NRS
NATIONAL RETIREMENT SERVICES, INC.

AMERICAN TAXPAYER RELIEF ACT EXPANDS USE OF RETIREMENT PLAN "IN-PLAN ROTH CONVERSIONS"

In a well publicized twelfth hour action primarily designed to avoid the "fiscal cliff," Congress enacted the American Taxpayers Relief Act ("ATRA"). The new law expands the ability of retirement plan participants to use post-tax Roth Accounts. This measure is designed to provide the government with much needed income tax revenue in 2013 and later years by making it easier for individuals to convert current pre-tax qualified plan money into an after-tax Roth Account within their plan.

The Roth Account feature in employer retirement plans has been available since 2006 with limited success. Participant elective deferrals are deposited net of tax withholding to a suitably designated after- tax Roth Account within the plan. Roth Accounts are permitted to accumulate on a tax free basis as long as they are not withdrawn earlier than allowed by Internal Revenue Code rules. Distributions from Roth Accounts that meet these requirements are entirely tax free. A plan participant who is to receive a pre-tax plan distribution can elect to receive the money net of mandated tax withholding, add it to their taxable income for that year, and within 60 days transfer the money to a Roth IRA. It is also possible to have the retirement plan trustee directly transfer the distribution to a Roth IRA.

In 2010, individuals were permitted to make a "Roth Conversion" within a single employer retirement plan without actually receiving any plan distribution. Under the 2010 law, plan participants could transfer money held in the retirement plan from a pre-tax account to a post-tax account as long as the money was available for distribution at their election. Such transfers do not require tax withholding, but the participant does receive currently taxable income. There was one large stumbling block to the 2010 law: any amounts converted must have been available to the participant for an **immediate** distribution at the time of the conversion. This ruled out conversions of tax deferred employee contributions to employees under age 59½, not to mention the fact that many retirement plans prohibit distributions to employees during continued employment.

The ATRA removes the requirement that the Roth Conversion only applies to amounts currently distributable and permits in-plan conversions of any amount held by the plan for the employee. This provision is projected to raise at least $12 billion in additional tax revenue over the next ten years. Furthermore, employers that want to incorporate the new feature in their retirement plans must amend the plan to do so. The amendment must wait for needed federal guidance that is expected to occur later in 2013. In the meantime, employers may implement the new provision and retroactively amend the plan to ratify the action no later than the last day of the plan year for which it is effective.

Please note: If a Roth feature is adopted by a Plan Sponsor, it is important for Plan Participants to fully understand its impact if utilized. Hence, we recommend seeking consultation from their Tax Advisor.

IRS AUDIT CHIEF: "INTERNAL CONTROLS ESSENTIAL FOR RETIREMENT PLANS"

According to Monica Templeman, Director of Employee Plan Examinations, employer sponsored retirement plans must establish and implement effective internal controls for monitoring the operation of their plans, stating "an ounce of prevention is worth a pound of cure." We believe

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that the unbundled service model is an effective internal monitoring measure that addresses this concern. As third party administrator ("TPA"), NRS provides the required plan level compliance and administration, while Plan Assets are managed by the Financial Advisor and/or the Investment Institution's platform and record keeping vehicle, represented by the Financial Advisor. The IRS auditors who examine tax qualified retirement plans are trained to look for a program of internal controls. Weak or non-existent controls, coupled with failures to operate the plan in accordance with its terms, usually results in financial penalties. These penalties are imposed under "Audit CAP," a program whereby the IRS negotiates a sanction with the employer so the employer and participants avoid loss of the tax advantages of a qualified plan.

IRS agents are trained to examine all plan documents, including "interim amendments" required to keep the plan up to date with current laws and regulations. Missing documents can also lead to Audit CAP and is a condition frequently disclosed by an IRS examination. Ordinarily, failure to follow the terms of the formal plan document results in "operational failures," which may lead to Audit CAP. However, if the operational failure is relatively insignificant, and if it happened despite the existence of suitable internal controls, the failure can usually be corrected by the employer without penalty.

Other failures often encountered by IRS auditors involve the use of standard administrative forms for participant distributions or participant loans. According to Templeman, "These forms often contain provisions that are inconsistent with the terms of the retirement plan being examined and can result in plan operational failures." Another common mistake discovered in IRS audits involves companies with common ownership. Referred to as a "controlled group of corporations" or "partnerships and proprietors under common control," failure to take these related companies into account when attempting to meet prescribed coverage or non-discrimination requirements often result in failures that go undetected until the IRS auditor arrives.

Once again, NRS in conjunction with the Plan Sponsor's Financial Advisor and Investment Institution provide the tools necessary to properly manage, and administer the Plan, thus mitigating any challenge that the Plan Sponsor may encounter.

REMINDERS FOR FEBRUARY

- For plans who handle their own tax withholdings, if federal income tax was withheld from a participant distribution in 2012, the Annual Return of Withheld Federal Income Tax, Form 945 was required to be filed with the IRS by January 31, 2013. However, if payments were made on time and in full, the Form is due by February 11, 2013.

- Calendar year individual account plans that permit participant investment discretion must provide their quarterly statement for the period ending December 31, 2012 no later than February 14.

- The deadline to provide participants with the Tax Form 1099-R for pension distributions in 2012 was January 31, 2013. The deadline to send the related Forms 1096 and 1099-Rs to federal and state agencies is February 28, 2013.

- Don't forget to contact your Members of Congress using www.savemy401k.com, urging them to leave 401(k) plans intact. Our last two newsletters provided more details.

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