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NATIONAL RETIREMENT SERVICES, INC.

REAL ESTATE AS A RETIREMENT PLAN ASSET PRESENTS SEVERAL SPECIAL CONSIDERATIONS

Current tax law permits tax qualified retirement plans to invest in real estate. However, there are a number of issues for a Plan Trustee to consider before deciding to add parcels of real property to the portfolio. These considerations include, but are not limited to, the items presented below.

Valuing the asset – The fair market value of the property must be determined on at least an annual basis as part of the annual trust valuation and reporting (Form 5500 series). This usually requires the services of a professional appraiser.

Asset diversification is required – ERISA fiduciary requirements dictate that plans covering non-owner employees must be prudently diversified in order to protect participants from heavy swings in asset values. Small plan Form 5500 Schedule I requires specific disclosure of trust holdings consisting of any single parcel of real estate that exceeds 20% of total trust assets.

Asset liquidity may be compromised – Real estate investments generally require a significant period of time in order to convert the asset to cash, sometimes making it difficult for the plan to pay *discretionary* benefit obligations as they are requested, or *required* minimum distributions ("RMDs") upon attaining age 70.5.

Special bonding or plan audits may be required – Plans covering less than 100 participants are generally not required to retain an independent auditor as part of the annual valuation process. Parcels of real estate are not "qualifying plan assets."

Unless 95% of assets consist of "qualifying plan assets" additional bonding large enough to cover the value of all assets other than qualifying assets must be obtained. If this additional bonding is not obtained an independent audit is required.

Possible Unrelated Business Income – Income produced by a real estate parcel could be subject to a special tax on unrelated business income ("UBI"), depending upon the facts and circumstances.

Prohibited Transactions Can Occur – Care must be taken to avoid transactions between the plan and parties-in-interest that are prohibited under ERISA law. Generally, prohibited transactions must be reversed and an excise tax paid. For example, a prohibited transaction can occur if an employer or owner buys or sells property to or from the plan or occupies property owned by the plan.

Compliance with the Plan's terms – The plan administrator should confirm that the plan's terms allow for the investment of plan assets in real estate, and/or distributions "in kind," i.e. where real estate is explicitly included as a portion of the plan benefit payment.

In short, while real estate investments may produce attractive yields, complications associated with holding this investment strongly suggests careful, advance planning before acquiring this type of asset.

USING AFTER-TAX EMPLOYEE CONTRIBUTIONS AS A TAX PLANNING TOOL

Although many plans offer participants the opportunity to make *Roth* contributions, where after tax contributions are made subject to the same limits as salary deferrals ($18,000 for 2015), these are not the same as *after-tax* contributions.

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Investment earnings in a Roth account may be distributed tax free as long as they are held for what is generally a five year period. Investment earnings in an after-tax account are always taxed when distributed. In addition, after-tax contributions are subject to overall Section 415 contribution limits when aggregated with salary deferral contributions, Roth contributions, and employer contributions.

Recent IRS guidance has provided tax qualified retirement plan participants with a tax planning tool that includes 401(k) compensation deferrals, "catch-up" contributions for those 50 or older, and after-tax employee contributions to a qualified retirement plan. The strategy is generally limited to owner only plans or plans with only Highly Compensated Employees, however, because after-tax employee contributions must satisfy a nondiscrimination test (Average Contribution Percentage "ACP" Test) even if the plan is otherwise a safe harbor plan. Plans open to non-owners are rarely able to pass this test since, all or most, after-tax contributions come from Highly Compensated Employees.

The recent IRS allowed strategy involves:

a) Maximizing the amount that a participant can add to a defined contribution plan in a given plan year,

a) Periodically rolling over after-tax contributions from the plan to a Roth IRA where required minimum distributions ("RMDs") after age 70.5 are not required, provided the plan design permits it, and

a) Reducing the requirement of having to file a Form 5500-EZ for an owner only plan by reducing plan assets below the $250,000 filing threshold.

The strategy can best be illustrated by a *specific example.*

Let's assume that John, age 54, is the only employee/participant in his employer sponsored 401(k) plan. John's compensation is $50,000, but he would prefer to maximize his employee and employer contributions to his retirement plan. Under existing rules, he can contribute the usual $18,000 maximum for the 2015 plan year, take advantage of the $6,000 catch-up contribution, and then he, as the employer, can make a 25% employer contribution of $12,500. (This is calculated as his $50,000 compensation times a 25% employer contribution = $12,500 employer contribution on behalf of the plan year 2015.) Taken together this tentatively totals $36,500 for the 2015 plan year. Since the maximum "annual addition" to his account is 100% of his $50,000 compensation for the 2015 plan year, he can make an additional $13,500 as an *after-t*ax contribution, provided the plan document allows for such an after-tax contribution.

SURVEY SHOWS MOST EMPLOYERS MAKE 401(K) CONTRIBUTIONS

According to a recent study of 401(k) plans by software provider **Brightscope**, more than 80% of employers who sponsor 401(k) retirement plans for their employees make contributions in addition to their employees' salary deferral contributions. Matching contributions are the most common form of employer contribution. Some sort of employer match occurred in nearly half of all plans surveyed. This indicates continuation of a trend for greater employer financial involvement in 401(k) plans as these plans increasingly represent the sole retirement plan offered by employers.

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REMINDERS FOR JANUARY

January 15 – Retirement plan employer contributions are due in order to be **deducted** on employer tax returns due to be filed January 15.

January 15 – **Minimum funding requirements** for defined benefit plan years ended 04/30/14 must be met by January 15 in order to avoid excise taxes.

January 15 – **Form 5500 Series/8955-SSA** – Forms that are on extension are due for the Plan Year ending 03/31/2014.

February 2 – **Form 5500 Series/8955-SSA** – Forms are due for the Plan Year ending 06/30/14 that are not on extension.

HOW ARE WE DOING? PLEASE COMPLETE THE NRS CLIENT SATISFACTION SURVEY!

We are grateful and thankful for the strong response to our Client Satisfaction Survey! In an effort to maintain high level client satisfaction, we need client feedback! The content of these replies will be sent directly to Executive Management. This survey takes less than 2 minutes to complete. To access the Client Satisfaction Survey, please click here.

As always, NRS truly values your continued business!

FOR MORE INFORMATION OR TO REQUEST A PROPOSAL, PLEASE VISIT OUR WEBSITE AT WWW.NRSERVICES.COM, OR FOR SALES SUPPORT, PLEASE CONTACT:

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