SOLUTIONS

NEWSLETTER - SECOND QUARTER 2017

WINDES

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PROTECTING TAXPAYERS FROM FRAUD

The IRS has joined forces with states and the tax preparation industry to identify and implement additional taxpayer safeguards as part of its continuing effort to improve fraud detection and prevention measures. These measures include enhanced authentication procedures through various filters, improved information sharing, heightened cyber security, new tax software log-in standards, and greater education and outreach to the public. Some states have also taken measures by requesting information from a taxpayer's driver's license or state-issued identification (ID) card before the returns can be electronically filed, while other states *require* this information.

One of the prevention measures the IRS has taken is partnering with payroll and software companies to add verification codes to W-2 forms. These codes consist of 16-digit alphanumeric characters that must be entered into tax software products to aid in verifying the filer's identity and prevent ID thieves from using fake W-2 forms.

CONTINUED PAGE 7

ENTERING INTO A ROTH IRA THROUGH THE "BACKDOOR"

The Roth IRA offers tax-free retirement growth opportunities that are attractive to many taxpayers. However, some find themselves ineligible to contribute because their income is too high. The IRS has provided a way to avoid the income limitation rules by enabling taxpayers to roll traditional IRA contributions into a Roth IRA through a "backdoor."

ROTH IRAS AND LIMITATIONS

A Roth IRA is a beneficial retirement tool where already taxed dollars can be contributed to a retirement account and are allowed to grow tax-free. Withdrawals can be taken from a Roth IRA, on or after age 59½, free of tax,

CONTINUED PAGE 3

NEW IRS GUIDELINES FOR HARDSHIP DISTRIBUTIONS

Retirement plan sponsors have long struggled with obtaining documentation from participants to support hardship distribution claims. There has been uncertainty over the type of documentation required and as to who was responsible for verifying the claim. In February 2017, the Treasury Department issued a "Memorandum for Employee Plans Examinations" outlining substantiation guidelines for safe harbor hardship distributions from 401(k) and 403(b) plans. It provides a simple mechanism of self-certification by an employee to demonstrate hardship events that should be less burdensome for plan sponsors. While the memorandum is directed at IRS employees conducting

CONTINUED PAGE 4

INSIDE

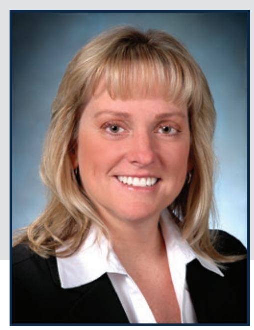
Proposed New Audit Standards for ERISA Plans

In a report released in May 2015, the Department of Labor (DOL) Employee Benefits Administration expressed concerns over the quality of employee benefit plan (EBP) audits. The Accounting Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) and the DOL believe that auditors' reports could be more informative and transparent about both the auditor's role and management's responsibilities, resulting in greater audit quality. In response to this, the ASB recently issued an Exposure Draft, "Proposed Statement on Auditing Standards (SAS), forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA." This exposure draft would apply specifically to audits of financial statements of EBPs subject to the Employee Retirement Income Security Act (ERISA). The comment period on the draft ends on August 21, 2017. If issued, the proposed standards would be effective for audits of EBP financial statements for periods ending on or after December 15, 2018.

The proposed SAS includes the form and content of the auditor's report for an unmodified opinion, a new form of opinion when an ERISA-permitted audit scope limitation exists and reporting requirements on findings from procedures performed on specific plan provisions relating to the financial statements (either included in the auditor's report on the ERISA plan financial statements or issued as a separate report).

Following is a summary of the more significant amendments to existing standards if the proposed SAS is issued. The amendments, intended to improve audit quality and transparency, include:

- engagement acceptance requirements in addition to U.S. Auditing Standards – AICPA (Clarified) (AU-C) section 210;
- new performance requirements that serve as a basis for a new reporting requirement, *Report on Specific Plan Provisions Relating to the Financial Statements;*
- new required procedures when the ERISA-permitted audit scope limitation is imposed;
- written management representations in addition to AU-C section 580;
- considerations relating to the IRS Form 5500, which are accompanied by the EBP financial statements and auditor's report;
- expanded description of management's responsibilities;
- expanded communication on the ERISA supplemental schedules;
- new form and content requirements of the auditor's report when management instructs the auditor to limit the scope of the audit, as permitted by ERISA, including expanded auditor's responsibilities relating to the certified information; and
- required emphasis-of-matter paragraphs.



If you have questions or would like more information, please contact Marilyn Thompson at **mthompson@windes.com** or **844.4WINDES** (844.494.6337).

Marilyn Thompson, CPA, MST
Partner
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Entering into a Roth IRA through the "Backdoor"

Continued from page 1

assuming funds have remained in the Roth IRA for five years. However, Roth IRAs come with certain limitations:

- **Income Limitation** – Taxpayers wishing to make a 2017 Roth IRA contribution are not eligible to contribute if filing a joint return with modified adjusted gross income (AGI) of $196,000 or more. Taxpayers who do not file jointly cannot contribute to a Roth IRA if modified AGI is $133,000 or more.
- **Contribution Limitation** – Taxpayers eligible to contribute to a Roth IRA for 2017 cannot contribute more than $5,500 ($6,500 if age 50 or older). Other contribution limitations are based on annual taxable compensation and phase-out for eligible high income taxpayers.

The Backdoor Roth IRA

Taxpayers can fund a Roth IRA by making nondeductible contributions to a traditional IRA and then rolling amounts from the traditional IRA into a Roth IRA, known as the backdoor Roth IRA contribution. The backdoor Roth IRA contribution is allowed because there are currently no income limitations for nondeductible contributions to a traditional IRA or limitations on conversions from a traditional IRA to a Roth IRA.

The Aggregation Rule

The backdoor Roth IRA is not without complications. Taxpayers interested in funding a backdoor Roth IRA must be careful of the IRA aggregation rule, which may create an unexpected tax bill on amounts deemed to be converted from pre-tax and previously deducted contributions in other IRA accounts. The aggregation rule states that all IRA balances must be combined and the nondeductible portion prorated to determine taxation of the conversion amount. Even if nondeductible contributions are made to a separate IRA and then converted to a Roth IRA, a portion of the conversion is deemed to have been made from a currently taxable amount of all IRAs. The aggregation rule is best illustrated by example.

Example 1 - Backdoor Roth IRA with No Taxable Aggregation:

Hillary does not have any IRA accounts and wants to open a Roth IRA. Hillary files a joint tax return with husband Bill and has modified AGI of $300,000 in 2017. She is not eligible to contribute to a Roth IRA because her joint AGI is over $196,000. Instead, Hillary makes a $5,500 nondeductible contribution to a traditional IRA and then rolls it into a Roth account. Since Hillary has no other IRA balances for aggregation, none of her conversion is taxable and the Roth IRA balance can be withdrawn free of tax, on or after age 59½, if the account has remained open for at least five years.

Example 2 - Backdoor Roth IRA with Taxable Amounts from Aggregation:

Donald wants to contribute to a Roth IRA, but he is filing a 2017 joint return with modified AGI over $196,000 and is not eligible to contribute to a Roth IRA. Donald already has several IRA accounts totaling $95,000, which were funded with pre-tax and previously deducted contributions. Donald makes a $5,000 nondeductible contribution to a traditional IRA in 2017, bringing his total IRA balances to $100,000. Donald wants to make a $5,000 backdoor Roth IRA conversion at the end of 2017. The aggregation rule requires that 95% of Donald's backdoor Roth IRA conversion is taxable because $95,000 of the $100,000 total IRA balance is from pre-tax and previously deducted IRA contributions. Donald will be taxed on $4,750 of his $5,000 Roth conversion on his 2017 tax return even though he made a $5,000 nondeductible IRA contribution during the year. Donald's $5,000 Roth IRA balance can grow and be withdrawn free of tax, on or after age 59½, if the account has remained open for at least five years.

Continued page 5

Continued from page 1

examinations of plans, it provides valuable guidance to plan sponsors regarding the preferred IRS method for documenting hardship claims.

Generally, 401(k) and 403(b) plans may permit distributions on account of financial hardship if the distribution is made on account of an "immediate and heavy financial need" and the distribution does not exceed the amount needed to satisfy the financial need. A distribution is deemed to be for an immediate and heavy financial need if it is made for any one or combination of the reasons set forth in the Treasury regulations, such as medical expenses, the purchase of or substantial repairs to a primary residence, college tuition, to prevent eviction, or funeral expenses. Prior to this guidance, a participant had to present documented proof of existing hardship, which required detailed disclosure of the participant's financial situation.

The new guidelines provide a streamlined documentation process. Rather than retaining source documents (such as bills, statements, etc.), an employer may retain a summary of information contained in the source documents. For all types of hardship distributions, the summary must contain the:

- participant's name;
- total cost of event causing the hardship (for example, total cost of medical care, total cost of funeral/burial expenses, payment needed to avoid foreclosure or eviction);
- amount of distribution requested; and
- certification by the participant that the information provided is true and accurate.

In addition, the summary must include basic information specific to the type of hardship involved. For example, a summary for a hardship distribution for funeral and burial expenses must include the name of the deceased, the relationship to the participant, date of death, and the name and address of the service (cemetery, funeral home, etc.).

If summary information provided by an employee to the plan appears to be incomplete or inconsistent, the examining IRS agent may request backup documents to substantiate the hardship from the employer or third party administrator.

If an employee receives more than two hardship withdrawals in one plan year, the IRS noted that an agent may, with managerial approval and in the absence of an adequate explanation, request additional physical backup documentation to verify the hardships.

To rely on such a summary, the employee obtaining a hardship distribution must be provided a notice containing the following information:

- The hardship distribution is taxable and additional penalties could apply.
- The distribution cannot exceed the immediate and heavy financial need.

Continued page 5

New IRS Guidelines for Hardship Distributions

Continued from page 4

- Hardship distributions cannot be made from earnings on elective contributions or from qualified non-elective contribution (QNEC) or qualified matching contribution (QMAC), if applicable.
- The recipient agrees to preserve source documents and make them available upon request to the employer or plan administrator at any time.

Third party administrators should provide a report or other data to the employer, at least annually, that describes hardship withdrawals made during the plan year.

Employers sponsoring 401(k) or 403(b) plans that offer hardship distributions should review their hardship distribution procedures and revise them to conform to the guidelines set out in the IRS memorandum.

If you have any questions about the new guidelines or require any assistance in determining whether your plan is meeting its substantiation and documentation requirements, please contact Connie Lee at **clee@windes.com** or **844.4WINDES** (844.494.6337).

Connie Lee, CPC, QPA, QKA
Manager
Employee Benefit Services

Entering into a Roth IRA through the "Backdoor"

Continued from page 3

Example 3 – Backdoor Roth IRA with Taxable Aggregation and a Workplace Retirement Plan:

Using Donald in example 2, suppose he has a workplace retirement plan that accepts rollovers. During the taxable year, Donald first rolls all of his pre-tax IRA accounts to his employer's plan. He then executes the backdoor IRA strategy outlined above. Because he has no pre-tax IRA accounts at the time of the contribution to the Roth IRA, he has no taxable income on the conversion.

Conclusion

The backdoor Roth IRA provides high-income taxpayers a way to fund Roth IRAs, but can come at a price if the taxpayer already has pre-tax or deductible balances in other IRAs. Roth conversions should be coordinated carefully with a tax advisor to produce intended results. New laws and limitations could close this backdoor without warning.

If you have questions or would like more information, please contact Tim Suarez at **tsuarez@windes.com** or **844.4WINDES** (844.494.6337).

Tim Suarez, CPA
Manager
Tax & Accounting Services

No Vacation for Data Security

Summer is prime vacation time. However, it is good to be aware that whenever you hit the road for fun, criminals are on the prowl for information leaks to steal your data, property, and money. To avoid being a victim, follow the tips below before you depart:

- Protect your mobile phone by enabling Find My iPhone on IOS devices, or Android Device Manager on Androids. These apps track the location of a missing phone.
- Install the latest software patches on all laptops or mobile devices.
- Enable passwords and data encryption for all devices: laptops, phones, tablets, etc.
- Record brand, model, and serial numbers of all valuable electronics.
- Remove all sensitive information from your devices. In some countries, customs may request data decryption or even take a copy of your data for later inspection.
- Consider purchasing throw-away cell phones instead of taking your everyday phone.
- Fight the temptation to post a detailed travel itinerary on social media. It is well documented that criminals troll the internet looking for clues of empty residences to burglarize.
- If traveling internationally, review the travel alerts at **https://travel.state.gov**.

While on vacation

- Be suspicious of Wi-Fi provided in private rental accommodations, especially where the wireless router is readily accessible. With physical access, routers can be reprogrammed to facilitate data compromise on connected devices.
- Watch out for Wi-Fi networks in hotels and other public areas. These can be spoofed to create a Man-in-the-Middle (MITM) attack, a common ploy of data thieves. Alternatively, you can bring your own or rent a hot spot.
- Use a VPN (virtual private network) to protect business data whenever possible.
- If device theft or loss occurs, file a police report and provide the serial numbers.
- Remember that in some countries, you have no expectation of privacy from government monitoring of your communications.
- If renting a car that has the latest technology, be aware that Bluetooth connections to the entertainment and navigation system may expose your contact list, call log, or other personal information. Clear the history before returning the rental car.
- At hotel reception desks, be aware of who may be listening to your personal travel details.
- Turn off geotagging on mobile device cameras when posting photos on social media. These are an easy key to reveal your exact location.

Continued page 7

No Vacation for Data Security

Continued from page 6

When you return home

- Change your passwords after you return home, in case they were compromised while you were away.
- Scan all devices for malware with an up-to-date security scanner. Even better, consider performing a full wipe and reset on mobile devices to positively remove malware.

Norm DuBow
Director
Information Technology Services

Following these steps will not guarantee the security of your information, but will certainly make it more difficult for criminals to take advantage while you are vacationing. Happy travels!

If you have questions or would like more information, please contact Norm DuBow at **ndubow@windes.com** or **844.4WINDES** (844.494.6337).

Protecting Taxpayers from Fraud

Continued from page 1

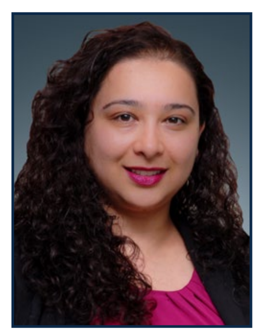
In order to allow electronic filing, Alabama, Ohio, and New York are among the states requiring a taxpayer's driver's license or state-issued ID card information. Requirements associated with reporting this information differ between states. For instance, in the case of married taxpayers filing jointly, New York requires information from either the primary taxpayer or the spouse, while Alabama and Ohio require information on both taxpayer and spouse. New York requires the inclusion of the taxpayer's driver's license or state-issued ID number, issuing state, issuance date, and expiration date when electronically filing a tax return. However, New York will not prevent the electronic filing of a return if a taxpayer has never been issued a New York driver's license or state ID number.

California has its own fraud detection and prevention procedures in place, such as cross-referencing the information it receives from taxpayers with other state agencies and verifying W-2 information with records available through the Employment Development Department. Tax returns are also manually reviewed for authentication purposes. Although California does not require the taxpayer's driver's license or state-issued ID card information for electronic filing, the Franchise Tax Board has indicated that providing such data may potentially lead to faster processing times.

Some states have joined forces with the financial industry to help them identify state tax refunds that appear to be fraudulent and return them to the applicable state for validation and further review before accepting the deposit. As part of the anti-fraud movement, "ID quizzes," "validation key letters," and other governmental notices relating to taxpayers' identity verification have become routine.

Although some of these procedures may be burdensome for taxpayers, implementing safeguards is crucial to protect taxpayers' personal and financial information from fraud.

If you have questions or would like more information, please contact Freshta Ali at **fali@windes.com** or **844.4WINDES** (844.494.6337).



Freshta Ali, CPA, MBT
Senior Tax Accountant
Tax & Accounting Services

Tom Huey Promoted to Partner

Tom Huey, CPA

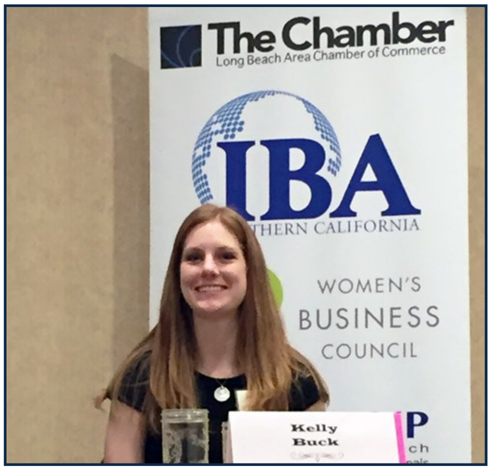
We are pleased to announce that Tom Huey has been promoted from Senior Manager to Partner of Windes. He is based in the firm's Long Beach office and provides auditing, financial reporting, and consulting services to a variety of industries including manufacturing, professional services, maritime-related operations, nonprofits, private foundations, museums, member associations, and governmental agencies. His governmental experience includes auditing, as well as providing financial reporting under the Governmental Accounting Standards Board (GASB) format and performing Single Audits. Tom joined Windes in 2007 and has served in public accounting for nearly two decades.

Tom received a bachelor of arts in business economics with an accounting minor from the University of California Los Angeles (UCLA). He is a Certified Public Accountant and a member of the American Institute of Certified Public Accountants (AICPA) and the California Society of Certified Public Accountants (CalCPA).

Windes in the Community

Windes Audit Manager Key Part of S.T.E.A.M.

Windes Audit Manager, Kelly Buck, recently participated as an accomplished panelist at a breakfast event attended by 75 people at the Long Beach Chamber Women's Business Council on March 7. The event focused on career highlights and challenges for women in the fields of Science, Technology, Engineering, Arts, and Mathematics (S.T.E.A.M.). Kelly was one of five esteemed colleagues on the panel and represented the "Mathematics" field, discussing the importance of math in schools and everyday life.



Kelly Buck, CPA, MAcct

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