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ALSO IN THIS ISSUE –

Rollovers for 2006-2008 Traditional IRAs – by Age, *Page 2*

Basic Beneficiary RMD Rules, *Page 4*

Michigan IRA Custodians – New Withholding Duties as of January 1, 2012, *Page 5*

HSAs and State Dormancy or Escheat Laws, *Page 6*

DOL Updates Regulation Governing Procedures For PT Exemptions, *Page 6*

Seeking IRA Contributions, *Page 8*

Inform HSA Owners of an Important IRS Reporting Difference For Excess Contributions, *Page 8*

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"The Pension Specialists"

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IRS Releases 2011 Publication 590

The 2011 version of Publication 590, IRA Arrangements, is virtually the same as the 2010 version except the examples and the forms have been updated to include the 2011 versions and the discussion of those rules applying for 2010, but not for 2011, have been deleted. The 2010 version has 108 pages whereas the 2011 version has 106 pages.

There are six (6) changes deserving discussion.

1. **Qualified HSA Funding Distributions.** On page 38 the IRS added five (5) paragraphs discussing the rules applying when one transfers funds from their IRA to their HSA. CWF had suggested to the IRS that some discussion should be added. The IRS explanation is good. It could have been made better if the IRS would have also explained that the IRA custodian is to report this "deemed distribution" as taxable and that the individual must complete line 15a and 15b of his or her Form 1040 to show the distribution is not taxable by inserting a 0.00 on line 15b and writing "QFD" next to line 15b.

2. **Updating Publication 590.** The IRS has announced a new procedure for discussing "changes" to be made to the upcoming version of Publication 590. This would be the 2012 version since the 2011 version was just issued in December of 2011.

   The current IRS procedure of issuing the current year version (e.g. 2011) in December of 2011 and not furnishing the 2012 version until December of 2012 has limitations. From January 1 to December 2011, a taxpayer did not have the 2011 version to review to help him or her make informed IRA decisions. An example, the 2011 Publication does discuss the rules applying to qualified charitable distributions, but there is no indication of what the rules will be for 2012. A statement should indicate that a person can not make a qualified charitable distribution for 2012 unless a new tax law would be enacted authorizing it for 2012.

   The IRS has stated that it will have information at a specific internet address discussing such law changes. At www.irs.gov/pub590 the IRS will set forth changes to be made or most likely to be made in the next version. Such changes normally would come from tax law changes.

   It would be better for taxpayers if the IRS would issue Publication 590 at least twice during the year, but the IRS has chosen not to do so. Presumably, the IRS has decided that the additional work will not sufficiently benefit taxpayers to make the additional cost worthwhile.

3. **Special Rules for 2010 Conversions.** The 2010 version of Publication 590 contained an extensive discussion of the special conversion rules requiring a taxpayer to include 50% of his or

Continued on page 2

Publication 590,
Continued from page 1

her conversion amount in income for 2011 and the remaining amount for 2012. However, the taxpayer could elect to include the entire conversion amount in income for 2010. If a person withdraws some portion of all of such conversion in 2010 or 2011, there are special income acceleration rules.

The discussion relating to the 2010 taxation rules have been greatly reduced as those distributions have already occurred and do not apply conversions made in 2011 and 2012.

The discussion relating to the income acceleration rules have been expanded in the 2011 version as 2011 is the last year for such an acceleration. Examples have been added to illustrate the effect of withdrawing funds in 2010 and/or 2011.

4. **Distributions - Figuring the Nontaxable and Taxable Amounts.** A paragraph has been added clarifying how this calculation is made with respect to a person who died during the year, who had basis within his traditional IRA, and who took one or more distributions prior to his or her death.

   To determine the taxable and nontaxable portions of the IRA distributions, the value of the decedent's traditional IRAs, SEP-IRAs and SIMPLE-IRAs must be aggregated. The values to be aggregated are the values as of his or her date of death and not as of December 31.

5. **First (or subsequent) Inheriting IRA Beneficiary Dies.** A clarifying sentence has been added to determining the divisor for an inheriting beneficiary for the RMD formula. The new instruction is,"If the designated beneficiary dies after September 30 of the year following the year of the IRA owner's death, continue to use the designated beneficiary's remaining life expectancy to determine the distribution period; do not use the life expectancy of any subsequent beneficiary." In plain english this means, continue to use the schedule as originally determined for the first inheriting beneficiary even after he or she dies.

6. **IRS Tax Help.** On pages 74-76 the IRS has changed the discussion of the tax help available to taxpayers.

   There is a substantial amount of free tax help available. The Volunteer Income Tax Assistance (VITA) program is designed to help low-moderate income taxpayers and the Tax Counseling for the Elderly (TCE) program is designed to assist taxpayers age 60 and older with their tax returns. Most VITA and TCE sites will have free electronic filing of federal income tax returns.

   The IRS website is to be found at www.irs.gov and is always available. Substantial tax research may be done at this site.

   A taxpayer may also call the IRS to ask questions (1-800-829- 1040), order forms (1-800-829-3676) or seek other assistance. A taxpayer may visit certain IRS offices and seek in-person assistance.

   The IRS has a Taxpayer Advocate Service (TAS) . If you are having problems resolving a tax situation with the IRS, you may qualify to have TAS help you. Their toll free number is 1-800-777-4778.

In summary, the IRS made only a few changes in the 2011 version of Publication 590, IRA Arrangements. There were no IRA law changes in 2011. It is encouraging to know that the IRS solicits requests for changes and in many cases will revise the Publication 590 to include the changes. ◆

Rollovers for 2006-2008 Traditional IRAs – by Age

	Number of Taxpayers	Rollover Amts (1,000s)	Average
2006	4,150,140	$281,976,973	$67,944
2007	4,421,849	$322,336,641	$72,896
2008	4,448,705	$307,577,823	$69,138
Total	13,020,694	$911,891,436	$70,034

As discussed in the November newsletter, the IRS has compiled data from the 5498 forms filed with the IRS. At this point, the IRS has published data for 2004-2008. More recent data would be preferred, but some data is better than no data.

What are the ages of those taxpayers making rollovers?

Continued on page 3

The Pension Digest

Rollovers,
Continued from page 2

What is the size of these rollovers?

Set forth below are the tables showing rollover contributions by age for 2006, 2007 and 2008.

2006 IRA rollovers by age of taxpayer

Age Categories	Number of Taxpayers	Percent	Amount (in 1,000's)	Percent	Average
Under Age 15	8	0	1,280	0	$0
15 under 20	1,650	0.04	4,672	0	$2,832
20 under 25	47,545	1.14	357,299	0.13	$7,515
25 under 30	211,678	5.10	1,785,877	0.63	$8,435
30 under 35	305,561	7.36	5,263,711	1.87	$17,226
35 under 40	406,231	9.79	11,716,148	4.16	$28,841
40 under 45	384,640	9.27	15,060,538	5.34	$39,155
45 under 50	466,195	11.23	26,635,206	9.45	$57,133
50 under 55	505,071	12.17	32,586,514	11.56	$64,519
55 under 60	545,962	13.15	52,411,258	18.59	$95,998
60 under 65	599,066	14.43	70,399,885	24.96	$117,516
65 under 70	348,391	8.40	37,480,181	13.29	$107,581
70 under 75	159,594	3.85	14,331,042	5.08	$89,797
75 under 80	99,956	2.41	9,398,693	3.33	$94,028
80 and over	66,628	1.61	4,477,165	1.59	$67,196
No age info	1,964	0.05	67,576	0.02	$34,407
Total	4,150,140	100.00	281,976,973	100.00	$67,944

2007 IRA rollovers by age of taxpayer

Age Categories	Number of Taxpayers	Percent	Amount (in 1,000's)	Percent	Average
Under Age 15	1,644	0.04	19,130	0.01	$11,636
15 under 20	652	0.01	985	0	$1,511
20 under 25	41,788	0.94	267,507	0.08	$6,402
25 under 30	239,332	5.41	2,378,178	0.74	$9,937
30 under 35	276,802	6.26	5,415,349	1.68	$19,564
35 under 40	368,408	8.33	11,352,096	3.52	$30,814
40 under 45	411,496	9.31	20,460,207	6.35	$49,722
45 under 50	512,209	11.58	26,943,486	8.36	$52,603
50 under 55	547,561	12.38	41,314,233	12.82	$75,451
55 under 60	567,348	12.83	55,944,059	17.36	$98,606
60 under 65	637,560	14.42	77,149,128	23.93	$121,007
65 under 70	441,198	9.98	48,302,034	14.98	$109,479
70 under 75	193,241	4.37	19,409,494	6.02	$100,442
75 under 80	115,079	2.61	9,290,264	2.88	$80,729
80 and over	63,197	1.43	3,991,205	1.24	$63,155
No age info	4,334	0.1	88,286	0.03	$20,371
Total 4	421,849	100.00	322,336,641	100.00	$72,896

2008 IRA rollovers by age of taxpayer

Age Categories	Number of Taxpayers	Percent	Amount (in 1,000's)	Percent	Average
Under Age 15	1,003	0.02	173	0	$172
15 under 20	2,308	0.05	11,026	0	$4,778
20 under 25	53,820	1.21	125,233	0.04	$2,327
25 under 30	250,865	5.64	1,452,568	0.47	$5,790
30 under 35	315,924	7.1	4,975,846	1.62	$15,750
35 under 40	332,587	7.48	9,451,606	3.07	$28,418
40 under 45	405,484	9.11	14,420,054	4.69	$35,563
45 under 50	457,690	10.29	22,612,346	7.35	$49,405
50 under 55	506,069	11.37	36,474,311	11.86	$72,074
55 under 60	591,055	13.29	53,364,177	17.35	$90,286
60 under 65	674,330	15.16	78,210,470	25.43	$115,982
65 under 70	456,779	10.27	51,315,114	16.69	$112,341
70 under 75	216,446	4.87	20,061,185	6.52	$92,684
75 under 80	103,626	2.33	7,641,005	2.48	$73,736
80 and over	72,945	1.64	7,098,715	2.31	$97,316
No age info	7,774	0.17	363,993	0.12	$46,822
Total	4,448,705	100.00	307,577,822	100.00	$69,138

Observations

1. 911 billion was rolled over during these 3 years.
2. The overall average of all rollovers is $70,034.
3. The data is very consistent over the 3-year period. For example, for 2008, individuals under age 45 comprise 30.6% of those making rollover contributions. However, as for amounts being rolled over, these groups only rollover 9.9% of the dollars. For 2007 these percentages are 30.3% and 12.4%. For 2006 these percentages are 32.7% and 12.1%. Another example, for 2008, the group 60-65 makes 15.16% of the rollovers, but the amount they rollover is 25.43%. For 2007 these percentages are 14.42% and 23.93%. For 2006 these percentages are 14.43% and 24.96%.
4. The largest average rollover is for individuals in the age 60-65 category; it is $115,982 for 2008, $121,007 for 2007 and $117,516 for 2006.
5. The next largest average rollover is for individuals in the age 60-65 category; it is $112,341 for 2008, $109,479 for 2007 and $107,581 for 2006.
6. The average rollover for those between ages 55-80 is in excess of $90,000.
7. The amounts being rolled over by individuals under age 30 is less than $10,000 and those under age 24 is less than $7,500.
8. Substantial rollovers from a dollar standpoint are being made by the age 70-75 group.

The average rollover is 10-12 times the size of $5,000-$6,000 annual contribution.

Continued on page 4

Rollovers,
Continued from page 3

This rollover information is, in many cases, what you would expect. Those who are older are making the largest rollover contributions. ◆

Basic Beneficiary RMD Rules

Rules for The Year the IRA Owner Dies.

1. Before 70½ Year. There is no RMD required for the year of death if an IRA accountholder dies in a year when he or she has not or would not have attained age 70½. This is true for all beneficiaries – spouses and nonspouses.
2. During 70½ Year. There is an RMD required for the year of death if an IRA accountholder either attained age 70½ during such year or would have attained age 70½ during such year since an RMD is determined as if the IRA accountholder had lived throughout the year.

   The RMD must be distributed to the beneficiary to the extent it was not distributed to the IRA accountholder prior to his or her death. Again, this rule applies to all beneficiaries – spouses and nonspouses.

   CWF Comment. A literal reading of the statutory law is that there is no RMD due when an IRA accountholder dies before his or her required beginning date. The effect of the regulation is to create an RMD for the 70½ year even when the accountholder dies before his or her required beginning date.

3. After 70½ Year. There is an RMD required for the year of death if an IRA accountholder dies in any year after the year he or she attained age 70½. Again, it is assumed that he or she lived through out the year. Thus, the RMD amount as calculated for the deceased accountholder using the Uniform Lifetime Table (or Joint Table,if applicable) is the RMD for such year. If this RMD amount is not distributed to the IRA accountholder prior to his or her death, then the remaining RMD must be paid to the beneficiary by December 31 of the year the accountholder died or the 50% tax is owed unless the IRS would waive it.

RMD Rules For the Years After the Year the IRA Owner Dies

If the IRA accountholder died before his or her required beginning date, then the IRA plan agreement provides that the required distributions for the year after the year of the death will be determined using the life distribution rule by using the initial life expectancy of the nonspouse beneficiary. The one year reduction rule will be used for subsequent years.

Exception – the beneficiary may elect to use the 5-year rule rather than the life distribution rule. Such election must be made by the beneficiary by December 31 of the year following the year the accountholder died.

If a beneficiary under the life distribution rule misses some RMDs, the IRS has the authority to consent to a beneficiary's request to switch to the 5-year rule.

If the IRA accountholder died on or after his or her required beginning date, then the IRA plan agreement provides that the required distributions for the year after the year of the death will be determined by using the life distribution rule and by using the initial life expectancy of the nonspouse beneficiary. The one year reduction rule will be used for subsequent years. The 5-year rule does not apply when the IRA accountholder dies on or after his or her required beginning date

There are three exceptions to the rule that the life expectancy to be used as the divisor in the RMD calculation for years after the year of death is the life expectancy of the designated beneficiary. Exception #1 is when the designated beneficiary is older than the deceased IRA accountholder. Exception #2 is when there is no designated beneficiary so the estate becomes the beneficiary. Exception #3 is when the surviving spouse is the sole beneficiary of his or her deceased spouse who had not yet attained age 70½.

In the cases of both Exception #1 and #2, the distribution period applying will be based on the single life expectancy of the deceased IRA accountholder as determined in the year of his or her death, but reduced by one for each elapsed year to determine the divisor for subsequent years. In case of Exception #3, the surviving spouse must commence distribution by December 31 of the year the deceased IRA accountholder would have attained age 70½.

The purpose of this article has been to present the basic RMD rules for beneficiaries. All exceptions have not been discussed. ◆

THE Pension Digest

Michigan IRA Custodians – New Withholding Duties as of January 1, 2012

Financial institutions understand all too well the costs and burdens imposed by the many laws and regulations applying to financial institutions.

As of January 1, 2012, Michigan financial institutions will have to comply with new withholding requirements for IRA and pension payments. This will create a new burden for Michigan IRA custodians. An IRA custodian will generally have to withhold 4.35% of each "taxable" IRA distribution and remit it in a timely fashion to the State of Michigan.

There is a major exception. The recipient may elect as under federal tax law to have no state income tax withheld or have a lesser amount to be withheld than 4.35% because he or she qualifies for various deductions and allowances. To do this, the recipient must complete Form MI W-4P, check box #1 to indicate no state withholding and furnish it to the IRA custodian. The Form MI W-4P stays in effect until it is revised.

The IRA custodian may make available to its IRA owners and inheriting beneficiaries a copy of Form MI W-4P so that the recipient may instruct to have no withholding of state income tax. The IRA custodian, however, may not require the recipient to instruct to have no withholding of Michigan income tax or pre-complete the form to show no withholding.

Note that the Michigan withholding rules do not depend upon whether or not the recipient will have federal income tax withheld. Michigan IRA custodians must comply with the Michigan income tax withholding rules and also the federal income tax withholding rules. The two withholding rules are independent of each other.

Why this change? States are in need of tax revenues. The State of Michigan is no exception. Michigan like many states have had tax laws allowing an initial retirement amount not to be taxed. In addition, Michigan and many states have not applied very aggressively their withholding and estimated tax payment rules to IRA and pension distributions.

As of January 1, 2012, the State of Michigan is implementing new tax rules (and withholding rules) for IRA and pension distributions. Michigan is ending for many taxpayers the special deduction granted for IRA and pension distributions. And Michigan is implementing new withholding and estimated tax payment rules.

The new law will be complicated in the sense that the taxation and withholding rules will differ depending upon a person's age. There are 3 categories:

A. A recipient born before 1946;

B. A recipient born between 1946 and 1952; and

C. A recipient born after 1952.

For recipients born after 1952, the general rule is, all taxable IRA distributions are fully taxable and subject to withholding at the rate of 4.35%. There are two exceptions. First, the recipient may instruct that he or she does not want any amount withheld. If the individual does not have sufficient withholding on his or her taxable income, penalties and interest may be assessed. Second, the individual may instruct the IRA custodian as to the number of personal exemptions he or she is eligible for under Michigan tax law. The recipient will indicate on Form MI W-4P the number of his or her personal exemptions. The standard monthly withholding table must be used or the rate of 4.35% may be used. An allowance of $308.33 may be claimed for each exemption.

For recipients born before 1946, the law was not changed. That is, they were grandfathered-in and they are allowed to deduct all qualifying pension and retirement benefits received from public sources and may subtract with respect to IRAs and private plans benefits up to $45,842 if single or married filing separate, or $91,684 if married filing a joint return. Withholding would be mandatory only with respect to amounts in excess of these limits. Such a recipient may also instruct that he or she does not want any amount withheld or claim his or her exemptions.

Recipients born during 1946 to 1952 were partially grandfathered-in. Such a person is able to claim a tax deduction for certain IRA and pension benefits. If filing single or married filing separately, the deduction is lim-

Continued on page 6

Michigan Custodians,
Continued from page 5

ited to $20,000. If filing married filing jointly, the deduction is limited to $40,000. A person may not claim this deduction if he or she has withdrawn payments from a section 457 plan, 401(k) plan, 403(b) or any other deferral plan if only he or she has made the contributions. Such a recipient may also instruct that he or she does not want any amount withheld or claim his or her personal exemptions.

In summary, IRA custodians will be required to withhold Michigan income tax from IRA and pension distributions occurring in 2012 unless the recipient furnishes the IRA custodian with Form MI W-4P and instructions he or she does not want any such withholding or otherwise qualifies to have no withholding.

HSAs and State Dormancy or Escheat Laws

A financial institution offering HSAs needs to understand the dormancy laws of its home state plus those of any state in which it is doing business.

Many states have modified their laws so that certain accounts become "dormant" faster and need to be turned over to the state coffers quicker.

What about HSAs? Will HSAs be treated more like IRAs or will the standard dormancy rules for checking account rules apply?

A financial institution will want to check with its attorneys to learn the timing rules as to when an HSA custodian must transmit "dormant" HSA funds to the state.

We would expect that most states would adopt the approach as adopted by the State of Iowa. An HSA is a special tax-preferred account similar to an IRA. Such accounts are considered to be a"trust" type account. Iowa law provides that a trust account needs to be paid to the State only after a 3-year time period has expired. This 3-year rule applies rather than the 1-year turn-over rule applying to normal checking accounts.

With respect to IRAs, the State of Iowa has adopted the rule that the 3-year rule only applies after the year the individual is required to take a required distribution. Will such a rule also apply to HSAs? Although not identical, one could see the State of Iowa adopting the rule that the 3-year rule would not apply until the individual was age 65 or older. Current tax laws do not require an HSA owner to take any distribution while he or she is alive. The HSA owner is permitted to accumulate funds within his or her HSA without taking any distributions.

DOL Updates Regulation Governing Procedures For PT Exemptions

Federal income tax laws contain restrictions on the investing of plan assets so that participating in certain plan investments is prohibited. For purposes of this article, a plan means either an employer sponsored retirement plan or an IRA. The law is concerned about conflicts of interest and consequently neither the sponsoring employer nor a plan fiduciary, in general, may do a business transaction with the plan.

The law grants the DOL the authority to grant either a class exemption or an individual exemption on account of a prohibited transaction. The issuance of the exemption means the transaction which normally is prohibited is permitted.

In November, 2011, the DOL adopted a revised final regulation setting forth the rules and procedures to be used by EBSA to process applications for an exemption. These new procedures are effective as of December 27,2011.

There have been changes in the existing regulation. The main purpose of the regulation is clarify the information and documentation needed in order to have the application processed. Submissions may now be made electronically via the web. And the notice requirements applying to interest parties have been expanded so they will have a more thorough understanding of the exemption being requested and they will have the right to comment.

In order to grant the PT exemption, the DOL must find that the exemption is:

(1) administratively feasible;

(2) in the interest of the plan (or the Thrift Savings Fund in the case of FERSA) and of its participants and beneficiaries; and

(3) protective of the rights of the participants and beneficiaries of such plan.

Continued on page 7

The Pension Digest

**DOL Update,
Continued from page 6**

The DOL has the authority to issue administrative exemptions under both ERISA and the Internal Revenue Code. The DOL may conditionally or unconditionally exempt any fiduciary or transaction, or class of fiduciaries or transactions, from all of part of the prohibited transaction rules.

Normally, an exemption is granted on a prospective basis. In limited situations, an exemption will be granted on a retroactive basis.

What surprises many people is the fact that there is no filing fee to be paid in order to have the DOL process a request for a PT exemption.

There are two new important terms, a qualified independent appraiser and a qualified independent fiduciary. How does the EBSA determine that the proposed business is in the best interest of the plan or IRA and not to primarily benefit the employer or the fiduciary? The answer – have an independent fiduciary make the decision the business transaction is good for the plan and have an independent appraiser determine the "value" or the sales or lease price which is a part of the business transaction.

The EBSA is concerned that an appraiser might not be independent since the fee being paid by the employer or the plan might influence the appraiser's determination of value. There is a presumption of independence if the fee to be paid to the appraiser is 2% or less than its annual revenues based on its prior income tax year. If the fee exceeds 2% then there is no presumption. However, there still may be independence based on the facts and circumstances as long as the fee is 5% or less than the projected revenues for the current year.

Who may apply for an exemption?

The plan itself or any party in interest to plan who is or who may be a party to the exemption transaction.

When will the EBSA not act on an application submission?

If all of the requested information is not submitted, the application will not be processed. If there is a current investigation involving the plan, the application will not be processed.

What information must be included in the application?

The required information is set forth in Section 2570.34. This includes a declaration of perjury and specialized statements, if applicable.

Will applications for individual exemptions need to furnish some special information? Yes, See section 2570.35.

Where and what method is to be used to file an application?

Any exemption application may be mailed via first class mail to: Employee Benefits Security Administration, Office Exemptions Determinatious, U.S. Department of Labor, Room N-5700 200, Constitution Avenue NW, Washington, D.C. 20210

Any exemption application may be emailed to the DOL at e-OED@dol.gov. However, one paper copy will need to be submitted.

Any exemption application may be faxed to the DOL at 1-202-219-0204. However, one paper copy will need to be submitted.

Is there a duty for an applicant to amend and supplement filing materials if there is a change in the original filing or a change in circumstances which the DEOL should consider?

Yes.

Does the DOL have procedures for tentative denials, conferences, submitting additional information or request for reconsideration of a denial?

Yes. And the DOL has the right to change its mind at any point; even to the point of revoking an issued exemption. Normally, this would he done only prospectively.

Are there revised procedures for furnishing notice to possible interested parties of the exemption request?

Yes. See section 2570.43.

Is it possible to withdraw an exemption application?

Yes. Generally, there will be no adverse consequence to a withdrawal. The procedures are set forth in section 2570.44. ◆

Continued on page 8

Seeking IRA Contributions

A financial institution wants to identify those of its customers who most likely are eligible to make IRA contributions and will do so.

John and Jane are customers of your bank. They are married to each other. They have high incomes. For 2011 John earns $85,000 and Jane earn $93,000. They will earn the same amount in 2012. Both are active participants in their employer's 401(k) plan. John presently does not have a traditional IRA. Jane has a traditional IRA with a balance of approximately $20,000. Her balance is due to a rollover contribution 3 years ago from a 401(k) plan of a former employer.

What IRA contributions are they eligible to make?

What planning approaches might they take?

Discussion.

1. They are ineligible to make Roth IRA contributions since their combined incomes exceed $179,000 for 2011 and $183,000 for 2012.
2. They can make contributions to their traditional IRAs, but their contributions will be nondeductible since they are active participants and their combined income exceeds $120,000 for 2011 and $122,000 for 2012.
3. John should make a $5,000 nondeductible contribution to a traditional IRA for 2011 and then convert it immediately to a Roth IRA. If he waited until January, he could contribute $10,000 ($5,000 for 2011 and $5,000 for 2012) and convert it immediately.
4. Whether Jane should make a nondeductible IRA contribution of $5,000 for 2011 is not so clear.

She could certainly contribute $5,000. It will be a nondeductible contribution. Because she will have both taxable and nontaxable funds within the IRA, the prorata taxation rule will apply if she takes distributions.

After her contribution of $5,000 assume she has a total IRA balance of $25,000. $20,000 of it is taxable when distributed and the other $5,000 is nontaxable. The ratio is 4/5 or 80.00% is taxable and 1/5 or 20% is nontaxable.

She could also consider converting some or all of this $25,000. If she converts the entire IRA, she would include $20,000 in her (their) income and pay tax on it. If she would convert $15,000 of the $25,000, then she would include $12,000 in income (80% x $15,000).

Another possible option might be – she could rollover the $20,000 or taxable part of her IRA to her employer's 401(K) plan. The 401(k) must be written to allow such rollover contributions to be made, Some plans do not permit such rollovers, but many or most will. This would leave the nontaxable $5,000 in her traditional IRA. She then convert this $5,000 to a Roth IRA with no income tax owing. ◆

Inform HSA Owners of an Important IRS Reporting Difference For Excess Contributions

There are more excess contributions made to HSAs than to IRAs. You as HSA custodians will be assisting HSA owners with correcting their excess contributions. As with IRAs, the HSA owner must withdraw the excess contribution as adjusted for earnings or losses.

The difference is this – there is only one way to report the withdrawal of an excess HSA contribution, insert a reason code "2" in box 3 of Form 1099-SA. There are two codes to report the withdrawal of an excess IRA contribution: "8" is used to report the withdrawal of an excess made and withdrawn during the same calendar year and a "P" is used to report the withdrawal of an excess made in one year and withdrawn in the following year.

Example. John Doe contributes $4,050 to his HSA in 2011, but he is eligible to contribute only $3,050 since he is age 37. He withdrew the excess of $1,000 on January 15, 2012. The HSA custodian will prepare a 2012 Form 1099-SA to report this distribution. It will not indicate whether the excess relates to 2011 or 2012. Even though this withdrawal will not be reported until the 2012 Form 1099-SA is prepared, he will need to explain this withdrawal on his 2011 tax return. He will need to complete Form 8889 (HSAs).

CWF has created a form, "HSA – Special Explanation Regarding the Withdrawal of an Excess HSA Contribution", so that an HSA custodian can inform an HSA owner that he or she will need to explain the withdrawal of an excess HSA contribution on their current year's tax return.