THE Pension Digest

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IT'S ALMOST THAT TIME AGAIN

...for January IRA Statements and IRS Form 5498 for the 1990 IRA Tax Year

It's the beginning of November and an appropriate time to discuss the rules that require an IRA custodian/trustee to prepare January IRA statements and 5498 Forms.

To prepare his or her income taxes, an IRA customer/taxpayer needs to properly consider and (if necessary) report information on contributions, distributions and year-end fair market value (FMV). The customer statement and the Form 5498 furnish both customer and IRS with the fair market value and the contribution information. (Distributions are reported on the Forms W-2P and 1099-R, and therefore are not discussed here.)

The IRA custodian/trustee must keep in mind that its primary role is to inform the IRS of the overall transaction, not to report to the IRS the specific tax consequences of a given IRA transaction.

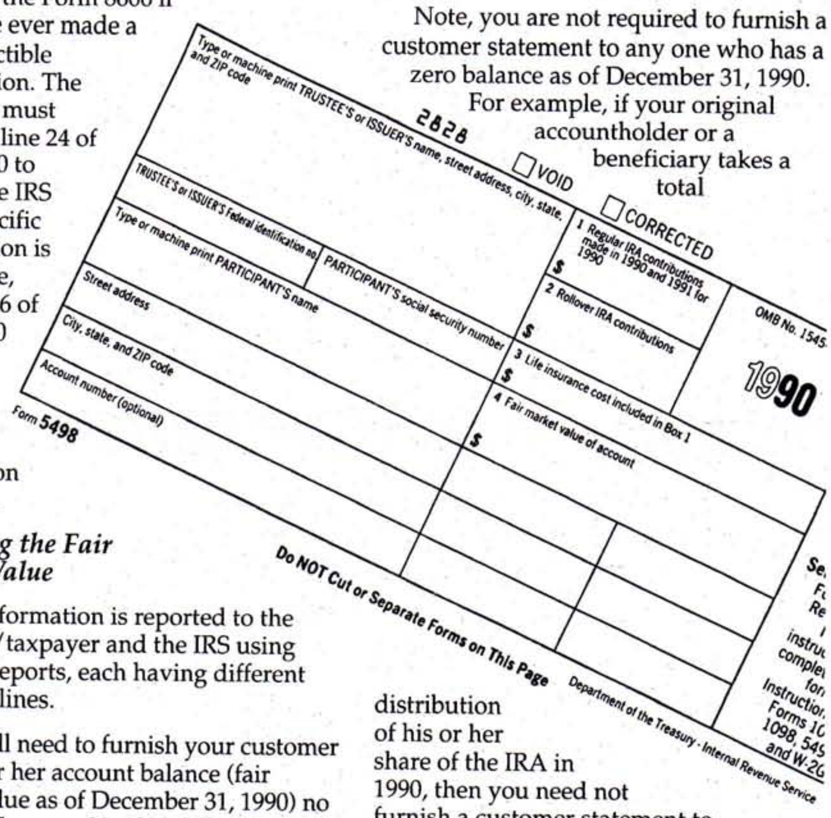
The IRS will use this overall information to determine if the IRA customer/taxpayer has properly reflected the IRA transactions on his or her income tax return (that is properly determined which portion of a contribution is deductible and which portion of a distribution is taxable) The IRS may need to ask your customer to provide additional information to support his or her claims.

Generally, the IRA customer for whom you are reporting to the IRS will be the person who established the IRA. However, once the IRA customer dies, each beneficiary becomes your customer also.

Extent of Your Reporting Obligations

The custodian/trustee is not required to inform the customer or the IRS whether a contribution is deductible or nondeductible. Furthermore, the customer need not tell you if the contribution is deductible or not. Neither are you required to inform the IRS or the customer whether a distribution is taxable or not; and the customer need not tell you which portion of a distribution is nontaxable.

These tax determinations are between the IRS and your customer. That is, the customer tells the IRS that a contribution is nondeductible by filing the 1990 Form 8606, and the customer also tells the IRS that a distribution is nontaxable by filing the same 1990 Form 8606. In general, a customer/taxpayer only needs to complete the Form 8606 if they have ever made a nondeductible contribution. The customer must complete line 24 of Form 1040 to inform the IRS that a specific contribution is deductible, and line 16 of Form 1040 to inform the IRS that a specific distribution is taxable.



Reporting the Fair Market Value

This information is reported to the customer/taxpayer and the IRS using different reports, each having different time deadlines.

You will need to furnish your customer with his or her account balance (fair market value as of December 31, 1990) no later than January 31, 1991. Why?

To complete the 1990 Form 8606, the customer will need to know the FMV of each IRA as of 12-31-90. Since the customer will need to file his or her 1990 return on or before April 15, 1991, the IRS has set January 31, 1991, as the deadline for furnishing this statement/balance to each customer.

You communicate this FMV by furnishing all your IRA customers (living customers or beneficiaries) with an IRA statement. This statement may be in "any written format" as long as the FMV as of December 31, 1990 is disclosed.

Note, you are not required to furnish a customer statement to any one who has a zero balance as of December 31, 1990. For example, if your original accountholder or a beneficiary takes a total distribution of his or her share of the IRA in 1990, then you need not furnish a customer statement to that person. Therefore, you need to

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generate a 1990 customer statement (and Form 5498) for a decedent who dies in 1990, but you will not need to generate such forms for future years.

Also, note that January 31st is the deadline for reporting the FMV, and not the deadline for reporting contributions. Contributions are not required to be reported on the customer statement, but are required to be reported on the Form 5498 as discussed later.

Special Rules for Inherited IRAs

If the customer has died sometime in 1990, then the customer's executor will need to know the FMV as of the date of death, and not as of December 31, 1990 (be aware of a major exception, discussed below). The IRS' long-held position is that a decedent's tax year ends on his or her date of death. Secondly, an inherited IRA must be titled so that the IRA clearly identifies that it was once owned by a now-deceased person. Why? The beneficiary steps into the "tax shoes" of the decedent, so the IRS needs to know who the deceased was. For example, the account would need to be titled as follows — "Brian Young as beneficiary of Ellen Young."

The IRS has clearly indicated that once a spouse elects to treat the decedent's IRA as his or her own (this happens if the spouse makes any contributions to the IRA or fails to take the distributions required by Code section 401(A)(9)(B)) the IRA is no longer an inherited IRA. Therefore, the account would be titled "Brian Young" and not "Brian Young as beneficiary of Ellen Young."

The "Zero Option" for Fair Market Value

As an alternative (the exception to using the actual date of death value, as referred to above) the IRS allows you to report zero as the FMV if you also inform the executor or administrators of the decedent's estate of his or her right to request a true date-of-death value. You may meet this information requirement in one of two ways. First, you may actually use copy B of the official 1990 Form 5498; or second, you may use the language of Box 4 as found on the back of Copy B of the official 1990 Form 5498, which reads as follows:

" Box 4. - This is the fair market value (FMV) of your account at the end of the year. However, if a decedent is shown as the participant on this form, it may be the FMV at date of death. If a decedent's name is shown as the participant and the FMV shown is -0-, the executor or administrator of the decedent's estate may request a date of death valuation from the financial institution."

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Hot Topic—IRA Beneficiary Cases: Interest Released; Interest Disclaimed

This article is intended to make you as an IRA custodian aware of recent rulings concerning payouts to beneficiaries. Many times, this is a complex subject that will require the involvement of your legal counsel.

The starting point is that there are no federal rules governing the naming of beneficiaries for IRAs. Each individual state may have its own unique set of rules. The general rule is that the named beneficiary of an IRA is entitled to receive the funds even if there is a conflict with the will, estate, etc.

Two recent rulings shed some new light on this subject.

Case 1
Release of Interest . . .

A recent case, Margaret A. Kruse, v. Dolly H. Todd, et al, was decided by the Georgia Supreme Court. This case involved a conflict over who was entitled to receive the IRA funds of a deceased IRA accountholder. The accountholder had signed a beneficiary form indicating his third wife was his beneficiary and that she was entitled to receive the funds upon his death. After signing this beneficiary form, the accountholder divorced his third wife, but he did not change the beneficiary designation. However, the third wife had signed a divorce decree in which she had agreed to the following provision... "Any stocks, bonds....IRAs or any other monies wherever located presently are the sole and exclusive property of the designated depositor....".

The court found this language to show a clear intent by the third spouse to release all interests in the IRA account, including her interest as a beneficiary. Thus, the court held that the funds were to be paid to the executor of the estate.

The point of this case is this: there may be legal forms and designations outside of the bank instrument (i.e. a divorce decree) which a court may find override the IRA beneficiary form that is in the IRA custodian's file.

Rulings on Disclaiming of Interest . . .

On June 20th, 1990, the IRS in private letter ruling 9037048 addressed the issue of whether an IRA beneficiary could disclaim her beneficiary interest, and if so, what effect this would have for income tax and required minimum distribution purposes.

The facts: the surviving spouse was the listed primary beneficiary of the decedent's IRA. The contingent beneficiary was a testamentary trust. The beneficiary of the irrevocable testamentary trust was their disabled child. The surviving spouse executed two disclaimers. First, she disclaimed any interest in the IRA assets. Thus, the asset would go to the testamentary trust and not to the surviving spouse. Secondly, she disclaimed any interest in the testamentary trust as it related to the IRA assets.

If approved, these disclaimers would free the surviving spouse of the inherited IRA's tax obligations.

The three requested rulings and our summary of the IRS analysis is as follows:

Request #1. That the disclaimers executed by the surviving spouse are valid under section 2518 of the Internal Revenue Code.

The IRS found the disclaimer to be valid. The practical effect of a disclaimer is that the surviving spouse need not continue the distributions which the decedent had commenced from the IRA, and thus will not be taxed on these amounts even though she was the named beneficiary.

Code section 2518(a) stipulates that if a beneficiary makes a "qualified disclaimer" with respect to any interest they might hold in property, that such an interest will be treated as though it had never been transferred to the disclaimant (in this case the listed primary beneficiary). Rather, the interest will be considered to have passed directly from the decedent to the person that would be entitled to receive the interest in the property as a result of the disclaimer.

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Further, from Code section 2518(b): the term "qualified disclaimer" is defined to be an unqualified (unreserved) and irrevocable refusal to accept an interest in property, BUT IS QUALIFIED ONLY IF;

- such refusal is in writing

- it is made not later than nine (9) months after the interest being disclaimed was transferred to the (now) disclaimant

- the disclaimant has not accepted or benefitted from this "interest"

- the interest then passes WITHOUT DIRECTION FROM THE DISCLAIMANT to either the spouse of the decedent, or to another person other than the disclaimant.)

Request #2. That any distribution from the decedent's IRA to the trust will be taxable to the trust in the year of distribution.

The IRS agreed. Since the trust will receive the funds after the disclaimers, it will have to pay tax on the amount it receives during its tax year. Section 408(d)(1) provides that any amount paid or distributed out of an IRA shall be included in gross income by the payee or distributee, as the case may be, in the manner provided in section 72.

Request #3. That distributions from the IRA to the trustee of the testamentary trust, if made at least as rapidly as under the method of distribution being used to make distributions to the accountholder when he was alive, will not be subject to the 50% excise tax of Code section 4974.

Again, the IRS agreed. The important point to note is that the testamentary trust is not required to take a lump sum distribution from the inherited IRA account. It only is required to take out at least as much as would have been paid out to the accountholder under the schedule he had selected prior to his death, since he died after reaching his required beginning date.

Thus, thanks to these rulings, the tax consequences of the IRA inheritance event were held to a minimum. PD

Marketing
Pension Products and Services

Demographics - IRAs By The Numbers

When marketers of any product or service are planning their strategy, the term "demographic characteristics" is certain to be part of their conversation. In a sense, you could think of demographic characteristics as the "fingerprint" of the target group they're trying to track down and sell to.

Unless one is marketing an extremely generic product that virtually EVERYONE uses—like table salt for instance—they'll find that there is a special set of characteristics that many potential buyers have in common. Age, income, gender, occupation, education, marital status, these are just a handful of the measurable factors that are part of this profile termed "demographic characteristics." This is as true of IRAs as it is of eyewear.

Why are factors like these significant? Marketers know that people with many of the same shared demographic characteristics have similar purchasing patterns. Find a "buyer," measure his or her demographic variables, then find a non-buyer with the same profile. In most cases, you've found another excellent candidate for purchasing the same product or service.

Who's Buying IRAs?

To the bank that is trying to market IRAs, knowing which factors characterize the existing IRA accountholder is like having a road map to additional IRA deposits. Whether the bank is considering its existing customer base, or its overall market area, the same rules apply.

1. Find out the common denominators of the buyers

2. Identify non-buyers who share the important characteristics of the buyers

3. Communicate effectively to that group with a compelling sales message

What characteristics are shared by those who have made this investment in their future?

✓ Approximately 75% of IRA accountholders are in the over-40 age group. There are several possible reasons. One is that this is a large population segment in most areas of the U.S. But there's certainly more to it than that. This is also an age when retirement looms as a reality in roughly 20 years, perhaps less. It's a time of life when we look forward to either the pleasures of having time to enjoy our new found "freedom," or dread the reduced income that may accompany retirement. In either case, there is an incentive to supplement retirement income.

✓ More than 80% are married. Yes, part of the reason may simply be that marrieds make up a great segment of the U.S. population. But more significantly, married or dual-income households usually have higher disposable (after-necessities) per-capita income, making an IRA more affordable.

✓ The best candidates have higher incomes, say $50,000 or more of household income. This translates into a greater ability to fund an IRA, not having to spend every dollar earned on life's necessities. Higher income also increases the likelihood that there will be a tax advantage to funding an IRA. Low income households often have neither the assets nor the tax incentive to fund an IRA.

✓ Over half of IRA accountholders are graduates of college or a specialized post-secondary educational institution. These individuals or couples generally have higher incomes than the less educated (relates to preceding item), and may also be better informed about – and concerned with – the importance of planning for retirement.

✓ Two-thirds or more are homeowners, a fact that may or may not be significant, but which is a demographic characteristic nonetheless. This may simply be one of those coincidental characteristics that reflects the overall population more than it reflects a desire to have an IRA. Or - on the other hand - it may be part of that "burdens of responsibility" profile which we sometimes associate with people who have greater commitments and obligations in life; and therefore perhaps a greater need or desire to remove some of life's uncertainties.

Putting the Numbers to Work

What to do with these characteristics?

* Evaluate and market more thoroughly to your existing customer base. Customers who have been with your institution for any amount of time - particularly those that have made transactions requiring substantial disclosure (major loans) — can be identified with respect to most of the above demographic characteristics. Market directly to this group, by mail, telephone, or both.

* In the wider marketing arena, try to tailor your media advertising messages to people with these characteristics and inclinations (in itself a subject that merits more discussion in the future). PD

Will User Fees Remain in Effect?

In the past — under the authority of Rev. Proc. 90-17 — requests to the IRS for determination letters and private letter rulings to resolve pension plan questions have required payment of a "user fee." A virtual laundry list of different letter and ruling fees has existed, with amounts ranging from "small change" to several thousand dollars.

But legislative authority for the charging of these fees ended when Congress failed to enact extending legislation before this authority expired on September 29, 1990. Whether they will be reinstituted is an open question, perhaps lost in the wider budgetary clashes and uncertainties that have characterized recent weeks of the current legislative session.

To assist those now in the process of filing for determination letters and letter rulings, the IRS recently issued guidance on this subject. The Service has said that requests made after September 29 and prior to any reenactment of the fee schedule, should not be accompanied by a fee payment, regardless of the amounts that these rulings cost prior to September 29, 1990.

Several options exist for the future:

1. No future fees will be charged.

2. Fees will be re-instituted, with no retroactive effect back to September 29 (this would seem an unjust "loophole" for those filing in the interim, and therefore seems unlikely).

3. Fees will be reinstated, and a method for paying the applicable fee for requests made in the interim announced at that time.

It should be pointed out that fees received in the interim period but applicable to requests filed ON OR BEFORE September 29, 1990 (still under the authority of Rev. Proc. 90-17) will not be refunded, as those fees still apply.

The Pension Digest will keep you updated on any legislative action pertaining to these user fees. PD

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Special Rule for Late Notification

There is a special rule covering a situation in which an IRA customer dies but you are not notified of the death until after May 31, 1991 (the deadline for filing the Form 5498). In this situation you are not required to file a corrected Form 5498 or a corrected annual statement. However, if the executor or administrator requests the FMV as of the actual date of death, then you must furnish it in a timely manner (90 days) to the executor, but you do not need to inform the IRS.

Deadline to IRS

You will need to furnish the IRS with the account balance of each IRA (FMV as of December 31, 1990) no later than May 31, 1991. Why? The IRS needs the ability to verify that customers have calculated the right December 31, 1990 value as reported on Form 8606. You do not send the IRS a duplicate copy of the customer statement. Rather, you input this FMV amount in box 4 of Form 5498. The IRS does not need this information by January 31, 1991 as the customer does. Note that the balance reported to the IRS on Form 5498 and the balance reported to the customer on the January statement must be identical. If the balances are different, then you will need to prepare a corrected report either for the customer or the IRS, telling them of the correct amount and that the prior amount was in error.

Reporting Contributions to the Customer and the IRS

You generally report the item identified as "certain contributions" to both the customer/taxpayer and the IRS using the same form (Form 5498). Also, your time deadline to furnish this information is the same for both your customer and the IRS - May 31, 1991.

You will note that is after the customer's deadline for filing their tax return. The IRS assumes that the customer has kept track of the contributions he or she has made, and will report them correctly on his or her Form 1040. As a customer service, some IRA custodians <u>do</u> furnish other statements on or before April 15th, 1991, to inform the customer of contributions, distributions, etc. But such other statements are not required by the IRS. However, once the customer receives this information in May, he or she should review it to see if it agrees with how their tax returns were prepared. The IRS also receives this information from you on or before May 31, 1991. The IRS will also check this information against the customer's tax return to see if it agrees.

What information is reported on the 1990 Form 5498?

The Form 5498 reports to the IRS regular and rollover IRA contributions and the FMV of the IRA. However, SEP contributions made by an employer (even a one person business) are not reported, and direct transfer contributions (i.e. no payment or distribution of funds to the IRA customer) are not reported.

What contributions are reported?

Box 1 is used to report regular contributions to an IRA made for the 1990 tax year. Therefore, any contributions made from January 1, 1990 to April 15, 1991, when made and designated for 1990 must be reported. Since an employer may have a SEP plan which permits the employee to make "regular" contributions, you must remember that the employee's regular contribution must be reported, but the employer SEP contribution is not. You must report the gross amount of the contribution in all cases including when an excess contribution has been made, even if it is withdrawn.

Box 2 is used to report rollover contributions made to an IRA for the period of January 1, 1990 to December 31, 1990 (not including January 1 to April 15, 1991).

Box 3 is used to report on life insurance endowment contracts. Box 3 is that portion of box 1 that is allocable to the cost of life insurance. This box is completed by insurance companies and not generally by banks or savings and loans.

Box 4 is used to report the fair market value (FMV) of the IRA or SEP as of December 31, 1990, as discussed in detail above with respect to the January IRA statement. All of that discussion applies here also, including the discussion with respect to inherited IRA accounts.

Summary

The purpose of this article has been to describe the statements and forms you must prepare for your IRA customers and the IRS, regarding contributions and the FMV amount. Although it is not always apparent, there is some logic to these IRS rules. Hopefully, this article has made the reasons for these rules more understandable. PD