



THE Pension Digest

ALSO IN THIS ISSUE –

2011 IRA Balances,
Contributions, and Rollovers,
Page 3

Email Consulting Guidance,
Page 7

**Collin W. Fritz and
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“The Pension Specialists”



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Inherited IRAs and Bankruptcy – Not so Simple Any More

Where a person lives is now extremely important if the person is an IRA beneficiary who has inherited an IRA due to the death of the IRA account holder and wants to or has filed a bankruptcy action.

When a person files for bankruptcy, his bankruptcy estate will, in general, be used to pay his creditors. His bankruptcy estate is comprised of all of his assets or property. Bankruptcy trustees have the duty (and the self-interest) of collecting funds so that creditors will be paid. In 2005, the bankruptcy laws were revised greatly. Some of the changes creditors liked and some were not liked. Bankruptcy Code Section 522 authorizes a debtor/filer to exempt certain property from his estate.

Federal bankruptcy law now authorizes, in general, a person to claim as exempt IRA funds up to one million dollars from creditors (and the bankruptcy trustee).

Bankruptcy section 522(b)(3)(C) and d(12) are identical. They both provide a person who has filed for bankruptcy an exemption under federal law so that certain assets or funds are exempt from creditors' claims. These sections provide, "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under sections 401, 403, 408, 408A, 414, 457 or section 501(a) or the Internal Revenue Code."

Continued on page 2

Will the IRS Revise the IRA/Pension Life Expectancy Tables in the Near Future?

We are awaiting an answer from the IRS. The IRS has recently updated various mortality tables for defined benefit pension plan purposes. More Americans are living longer. This fact certainly affects pension plans and it also affects to IRAs. The IRS will inform the public in the near future whether the IRA/pension life expectancy tables have been or will be revised to reflect individuals living longer. If so, the RMDs of most individual RMDs would decrease slightly. This would be true for both account holders and also inheriting beneficiaries.

Since smaller distributions means less tax dollars collected, it may be the IRS will not adjust the IRA life expectancy tables. As discussed below, there is no tax law requiring the IRS to make such an adjustment in 2013, but public policy would seem to support the adjustment. Most IRA account holders age 70^{1/2} and older want to take only their required distribution and not a penny more.

Section 634 of EGTRRA (2001) instructed the Secretary of the Treasury to modify the life expectancy tables for purposes of the minimum distribution rules to reflect current life expectancies. In 2002-2003 the IRS in its final regulation adjusted these tables to reflect improvements in mortality from 2000-2003. The Uniform Lifetime table, the Joint Life Expectancy table, and the Single Life

Continued on page 3

**Inherited IRAs,
Continued from page 1**

Since 2005, Bankruptcy trustees have been arguing that inherited IRA funds are NOT really “retirement funds” within the meaning of section 522(d)(12) and such funds should be able to be taken by the bankruptcy trustee and transferred to the creditors.

The Fifth and Eight Circuit previously ruled that inherited IRAs are “retirement funds” entitled to the exemption/protection of section 522(d)(12). In re Nessa, 426 B.R. 312(BAP 8th Cir. 2010). In re Chilton, 674 F. 3d 486 (5th Cir. 2012).

These courts found that the inherited IRA funds were certainly “retirement funds” for the IRA accountholder. The fact that the IRA accountholder died does not mean these funds were no longer retirement funds. The courts made the statement that section 522(d)(12) used the term “retirement funds” and there was nothing to indicate that such funds had to be the “retirement funds” of the person who has filed for bankruptcy.

Anyone having a basic knowledge of IRAs and pension plan law would agree with the analysis of the Fifth and Eight Circuit courts. Under Internal Revenue Code sections 401, 408, 408A, 403, 414, 457, or 501(a), the statutory law is clear that the public policy is to create tax incentives so that individuals and employers may save for the retirement of the IRA accountholder or pension participant, but after his or her death, such retirement funds may be distributed to his or her beneficiary over his or her life expectancy. The intent of the Tax Code sections 401, 408, 408A, 403, 414, 457 or 501(a) is to provide various tax benefits to a person who has inherited the IRA funds in addition to providing tax benefits to the IRA accountholder.

Recently, the United States Circuit Court of Appeals for the Seventh Circuit made things much more complicated as it adopted the rule that funds within an inherited IRA are not retirement funds entitled to be exempted from the creditors because they are not the retirement funds of the beneficiary/bankruptcy filer. The Seventh Circuit concluded that it was necessary to define the term “retirement fund” as found in section 522(d)(12) as being the retirement fund of the bankruptcy filer. The statute contains no such requirement.

The Seventh Circuit is comprised of the states of Illinois, Indiana and Wisconsin.

The Eighth Circuit is comprised of the states of Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota and South Dakota.

The Fifth Circuit is comprised of the states of Texas, Louisiana and Mississippi.

In summary, one may wonder why the bankruptcy law was ever written to allow a debtor to exempt from creditors up to \$1,000,000 of IRA funds. But the law has been so written.

Bankruptcy Code section 522 made no attempt to treat the IRA funds of an IRA accountholder differently than for an inheriting beneficiary. However, the recent decision of the Seventh Circuit has complicated the law with respect to inherited IRAs for individuals residing in Illinois, Indiana and Wisconsin. In those states, inherited IRA funds may now be taken by the bankruptcy trustee to pay creditors. It would be wise for those inheriting IRA beneficiaries who live in Illinois, Indiana or Wisconsin to move to a state within either the Fifth Circuit or Eighth Circuit in order to prevent the inherited IRA funds from being lost to bankruptcy trustee. Moving to a state located in another circuit, which has not settled this issue, would be risky.

This ruling may increase the desire for an IRA accountholder living in Illinois, Indiana or Wisconsin to designate a trust as the beneficiary of his or her IRA. Funds within this other trust may generally be protected from the creditors of a beneficiary.

Once funds are withdrawn from an inherited IRA or a regular IRA they no longer are “IRA funds” and such funds may be reached by creditors.

**Life Expectancy Tables,
Continued from page 1**

table were changed to reflect mortality improvement from 2000 to 2003. Earlier the IRS had adjusted various tables to create the Annuity 2000 mortality table. And such revised tables were created by combining on a basis of 50% male and 50% female. The mortality of females is superior to that of males as the tables demonstrate.

These mortality tables are of critical importance for administering defined benefit pension plans. An employer sponsoring a defined benefit plan will be required to make larger contributions if mortality improves. The plan benefit (i.e. amount) an employee is entitled to be paid at his or her normal retirement date will be larger if mortality has improved. The IRS has recently released Notice 2013-49. This Notice provides updated static mortality tables for the years 2014 and 2015.

Code section 430 does contain a provision providing that periodically (at least every 10 years) these mortality tables shall be revised to reflect the actual experiences of pension plans.

What about IRAs? 10 years or more have passed since the IRS last updated the IRA/pension life expectancy tables.

We expect the IRS will respond to CWF's question within the next 2-6 weeks. We will let you know what we are told in a future newsletter. We hope the IRS will revise the life expectancy tables thereby allowing accountholders and inheriting beneficiaries to take slightly smaller required distributions.

**2011 IRA Balances, Contributions,
and Rollovers**

Who is making IRA contributions, including rollovers, and in what amounts?

Good information about IRA balances and contributions is rare. In 2010 the IRS did release data from the 5498 forms for 2004-2008, but that information is now 4 years old. The Employee Benefit Research Institute (EBRI) has primarily focused on reporting on 401(k) plans and other private employer pension plans. Since such 401(k) funds are often rolled over or directly rolled over into a traditional IRA or a Roth IRA, the EBRI has decided to accumulate data on IRAs and make it available to others. The EBRI collects data from various IRA plan administrators. For 2011, the data base had data for 20.5 million IRAs as established for 16.6 individuals. Some individuals have more than one IRA within the data base. The total value of these IRAs is 1.46 trillion. Since IRAs had approximately 4.7 trillion as of the end of 2011, one can estimate that approximately 30% of IRAs in the United States are within the data base.

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The Report categorized the IRAs by the types of IRAs. There are five categories – Roth IRAs, SEP/SIMPLE IRAs, unknown IRAs, and two categories for traditional IRAs – those where the first contribution was an annual contribution and then those where the first contribution was a rollover contribution. The unknown category is large at 19.2%. Most likely a large portion would be allocated to the two traditional IRA categories.

	Percentages
Traditional IRA originating with only <u>annual</u> contributions	27.1%
Traditional IRA originating with only <u>rollover</u> contributions	27.7%
Roth IRAs	19.7%
SEP-IRAs and SIMPLE IRAs	6.4%
Other/Unclassified	19.2%
Total	100.00%

Please Note:

CWF's Summer Hours

8:00a.m. – 4:30p.m.

Monday – Friday

IRA Ownership and Account Balances – All IRAs

Gender	Percentage
Female	30.3
Male	37.8
Unknown	31.9
Total	100.0

Account Balance	Percentage
Less than \$5,000	24.9
\$5,000-\$9,999	11.6
\$10,000-\$24,999	18.7
\$25,000-\$49,999	14.9
\$50,000-\$99,999	12.5
\$100,000-\$149,999	5.7
\$150,000-\$249,999	5.3
\$250,000 or more	6.4
Total	100.0

Age of Owner	Percentage
Under age 29	4.2
30-39	11.7
40-49	18.9
50-59	24.5
60-69	21.8
70 or older	13.8
Unknown	5.0
Total	100.0

Observations

1. More males (37.8% own an IRA than females (30.3%).
2. 17.4% of the IRAs had a balance of \$100,000 or more.
3. 55.2% of the IRAs had a balance of less than \$25,000
4. 27.4% of the IRAs had a balance of more than \$25,000, but less than \$100,000.
5. 35.6% owned by individuals age 60 or older.
6. 60.1% owned by individuals age 50 or older.
7. 4.2% owned by individuals age 29 or younger.
7. 15.9% owned by individuals age 39 or younger.
9. 34.8% owned by individuals younger than age 50.

Average IRA Balance by IRA Type, 2011 – All IRAs

	Average
Traditional IRA originating with only <u>annual</u> contributions	\$74,966
Traditional IRA originating with only <u>rollover</u> contributions	\$104,235
Roth IRAs	\$25,228
SEP-IRAs and SIMPLE-IRAs	\$54,902
Other/Unclassified	\$69,190
Total	\$70,915

Age of Owner	Average Balance
Under age 25	\$10,915
25-29	\$11,465
30-34	\$16,084
35-39	\$23,512
40-44	\$31,960
45-49	\$42,110
50-54	\$54,410
55-59	\$69,386
60-64	\$92,098
65-69	\$116,065
70 or older	\$122,715
Unknown	\$129,120
Total	\$78,051

Observations

1. As expected a higher average is found in IRAs established by making a rollover contribution.
2. Roth IRAs have the lowest average balance.
- 3 The average balance does increase for each 5-year age category.
4. The average balance is in excess of \$70,000.

IRA ownership and account balances – Traditional IRAs originating from annual contributions.

Gender	Percentage
Female	38.9
Male	43.3
Unknown	17.7
Total	100.0

Account Balances	Percentage
Less than \$5,000	20.1
\$5,000-\$9,999	11.1
\$10,000-\$24,999	19.4
\$25,000-\$49,999	16.4
\$50,000-\$99,999	14.5
\$100,000-\$149,999	6.5
\$150,000-\$249,999	5.6
\$250,000 or more	6.6
Total	100.0

Age of Owner	Percentage
Under age 29	2.2
30-39	7.9
40-49	16.1
50-59	26.0
60-69	24.3
70 or older	17.4
Unknown	6.2
Total	100.0

Observations

1. More males (43.3% own this type of IRA than females (38.9%)
2. 18.6% of the IRAs had a balance of \$100,000 or more.
3. 50.6% of the IRAs had a balance of less than \$25,000.
4. 30.9% of the IRAs had a balance of more than \$25,000, but less than \$100,000.
5. 41.7% owned by individuals age 60 or older.
6. 67.7% owned by individuals age 50 or older.
- * 7. 2.2% owned by individuals age 29 or younger.
- * 8. 10.1% owned by individuals age 39 or younger.
9. 26.2% owned by individuals younger than age 50.

IRA ownership and account balances – Traditional IRAs originating from rollover contributions.

Gender	Percentage
Female	35.6
Male	50.0
Unknown	14.4
Total	100.0

Account Balances	Percentage
Less than \$5,000	25.7
\$5,000-\$9,999	7.2
\$10,000-\$24,999	13.5
\$25,000-\$49,999	12.9
\$50,000-\$99,999	14.0
\$100,000-\$149,999	7.8
\$150,000-\$249,999	8.0
\$250,000 or more	10.9
Total	100.0

Age of Owner	Percentage
Under age 29	3.0
30-39	13.1
40-49	22.0
50-59	24.6
60-69	21.0
70 or older	10.7
Unknown	5.7
Total	100.0

Observations

1. More males (50%) own this type of IRA than females (35.6%)
2. 26.7% of the IRAs had a balance of \$100,000 or more.
3. 46.4% of the IRAs had a balance of less than \$25,000
4. 26.9% of the IRAs had a balance of more than \$25,000, but less than \$100,000.
5. 31.7% owned by individuals age 60 or older.
6. 56.3% owned by individuals age 50 or older.
7. 3.0% owned by individuals age 29 or younger.
8. 16.1% owned by individuals age 39 or younger.
9. 38.1% owned by individuals younger than age 50.

**IRA Ownership and Account Balances –
Roth IRAs**

Gender	Percentage
Female	38.1
Male	45.2
Unknown	16.7
Total	100.0

Account Balances	Percentage
Less than \$5,000	28.6
\$5,000-\$9,999	18.0
\$10,000-\$24,999	25.7
\$25,000-\$49,999	16.7
\$50,000-\$99,999	7.7
\$100,000-\$149,999	1.6
\$150,000-\$249,999	1.0
\$250,000 or more	.8
Total	100.0

Age of Owner	Percentage
Under age 29	9.0
30-39	18.9
40-49	22.1
50-59	21.6
60-69	16.2
70 or older	6.4
Unknown	5.9
Total	100.0

Observations

1. Males own a slightly larger percentage of Roth IRAs than females.
2. 3.4% of the Roth IRAs had a balance of \$100,000 or more. This is a clear indication that MAGI limits do not restrict contributions by higher income individuals. It also indicates that few higher income individuals make non-deductible contributions.
3. 72.3% of the Roth IRAs had a balance of less than \$25,000
4. 9.3% of the Roth IRAs had a balance of more than \$25,000, but less than \$100,000.
5. 22.6% owned by individuals age 60 or older.
- * 6. 44.2% owned by individuals age 50 or older.
- * 7. 9.0% owned by individuals age 29 or younger.
8. 27.9% owned by individuals age 39 or younger.
9. 50.0% owned by individuals younger than age 50.

**IRA Ownership and Account Balances –
SEP-IRAs/SIMPLE-IRAs**

Gender	Percentage
Female	37.3
Male	52.2
Unknown	10.5
Total	100.0

Account Balances	Percentage
Less than \$5,000	29.7
\$5,000-\$9,999	11.6
\$10,000-\$24,999	18.3
\$25,000-\$49,999	13.7
\$50,000-\$99,999	11.9
\$100,000-\$149,999	5.7
\$150,000-\$249,999	4.9
\$250,000 or more	4.4
Total	100.0

Age of Owner	Percentage
Under age 29	4.6
30-39	13.4
40-49	23.3
50-59	28.0
60-69	17.8
70 or older	5.9
Unknown	7.1
Total	100.0

Observations

1. 15.0% of the IRAs had a balance of \$100,000 or more.
2. 59.6% of the IRAs had a balance of less than \$25,000
3. 25.6% of the IRAs had a balance of more than \$25,000, but less than \$100,000.
4. 23.7% owned by individuals age 60 or older.
5. 51.7% owned by individuals age 50 or older.
6. 4.6% owned by individuals age 29 or younger.
7. 18.0% owned by individuals age 39 or younger.
8. 41.3% owned by individuals younger than age 50.

Email Consulting Guidance

Q-1 An IRA and A Revocable Trust

I have an individual who has everything in the name of her Trust. Can an IRA be titled in the name of the Trust?

A-1

Our understanding is that it cannot be. An IRA is itself a revocable trust. An IRA is a special tax preferred revocable trust which must comply with special laws. One of those laws is that a bank must be the IRA custodian/trustee.

An IRA must be established for an individual. It can not be established for a person's trust. All IRS reporting must use the name of the individual until such individual would die.

The individual may name his or her revocable trust as the designated beneficiary of his or her IRA (trust). This can be beneficial if the attorney drafting the revocable trust has included provisions discussing how and when the IRA funds are to be withdrawn from the inherited IRA (trust) and paid to the revocable trust and then what will happen with these funds once they are no longer within the inherited IRA.

Alternatively, the individual may decide that the IRA funds will not be added to the revocable trust. They will be dispersed to his or her IRA beneficiaries totally independent of the terms of the revocable trust.

Q-2 IRA Transfers – Mandatory or Permissive

I looked through your IRA manual and could not find the answer to my question.

I was told that if we receive a transfer request it must be completed within 60-days of being signed by the owner. Is this true?

1) We received a request for transfer at maturity. The customer signed it in 2012 and the rep from the other bank didn't sign it at all. We received it June of 2013. Allowed?

2) We received a request for transfer at maturity. The customer signed it March 19, 2013; we received it March 27, 2013; maturity is June 23, 2013. Allowed?

A-2

A transfer occurs between two financial institutions. It is most important that both institutions sign the transfer form. In the two situations you presented, if there is a proper transfer, your bank will not prepare the Form 1099-R to report the distribution. Your bank is able to treat it as a transfer only if the other bank acknowledges in writing that they are treating it as a transfer. An unsigned form does not show the other bank is handling it as a transfer. Your bank can be fined \$100 for not preparing a Form 1099-R required to be prepared.

If your bank has the money, then you do not want to release it until the other institution signs the transfer form. You will also want written instruction from the individual that he or she has requested the transfer.

I don't understand why a financial entity which wants the money transferred to it is too often unwilling to sign a transfer form. Most IRA forms provide that a transfer is made at the discretion of the institution holding the money. There is no statutory right to a transfer. It is a plan document right. There is no 60-day period applying to transfers. The 60-day rule is a rollover rule.

The fact that your bank is sent a transfer form by another institution does not mean that it must accept this form. If it is not signed by the other institution, tell them it needs to be. You also have the right to say – our transfer form will be used if the funds are to be transferred since transfers are at our discretion. If the individual wishes to take an actual distribution and roll it over, he or she may do so.

Q-3 Imposing Interest Penalty for Roth IRA Withdrawal

I was wondering if you could tell me what is the normal procedure for most places offering ROTH's. I understand what I am asking is more a bank policy but we realized we may have not been consistent here and would like to confirm our policies and the way it should be.

We currently charge a 3-month interest penalty for early withdrawal from a traditional IRA.

Continued on page 8

I would assume a penalty should be charged on a ROTH distribution if they are under 59^{1/2} and it has not been in for 5 years? If a person is under 59^{1/2} but have had their funds in a ROTH for more than 5 years is it still normal to charge a penalty?

A-3

Each bank will need to decide its policies for an early surrender of a traditional IRA time deposit or a Roth IRA time deposit.

A good number of banks have continued the policy that it will waive the penalty if the accountholder is age 59^{1/2} or older and takes an early distribution even if the time instrument is surrendered prior to maturity.

However, more banks have adopted the policy that the penalty will be imposed for an early surrender even if the accountholder is age 59^{1/2} or older unless the amount being withdrawn is the required distribution.

A bank could choose to have different policies for traditional and Roth IRAs, but would not need to.

Since a Roth owner is never required to take a distribution while alive, there is more logic for still imposing the penalty for an early surrender to a Roth IRA CD. Or, the bank could allow a distribution amount of a certain amount or percentage without the penalty being imposed.

Whether the distribution is qualified or nonqualified should not be a factor to be considered as to whether or not any penalty for early withdrawal will be waived.

Q-4 Roth Conversion and Form Corrections

In 2010 both a customer and his spouse had established individual IRA accounts. Ages at the time were 54. In May of 2010 they each converted their IRA to a Roth IRA, then in December of that year they transferred the Roth IRA out of the bank to an account R.W. Baird.

A 2010 1099-R was generated for each of them with the IRA distribution coded as a code 7. A 2010 5498 Roth IRA form was also generated for that year. The customer and their preparer are questioning the code 7? Not sure if this was the tax year they could convert to a Roth without imposing a tax liability?

A-4

A Form 1099-R must be prepared when there is a "distribution" which is converted. A "7" is to be used if the individual is age 59^{1/2} or older and a "2" is to be used if the individual is under age 59^{1/2}.

Technically, you should prepare two corrected 2010 Form 1099-Rs since they were age 54.

Both the "7" and the "2" tell the IRS that the 10% tax is not owing, so one could try to argue, why does it need to be corrected?

I would still correct it. A person who did a conversion in 2010 was able to use the special rule allowing him or her to include 50% of the distribution in income for 2011 and 50% for 2012 and nothing for 2010. This result does not change on account of the distribution code being a "7" or a "2". Neither the "7" or the "2" expressly mean a person did a conversion.

Various IRS statistics will be wrong unless corrected.

Q-5 Periodic IRA Distributions

I found the Form 63 in your software and assume this is what I use to set up the Periodic Payment Schedule.

Is it really that easy that they could just select number 1 and say what they want and for how many years?

Maybe I think it should be harder because I am used to the 70^{1/2} crowd.

A-5

It is that simple. The funds will be directly rolled over into his or her IRA. He or she can set up a "monthly" scheduled distribution. If he or she would need additional funds (i.e. a non-periodic distribution), he or she would complete an additional distribution form. He or she can change the periodic schedule any time either by stopping it or instructing to increase the monthly amount.

Since at age 64 he or she will not owe the 10% pre-age 59^{1/2} tax. Most likely he or she will include in his or her 2013 income the amount withdrawn as most people have no basis within the 401(k).