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KRAVITZ Retirement Plan News

Rollover portability rules

Generally, a rollover is the movement of a tax-free distribution of cash or other assets from one retirement plan, such as a 401(k), to another retirement plan or account, such as a traditional individual retirement account (IRA). This "contribution" to the second retirement account is called a "rollover" contribution.

Thanks to ongoing tax law and regulatory changes, rollovers have become quite complex. The portability chart on page two provides a complete list of all the places rollovers can "go" in 2011.

The basics

Before assets from a qualified plan (or a governmental 457 or a 403(b) plan) can be rolled over, a distributable event must occur. Distributable events include, but are not limited to, termination of employment, death, in-service distribution, plan termination, or disability. In addition, the eligible rollover distribution rules apply:

- If assets are sent to the receiving plan or account by direct rollover, no tax withholding occurs.
- If the distribution is eligible to be rolled over but is paid directly to the participant, there is a 20% mandatory federal tax withholding (that plan sponsors must send to the IRS) and the participant has 60 days from the day the funds were received to roll them into an IRA (or other eligible retirement plan). Note that the participant also may contribute an amount equal to the withheld tax to the rollover IRA (or other eligible retirement plan) within 60 days.

Distributions *not* eligible for rollover

An "eligible rollover distribution" from a qualified plan, such as a 401(k), is any distribution of all or any part of the participant's balance *except*:

- Any of a series of substantially equal distributions paid at least once a year over
  - The lifetime or life expectancy of the participant,
  - The joint lives or life expectancies of the participant and his/her beneficiary, or
  - A period of 10 years or more;
- A required minimum distribution or hardship distribution;
- A corrective distribution or participant loan that is a deemed distribution;
- Dividends paid on employer securities; or
- The cost of life insurance coverage acquired with plan assets.

Beneficiary rollovers

A surviving spouse beneficiary may roll the deceased participant's funds to his/her own IRA. If the surviving spouse is working and his/her plan accepts rollovers, the surviving spouse could also choose to roll it to his/her own plan. However, the surviving spouse may not become a participant in the deceased spouse's plan.

A nonspouse beneficiary may roll the deceased participant's funds into an inherited IRA. The required minimum distribution (RMD) rules for beneficiaries apply to amounts rolled into an inherited IRA.

After-tax amounts

Any time after-tax amounts are distributed, special care should be taken to determine if they are eligible

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Portability chart as of 2011

Rollover to

From	Traditional and SEP IRA	SIMPLE IRA	403(b)	Gov't 457(b)	Qualified plan	Roth 401(k), 403(b), and 457(b)	Roth IRA
Traditional and SEP IRA	Y	N	Y[a]	Y[a]	Y[a]	N	N[f]
SIMPLE IRA	Y[b]	Y[b]	Y[b]	Y[b]	Y[b]	N	Y[b]
403(b) other than Roth 403(b)	Y	N	Y[d]	Y	Y[d]	Y	Y[e]
Gov't 457(b)	Y	N	Y	Y	Y	Y	Y[e]
Qualified plan other than Roth 401(k)	Y	N	Y[d]	Y[c]	Y[d]	Y	Y[e]
Designated Roth 401(k), 403(b), or 457(b) by direct rollover	N	N	N	N	N	Y	Y
Roth IRA	N	N	N	N	N	N	Y

LEGEND

a Only pretax amounts from an IRA or SEP may be rolled to these plans.

b Rollovers from SIMPLE IRAs are prohibited until after two years of participation.

c Pretax amounts only.

d After-tax amounts may be received only by direct transfer or direct rollover.

e PPA permits direct rollover from a non-Roth qualified plan source, non-Roth 403(b) source, and governmental 457(b) to a Roth IRA as of 2008. However, the direct rollover pretax amount is taxable in the year directly rolled to a Roth IRA. As of 2010, TIPRA permits conversion to a Roth IRA without AGI limit and without the joint return filing requirement for married individuals.

f Traditional and SEP IRAs may not be rolled into a Roth IRA, but there is a conversion process. As of 2010, TIPRA permits conversion to a Roth IRA without AGI limit and without the joint return filing requirement for married individuals.

Rollover portability rules

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for rollover. This does not refer to Roth contributions. Here are some examples of what can and cannot be done:

- After-tax amounts from a qualified plan may be directly rolled to an IRA by direct transfer but *not* by the 60-day participant rollover method.
- A direct rollover of after-tax amounts from a qualified plan may be made only to a defined contribution plan or an IRA, not to a defined benefit plan.
- After-tax amounts rolled from a qualified plan to an IRA may not be rolled back to a qualified plan.

Traditional IRA rollovers

A traditional IRA may be rolled into a qualified plan, such as a 401(k), if the qualified plan accepts IRA rollovers. Once the rollover has been made, the traditional IRA funds lose their IRA characteristics and are treated as rollover funds in a qualified plan. Thus, they have creditor protection, are available for participant loans, and may be invested in insurance. The required minimum distribution rules of the plan also apply.

SIMPLE IRA rollovers

Once a participant in a SIMPLE IRA plan has satisfied the rule requiring two years of participation, he/she may roll the funds to any plan eligible to receive a rollover. **Note:** A SIMPLE IRA may not *receive* rollovers from any plan other than another SIMPLE IRA.

Qualified rollover contributions

This relatively new term describes a rollover to a Roth IRA. It could be a rollover from a 401(k) designated Roth account or a conversion (e.g., from non-Roth sources in a 401(k)).

The once-a-year rule

When a participant moves funds from one IRA to another IRA, a one-year waiting period between rollovers applies. The 12-month wait begins when the funds are distributed from the first IRA and applies to both the IRA from which the distribution is made and the funds that are actually rolled over. If a rollover is made from a qualified plan to an IRA, however, there is no 12-month wait because there has been no IRA-to-IRA rollover.

Safe harbor 401(k) plan
top-heavy rules

The safe harbor 401(k) retirement plan is the design of choice for many small business owners. Often, however, these same employers see their plans become top heavy. A plan is considered top heavy when more than 60% of the aggregate value of the plan accounts belongs to key employees — the owners and officers of the business.

Satisfying the top-heavy contribution

If a plan becomes top heavy and any key employee has made contributions (including elective deferrals) of 3% or more, then the employer must provide a minimum top-heavy contribution of 3% to *all* eligible employees employed on the last day of the plan year. If the plan is a safe harbor 401(k) plan, however, the employer is *already providing* a contribution, so there are special top-heavy rules that apply to safe harbor plans.

If the employer is making a safe harbor matching contribution and the plan is top heavy, the match may be counted toward satisfying the top-heavy minimum contribution for those employees who receive it. For example, if a participant defers 2% and receives a 2% employer match, that employee would need to receive only 1% more to satisfy the 3% top-heavy contribution requirement.

If the employer is making a safe harbor nonelective contribution (NEC) of 3% or more and the plan is top heavy, the NEC will generally satisfy the top-heavy contribution requirement. Note that the top-heavy contribution must be based on compensation for the entire plan year (Section 415 compensation). If the 3% safe harbor NEC is based on compensation for less than the entire plan year, an additional allocation would be necessary to satisfy the top-heavy contribution requirement.

Exemptions

A safe harbor 401(k) may be exempt from the top-heavy rules if certain requirements are satisfied. Basically, to be exempt, there cannot be *any* contributions to the plan other than participant elective deferrals and employer contributions that satisfy the ADP and ACP safe harbor. Thus, if a safe harbor 401(k) plan permits only elective deferrals and safe harbor matching contributions, the plan is exempt from being top heavy.

What if a safe harbor 401(k) plan provides for elective deferrals, safe harbor matching contributions, *and* has a plan provision permitting a discretionary nonelective contribution? As long as the employer does not make a discretionary nonelective contribution, the plan is exempt from being top heavy. Thus, there can be no profit sharing contributions.

There *is* an exception that permits discretionary matching contributions provided they stay within the ACP safe harbor requirements (matching less than 4% of compensation and not matching deferrals that exceed 6% of compensation). Forfeitures generally may not be reallocated as additional contributions.

An annual determination

Top-heavy status is determined on a yearly basis. If a profit sharing contribution was made in 2010, for example, the plan cannot be exempt from the top-heavy rules in 2010. However, if no profit sharing contributions or employer contributions (other than the employer safe harbor contribution) are made in 2011, then the plan will be exempt from the top-heavy rules for this year.

A safe harbor 401(k) plan is *not* exempt from top-heavy rules if:

1. The employer makes a discretionary nonelective contribution;
2. Forfeitures are allocated to participant accounts in the same manner as nonelective contributions;
3. The plan permits new employees to join the plan immediately (or after a short eligibility period) for the purpose of making elective deferrals, but imposes a longer service requirement (such as one year) for the employee to receive safe harbor contributions.

Cancellation or termination

If an employer amends a plan midyear to cancel the safe harbor provision, the plan is no longer a safe harbor plan and is not eligible for the top-heavy exemption.

A safe harbor plan that is eligible for a top-heavy exemption and is terminated during a plan year could lose its top-heavy exemption, depending on the reason for termination. If an employer terminates a plan due to a substantial business hardship or a merger or acquisition, the plan will receive a top-heavy exemption in the year of termination as long as the safe harbor contribution is made up until the "event" occurs. If an employer decides to terminate its plan for another reason, the plan will lose its exemption and will be subject to top-heavy rules.

RECENT developments

Social Security tax break

The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 reduces the Social Security portion of payroll taxes by 2% in 2011. The change from 6.2% to 4.2% applies to individual earnings up to the Social Security taxable wage base of $106,800. The 2% decrease provides plan participants with an ideal opportunity to increase their 401(k) deferrals by 2% without impacting take-home pay amounts. Employers are still responsible for paying the full 6.2% of employees' covered wages.

Temporary change for the self-employed

The Small Business Jobs Act of 2010 allows self-employed individuals to deduct eligible health insurance costs from their self-employment tax. Normally, this deduction only reduces income tax. The change is effective for the 2010 tax year only. See IRS Publication 560 for more details.

Fee disclosure deadline extended

The Department of Labor (DOL) has extended the effective date of new IRC Section 408(b)(2) disclosure rules from July 16, 2011, to January 1, 2012. The new rules will require certain "covered service providers" to provide responsible plan fiduciaries with information regarding the services the plan is receiving and the indirect compensation the service providers are receiving for rendering those services. This will permit fiduciaries to better understand the fees received by the service provider and identify any potential conflicts of interest that may affect the quality of the services being provided. The deadline was extended to give the DOL additional time to finalize the interim final rule that was published last year.

Change in reporting of plan loans

The Financial Accounting Standards Board (FASB) has clarified how 401(k) and other defined contribution plans should classify and measure the value of participant loans on the plan's annual financial statements. Loans are to be classified as notes receivable from participants. They are to be segregated from plan investments and measured at the outstanding principal amount plus accrued but unpaid interest. Prior to this change, loans were classified as investments and measured at fair market value. The change is effective for fiscal years ending after December 15, 2010.

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