

***Individual Retirement Accounts:
A User's Guide to the Varied World of IRAs***

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I. INTRODUCTION

NOTE: Individual Retirement Accounts have become the largest source of Retirement Plan Assets in the United States.

<u>Retirement Plan</u>	<u>2012 Assets (Trillions)</u>
IRAs	\$5.4
Defined Contribution Plans	\$5.1
Defined Benefit Plans	<u>\$2.6</u>
	\$13.1

A. Eligibility for Establishing Individual Retirement Accounts.

Internal Revenue Code Section 219(g) establishes (with annual COLAs) the adjusted gross income (AGI) phaseout limits for deductible IRA contributions for individuals who are active participants in employer-sponsored retirement plans. Active participants below a threshold level of income may make deductible IRA contributions. The deduction available to active participants is reduced proportionately over a phaseout range. Active participants with AGI above the phaseout range are not entitled to any deduction for a contribution to an IRA. I.R.C. § 219(g).

The Phaseout Limits are as follows:

<u>Tax Year Beginning In:</u>	<u>Single Taxpayers</u>
2014	\$60,000-\$79,000
<u>Tax Years Beginning In:</u>	<u>Married Taxpayers Filing Jointly</u>
2014	\$96,000-\$116,000

B. Active Participant Status Not Attributed to Spouse.

For years commencing prior to 1998, an individual was considered to be an active participant in a plan if such individual's spouse was an active participant. For years commencing after 1997, however, an individual will not be considered to be an active participant in an employer-sponsored plan

merely because the individual's spouse is an active participant during such year.

Increased phaseout limits for spouse of active participant. The maximum deductible IRA contribution for an individual who is not an active participant, but whose spouse is, will be phased out for AGI between \$181,000 and \$191,000 for 2014. I.R.C. § 219(g)(7).

C. Active Participant Defined. IRS Notice 87-16. I.R.C. § 219(g)(5).

1. In the case of a defined benefit plan, an individual who is not excluded under the eligibility provisions of the plan for the plan year ending with or within the individual's taxable year shall be an active participant in the plan, regardless of whether the individual actually participates in the plan for such years. *Wartes*, 65 TCM 2058 (1993). For purposes of the § 219(g) limit on deduction for IRA contributions, active participation in an employer's defined benefit plan ends when the plan is frozen and future benefit accruals cease. PLR 8948008, IRS Announcement 91-11.
2. In the case of a defined contribution plan, an individual shall be an active participant if employer or employee contributions or forfeitures are allocated to such individual's account with respect to a plan year ending with or within the individual's taxable year. Participation in a defined contribution plan for a year during which no employer or employee contributions are made and no forfeitures are allocated does not constitute active participation. PLR 9008058. However, if the employer is required to make a contribution to an individual's account and has not done so, the individual is still considered an active participant. IRS Announcement 91-11.
3. If, with respect to a particular plan year, no amount attributable to forfeitures, employer contributions or employee contributions has been allocated to an individual's account by the last day of the plan year, and contributions to the plan are purely discretionary for the plan, such individual shall not be an active participant for the taxable year in which such plan year ends. If, however, after the end of such plan year, the employer contributes an amount for such plan year, an individual to whose account an allocation is made shall be an active participant for the taxable year in which the contribution is made. Employer contributions made in 1989 for the 1988 plan year result in active participation for 1989, not 1988. PLR 9008056.

II. ROTH IRAs. I.R.C. § 408A

A. In order for the Roth IRA rules to apply, an IRA must be designated as a Roth IRA at the time of its establishment. I.R.C. § 408A(b).

B. Contribution Limits.

The contribution limits on Roth IRAs, deductible IRAs and non-Roth nondeductible IRAs are coordinated and limited to \$5,500 per year (not including rollovers) for all three types of IRAs. I.R.C. § 408A(c)(2). Limits are:

2013-2014 \$5,500

1. The maximum yearly contribution that can be made to a Roth IRA is phased out for single taxpayers with adjusted gross income (AGI) between \$114,000 and \$129,000 for 2014 (adjusted) and for joint filers with AGI between \$181,000 and \$191,000 for 2014 (adjusted). I.R.C. § 408A(c)(3). The phaseout limit for a married individual filing a separate return is \$0 to \$10,000 AGI. I.R.C. § 408A(c)(3)(A)(ii). Rev. Proc. 2007-66.
2. Catch-up contributions for individuals age 50+ also apply to Roth IRAs.
3. Contributions may be made to a Roth IRA even after the individual for whom the account is maintained has attained age 70½.
4. Excess contributions to a Roth IRA are subject to a six percent excise tax. I.R.C. § 4973.
5. SEPs and SIMPLE IRAs may not be designated as Roth IRAs and contributions to a SEP or a SIMPLE IRA are not taken into account for purposes of the \$5,500 IRA contribution limit. I.R.C. § 408A(J). Therefore, contributions to a SEP or SIMPLE IRA do not affect the amount that an individual can contribute to a Roth IRA.

C. Contributions Are Nondeductible.

Contributions to Roth IRAs are nondeductible. Rather than deducting the contribution up front as with a deductible IRA, the tax benefits are backloaded. Qualified distributions (including earnings) from Roth IRAs are tax-free. Thus, unlike deductible IRAs and tax-qualified plans which provide tax-deferral, Roth IRAs provide true tax-free buildup of investment earnings within the IRA.

D. Rollover/Conversion to a Roth IRA.

Prior to 2010, an existing IRA could be rolled over (or converted) into a Roth IRA by a taxpayer with AGI of less than \$100,000 (not counting the rollover

or conversion amount) for the taxable year of the rollover. I.R.C. § 408A(c)(3)(B).

1. Elimination of \$100,000 AGI limit for Roth IRA Rollover (effective in 2010).

The Tax Increase Prevention and Reconciliation Act of 2005 ("TIPRA") amends Internal Revenue Code §408A to eliminate the requirement that a taxpayer's gross income not exceed \$100,000.00 in order to be eligible to convert a non-Roth IRA into a Roth IRA. This change is effective for tax years beginning after December 31, 2009. Additionally, TIPRA amends Internal Revenue Code §408A to provide a two-year ratable income option for taxpayers who elect Roth IRA conversions in 2010. Under this rule, the amount of the conversion that must be included in gross income is recognized in two equal installments in 2011 and 2012. Taxpayers who are subject to this two-year ratable income rule would incur no taxation in the year of conversion (i.e. 2010). A taxpayer may elect not to have the two-year ratable income rule apply and include the entire taxable amount in income in 2010.

2. Direct rollovers from retirement plans to Roth IRAs. IRC §408A(e).

Effective for distributions after December 31, 2007, the Pension Protection Act of 2006 permits distributions from tax-qualified retirement plans, section 403(b) tax-sheltered annuities, and government 457 plans to be rolled over directly from such plan into a Roth IRA. Such rollovers are subject to the same rules that apply to rollovers from a traditional IRA into a Roth IRA.

3. An amount can be converted by any of three methods.
 - a. An amount distributed from a traditional IRA is contributed (rolled over) to a Roth IRA within sixty days after the distribution;
 - b. An amount in a traditional IRA is transferred in a trustee-to-trustee transfer from the trustee of the traditional IRA to the trustee of a Roth IRA; or
 - c. An amount in a traditional IRA is transferred to a Roth IRA maintained by the same trustee (in this case, no physical transfer of assets is necessary, but the instrument governing the non-Roth IRA must be replaced by a Roth IRA instrument). Treas. Reg. § 1.408A-4.

4. SEP or SIMPLE IRA may be converted.

Amounts in a SEP or a SIMPLE IRA may be converted into a Roth IRA. Treas. Reg. § 1.408A-4, Q&A-4. A SIMPLE IRA may only be converted after the expiration of the two-year period under I.R.C. § 72(t)(6). Treas. Reg. § 1.408A-4, Q&A-4(b). This is the period during which a twenty-five percent penalty applies to distributions made before the SIMPLE-IRA participant has attained age 59½.

5. Amounts rolled over into a Roth IRA are includable in the income of the taxpayer for the year of the rollover or conversion to a Roth IRA.
6. The ten percent early distribution tax under I.R.C. § 72(t) does not apply to rollovers to Roth IRAs.
7. Inherited IRAs cannot be rolled over into Roth IRAs. IRC §408(d)(3)(C).

E. Recharacterization of Conversions, Rollovers or Contributions to Roth IRAs.

A taxpayer who wishes to undo a Roth IRA conversion or rollover for any reason may undo the conversion or rollover by a trustee-to-trustee transfer from the Roth IRA to another IRA by the due date for the taxpayer's return for the year of the contribution (including extensions). Excess contributions to Roth IRAs made be similarly transferred. I.R.C. §§ 408A(d)(6)(A) and 408A(d)(7). Treas. Reg. § 1.408A-5, Q&A-1. IRS Notice 2000-30.

1. An individual makes an election to recharacterize by notifying, on or before the date of the transfer, both the trustee of the *First IRA* and the trustee of the *Second IRA* (i.e., the recharacterized IRA) that the individual has elected to treat the contribution as having been made to the *Second IRA*, instead of to the *First IRA*, for Federal tax purposes. Treas. Reg. § 1.408A-5, Q&A-6.

In general, a recharacterization of a contribution must be made on or before the due date (including extensions) for filing the individual's federal income tax return for the taxable year for which the contribution was made to the *First IRA*. Treas. Reg. 1.408A-5, Q&A-1(b). IRS Notice 2000-30.

2. Recharacterization of an IRA is not treated as a rollover for purposes of the one-rollover-per-year limitation of I.R.C. § 408(d)(3)(B). Treas. Reg. § 1.408A-5, Q&A-8.

3. Reconversion to Roth IRA.

a. Example.

- i. Step 1: IRA converted to Roth IRA.
- ii. Step 2: Roth IRA recharacterized as IRA.
- iii. Step 3: IRA reconverted to Roth IRA.

Q&A-9(a) addresses reconversions made on or after January 1, 2000. When a taxpayer converts a traditional IRA to a Roth IRA, then recharacterizes that amount back to a traditional IRA, a reconversion of that amount back to a Roth IRA is not permitted until the *later* of: (1) the beginning of the taxable year following the taxable year in which the amount was originally converted to a Roth IRA; or (2) thirty days following the recharacterization of that amount to a traditional IRA. A conversion attempted before this period ends in a *failed conversion*. A failed conversion may be recharacterized as a traditional IRA under the rules described in this part of the summary. If not timely recharacterized, the failed conversion is treated as a regular Roth IRA contribution, and will be subject to the excise tax under I.R.C. § 4973 if it exceeds the contribution limit for the applicable taxable year. *See* Q&A-3 of § 1.408A-4.

4. Reporting method for IRA recharacterizations and reconversions.

Each recharacterization or reconversion occurring after December 31, 2000 (including a recharacterization or reconversion of an amount contributed before January 1, 2001), whether or not using the same trustee, must be reported as described in Notice 2000-30. The trustee of the *First IRA* (*i.e.*, the distributing IRA) reports the distribution or recharacterization on Form 1099-R. The trustee of the *Second IRA* (*i.e.*, the recipient IRA or recharacterized IRA) reports the contribution or recharacterization on Form 5498. IRS Notice 2000-30.

F. Distributions from Roth IRA.

Qualified distributions from a Roth IRA are not included in the taxpayer's gross income and are not subject to the ten percent tax on early withdrawals. Qualified distributions must satisfy a five-year holding period *and* must meet one of four criteria for a distribution.

1. Five-year holding period.

The five-year holding period begins with the first taxable year for which the individual made a contribution to a Roth IRA (or such individual's spouse made a contribution to a Roth IRA) established for such individual. In the case of a rollover, the five-year period begins

with the taxable year in which the rollover contribution was made or, if earlier, the taxable year in which a prior contribution was made to a Roth IRA. A subsequent rollover or conversion does *not* start the running of a new five-year period. I.R.C. § 408(A)(d)(2)(B).

2. Qualified distributions.

Distributions which have satisfied the five-year holding period will be qualified if the distribution is:

- a. Made on or after the date on which the individual attains age 59½;
- b. Made to a beneficiary (or the individual's estate) on or after the individual's death;
- c. Attributable to the disability of the individual; or
- d. A distribution made for qualified first-time home buyer expenses. (Up to \$10,000 over the taxpayer's lifetime.) I.R.C. § 408A(d)(2)(A).

3. Nonqualified distributions.

In applying the taxation rules of I.R.C. § 72 to any distribution from a Roth IRA which is not a qualified distribution, such distribution shall be treated as made from contributions to the Roth IRA to the extent that such distribution, when added to all previous distributions from the Roth IRA, does not exceed the aggregate amount of contributions to the Roth IRA. I.R.C. § 408A(d)(1)(B).

4. The ten percent early distributions tax is assessed on withdrawals from a Roth IRA within the five-year period beginning with the conversion year.

G. 10% Tax on Early Distributions / 5 Year Holding Period. IRC §408A(d)(3)(F)(i).

1. A 10% early distribution tax is assessed on withdrawals from a Roth IRA within the five-year period beginning with the conversion or rollover year.
2. This is a different five year holding period than the five year period to determine a qualified distribution. The period begins with the year of the conversion or rollover, not the year of the individual's first contribution to a Roth IRA. Treas. Reg. §1.408A-6, Q&A-2, -4, -5.
3. The 5 year period is determined separately for each conversion / rollover contribution.

4. This special rule does not apply to amounts converted from a nondeductible IRA.
5. Under this special rule, the entire distribution is generally subject to the 10% penalty although the distribution represents the non-taxable return of the after-tax conversion amount.
6. Once the 5 year holding period is met, the return of the conversion contributions follow the same rule as the return of annual Roth contributions: a distribution of after-tax contributions is neither taxed nor penalized. Treas. Reg. 1.408A-6, Q&A-8.

H. Minimum Distribution Rules Do Not Apply Before Death.

The pre-death required distribution rules of I.R.C. § 401(a)(9) that require distributions from IRAs commencing at age 70½ do not apply to Roth IRAs. If the spouse elects to treat the Roth IRA as his or her own, then minimum distributions would not be required until after *the spouse's death* (§ 1.408A-2, Q&A-4). IRS Publication 590, pp. 70-71.

Minimum distribution rules apply *separately* to Roth IRAs and non-Roth IRAs (§ 1.408A-6, Q&A-15). An individual may *not* withdraw funds from a Roth IRA to satisfy minimum distribution requirements from a non-Roth IRA. A beneficiary may aggregate Roth IRAs for the post-death minimum distribution requirements described in the prior paragraph only if the Roth IRAs are inherited from the same decedent.

III. CONTRIBUTIONS TO AN IRA

A. General Rule.

General Rule of the Lesser of \$5,500 or 100% of Compensation. I.R.C. § 219(b)(1).

1. Spousal IRA of nonworking spouse.

As long as a joint return is filed and a separate IRA is established for the spouse, nonworking spouses may contribute up to \$5,500 per year to a deductible IRA. Thus, each spouse may contribute \$5,500 to a deductible IRA (for a total of \$11,000). I.R.C. §§ 219(c), (f)(2) and (g)(1).

2. \$10,000 (adjusted) maximum if both spouses have earned income.

This amount must not exceed 100% of earned income, and neither account can receive more than \$5,500 (adjusted) per year.

3. Catch-up contribution.

Individuals who have attained Age 50 may make additional catch-up contributions of \$1,000 per year.

4. No limit on the amount that can be rolled over from a qualified plan.

However, the distribution must be eligible for rollover treatment. The limitations on deductible IRA contributions do *not* restrict rollovers to an IRA. I.R.C. § 408(b)(8).

a. Effective for distributions after December 31, 2001, after-tax contributions by an employee to a qualified plan can be rolled over to an IRA. I.R.C. § 403(b)(8). Rev. Rul. 89-50.

b. Hardship distributions from a § 401(k) plan or a § 403(b) plan are *not* eligible rollover distributions and may not be rolled over to an IRA or to another qualified plan or § 403(b) plan. I.R.C. §§ 402(c)(4) and 403(b)(8)(B), as amended by the 1998 Act. Please note, however, that since hardship distributions are not eligible rollover distributions, such distributions are not subject to the twenty percent federal income tax withholding requirement.

5. Nondeductible contributions.

An individual ineligible for the full deductible contribution to an IRA may make nondeductible contributions. Total nondeductible and deductible contributions cannot exceed \$5,500 (adjusted) for any year. I.R.C. § 408(o). Nondeductible contributions are reported on Form 8606.

6. IRA owner's payment of fees.

An IRA owner's payment of fees charged by the IRA custodian, other than sales charges or commissions, escapes classification as an IRA contribution. PLR 9005010. Similarly, an employer's payments for investment management of qualified plan assets can be deducted under § 162 and are not deemed to be contributions under § 404 or § 415. PLR 9252029; PLR 8941009; PLR 8941010; PLR 8940014. However, payments by an employer to the plan trustee to reimburse investment management expenses are deemed to be contributions. PLR 9124036.

B. Timing and Calculation of Contribution.

1. Contributions must be made by the due date for an individual's tax return, without taking extensions into consideration.

I.R.C. § 219(f)(3). Thus, the contribution must be made by April 15. The IRS has ruled that a contribution postmarked on April 15 will be considered to have been made on that date.

2. Deductible contributions must be made in cash (check, *etc.*).

Rollover contributions may be made in the form of property, provided, that the IRA is not precluded from holding that property. Apparently, a credit card cash advance or other loan can be used to properly fund an IRA if the taxpayer otherwise has earned income which at least equals the contribution amount. PLR 8622051.

3. No deduction allowed for an individual who has attained age 70½.

I.R.C. § 219(d)(1). However, if the participant's spouse is not 70½, contributions can still be made on the spouse's behalf. Additionally, a rollover may be made by an individual after age 70½.

4. The 100% of compensation is determined by reference to "earned income" or "gross income." I.R.C. §§ 219(f)(1); 401(c)(2).

- a. Gross income definition only applies to an amount received pursuant to a divorce or separation decree.

- b. Earned income includes amounts received for personal services actually rendered. However, a net loss from self-employment does not reduce the salary earned by a taxpayer for IRA purposes. Rev. Rul. 79-286. Earned income does not include investment income, income from a retirement or deferred compensation plan, or any income otherwise excluded from gross income.

5. Return of excess contributions.

Excess IRA contributions that are returned by the due date of the IRA holder's tax return for the year are not included in the taxpayer's income and are not subject to the six percent excise tax on excess contributions or the ten percent additional tax on premature distributions. No deduction may have been allowed or allowable under I.R.C. § 219 for the excess contribution. I.R.C. § 408(d)(5). A SIMPLE IRA contribution that exceeds the applicable limit and is not excludable from an employee's income may be included as a corrective distribution. I.R.C. § 408(d)(7)(B).

IV. LIMITATIONS ON AN IRA

A. Penalty for Excess Contributions.

1. Contribution must either be a deductible contribution, a rollover contribution, a non-deductible contribution or a Roth IRA contribution.

A non-rollover contribution greater than \$5,500 (adjusted) is an excess contribution. I.R.C. § 4973(b).

2. If an excess contribution is not corrected, it is subject to a six percent annual penalty until it is corrected. I.R.C. § 4973(a).
3. Methods of alleviating excess contribution problem.
 - a. Do not take a deduction for the amount in excess, which should be withdrawn. Must also pay income tax on any earnings as taxable income for the year in which the contribution was made. I.R.C. § 408(d)(4); or
 - b. Treat the excess amount as a deduction for the subsequent tax year. I.R.C. § 219(f)(6).
4. I.R.C. § 6693(b) provides a penalty of \$100 for erroneously reporting the overstatement of a nondeductible IRA contribution, unless the overstatement is due to reasonable cause.

B. Additional Taxes Attributable to IRAs Are Reported on IRS Form 5329.

1. The six percent excise tax on excess contributions to an IRA is reported on Part I of Form 5329. I.R.C. § 4973.
2. The ten percent excise tax on early distributions made prior to age 59½ (unless the distribution fits into one of the exceptions) is reported on Part II of Form 5329. I.R.C. § 72(t).
3. The fifty percent excise tax on distributions not meeting the minimum distribution requirements for distributions after age 70½ is reported on Part III of Form 5329. The tax is fifty percent of the under-distributed portion. I.R.C. § 4974.

C. Applicability of Prohibited Transaction Rules/Restrictions on IRA Investments.

1. Since IRA is not a qualified plan, the prohibited transaction rules of I.R.C. § 4975, as opposed to ERISA, apply.

If the owner or beneficiary of an IRA engages in a prohibited transaction with the IRA, the entire IRA is disqualified, not just the amount involved in the prohibited transaction. I.R.C. § 408(e)(2); Reg. § 1.408-1(c)(2).

2. A loan cannot be secured by an IRA.

An assignment or pledging of any amount will be considered a distribution. I.R.C. § 408(e)(4); Reg. § 1.408-1(c)(4).

3. Precedent exists disqualifying the entire individual retirement annuity of a taxpayer who borrowed against the loan value of an annuity contract.

The disqualification was retroactive to the first day of the taxable year during which the loan was incurred. The taxpayer was also deemed to have received a distribution. *See Griswold v. Commissioner*, 85 TC No. 51 (11/26/85).

4. Bank services to IRA owners.

The IRS has stated that it will not raise issues concerning the effects of possible prohibited transactions arising from certain cash, property or services offered by financial institutions that maintain IRAs or Keoghs for self-employed individuals. This exemption does *not* apply to employer-maintained IRAs or to Keogh Plans which cover individuals other than the self-employed individual. IRS Announcement 90-1. The Department of Labor has also issued a class exemption which permits banks to provide low-cost or no-cost services to individuals with IRAs or Keogh plans. Department of Labor PT Exemption 93-33.

5. IRA cannot be used to purchase life insurance. I.R.C. § 408(e)(5)(B).

Consequently, rollover contributions from a qualified plan may not include life insurance.

6. An IRA cannot invest in collectibles. I.R.C. § 408(m).

This includes coins, stamps, art, antiques, wine, *etc.* Any amount invested in a collectible will be considered a distribution. However, an IRA may invest in gold, silver or platinum coins issued by the United States or any coin issued under the laws of any state. An IRA may also invest in gold, silver, platinum or palladium bullion acquired after December 31, 1997 if such bullion is in the physical possession of the IRA trustee or custodian. I.R.C. § 408(m).

D. Rollover to Same IRA.

The withdrawal and redeposit of funds into the same IRA within a sixty-day period constitutes a tax-free rollover. Technical Advice Memo 9010007. An

individual is only permitted to have one IRA rollover within any rolling twelve-month period.

E. IRA Rollover — *Bobrow v. Commissioner* (TC Memo 2014-21); IRS Announcement 2014-15.

1. The holder of an IRA can use the 60-day rollover rule only once in a rolling twelve-month period.
2. Effective January 1, 2015, an individual who made a rollover from an IRA cannot make another IRA rollover within the next 365 days.
3. The restriction does not apply to direct trustee-to-trustee transfers between IRAs.

V. NONTRADITIONAL IRA INVESTMENTS: POTENTIAL ISSUES

A. Prohibited Transactions under IRC § 4975.

1. As noted in Section IV above, IRAs are subject to the prohibited transaction (PT) rules under IRC § 4975. IRC §4975(e)(1).
2. The PT rules can be quite broad and include a "catch-all" provision in IRC §4975(c)(1)(v.) prohibiting any direct or indirect: "v. act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account."
3. "Disqualified persons" include the person who establishes the IRA, members of his or her family, corporations, trusts or other entities owned or controlled by such individuals, and fiduciaries. IRC § 4975(e)(2).
4. If the IRA owner receives any benefit from an IRA investment other than the IRA's investment return, the potential for a PT exists.
5. If the owner of an IRA engages in a PT, the IRA ceases to be an IRA as of the first day of the taxable year in which the transaction occurs. IRC § 408(e)(3).
6. If an IRA ceases to be an IRA due to a PT, the entire value of the IRA is treated as distributed to the IRA owner. IRC § 408(e)(2)(B).

B. Loss of Creditor Protection for IRA due to PT.

1. As noted above, if there is even one minor PT, the rule is that the entire IRA is treated as terminated and all of the assets of the IRA are distributed to the IRA owner on the first day of the year in which the PT occurred. In *In re: Ernest W. Willis*, 2011 WL 1522383 (11 Cir. 2011), the U.S. Eleventh Circuit Court of Appeals affirmed the judgment of a U.S. Bankruptcy Court in Florida that as a result of a PT

on IRA lost its status as an IRA and thereby lost its exemption in bankruptcy.

- C. Unrelated Business Taxable Income (UBIT).
 - 1. An investment by an IRA in a partnership or LLC may result in UBIT for the IRA. Similarly, if the IRA actually owns or operates a business, it may produce UBIT.
 - 2. A debt financed investment may also produce UBIT for the IRA. Worse, if the IRA owner guarantees the debt a PT could result disqualifying the entire IRA.
- D. Nontraditional investments may be higher risk/high return (or high loss) investments.
 - 1. These may be inappropriate if the IRA owner is relying on the IRA assets for his/her retirement.
- E. Practice Hint:

If an individual desires to invest IRA assets in a non-traditional investment, set up a separate IRA for that investment. If the investment results in a prohibited transaction only that specific IRA will be disqualified and deemed to be distributed.

VI. TRUSTEED IRAs.

- A. IRAs may be Custodial Accounts or Trusts.
 - 1. IRC § 408(h) permits IRAs to be custodial accounts. However, an IRA may also be established as a Trust with an institutional trustee under IRC § 408(a).
- B. Trusteed IRAs are used as estate planning tools.
 - 1. Trusteed IRAs are an alternative to Conduit Trusts or Accumulation Trusts with respect to an individual's estate planning.
 - 2. All of these options can be used by the IRA owner to limit the discretion of IRA beneficiaries to withdraw funds from the IRA following the death of the IRA owner.
 - 3. Financial institutions may limit trusteed IRAs to accounts with significant assets (e.g., \$500,000 or \$1,000,000). Additionally, the fees charged for trusteed IRAs may be significantly higher than the fees for custodial IRAs.
 - 4. Trusteed IRAs are useful if the IRA owner desires to "stretch" the IRA payments after his or her death. This method permits the IRA assets to

continue to accumulate on a tax-deferred (or, in the case of a Roth IRA, tax free) basis for as long as possible. An IRA owner's desire to stretch payments may be thwarted if the beneficiary has total control of the IRA assets following the death of the IRA owner.

5. Trusteed IRAs also give the IRA owner control over where the IRA assets go if the beneficiary dies. A trusteed IRA allows the IRA owner to control the ultimate beneficiaries of the IRA by specifying contingent beneficiaries that cannot be changed by the primary beneficiary.
6. A trusteed IRA can restrict distributions to required minimum distributions (RMDs) to the beneficiary. Alternatively, the trustee can be provided with discretionary authority to make payments to the beneficiary in addition to RMDs for the beneficiary's health, education, welfare, or other circumstances.

VII. SIMPLIFIED EMPLOYEE PENSIONS (SEP)

A. SEP Requirements. I.R.C. § 408(k).

1. A SEP is an individual retirement account which is employer-funded and can accept an expanded rate of contributions. An employer's annual contribution to a SEP on behalf of each employee is limited to the lesser of (a) 25% of the employee's compensation (not reduced for employee contributions to the SEP), or (b) \$52,000 (adjusted). I.R.C. §§ 408(j) and 415(c)(1)(A). The SEP/IRA is owned by the employee, who may be self-employed. Note: SEPs are IRAs and, as such, do not enjoy the protection from creditor's claims afforded to tax-qualified plans under I.R.C. § 401(a)(13) and ERISA § 206(d). The SEP/IRA is owned by the employees, who may be self-employed.
2. The employer must contribute to the SEP on behalf of each employee who:
 - a. Has attained age twenty-one;
 - b. Has performed service for the employer for at least three of the immediately preceding five years;
 - c. Has performed service for the employer during the year for which the contribution is made (regardless of whether the employee is still employed by the employer at the end of such year) and has received at least \$550 (adjusted for COLA) in compensation for such year; and
 - d. Non-resident aliens with no income from U.S. sources and employees covered by a collective bargaining agreement with whom retirement benefits have been the subject of good faith

bargaining may be excluded from participation. I.R.C. § 408(k)(2). Prop. Regs. § 1.408-7(d) and § 1.219-3(b)(2).

3. To establish a SEP, an employer must execute a written instrument which must include:
 - a. The name of the employer;
 - b. The requirements for participation;
 - c. The signature of an appropriate official;
 - d. A definite formula for the allocation of employer contributions which specifies the manner in which the allocation is determined and what requirements an employee must satisfy to share in the allocation. Prop. Reg. § 1.408-7(e); and
 - e. No minimum funding standards are imposed for a SEP.
4. Withdrawals from a SEP must be permitted. Therefore, employer contributions cannot be conditioned on their retention in the plan and withdrawals cannot be prohibited. I.R.C. § 408(k).
5. SEPs are subject to the top-heavy rules. A top-heavy SEP is subject to the defined contribution plan minimum contribution rules. I.R.C. §§ 408(k)(1); 416(c)(2).
6. SEPs may be integrated with social security in the same manner as a qualified defined contribution plan. I.R.C. § 408(k)(3)(1). An employer cannot maintain an integrated SEP if the employer has an integrated qualified plan (*e.g.*, pension, profit-sharing or stock bonus) during the same year. I.R.C. §§ 408(k)(3)(D); 401(l)(4)(F).
7. Employer contributions to a SEP may either be made on the basis of a calendar year or on the basis of the employer's non-calendar taxable year. Employer contributions on account of a given calendar year or taxable year must be contributed by the due date (plus extensions) for the employer's tax return for such year. I.R.C. § 404(h)(1)(A).
8. Contributions by an employer may not discriminate in favor of highly compensated employees and must bear a uniform relationship to compensation (excluding compensation in excess of \$260,000, adjusted). I.R.C. § 408(k)(3)(C).
9. Contributions must also be made to SEPs on behalf of employees who have attained age 70½. I.R.C. § 219(b)(2).

B. Salary Reduction Simplified Employee Pensions (SARSEPS). I.R.C. § 408(k)(6).

1. A SARSEP may be maintained by an employer who did not have more than twenty-five employees who were eligible to participate at any time during the preceding taxable year. Employees may elect to receive cash or make elective deferrals to a SARSEP. The elective deferrals are subject to the same \$17,500 (indexed) limit applicable to § 401(k) plans and are aggregated with § 401(k) elective deferrals for the purposes of such limit.
2. The election is available only if at least fifty percent of the eligible employees elect to make such deferrals. Additionally, the deferral percentage for each highly compensated employee cannot be more than 125% of the average deferral percentage for non-highly compensated employees. I.R.C. § 408(k)(6)(C).
3. State or local governments and tax-exempt organizations cannot adopt SARSEPS. I.R.C. § 408(k)(6)(E).
4. FICA and FUTA must be withheld from employee elective deferrals to SARSEPS.
5. Note: SARSEPs repealed.

Employers are not permitted to establish SARSEPs after 1996. SARSEPs established prior to 1997 may continue to receive contributions under the pre-1997 rules. Employees hired after 1996 may participate in SARSEPs established before 1997. I.R.C. § 408(k)(6)(H).

C. SEP Establishment and Contribution Deadlines. IRS Publication 560.

1. Deadline for setting up a SEP. You can set up a SEP for a year as late as the due date (including extensions) of your income tax return for that year. A SEP is the only type of employer-sponsored retirement plan that can be established after the end of the year for which it will be effective.
2. Time limit for making contributions. To deduct contributions for a year, you must make the contributions by the due date (including extensions) of your tax return for the year.

Please note: A SEP is a type of employer-sponsored IRA and is not a tax-qualified plan under IRC Section 401(a). SEPs do not enjoy the protection from creditor claims afforded to tax-qualified plans under ERISA §206(d) and IRC §401(a)(13), but are protected in bankruptcy under the 2005 Bankruptcy Act.

VIII. SIMPLE IRA. I.R.C. § 408(p)

A. Savings Incentive Match Plans for Employees (SIMPLE Plans).

Employers with 100 or fewer employees who received at least \$5,000 in compensation in the preceding year may adopt a SIMPLE plan *if they do not maintain another qualified plan (i.e., a qualified plan, a SEP or a 403(b)).*

1. Employer may not maintain a plan to which any employee receives an allocation of contributions or an increase in accrued benefits for plan years beginning or ending in that calendar year.
2. However, an employer may adopt and maintain a SIMPLE IRA for noncollectively bargaining employees even if it maintains a qualified plan for collectively bargained employees. I.R.C. § 408(p)(2)(D)(I).

B. Employees May Contribute by *Salary Reduction Up to \$12,000* of Compensation Per Year (Up to 100% of Earned Income or Compensation).

1. Catch-up contributions for individuals who have obtained age 50:

2014: \$2,500

C. Employer Must Satisfy One of Two Contribution Formulas.

1. Employer must match 100% of contributions up to three percent of compensation.
 - a. Employer can reduce the total match to less than three percent of compensation (but not less than one percent of compensation) in two out of five years.
 - b. In order to apply the lower matching percentage, the employer must notify employees of the lower percentage within a reasonable time prior to the sixty-day election period during which employees are allowed to determine whether to participate in the SIMPLE plan.
2. Employer may elect to make a nonelective contribution of two percent of compensation for each eligible employee who has earned at least \$5,000 of compensation from the employer during the year.

D. Compensation Limited to \$260,000 (adjusted) for Two Percent Non-Elective Contributions (But Not for Matching Contribution). § 408(p)(2)(B)(ii).

1. Maximum contribution is \$12,000 elective deferral (plus \$2,500 catch-up) plus matching contribution.
2. Matching contributions on behalf of self-employed persons to SIMPLE IRAs are *not* treated as elective contributions and, therefore,

are not subject to the \$12,000 (adjusted) limit on elective deferrals. I.R.C. § 408(p)(8).

E. Eligibility Requirements.

Employees may participate in SIMPLE Plan if they:

1. Received at least \$5,000 in compensation from the employer during any two preceding years; and
2. Are reasonably expected to receive at least \$5,000 in compensation during the year.

Employees who are covered under a collective bargaining agreement and certain nonresident aliens may be excluded from participation.

F. Contributions Are 100% Vested.

G. Overall Elective Deferral Limitation Applies to SIMPLE.

Elective deferrals to SIMPLE IRAs are subject to the overall \$17,500 limit on elective deferrals to retirement plans under I.R.C. § 402(g). The § 402(g) limit is a cumulative limitation applying to all elective deferrals by an individual in a given year made under § 401(k), § 403(b), § 408(k) (SARSEPs) and § 408(p) (SIMPLEs). I.R.C. § 402(g)(3).

H. Two-Year Grace Period.

Employers who maintain a SIMPLE plan but who fail to be eligible in subsequent years (*i.e.*, employer has 100 or more employees in subsequent years) may continue to maintain the plan for a transition period following a merger or acquisition. The transition period begins on the date of the transaction and ends on the last day of the second calendar year following the calendar year in which the transaction occurs. I.R.C. § 408(p)(10).

I. Sixty-Day Election Period.

Eligible employees may elect to make elective deferrals during the sixty-day period before the beginning of the year (or before the employee becomes eligible to participate). A plan may also allow a participant to modify salary reduction contribution percentages during the year.

J. Twenty-Five Percent Additional Tax for Early Withdrawals.

Employees who withdraw contributions during the two-year period beginning on the date that they first commenced participation in the SIMPLE plan will be assessed a twenty-five percent additional tax. I.R.C. Section 72(t).

K. Timetable for Elective Deferrals.

Employer must contribute elective deferrals to employee's account not later than thirty days after the last day of the month for which the contributions are made. Employer contributions must be made by the due date for the employer tax return (plus extensions) for the year on behalf of which the contributions are made.

L. Reporting Requirements.

Employer must notify employees of their rights to make salary deferrals to the SIMPLE plan and the contribution alternative elected by the employer (*i.e.*, three percent match or two percent nonelective contribution) immediately prior to the employee's sixty-day election period.

1. Trustee must annually provide the employer with a summary description and the employer must distribute the summary description to each eligible employee prior to the sixty-day election period.
2. IRS Forms 5304-SIMPLE and 5305-SIMPLE provide a model sixty-day notification form. The summary description requirement can be satisfied by providing the employee with a completed copy of the first two pages of applicable Form.

M. Automatic Contribution Arrangement (ACA) in a SIMPLE-IRA.

1. IRS Notice 2009-66 provides guidance on including an automatic contribution arrangement (ACA) in a SIMPLE-IRA.
2. IRS Notice 2009-67 provides a sample amendment for adding an ACA to a SIMPLE-IRA.

N. Note re: SIMPLE-IRA.

Please note: A SIMPLE-IRA is a type of Employer-sponsored IRA and is not a tax-qualified plan under IRC Section 401(a). A SIMPLE-IRA does not enjoy the protection from creditor claims afforded to tax-qualified plans under ERISA §206(d) and IRC §401(a)(13), but are protected in bankruptcy under the 2005 Bankruptcy Act.

**STATE-BY-STATE ANALYSIS OF
INDIVIDUAL RETIREMENT ACCOUNTS AS EXEMPT PROPERTY***

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Alabama	Ala. Code §19-3B-508	Yes	Yes	
Alaska	Alaska Stat. §09.38.017	Yes	Yes	The exemption does not apply to amounts contributed within 120 days before the debtor files for bankruptcy. Alaska provides a specific exemption for inherited IRAs.
Arizona	Ariz. Rev. Stat. Ann. §33-1126(B)	Yes	Yes	The exemption does not apply to a claim by an alternate payee under a QDRO. The interest of an alternate payee is exempt from claims by creditors of the alternate payee. The exemption does not apply to amounts contributed within 120 days before a debtor files for bankruptcy. Arizona provides a specific exemption for inherited IRAs.
Arkansas	Ark. Code Ann. §16-66-220	Yes	Yes	A bankruptcy court held that the creditor exemption for IRAs violates the Arkansas Constitution — at least with respect to contract claims.
California	Cal. Code of Civ. Proc. §704.115	No	No	IRA's are exempt only to the extent necessary to provide for the support of the judgment debtor when the judgment debtor retires and for the support of the spouse and dependents of the judgment debtor, taking into account all resources that are likely to be available for the support of the judgment debtor when the judgment debtor retires.

* Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), qualified plan, SEP, and SIMPLE assets are protected with no dollar limitation. IRAs and Roth IRAs are protected to \$1,000,000 (increased by COLAs to \$1,245,475). However, rollover assets in an IRA are not subject to the \$1,000,000 limit BAPCPA only applies to assets in bankruptcy. One must look to state law for protection of IRA assets in state law (e.g., garnishment) actions or other creditor claims outside of bankruptcy.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Colorado	Colo. Rev. Stat. §13-54-102	Yes	Yes	Any retirement benefit or payment is subject to attachment or levy in satisfaction of a judgment taken for arrears in child support; any pension or retirement benefit is also subject to attachment or levy in satisfaction of a judgment awarded for a felonious killing.
Connecticut	Conn. Gen. Stat. §52-321a	Yes	Yes	
Delaware	Del. Code Ann. Tit. 10, §4915	Yes	Yes	An IRA is not exempt from a claim made pursuant to Title 13 of the Delaware Code, which Title pertains to domestic relations order.
Florida	Fla. Stat. Ann. §222.21	Yes	Yes	IRA is not exempt from claim of an alternate payee under a QDRO or claims of a surviving spouse pursuant to an order determining the amount of elective share and contribution. Florida provides a specific exemption for inherited IRAs.
Georgia	Ga. Code Ann. §44-13-100	No	No	IRA's are exempt only to the extent necessary for the support of the debtor and any dependent.
Hawaii	Haw. Rev. Stat. §651-124	Yes	Yes	The exemption does not apply to contributions made to a plan or arrangement within three years before the date a civil action is initiated against the debtor.
Idaho	Idaho Code §55-1011	Yes	Yes	The exemption only applies for claims of judgment creditors of the beneficiary or participant arising out of a negligent or otherwise wrongful act or omission of the beneficiary or participant resulting in money damages to the judgment creditor.
Illinois	Ill. Rev. Stat. Ch. 735, Para. 5/12-1006	Yes	Yes	
Indiana	Ind. Code §34-55-10-2	Yes	Yes	Indiana provides a specific exemption for inherited IRAs.
Iowa	Iowa Code §627.6	Yes	Yes	

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Kansas	Kan. Stat. Ann. §60-2308	Yes	Yes	
Kentucky*	Ky. Rev. Stat. Ann. §427.150(2)(f)	Yes	Yes	The exemption does not apply to any amounts contributed to an individual retirement account if the contribution occurred within 120 days before the debtor filed for bankruptcy. The exemption also does not apply to the right or interest of a person in individual retirement account to the extent that right or interest is subject to a court order for payment of maintenance or child support.
Louisiana	La. Rev. Stat. Ann. Sects. 20-33(1) and 13-3881(D)	Yes	Yes	No contribution to an IRA is exempt if made less than one calendar year from the date of filing bankruptcy, whether voluntary or involuntary, or the date writs of seizure are filed against the account. The exemption also does not apply to liabilities for alimony and child support.
Maine	Me. Rev. Stat. Ann. Tit. 14, §4422(13) (E)	No	No	IRA's are exempt only to the extent reasonably necessary for the support of the debtor and any dependent.
Maryland	Md. Code Ann. Cts. & Jud. Proc. §11-504(h)	Yes	Yes	IRA's are exempt from any and all claims of creditors of the beneficiary or participant other than claims by the Department of Health and Mental Hygiene.
Massachusetts	Mass. Gen. L.Ch. 235, §34A	Yes	Yes	The exemption does not apply to an order of court concerning divorce, separate maintenance or child support, or an order of court requiring an individual convicted of a crime to satisfy a monetary penalty or to make restitution, or sums deposited in a plan in excess of 7% of the total income of the individual within 5 years of the individual's declaration of bankruptcy or entry of judgment.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Michigan*	Mich. Comp. Laws 600.6023	Yes	Yes	The exemption does not apply to amounts contributed to an individual retirement account or individual retirement annuity if the contribution occurs within 120 days before the debtor files for bankruptcy. The exemption also does not apply to an order of the domestic relations court
Minnesota	Minn. Stat. §550.37	Yes	Yes	Exempt to a present value of \$69,000 and additional amounts reasonably necessary to support the debtor, spouse or dependents.
Mississippi	Miss. Code Ann. §85-3-1	Yes	No	
Missouri	Mo. Rev. Stat. §513.430	Yes	Yes	If proceedings under Title 11 of United States Code are commenced by or against the debtor, no amount of funds shall be exempt in such proceedings under any plan or trust which is fraudulent as defined in Section 456.630 of the Missouri Code, and for the period such person participated within 3 years prior to the commencement of such proceedings. Missouri provides a specific exemption for inherited IRAs.
Montana	Mont. Code Ann. §31-2-106(3)	Yes	No	The exemption excludes that portion of contributions made by the individual within one year before the filing of the petition of bankruptcy which exceeds 15% of the gross income of the individual for that one-year period.
Nebraska	Neb. Rev. Stat. §25-1563.01	No	No	The debtor's right to receive IRAs and Roth IRAs is exempt to the extent reasonably necessary for the support of the Debtor and any dependent of the Debtor.
Nevada	Nev. Rev. Stat. §21.090(1)(r)	Yes	Yes	The exemption is limited to \$500,000 in present value held in an individual retirement account, which conforms with Sections 408 and 408A.

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
New Hampshire	N.H. Tit. 52 §511:2	Yes	Yes	Exemption only applies to extensions of credit and debts arising after January 1, 1999.
New Jersey	N.J. Stat. Ann. 25:2-1(b)	Yes	Yes	
New Mexico	N.M. Stat. Ann. §42-10-1, §42-10-2	Yes	Yes	A retirement fund of a person supporting himself / herself or another person is exempt from receivers or trustees in bankruptcy or other insolvency proceedings, fines, attachment, execution or foreclosure by a judgment creditor.
New York	N.Y. Civ. Prac. L. and R. §5205(c)	Yes	Yes	Additions to individual retirement accounts are not exempt from judgments if contributions were made after a date that is 90 days before the interposition of the claim on which the judgment was entered.
North Carolina	N.C. Gen. Stat. §1C-1601(a)(9)	Yes	Yes	North Carolina provides specific exemptions for inherited IRAs.
North Dakota	N.D. Cent. Code §28-22-03.1(7)	Yes	Yes	The account must have been in effect for a period of at least one year. Each individual account is exempt to a limit of up to \$100,000 per account, with an aggregate limitation of \$200,000 for all accounts. The dollar limit does not apply to the extent the debtor can prove the property is reasonably necessary for the support of the debtor, spouse, or dependents.
Ohio*	Ohio Rev. Code Ann. §2329.66(A)(10)	Yes	Yes	SEPs and SIMPLE IRAs are not exempt. Ohio provides a specific exemption for inherited IRAs.
Oklahoma	Okla. Stat. Tit. 31, §1(A)(20)	Yes	Yes	
Oregon	OR. Rev. Stat. 18.358	Yes	Yes	

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Pennsylvania	42 PA. Cons. Stat. §8124	Yes	Yes	The exemption does not apply to amounts contributed to the retirement fund in excess of \$15,000 within one year before the debtor filed for bankruptcy.
Rhode Island	R.I. Gen. Laws §9-26-4	Yes	Yes	The exemption does not apply to an order of court pursuant to a judgment of divorce or separate maintenance, or an order of court concerning child support.
South Carolina	S.C. Code Ann. §15-41-30	Yes	Yes	Specifically provides for exemption of inherited IRAs.
South Dakota	S.D. Cod. Laws 43-45-16; 43-45-17	Yes	Yes	Exempts "certain retirement benefits" up to \$1,000,000. Cites §401(a)(13) of Internal Revenue Code (Tax-Qualified Plan Non-Alienation Provision). Subject to the right of the State of South Dakota and its political subdivisions to collect any amount owed to them.
Tennessee*	Tenn. Code Ann. §26-2-105	Yes	Yes	Not exempt from claims of an alternate payee under a QDRO.
Texas	Tex. Prop. Code Ann. §42.0021	Yes	Yes	Texas provides a specific exemption for inherited IRAs.
Utah	Utah Code Ann. §78B-5-505	Yes	Yes	The exemption does not apply to amounts contributed or benefits accrued by or on behalf of a debtor within one year before the debtor files for bankruptcy.
Vermont	Vt. Stat. Ann. Tit. 12 §2740(16)	Yes	Yes	Non-deductible traditional IRA contributions plus earnings are not exempt.
Virginia	Va. Code Ann. §34-34	Yes	Yes	Exempt from creditor process to the same extent permitted under federal bankruptcy law. An IRA is not exempt from a claim of child or spousal support obligations.
Washington	Wash. Rev. Code §6.15.020	Yes	Yes	
West Virginia	W.Va. Code §38-10-4	Yes	No	

STATE	STATE STATUTE	IRA EXEMPT	ROTH IRA EXEMPT	SPECIAL STATUTORY PROVISIONS
Wisconsin	Wis. Stat. §815.18(3)(j)	Yes	Yes	The exemption does not apply to an order of court concerning child support, family support or maintenance, or any judgments of annulment, divorce or legal separation.
Wyoming	Wyo. Stat. §1-20-110	Yes	Yes	Exempt to the extent payments are made to the fund while solvent.

*Kentucky, Michigan, Ohio, and Tennessee: The U.S. Court of Appeals for the Sixth Circuit ruled in *Lampkins v. Golden*, 2002 U.S. App. LEXIS 900, 2002-1 USTC par. 50,216 (6th Cir. 2002) that a Michigan statute exempting SEPs and IRAs from creditor claims was preempted by ERISA. The decision appears, however, to be limited to SEPs and SIMPLE-IRAs.