from the responsible plan fiduciaries. Plan participants must be provided with sufficient information on the investment offerings available in a plan on a scheduled basis, no less frequent than annually. In addition, plan fiduciaries can hire service providers to take on some, or a majority of the fiduciary responsibilities.

Hiring service providers to act as a plan fiduciary

Since liability can never be fully removed for a plan sponsor, documenting the process for selecting and monitoring outside service providers is also a prudent practice. When selecting a plan service provider, here are a few items to evaluate:

- Background information on the firm's affiliations, financial position, assets under management, and experience with qualified retirement plans
- Description of the firm's process for investing assets, handling participant investment directions, and the fee structure for services
- Information on the experience and qualifications of the professionals that will be handling the plan's assets

Once a service provider is hired, additional action should be taken to monitor the provider(s). Here are a few items to regularly monitor:

- Review performance of the service provider
- Review reports issued by the service provider(s)
- Check the actual fees charged for the plan services
- Inquire about policies and procedures for trading, proxy voting, and investment turnover
- Look into participant complaints to determine validity

While there are many aspects of plan operation, these are general guidelines to aide responsible plan fiduciaries in understanding their responsibilities to providing a compliant retirement plan to employees.

[1] https://www.irs.gov/retirement-plans/retirement-plan-fiduciary-responsibilities

RMDs FOR MISSING PARTICIPANTS OF RETIREMENT PLANS

The Internal Revenue Service (IRS) issued a memo in October of 2017 to its Employee Plan (EP) Examiners not to contest plan sponsors on missed required minimum distributions (RMDs) by participants that cannot be located if certain requirements are met.

Qualified Retirement Plan participants must generally begin taking RMDs from their plans in the year in which they reach age 70½ and retire. However, when terminating employment, many participants leave their qualified plan balances in their former employer's plan. In these situations, it can be difficult, often years later, to locate a participant to remind them of the requirement to begin taking distributions at age 70½. Plan sponsors can be absolved of responsibility as long as they have taken the following actions:

- Searched plan and related plan, sponsor, and publicly available records or directories for alternative contact information;
- Used any of these search methods:
  - A commercial locator service;
  - A credit reporting agency; or
  - A proprietary internet search tool for locating individuals; and
- Attempted contact via U.S. Postal Service certified mail to the last known mailing address and through appropriate means for any address or contact information (including e-mail addresses and telephone numbers).

If a plan sponsor hasn't completed the steps above, IRS examiners can assert that a violation of the RMD standards has occurred. The violation must then be either corrected by the Self-Correction Program (SCP) or the Audit Closing Agreement Program (Audit CAP); otherwise the plan may become subject to disqualification.

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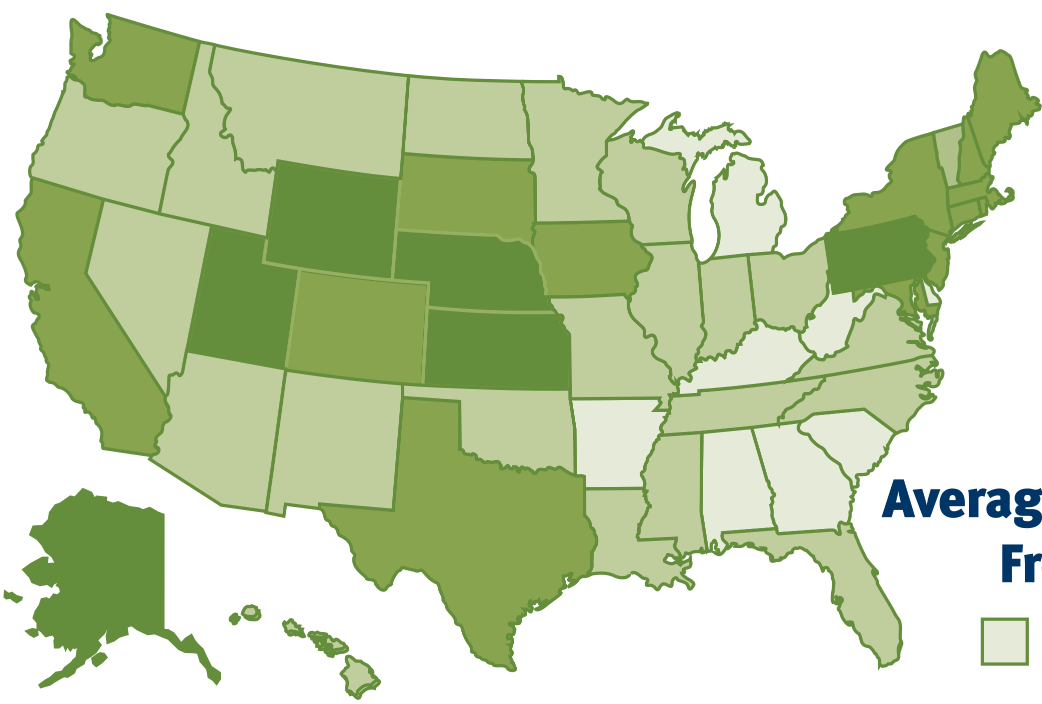

Average Retirement Age From State to State

Source: Smartasset.com, based on U.S. Census Bureau labor force participation data.