

Retirement PLAN news

Plan design and after-tax contributions

Recent IRS guidance has created a new interest in “after-tax” contributions as a plan provision because they can be used to maximize plan contributions and reduce future tax liabilities. Note: After-tax contributions are not the same as designated Roth contributions.

With proper plan design, after-tax contributions can be a valuable benefit to plan participants. Following is a discussion of some strategies and caveats.

After-tax contribution basics

After-tax contributions are not elective deferrals and therefore are not subject to the annual Section 402(g) maximum deferral limit (\$18,000 for 2015). However, they are subject to the annual Section 415 limit (\$53,000 for 2015; \$59,000 for individuals age 50 or older eligible to make catch-up contributions of \$6,000).

Conversion via IRR

A plan that permits both after-tax contributions and designated Roth contributions could be designed to also permit in-plan Roth rollovers (IRRs). This would allow participants to convert after-tax contributions into designated Roth amounts. Earnings converted with the after-tax

amounts would be taxed in the year of the IRR. However, future earnings in the Roth account would not be taxed when distributed, provided they satisfy the qualified distribution requirements (generally, that the participant must be age 59½ or older and the designated Roth contributions must satisfy the five-year rule).

Example: Steve is age 60 and earns \$225,000 in 2015. He makes \$24,000 in designated Roth contributions (\$18,000 + \$6,000 catch-up), \$20,000 in after-tax contributions, and receives a profit sharing contribution of \$15,000. At the end of 2015, he converts his after-tax contributions plus earnings of \$500 (a total conversion amount of \$20,500) into designated Roth amounts. He will owe tax on the \$500 of earnings in 2015. Steve now has an additional \$20,500 in designated Roth money in his account. Assuming the additional amounts eventually become qualified distributions, Steve will have more tax-free income than if he made only designated Roth contributions to the plan.

Potential issues

Including after-tax contributions in a plan can pose testing and administrative issues. “One-participant” plans (plans covering a



business owner with no employees or a business owner plus spouse) face the fewest issues. Plans with nonhighly compensated employees (NHCEs) face the greatest number of challenges because nondiscrimination testing must be performed on after-tax contributions.

ACP nondiscrimination testing

Actual contribution percentage (ACP) testing is generally required for plans with employer matching contributions. After-tax contributions are also subject to annual ACP nondiscrimination testing. If a plan has both after-tax and matching contributions, they are tested together in one ACP test. Note that safe harbor 401(k) plans are required to perform an ACP test for any after-tax contributions that are made; safe harbor matching contributions are exempt from testing.

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Portability chart as of 2015

From	Rollover to						
	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 ^g	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 ^d	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.
- g** Beginning in 2015, only one IRA-to-IRA rollover per 12-month period regardless of how many IRAs.

Plan design and after-tax contributions
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After-tax contributions are typically made by highly compensated employees (HCEs) who wish to contribute more than the annual Section 402(g) deferral limit allows. Since plans with HCEs often have nondiscrimination testing issues, such plans may face even greater testing issues if they allow after-tax contributions. One way to minimize the impact of after-tax contributions on nondiscrimination testing is to administratively limit the amount of after-tax contributions individuals can make for each plan year.

415 limitations

IRC Section 415 rules limit the total amount that can be contributed to a participant's account on an annual basis. Participants who make after-tax contributions need to be aware of that limit. Otherwise, they might run into a situation where an employer contribution causes them to exceed the annual Section 415 limit. If this limit is exceeded, the participant must receive a corrective distribution of the excess amount. After-tax contributions are generally the first type of contribution to be refunded.

Example: Ed is age 43. In 2015, he makes \$18,000 of designated Roth contributions and \$25,000 of after-tax contributions. After the end of the plan year, Ed's employer makes a \$12,000 profit sharing contribution to his account. Ed has exceeded the Section 415 limit of \$53,000 for 2015 by \$2,000 and must receive a \$2,000 refund from his after-tax contributions (adjusted for earnings/losses). Refunded after-tax contribution amounts are not taxable, but the earnings associated with the refunded amounts are.

Like deferrals, after-tax contributions are also not included in the employer's annual 25% deduction limit.

ADP testing and recharacterization

If plans subject to actual deferral percentage (ADP) testing fail to pass, sponsors typically either issue refunds to HCEs or make additional qualified nonelective contributions to NHCEs. A less commonly used ADP test correction allows refund amounts to be recharacterized as after-tax contributions and remain in the plan. Amounts recharacterized as after-tax contributions are subject to ACP nondiscrimination testing.

Permitting after-tax contributions could benefit HCEs who would otherwise receive an ADP refund. When pretax deferrals are recharacterized, the amount is taxable. However, earnings on the recharacterized amount are tax deferred. The recharacterized amount also can be rolled into a designated Roth account.



Blackout period and notice

Forms 5500, *Annual Returns/Reports of Employee Benefit Plan* and Forms 5500-SF have a two-part question about plan compliance with the blackout notice rules. The first part asks if an individual account plan had a blackout period. If the answer is yes, the follow-up question asks whether a blackout notice was provided or if one of the exceptions applied.

The IRS is monitoring compliance with blackout period and notice rules. Here is a review.

Definition of blackout period

A blackout period is defined as a period of more than three business days during which a participant is “temporarily suspended, limited, or restricted” from any one of the following activities:

- Directing or diversifying assets credited to his or her account,
- Obtaining a distribution, or
- Obtaining a loan.

Not every instance of suspended or restricted access is considered a blackout. Here are a few events that are not:

- Restrictions on an individual’s account due to a qualified domestic relations order (QDRO)
- Restrictions or third-party actions, such as a tax levy or beneficiary dispute of a deceased participant’s account
- “Regularly scheduled” restrictions, such as a regularly scheduled freeze on an investment, if the restriction has been disclosed beforehand in a summary plan description, summary of material modifications, enrollment form, or investment material
- Permanent restrictions, such as eliminating loan provisions from a plan or eliminating participant direction of investments
- Restrictions on investment education services

Blackout notice general rules

The notice must be written so the average plan participant can understand it. It must be provided to participants between 30 and 60 calendar days before the last date on which one of the three previously mentioned activities may be exercised. For example, if the last day participants can direct their assets is June 20, the blackout notice must be provided between April 21 and May 21.

The notice must include the length of the blackout period and provide the beginning and ending dates. The notice may indicate the calendar weeks in which the blackout period begins and ends as long as the notice includes a toll-free phone number and/or free website so participants can obtain the exact starting and ending dates. The notice must also include contact information, which may be the name, address, and phone number of an individual, or a department name (such as human resources).

The notice must specify only the rights being suspended. For example, if only plan loans are being suspended, then the notice should only address loans.

Here are some additional points:

- If the blackout dates change after the notice is sent, a second notice must be provided to reflect the change.
- Different restrictions may be included in the same notice. For example, the same notice may be used to announce a 25-day blackout for withdrawals and a 20-day blackout for investment changes.
- Single participant plans are exempt from the blackout notice rules.
- Directors and executive officers are prohibited from trading in employer stock during a blackout period imposed on participants in individual account plans. It is important to note that the restriction applies to stock owned outside of the plan subject to the blackout.



Blackout notice exceptions

In the following cases, notices must be given “as soon as reasonably possible.” The 30-day time period may be shortened if:

- Postponing the blackout period would violate ERISA’s exclusive purpose rule or prudence rule,
- The blackout period begins due to events that were unforeseeable or circumstances that were beyond the control of the plan administrator, or
- The blackout period occurs solely in connection with a merger, acquisition, divestiture, or similar transaction involving the plan sponsor.

If providing a notice is completely impossible, then none is required.

Blackout notice penalties

A daily penalty of \$100 will be imposed for each participant/beneficiary who does not receive a blackout notice. The penalty is imposed on a per-day-late, per-violation basis. For example, if a plan has 200 participants and the blackout notice is five days late, the penalty would be $200 \times 5 \times \$100$, or \$100,000. The plan administrator is liable for the penalty; it may not be shifted to the plan.



RECENT developments

► IRA-to-IRA rollovers

IRS Announcement 2014-15 addressed the application of the one-per-12-month-period limit on tax-free rollovers between individual retirement accounts (IRAs). Prior to 2015, the limit applied to each IRA an individual owned. Beginning in 2015, the limit will apply to the aggregate of all an individual's IRAs.

IRS Announcement 2014-32 provides additional clarification and a transition rule for distributions in 2015. Any IRA distribution that occurred in 2014 and was rolled over within 60 days is disregarded for purposes of the aggregate IRA-to-IRA rollover rule, even if the 60th day was in 2015. The aggregate

IRA-to-IRA rollover rule begins with distributions made from IRAs after December 31, 2014.

Example: John has several IRAs spread among various financial institutions. He takes a lump-sum IRA distribution on November 10, 2014, and rolls the distribution into another IRA on January 5, 2015. For 2015, John is permitted to take a lump-sum distribution from a *different* IRA (other than the IRA that issued the previous distribution and the IRA that received the rollover on January 5, 2015) and perform an IRA-to-IRA rollover within 60 days.

The 12-month waiting period between rollovers is measured from the date

of an IRA distribution that is subsequently rolled into another IRA within 60 days. If another IRA-to-IRA rollover is made before the 12-month period has passed, that rollover will be invalid and the amount rolled over will be taxable.

The IRS is encouraging IRA trustees/custodians/issuers to offer an alternative when IRA owners request a rollover distribution. The alternative is a transfer of trusteeship from one IRA to another IRA. IRA trustees can accomplish this by transferring amounts directly from one IRA to another or by providing the IRA owner with a check made payable to the receiving institution for the benefit of the individual's IRA.

The general information provided in this publication is not intended to be nor should it be treated as tax, legal, investment, accounting, or other professional advice. Before making any decision or taking any action, you should consult a qualified professional advisor who has been provided with all pertinent facts relevant to your particular situation.