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The Pension Digest

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Collin W. Fritz and Associates, Inc.,
"The Pension Specialists"

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 IRA contributions (other than amounts in boxes 2-4, 8-10, 13a, and 14a) $	OMB No. 1545-0747		IRA Contribution Information
	2 Rollover contributions $	2011 Form 5498		
	3 Roth IRA conversion amount $	4 Recharacterized contributions $		Copy A For Internal Revenue Service Center
TRUSTEE'S or ISSUER'S federal identification no. / PARTICIPANT'S social security number	5 Fair market value of account $	6 Life insurance cost included in box 1 $		File with Form 1096.
PARTICIPANT'S name	7 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐			For Privacy Act and Paperwork Reduction Act Notice, see the **2011 General Instructions for Certain Information Returns.**
	8 SEP contributions $	9 SIMPLE contributions $		
Street address (including apt. no.)	10 Roth IRA contributions $	11 Check if RMD for 2012 ☐		
	12a RMD date	12b RMD amount $		
City, state, and ZIP code	13a Postponed contribution $	13b Year	13c Code	
	14a Repayments $	14b Code		
Account number (see instructions)				

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2011 Instructions for Form 5498

This article discusses how the 2011 Form 5498 is to be completed and why. We hope you find it helpful. By furnishing this article now, you can discuss any shortcomings with your IRA software vendor/ provider, if applicable.

The IRS has created the Form 5498 and requires the IRA custodian to prepare and file it, because it will assist the IRS in determining if an individual has properly reflected on his or her federal income tax return the contributions he or she claims being made on his or her tax return.

Note that the Form 5498, in addition to reporting contributions, is used to report the IRA's fair market value as of December 31. Filing a Form 5498 is required for a person who is no longer eligible to make annual contributions (i.e. he or she must receive a RMD). The fact that an IRA is revoked or closed under special account closure rules does not negate the requirement that the contribution be reported on the Form 5498.

May 31, 2012 is the deadline to furnish Form 5498 to the IRS and to the IRA accountholder or inheriting beneficiary. It may be furnished between January 1, 2012 and May 31, 2012. If the IRA accountholder or inheriting beneficiary is alive as of December 31, the individual closed his or her IRA during the year by taking a total distribution, and he or she made no "reportable contribution", then the IRA custodian is not required to prepare and file the Form 5498.

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However, if the IRA accountholder or inheriting beneficiary died during the year, the IRA custodian will need to prepare a final Form 5498 for the deceased IRA accountholder or inheriting beneficiary as discussed later.

All IRA contributions are reportable, except true direct transfer contributions are not. The IRS instructions do not define the conditions which must be met to have a direct transfer. The IRS defines a direct transfer as occurring between the two IRA trustees and as (1) a traditional IRA to a traditional IRA or a SEP-IRA; (2) a SEP-IRA to a SEP-IRA or a traditional IRA; (3) a SIMPLE-IRA to a SIMPLE-IRA; or (4) a Roth IRA to a Roth IRA.

Reportable IRA contributions are annual contributions, recharacterizations, Roth conversions, rollovers, postponed contributions and repayments, and transfer contributions other than as defined above.

The IRS can and will assess a penalty of $50 per form when a Form 5498 is prepared incorrectly, late, or not at all.

The IRS indicates these instructions to complete to the 2011 Form 5498 were listed on the IRS website in March of 2011.

The IRS lists that only three items are new:

1. The instructions clearly state that the trial truncation program for social security numbers has ended and that the IRA custodian must use the complete (nine digits) on all copies of the forms. However, in Notice 2011-38 the IRS states that they are reinstating the trial truncation program for another 2 years. One can only guess why the IRS has not yet revised the instructions to make clear that the truncation program is still an option for a filer. It appears that even though the official position of the IRS is to allow truncating the social security number some within the IRS want no truncation of the social security number.

2. The IRS has special reporting procedures for when an IRA accountholder dies. In general, there will be a final Form 5498 for the decedent for the year of death and there will need to be a Form 5498 for each beneficiary for the year of death and each subsequent year. The IRS has suggested the following titling for this inherited IRA, "Jane Doe as beneficiary of John Doe's traditional IRA." It is assumed that Jane Doe designated her daughter, Mary as her beneficiary. The IRS has now given guidance on the reporting for when the first beneficiary, Jane Doe, dies. The IRS guidance is - apply the preceding rules by treating the prior beneficiary as the decedent and the successor beneficiary as the beneficiary. The inherited IRA is now to be titled, "Mary as beneficiary of Jane Doe's IRA."

3. The IRS has added a caution to the instructions for box 5, Fair market value of account. The caution makes clear that the IRA custodian has the duty to determine the fair market value and that this duty cannot be assigned to the IRA accountholder by contract or any other means.

   The IRS needs to define more specifically what it is required by the IRA custodian/trustee. The IRS basic approach is, "just get it done, determine the fair market value as of December 31." The IRS has never said that a professional appraiser must be used, but in some situations one can expect that the IRS would prefer seeing a professional appraiser.

In prior newsletters we have discussed the topic of how many 5498 forms is the IRA custodian/trustee required to prepare and file. The 5498 instructions clearly state that "if a participant has established more than one IRA plan with the same trustee, a separate form 5498 must be filed for each plan." The national office of the IRS has confirmed for CWF that this rule, a separate form 5498 is required for each separate IRA plan, even though the IRS office at Martinsburg, W, VA. had informed CWF that it would find permissible the electronic submission of an aggregated 5498 form.

The account number box must be completed if an IRA custodian has an individual who has multiple IRA plan agreements. This could be a traditional IRA or a Roth IRA, two traditional IRAs, three Roth IRAs, etc. Even though completing this account number box may not be mandatory, the IRS encourages an IRA custodian to assign an account number on all 5498 forms to be filed.

We will now discuss the completing the From 5498 for each type of IRA. In box 7, the IRA custodian is to check the appropriate box to indicate the type of IRA: IRA for traditional IRA; SEP for SEP-IRA; SIMPLE for SIMPLE-IRA and Roth IRA for Roth IRA. ◆

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Completing the 2011 Form 5498 for a traditional IRA

Box 1. IRA Contributions (other than amounts in boxes 2-4, 8-10, 13a and 14a). Enter the amount of the annual contributions made on or after January 1, 2011 through April 17, 2012 as designated for 2011. The IRA custodian is to report the gross amount of the annual contributions even if such contributions are excess contributions, or will be later recharacterized. These are still to be reported.

A traditional IRA contribution, which is not properly reported in one of the other traditional IRA boxes as discussed below, is to be reported in box 1. For example, if a person tries to roll over $28,000, but does so on day 70 and the IRA custodian learns of this fact prior to filing the current year's Form 5498, then the IRA custodian must report this $28,000 in box 1. This same procedure would apply if somehow non-IRA funds had been mistakenly transferred into an IRA.

Box 2. Rollover Contributions Into the Traditional IRA. Enter the amount of the rollover contributions made on or after January 1, 2011 through December 31, 2011. Made means received by the traditional IRA custodian. Also, enter those contributions which are treated as a rollover contribution (i.e. direct rollover).

A rollover may either be an indirect rollover or a direct rollover.

An indirect rollover means the paying plan (could be an IRA or an employer plan) issues the distribution check to the individual who then makes a rollover contribution by the 60 day deadline. A 60 day indirect rollover may occur between two traditional IRAs, two SEP-IRAs, or between a traditional IRA and a SEP-IRA or vice versa.

Remember that nonspouse IRA beneficiaries are ineligible to roll over a distribution from one inherited IRA and redeposit it into another inherited IRA.

A direct rollover occurs when an employer plan issues the check to the IRA custodian on behalf of the individual. By definition, a direct rollover cannot occur between IRAs. Employer plan means a qualified plan, section 403(b) plan or a governmental section 457(b) plan. The funds attributable to a nonspouse beneficiary of such plans are eligible to be directly rollover to an inherited IRA and would be reported in Box 2.

A special law authorizes a person who received qualified settlement income in connection with the Exxon Valdez litigation to rollover such funds into a traditional IRA. Certain limits apply.

As discussed above under box 1, an amount which is ineligible to be reported as a rollover since it does not qualify as a rollover, must be reported in box 1.

Box 3. Roth IRA Conversion Amount. This box will either be left blank or completed with 0.00 since there will never be a Roth conversion contribution made to a traditional IRA.

Box 4. Recharacterized Contributions. The IRS instructions are very brief, "Enter any amounts recharacterized plus earnings from one type of IRA to another." If a person had made either an annual contribution or a conversion contribution to a Roth IRA in either 2010 and/or 2011, he or she may elect to recharacterize it as adjusted by earnings or losses to be traditional IRA contribution in 2011. The total amount recharacterized is to be reported in box 4. Although the IRS instructions use the term, "plus earnings", the IRS should use the term, "plus or minus earnings or losses."

Box 5. Fair Market Value of Account. The IRS instructions for this box are also very brief, "Enter the FMV of the account on December 31."

The IRS added a caution to self-directed and trust IRAs as follows: "Trustees and custodians are responsible for ensuring that all IRA assets (including those not traded on established markets or with otherwise readily determinable market value) are valued annually at their fair market value."

The IRS needs to furnish additional guidance in addition to adding this caution note.

The instruction to report the FMV as of December 31 applies whether there is a living IRA accountholder or an inheriting IRA beneficiary.

If the IRA accountholder or inheriting beneficiary is alive as of December 31, the individual closed his or her IRA during the year by taking a total distribution and he or she made no "reportable contribution", then

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the IRA custodian is not required to prepare and file the Form 5498. **However, if the IRA accountholder or inheriting beneficiary died during the year, the IRA custodian will need to prepare a final Form 5498 for the deceased IRA accountholder or inheriting beneficiary as discussed below**.

With respect to a deceased accountholder or a deceased inheriting IRA beneficiary, the IRS gives the IRA custodian two options. Option #1 - report the FMV as of the date of death. Option #2 - report the FMV as of the end of the year in which the decedent died. This alternate value will usually be zero because the IRA custodian will be reporting the end of year value on the Form 5498's for the beneficiary or beneficiaries. If Option #2 is used, the IRA custodian must inform the executor or administrator of the decedent's estate of his or her right to ask for the FMV as of the date of death.

If the IRA custodian does not learn of the individual's death until after the filing deadline for the Form 5498 (i.e May 31), then it is not required to prepare a corrected Form 5498. However, an IRA custodian must still furnish the FMV as of the date of death if requested to do so.

Box 6. Life Insurance cost included in box 1. An IRA custodian will normally leave this box blank or will insert a 0.00 since it is only to be completed if there was a contribution to an IRA endowment contract as sold by an insurance company a long time ago.

Box 7. Checkboxes. Since we are discussing completing Form 5498 for a traditional IRA, the first box, the IRA box, will be checked.

Since the IRS has never really defined when a SEP-IRA quits being a SEP-IRA, the instructions provide that "if you do not know whether the account is a SEP-IRA, check the 'IRA' box."

Box 8. SEP Contributions. An IRA custodian will leave this box blank or will insert a 0.00 when the box for a traditional IRA is checked.

Box 9. SIMPLE Contributions. An IRA custodian will leave this box blank or will insert a 0.00 when the box for a traditional IRA is checked.

Box 10. Roth IRA Contributions. An IRA custodian will leave this box blank or will insert a 0.00 when the box for a traditional IRA is checked.

Box 11. Check if RMD for 2012. An IRA custodian is required to check this box if the IRA accountholder attains age 70½ or older during 2012. The instructions do not discuss whether or not this box is to be checked for an inheriting traditional IRA beneficiary. It should not be checked for an inherited IRA.

Completing this box is necessary only if the IRA custodian is required to prepare a 2011 Form 5498 for a person. This box is not checked with respect to an individual who died during 2011 and who would have attained age 70½ or older during 2012 had he or she lived.

Boxes 12a (RMD date) and 12b (RMD Amount). An IRA custodian's use of these two boxes is optional, it is not mandatory.

Under current IRS procedures, the IRS does not require the traditional IRA custodian to furnish it with the RMD amount. The law is unsettled whether or not the IRS has the legal authority to require that an IRA custodian furnish the RMD amount. Since the IRS would like to be furnished this information, the IRS has added boxes 12a and 12b to the Form 5498.

The approach adopted by the IRS is that a traditional IRA custodian by completing boxes 11, 12a and 12b on the Form 5498 and furnishing it to the IRA accountholder will meet the requirement that it must furnish a RMD Notice by January 31. The IRS instructions do permit the IRA custodian to furnish a separate Form 5498 with the only information being furnished is the information for boxes 11, 12a and 12b.

Box 13a. Postponed contribution(s). Since we are discussing completing the Form 5498 for a traditional IRA, we will discuss what needs to be done for postponed contributions to a traditional IRA. The individual will instruct you on an IRA contribution form the "prior" year or years for which he or she is making the postponed contribution(s). The individual must designate the IRA contribution for a prior year to claim it as a deduction on the income tax year.

Postponed contributions may be made by individuals who have served in a combat zone or hazardous duty area or individuals who are "affected taxpayers" due to federally designated disasters.

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If the IRA custodian will report the contribution made after April 15 and the individual designates a contribution for a prior year, then the IRA custodian must prepare either (1) a Form 5498 for the year for which the contribution was made or (2) on a Form 5498 for a subsequent year.

Under approach #1, the IRA custodian may choose to report the contribution for the year it is made. For example, if an individual in September of 2011 designated a contribution of $5,000 to a traditional IRA for 2009. The IRA custodian could choose to prepare a 2009 Form 5498 and report the $5,000 contribution in box 1. If the IRA custodian had not prepared a 2009 Form 5498 for this individual, the IRA custodian then would prepare an original Form 5498. If the IRA custodian had previously prepared a 2009 Form 5498 for this individual, the IRA custodian then would prepare a "corrected" Form 5498.

Under approach #2, if the the IRA custodian is furnished a contribution after April 15, the IRA custodian may choose to report it on that year's Form 5498. The amount of the contribution must be reported in box 13a and the year for which the contribution was made in box 13b and in box 13c the applicable code as follows:

AF - Allied Force

EF - Enduring Freedom or

IF - Iraqi Freedom

FD - Affected taxpayers of designated disaster area.

Definition. An individual who is serving in or in support of the Armed Forces in a designated combat zone or qualified hazardous duty area has an additional period after the normal contribution due date of April 15 to make IRA contributions for the prior year. The period of time is the time the individual was in the designated zone or area plus at least 180 days.

Box 14a. Repayments. A traditional IRA accountholder who has taken a distribution under special disaster rules or who has taken a qualified reservist distribution is eligible to repay the distribution even though such repayment does not qualify as a rollover. Enter the amount of the repayment(s).

Box 14b. Code. Enter the applicable code for the type repayment(s):

QR - repayment to a qualified reservist

DD - repayment of a federally designated disaster distribution.

Note that repayments only have one reporting procedure whereas postponed contributions have two reporting procedures.

Duty To Prepare/Furnish Corrected Form 5498. An IRA custodian is required to prepare a corrected form 5498 as soon as possible after it learns there is an error on the original form as filed. The IRS furnishes the following example. "If you reported as rollover contributions in box 2, and you later discover that part of the contribution was not eligible to be rolled over and was, therefore, a regular contribution that should have been reported in box 1 (even if the amount exceeds the regular contribution limit), you must file a corrected For 5498. ◆

Completing the 2011 Form 5498 for a Roth IRA

Box 1. IRA contributions (other than amounts in boxes 2-4,8- 10,13a and 14a).

This box will not be completed for a Roth IRA contribution.

At this point, the completion of Box 10 will be discussed because that is the box completed to report annual Roth IRA contributions.

Box 10. Roth IRA Contributions. Enter the amount of the annual Roth IRA contributions made on or after January 1, 2011 through April 17, 2012 as designated for 2011.

The Roth IRA custodian is to report the gross amount of the annual contributions even if such contributions are excess contributions, or will be later recharacterized.

A Roth IRA contribution, which is not properly reported in one of the other Roth IRA boxes as discussed below, is to be reported in box 10. For example, if a person tries to roll over $17,000, but does so on day 70 and the Roth IRA custodian learns of this fact prior to filing the current year's Form 5498, then the Roth IRA custodian must report this $28,000 in box 10. This

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same procedure would apply if a person tried to transfer funds not qualifying to be transferred to a Roth IRA.

Box 2. Rollover Contributions Into the Roth IRA. Enter the amount of the rollover contributions made on or after January 1, 2011 through December 31, 2011. Made means received by the Roth IRA custodian. Also enter those contributions which are treated as a rollover contribution.

A rollover may either be an indirect rollover or a direct rollover.

An indirect rollover means the paying plan (could be a Roth IRA or an employer plan) issues the distribution check to the individual who then makes a rollover contribution by the 60 day deadline. A 60 day indirect rollover may only occur between two Roth IRAs.

Remember that nonspouse Roth IRA beneficiaries are ineligible to roll over a distribution from one inherited Roth IRA and redeposit it into another inherited Roth IRA.

A direct rollover occurs when an employer plan issues the check to the Roth IRA custodian on behalf of the individual. By definition, a direct rollover cannot occur between Roth IRAs. Employer plan means a qualified plan, section 403(b) plan or a governmental section 457(b) plan.

A participant (or an inheriting nonspouse beneficiary) of an employer plan may instruct to have two types of plan funds go into a Roth IRA. Both are reported as a rollover in box 2. First, the individual may direct that his or her non-Roth funds be directly rolled over into a Roth IRA. The individual will be required to include such amount in his or her income. Second, the individual may direct that his or her Roth funds also be directly rolled over into a Roth IRA.

There are a number of special laws allowing a person to roll over certain special funds into a Roth IRA.

First, a person who received qualified settlement income in connection with the Exxon Valdez litigation to rollover such funds into a Roth IRA. Certain limits apply.

Second, a person who receives a military death gratuity or an SGLI payment may rollover into a Roth IRA.

Third, certain bankrupt airline amounts may be rolled over.

As discussed above under box 10, an amount which is ineligible to be reported as a rollover to a Roth IRA since it does not qualify as a rollover, must be reported in box 10.

Box 3. Roth IRA Conversion Amount. This box will be completed with the conversion amount(s) received by the Roth IRA from January 1, 2011 to December 31, 2011 from the other types of IRAs: traditional, SEP or SIMPLE.

Box 4. Recharacterized Contributions. The IRS instructions are very brief, "Enter any amounts recharacterized plus earnings from one type of IRA to another."

If a person had originally made an annual contribution to a traditional IRA in either 2010 and/or 2011, he or she may elect to recharacterize it to be Roth IRA contribution in 2011. The amount recharacterized in total is to be reported in box 4. Although the IRS instructions use the term, "plus earnings", the IRS should use the term, "plus or minus earnings or losses."

Box 5. Fair Market Value of Account. The IRS instructions for this box are also very brief, "Enter the FMV of the account on December 31."

The discussion for the traditional IRA will also apply to the Roth IRA. The same inherited IRA rules also apply.

Box 6. Life Insurance cost included in box 1. A Roth IRA custodian will normally leave this box will blank or will insert a 0.00 since it is only to be completed if there is an endowment contract as sold by an insurance company a long time ago.

Box 7. Checkboxes. Since we are discussing completing Form 5498 for a Roth IRA, the fourth box, the Roth IRA box, will be checked.

Box 8. SEP Contributions. This box does not apply to a Roth IRA. The Roth IRA custodian will leave this box blank or will insert a 0.00 when the box for a Roth IRA is checked.

Box 9. SIMPLE Contributions. This box does not apply to a Roth IRA. The Roth IRA custodian will leave this box blank or will insert a 0.00 when the box for a Roth IRA is checked.

Box 10. Roth IRA Contributions. Discussed previously.

Box 11. Check if RMD for 2012. The box must not be checked. It does not apply to a Roth IRA since a Roth accountholder is never required to take a distribution while alive. The instructions do not discuss whether or not this box is to be checked for an inheriting Roth IRA beneficiary. It should not be checked for an inherited Roth IRA.

Boxes 12a (RMD date) and 12b (RMD Amount). These boxes do not apply to a Roth IRA since a Roth accountholder is never required to take a distribution while alive. The Roth IRA custodian will leave this box blank or will insert a 0.00 when the box for a Roth IRA is checked.

Box 13a. Postponed contribution(s). As with traditional IRAs, certain individuals qualify to make postponed distributions.

Since we are discussing completing the Form 5498 for a Roth IRA, we will discuss what needs to be done for postponed contributions to a Roth IRA. The individual will instruct you on a Roth IRA contribution form the "prior" year or years for which he or she is making the contribution(s).

Postponed contributions may be made by individuals who have served in a combat zone or hazardous duty area or individuals who are "affected taxpayers" due to federally designated disasters.

If the Roth IRA custodian will report the contribution made after April 15th and the individual designates a contribution for a prior year, then the Roth IRA custodian must prepare either (1) a Form 5498 for the year for which the contribution was made or (2) on a Form 5498 for a subsequent year.

Under approach #1, the Roth IRA custodian may choose to report the contribution for the year it is made. For example, if an individual in September of 2011 designated a contribution of $5,000 to a Roth IRA for 2009. The Roth IRA custodian could choose to prepare a 2009 Form 5498 and report the $5,000 contribution in box 1. If the Roth IRA custodian had not prepared a 2009 Form 5498 for this individual, the Roth IRA custodian then would prepare an original Form 5498. If the IRA custodian had previously prepared a 2009 Form 5498 for this individual, the IRA custodian then would prepare a "corrected" Form 5498.

Under approach #2, if the the Roth IRA custodian is furnished a contribution after April 15, the IRA custodian may choose to report it on that year's Form 5498. The amount of the contribution must be reported in box 13a and the year for which the contribution was made in box 13b and in box 13c the applicable code as follows:

AF - Allied Force

EF - Enduring Freedom or IF - Iraqi Freedom

FD - Affected taxpayers of designated disaster area.

Definition. An individual who is serving in or in support of the Armed Forces in a designated combat zone or qualified hazardous duty area has an additional period after the normal contribution due date of April 15 to make IRA contributions for the prior year. The period of time is the time the individual was in the designated zone or area plus at least 180 days.

Box 14a. Repayments. A Roth IRA accountholder who has taken a distribution under special disaster rules or who has taken a qualified reservist distribution is eligible to repay the distribution even though such repayment does not qualify as a rollover. Enter the amount of the repayment(s).

Box 14b. Code. Enter the applicable code for the type repayment(s).

QR - repayment to a qualified reservist

DD - repayment of a federally designated disaster distribution.

Note that repayments only have one reporting procedure whereas postponed contributions have two reporting procedures.

Duty To Prepare/Furnish Corrected Form 5498. An IRA custodian is required to prepare a corrected form 5498 as soon as possible after it learns there is an error on the original form as filed. The IRS furnishes the following example. "If you reported as rollover contributions in box 2, and you later discover that part of the contribution was not eligible to be rolled over and was, therefore, a regular contribution that should have been reported in box 1 (even if the amount exceeds the regular contribution limit), you must file a corrected For 5498. ◆

Completing the 2011 Form 5498 for a SEP-IRA

Box 1. IRA contributions (other than amounts in boxes 2-4, 8-10,13a and 14a).

This box is be completed if an individual makes a regular IRA contribution in addition to an employer making a SEP contribution as discussed below. At this point, the completion of Box 8 will be discussed because that is the box completed to report employer SEP-IRA contributions.

Box 8. SEP-IRA Contributions. Enter SEP-IRA contributions made by an employer in 2011 (i.e. January 1 through December 31) regardless of the tax year for which the employer designated the contribution. That is, enter employer contributions made to a SEP-IRA during 2011, including contributions in 2011 for 2010, including contributions in 2011 for 2011, but not including contributions made in 2012 for 2011.

For purposes of the above rule, include in box 8, SEP-IRA contributions made by a self-employed person to his or her own SEP-IRA.

The above rules apply to both standard SEP-IRA contributions and also to SAR-SEP contributions.

Box 2. Rollover Contributions Into A SEP-IRA. The rules as discussed with respect to rollovers for traditional IRA will also apply to a SEP-IRA.

Box 3. Roth IRA Conversion Amount. This box will either be left blank or completed with 0.00 since there will never be a Roth conversion contribution made to a SEP-IRA.

Box 4. Recharacterized Contributions. The tax laws do not authorize a SEP contribution to be recharacterized. Therefore, this box will generally be either be left blank or will be completed with a zero. However, if an individual converts his or her SEP funds to a Roth IRA, and then recharacterizes it, it will be reported in this box.

Box 5. Fair Market Value of Account. The IRS instructions for this box are also very brief, "Enter the FMV of the account on December 31."

The IRS added a caution to self-directed and trust IRAs as follows: "Trustees and custodians are responsible for ensuring that all IRA assets (including those not traded on established markets or with otherwise readily determinable market value) are valued annually at their fair market value."

The discussion for reporting the FMV for a traditional IRA also apply to a SEP-IRA.

Box 6. Life Insurance cost included in box 1. An IRA custodian will normally leave this box blank or will insert a 0.00 since it is only to be completed if there is an IRA endowment contract as sold by an insurance company a long time ago.

Box 7. Checkboxes. Since we are discussing completing Form 5498 for a SEP-IRA, the second box, the SEP-IRA box, will be checked. The IRA custodian is required to know the type of IRA. Since the IRS has never really defined when a SEP-IRA quits being a SEP-IRA, the instructions provide that "if you do not know whether the account is a SEP-IRA, check the 'IRA' box."

Box 8. SEP Contributions. See the previous discussion.

Box 9. SIMPLE Contributions. An IRA custodian will leave this box blank or will insert a 0.00 when the box for a SEP-IRA is checked.

Box 10. Roth IRA Contributions. An IRA custodian will leave this box blank or will insert a 0.00 when the box for a SEP-IRA is checked.

Box 11. Check if RMD for 2012. The same RMD rules apply to a SEP-IRA as to a traditional IRA. Therefore, a SEP-IRA custodian is required to check this box if the SEP-IRA accountholder attains age 70$^1/_2$ or older during 2012. The instructions do not discuss whether or not this box is to be checked for an inheriting SEP-IRA beneficiary.

Completing this box is necessary only if the IRA custodian is required to prepare a 2011 Form 5498 for a person. This box is not checked with respect to an individual who died during 2011 and who would have attained age 70$^1/_2$ or older during 2012 had he or she lived.

Boxes 12a (RMD date) and 12b (RMD Amount). The discussion for these boxes under the traditional IRA apply equalling to a SEP-IRA.

Box 13a Postponed contribution(s). The same postponed contribution rules apply to a SEP-IRA as to a traditional IRA. Refer to the discussion for the traditional

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IRA. A primary difference is that postponed contributions will likely be made by individuals of a disaster area, but not individuals in a war zone.

Box 14a. Repayments. A SEP-IRA accountholder who has taken a distribution under special disaster rules or who has taken a qualified reservist distribution is eligible to repay the distribution even though such repayment does not qualify as a rollover. Enter the amount of the repayment(s).

Box 14b. Code. Enter the applicable code for the type repayment(s).

QR - repayment to a qualified reservist

DD - repayment of a federally designated disaster distribution.

Note that repayments only have one reporting procedure whereas postponed contributions have two reporting procedures.

Duty To Prepare/Furnish Corrected Form 5498. A SEP-IRA custodian is required to prepare a corrected form 5498 as soon as possible after it learns there is an error on the original form as filed. The IRS furnishes the following example. "If you reported as rollover contributions in box 2, and you later discover that part of the contribution was not eligible to be rolled over and was, therefore, a regular contribution that should have been reported in box 1 (even if the amount exceeds the regular contribution limit), you must file a corrected For 5498. ◆

Completing the 2011 Form 5498 for a SIMPLE-IRA

Box 1. IRA contributions (other than amounts in boxes 2-4, 8-10, 13a and 14a). This box will not be completed for a SIMPLE-IRA. It will either be left blank or a zero will be reported.

Box 9. SIMPLE-IRA Contributions. Enter SIMPLE-IRA contributions made by an employer in 2011 (i.e. January 1 through December 31) regardless of the tax year for which the employer designated the contribution. That is, enter employer contributions made to a SIMPLE-IRA during 2011, including contributions in 2011 for 2010, but not including contributions made in 2012 for 2011.

For purposes of the above rule, include in box 9. SIMPLE-IRA contributions made by a self-employed person to his or her own SIMPLE-IRA.

Box 2. Rollover Contributions Into A SIMPLE-IRA. The only funds that can be rolled over into a SIMPLE-IRA is funds that originated from another SIMPLE-IRA. There is no authority to do an indirect or a direct rollover from an employer plan into a SIMPLE-IRA.

Box 3. Roth IRA Conversion Amount. This box will either be left blank or completed with 0.00 since there will never be a Roth conversion contribution made to a SIMPLE-IRA. The instructions state enter the amount converted to a Roth IRA from one of the other types of IRAs.

Box 4. Recharacterized Contributions. The tax laws do not authorize a SIMPLE contribution to he recharacterized. Therefore, this box will normally he either he left blank or will be completed with a zero.

Box 5. Fair Market Value of Account. The IRS instructions for this box are also very brief, "Enter the FMV of the account on December 31."

The IRS added a caution to self-directed and trust IRAs as follows: "Trustees and custodians are responsible for ensuring that all IRA assets (including those not traded on established markets or with otherwise readily determinable market value) are valued annually at their fair market value."

The discussion for reporting the FMV for a traditional IRA also apply to a SIMPLE-IRA.

Box 6. Life Insurance cost included in box 1. An IRA custodian will normally leave this box blank or will insert a 0.00 since it is only to be completed if there is an IRA endowment contract as sold by an insurance company a long time ago.

Box 7. Checkboxes. Since we are discussing completing Form 5498 for a SIMPLE-IRA, the third box, the SIMPLE-IRA box, will be checked. The IRA custodian is required to know the type of IRA.

Box 8. SEP Contributions. An IRA custodian will leave his box blank or will insert a zero when the box for a SIMPLE-IRA is checked.

Box 9. SIMPLE Contributions. This was previously discussed.

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Box 10. Roth IRA Contributions. An IRA custodian will leave this box blank or will insert a 0.00 when the box for a SIMPLE-IRA is checked.

Box 11. Check if RMD for 2012. The same RMD rules apply to a SIMPLE-IRA as to a traditional IRA. Therefore, a SIMPLE-IRA custodian is required to check this box if the SIMPLE-IRA accountholder attains age 70½ or older during 2012.

Completing this box is necessary only if the IRA custodian is required to prepare a 2011 Form 5498 for a person. This box is not checked with respect to an individual who died during 2011 and who would have attained age 70½ or older during 2012 had he or she lived.

Boxes 12a (RMD date) and 12b (RMD Amount). The discussion for these boxes under the traditional IRA apply equally to a SIMPLE-IRA. ◆

HSAs and Prohibited Transactions

The purpose of this article is to remind HSA custodians and HSA owners that the prohibited transaction rules apply to HSAs. Unfortunately, IRS guidance has been very limited. See the end of this article for a summary on prohibited transactions as taken from page 9 of IRS Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans.

HSA custodians and HSA owners should work together to ensure that a prohibited transaction does not occur with respect to an HSA. Both need to understand the rules. It would be best if an HSA custodian's attorney and accountant have also reviewed this subject so that policies and procedures in the 2011 instructions for Form 1099-R are adopted.

The IRS has made clear that if a prohibited transaction occurs, the HSA custodian has the duty to report it regardless of whom owes the 15% tax.

The IRS sets forth in Notice 2008-59 a limited discussion of using debit cards for HSAs and whether the prohibited transaction rules apply to HSAs. Q & A's 27-37 discuss these topics. Go to to read these Q & A's at www.pension-specialists.com/200829IRB.PDF.

A loan or extension of credit between a plan (i.e. the HSA) and a disqualified person is a prohibited transaction. The disqualified person will normally be the HSA owner (or his or her power or attorney), but it also could be the HSA custodian/trustee or an employer.

The disqualified person engaging in or causing the prohibited transaction is liable for a 15% excise tax. If the HSA custodian trustee covers the NSF check, we believe it is the HSA custodian which is responsible to report and pay the excise tax. In most situations, if there are insufficient funds, the HSA custodian has the legal authority to not pay the check or debit claim.

Q & A 35 states very clearly that "any direct or indirect extension of credit between the HSA trustee and the HSA is a prohibited transaction." The covering or paying of a NSF check by the HSA custodian is a prohibited transaction.

The IRS gives two examples:

"Example #I. Bank A is the trustee of an HSA. Bank A extends a line of credit to the HSA. This line of credit is a prohibited transaction.

Example #2. Bank Y is the custodian/trustee of the HSA. The HSA owner accesses the funds in the HSA through a debit card. In addition, Bank Y extends a line of credit to the HSA owner, which is not secured by the HSA and amounts in the HSA cannot he used to repay the line of credit. This line of credit is not a prohibited transaction."

The difference in the two (2) examples is that in the first example the line of credit is granted to the HSA and in the second example it is extended to the individual in his or her personal capacity and not as an HSA owner.

The IRS does not expressly discuss what is being accomplished by extending a line of credit to the individual in his or her non-HSA owner status. Presumably, this type of line of credit could be established to resolve the NSF situation by being an immediate source of cash for the individual so he or she could contribute whatever amount is required to make an additional HSA contribution of a certain amount thereby eliminating the NSF situation and any fee associated with the NSF situation. The individual needs to be eligible to make this contribution otherwise it will be an excess contribution.

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Remember, that for 2011 HSA contribution purposes, the HSA custodian cannot allow a person's contributions to exceed $7,150. However, the individual has the primary duty to comply with the excess HSA contribution rules.

An HSA custodian/trustee does not want to take any action which would create a negative balance in the HSA. We understand that a negative balance with respect to an HSA means a short term loan has been made by the bank. That is, the bank expects that the account balance will be at least brought to zero, if not, made positive. Stated another way, the HSA custodian wants procedures in place to ensure that NSF checks are returned unpaid and that no fees are assessed if the HSA will go negative. This includes paying or covering a check which would result in a negative balance. It also includes assessing a fee against the HSA so that a negative balance is created or made larger.

What IRS reporting is required when a prohibited transaction occurs?

The IRS has not given as much guidance on the topic of HSAs and prohibited transactions as is needed. See the discussion in Notice 2008-59. There is no de minimus rule. There should be.

If a PT occurs, the HSA is deemed distributed as of the first day of the year. This creates a reporting headache and most likely a tax headache for the individual. First, the deemed distribution is a retroactive distribution. Second, since the distribution will not be qualified medical distribution, the account balance will need to be included in the individual's income and will be subject to the 20% excise tax.

CWF has never seen the IRS explain how the transactions occurring after the first day of the year are to be handled. Presumably, any distributions which occurred after January 1 would not be distributions from an HSA and so would not be reported. Presumably, any contributions made after January 1 will be treated as not being made to an HSA. That is, such contributions were made to a regular deposit account with Form 1099-INT reporting requirements. It is unclear, if and how setting up a new HSA would minimize the tax difficulties of the individual.

In those situations where the HSA owner uses the debit card causing a negative balance, but banking laws do not allow the HSA custodian to not honor the transaction, the HSA custodian will be able to argue that the individual caused the negative balance and not the bank.

If the HSA custodian causes the prohibited transaction, then it owes a 15% excise tax. It must file Form 5330 and pay the proper tax (15% times amount involved) or be subject to being assessed penalty taxes for not doing so. The standard penalties apply - interest is charged on taxes not paid, there is a penalty for filing late (5% of the unpaid tax for each month late up to a maximum of 25% of the unpaid taxes) and there is a penalty for paying late (.005 times the unpaid tax for each month not paid up to a maximum of 25%.

We have not read any articles discussing whether or not the IRS will actively seek to penalize HSA custodians who intentionally cover NSF check situations or who cover certain debit card situations because the banking laws require it.

The IRS viewpoint of HSAs has changed greatly. The IRS administration under the Bush administration liked HSAs. This cannot be said about the Obama administration. However, we don't expect the Obama administration to have the IRS increase its enforcement of this HSA negative balance issue. But we cannot guaranty this.

The HSA custodian must make the business decision whether or not a prohibited transaction has occurred with respect to an HSA so that it is reported to the IRS and the individual. Under the law, if a prohibited transaction occurs, it must be reported on the Form 1099-R.

CWF recommends that the HSA custodian adopt a conservative approach. Don't cover the NSF check or debit card if you have a choice. Don't charge fees if the fees will put the HSA into a negative balance. An HSA custodian has the duty to report the covering of a NSF check as a prohibited transaction and also when there is a negative balance due to a fee assessment. If the HSA custodian does not report these situations by filing Form 5330 and paying the tax, the HSA custodian could be assessed various tax penalties.

In conclusion, the tax laws applying to prohibited transactions are complex and are very harsh. They are also outdated. Until the prohibited transactions rules

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applying to HSAs are changed, a financial institution wants to adopt policies and procedures to prevent their occurrence. If a prohibited transaction occurs, it will need to be reported on the Form 1099-R. The party causing the prohibited transaction will be responsible to prepare the Form 5330 and pay the 15% tax.

IRS Discussion of HSAs and Prohibited Transactions (As taken from page 9 of Pub. 969). Remember that IRS publications are written for the taxpayer and not the financial institution. ◆

Deemed distributions from HSAs. The following situations result in deemed taxable distributions from your HSA.

- You engaged in any transaction prohibited by section 4975 with respect to any of your HSAs, at any time in 2010. Your account ceases to be an HSA as of January 1, 2010, and you must include the fair market value of all assets in the account as of January 1, 2010, on Form 8889, line 14a.
- You used any portion of any of your HSAs as security for a loan at any time in 2010. You must include the fair market value of the assets used as security for the loan as income on Form 1040 or Form 1040NR, line 21.

Examples of prohibited transactions include the direct or indirect:

- Sale, exchange, or leasing of property between you and the HSA,
- Lending of money between you and the HSA,
- Furnishing goods, services, or facilities between you and the HSA, and
- Transfer to or use by you, or for your benefit, of any assets of the HSA.

Any deemed distribution will not be treated as used to pay qualified medical expenses. These distributions are included in your income and are subject to the additional 10% tax, discussed later.

EBSA to Re-Propose Rule on Definition of a Fiduciary for IRAs and Pension Plans

On September 17, 2011, the Employee Benefits Security Administration (EBSA) of the Department of Labor announced it will re-propose its rule on the definition of a fiduciary. The new proposed rule is expected to be released in early 2012.

On October 22, 2010, the EBSA had published a proposed rule revising a 1975 regulation defining when a person is a “fiduciary” with respect to an IRA or pension plan by reason of giving investment advice for a fee. The 1975 regulation provided for a five-part test to determine if a person was a fiduciary. Under this rule, a person is a fiduciary only if he or she: (1) makes recommendations on investing in, purchasing or selling securities or other property, or gives advice as to their value; (2) on a regular basis; (3) pursuant to a mutual understanding that the advice; (4) will serve as a primary basis for investment decisions; and (5) will be individualized to the particular needs of the IRA or plan.

A person who did not meet all five conditions was and is not a fiduciary. The current EBSA believes there are situations where a person should be a fiduciary even though they are not one under existing law. So a new rule was proposed with the goal to make many more individuals fiduciaries.

On July 26, 2011, Phylis C. Borzi, assistant secretary of labor, EBSA, testified before the House Committee on Education and the Workforce, Subcommittee on Health, Employment, Labor, and Pensions. She testified as to the goals and need for a new definition of fiduciary. There was substantial negative feedback. Even Rep. Barney Frank, D-Mass., the ranking member of the House Financial Services Committee, wrote the DOL and suggested the withdrawal of the proposed rule and the issuance of a new proposed rule to be coordinated with similar actions being taken by the SEC and the CFTC.

CWF will keep you informed. ◆