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Alternatives for Preparing IRA Statements and Forms

The purpose of this article is to discuss the various methods which an IRA custodian/trustee may use to satisfy the IRA reporting requirements imposed by the IRS with respect to reporting contributions and the year end fair market value. The discussion is not only made with respect to the 1991 reporting year, but would apply for other years as well.

An IRA custodian/trustee is required to furnish the IRS with certain information and to furnish the IRA accountholder and/or beneficiary, with certain information.

The general rule is that the information which the IRA custodian must furnish to the IRS must also be furnished to the accountholder and/or beneficiary.

What differs is when the IRA custodian must furnish this information. As the discussion below indicates there are different time deadlines for furnishing this information to the accountholder versus the IRS.

Why must the IRA custodian furnish reports to the accountholder and to the IRS?

The accountholder needs this information to prepare his or her federal income tax return. Likewise, the IRS will use this information to determine if the accountholder/taxpayer has handled their IRA transactions correctly on their federal income tax return.

Deadlines and Requirements With Respect to the IRS

The IRA custodian must complete a 1991 Form 5498 (or its magnetic media equivalent) on or before June 1, 1992 as follows.

The IRS must be sent a completed Form 5498 for each IRA accountholder and certain beneficiaries. An IRA custodian/trustee must generate a Form 5498 if an accountholder or beneficiary has made a regular or spousal IRA contribution, a rollover contribution or has a fair market value balance as of December 31, 1991. With respect to an IRA accountholder who died

during the year, the same rules apply to determine if a Form 5498 must be prepared, except timing for the fair market value is the date of death and not December 31, 1991. Remember that contributions to inherited IRA accounts are not permissible.

Deadlines and Requirements With Respect to IRA Accountholders and Beneficiaries

There are two items which the IRA custodian must report: (1) the fair market value as of 12-31-91 and (2) the reportable contributions.

The fair market value as of 12-31-91 information must be provided on or before January 31, 1992. The IRA custodian can furnish this information in any written format.

The contribution information can be provided on or before May 31, 1992. The IRA custodian can choose to use the IRS Form 5498, or a substitute Form 5498.

This article will discuss the "proper procedures" and when various alternatives are used to report the fair market value and contribution information.

Before discussing the alternatives, it must be remembered that there may be a difference between the reporting the IRS mandates and the reporting a bank chooses to furnish its IRA accountholders.

Many IRA custodians will furnish their IRA accountholders a comprehensive statement on or before January 31, 1992, in the following format:

*Beginning Balance as of 1-1-91
Plus Regular and Spousal
Contributions for 1990
Plus Regular and Spousal
Contributions for 1991
Plus Rollover Contributions in 1991
Plus Transfer Contributions in 1991
Plus Interest Credited in 1991
Less Distributions in 1991
Ending Balance (Fair Market
Value) as of 12-31-91*

When an IRA custodian uses such a comprehensive statement it furnishes the IRA accountholder with more information

than is required by the IRS. The IRS requires the reporting only of reportable contributions (not transfers and SEP contributions) and the year end fair market value. Note that interest or any other type of earnings are not reported to the IRS.

Fair Market Value Reporting Alternatives

What, then, are an IRA custodian's alternatives for reporting the 12-31-91 fair market value on or before January 31, 1992?

Alternative #1 is to use a customer statement.

Alternative #2 is to use the IRS Form 5498. There are two subalternatives: (1) complete only box 4 or (2) complete boxes 1, 2 and 4 with the information as of December 31, 1991.

If a customer statement is to be used to satisfy the IRS reporting requirements, then the IRA custodian must make sure that it contains the proper informational messages as discussed in the November Pension Digest.

If the IRS Form 5498 is furnished in January, then the IRA custodian will need a procedure to furnish the final Form 5498 to those who made (carryback) contributions in 1992 for 1991. We do not recommend using the IRS Form 5498 in January of 1992, as we foresee real problems with indicating to the IRA accountholder what his or her "final contribution" amounts are. That is, how does the accountholder distinguish between the first Form 5498 which was issued and any later one? For this reason, we do not recommend using the IRS Form 5498 to satisfy the January statement requirement.

Contributions Reporting Alternatives

Alternative #1. An IRA custodian furnishes those IRA accountholders who made a reportable 1991 contribution the completed Form 5498. It is furnished after April 15, 1992, but on or before May 31st, 1992.

Why use alternative #1? All the information which is required to be given

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IRS form. By using the Form 5498, an IRA custodian knows it does not have a compliance problem, assuming the form has been completed correctly.

Note that under this alternative the IRS does not require a Form 5498 to be prepared for those IRA accountholders who did not make a reportable contribution. For those accountholders who did not make a reportable contribution, the IRS does not require the IRA custodian to furnish a Form 5498 or substitute statement. The IRS has rightfully concluded that the furnishing of a Form 5498 or a substitute statement with only box 4 completed, would simply duplicate the fair market value information which was furnished on the customer statement furnished on or before January 31, 1992.

Alternative #2. The IRA custodian will use the January statement to handle both the fair market value requirement and the contribution requirement. Thus, the IRA custodian will prepare on or before January 31, 1992, a statement (i.e. a substitute Form 5498) that will reflect the December 31, 1991 fair market value and the reportable contributions.

However, if this alternative is used, the IRA custodian must understand that it must furnish a "later statement" if the IRA accountholder makes a contribution for 1991 in 1992. Presumably, by reporting contributions only once on the January statement for most IRA accountholders, some money can be saved in less form preparation and lower mailing costs. This is a sensible approach to reporting fair market value and contributions.

WARNING: Any time a substitute 5498 form is used rather than the actual Form 5498, the IRS has stated very clearly in its instructions that it is important that the income tax items on this substitute statement be properly classified for federal income tax purposes. The IRS requires that the following message appear on the statement - "This information is being furnished to the Internal Revenue Service."

In addition, the IRS requires that the IRA custodian provide the recipient with

applicable instructions similar to those that appear on the back of the recipient's copy of the Form 5498 so that the information may be properly used by the recipient in meeting his or her tax obligations.

In plain English, this means that the IRA accountholder is entitled to receive the explanations for Box 1, Box 2 and Box 4 of Form 5498 or similar language. And, the accountholder is entitled to know specifically what information is being furnished to the IRS. Again, certain contributions are not reported, nor is interest reported.

Therefore, if your approach as an IRA custodian/trustee is to report contributions on your January statement, then you must include the messages/instructions for boxes 1, 2 and 4 somewhere on your January statement. A more conservative approach would be to give complete 5498 message/instructions, but indicate that box 3 (endowment contracts) does not apply.

If these messages/instructions are not included, then there is a noncompliance problem. From the audits we conduct, we conclude that most statements at this time do not contain the necessary messages. You may have to talk with your data processing software people to resolve this problem.

We would also recommend that an IRA custodian should also put the accountholder on notice that if he or she does make a contribution in 1992 for 1991 that you will be sending the customer an additional statement which will show the "final contribution" information which will be furnished to the IRS.

Summary

While the reporting of year-end fair market values (FMV) and contributions to the IRS is pretty much a cut-and-dried matter, there is more than one way to report these items to customers and yet remain in compliance with IRS regulations.

In particular, you have various options for reporting to your customers, but some may be "safer" than others.

1) One approach is to use the IRS Form 5498 for the January 31 FMV reporting, completing only Box 4 (FMV). Another

Form 5498 will later need to be sent (by May 31) with the 1991 contribution amount.

2) Another is to report both the FMV and (1991) contributions on the 5498 by January 31 (completing boxes 1, 2, and 4). But this will require that a second 5498 be sent to each customer who makes 1992 contributions for 1991 (carryback contributions).

We do not recommend either 1 or 2 above, because they can be potentially confusing to customers, many of whom will need to be told which Form 5498 was sent to the IRS. We are not even sure if the IRS would allow the issuance of two original Form 5498s.

3) A third approach is to use a customer statement to send FMV on or before January 31, and to furnish the 5498 by May 31 with final 1991 contribution information. This means that every customer who made a contribution for 1991—whether in 1991 or as a carryback before April 15 of 1992—will receive two mailings. But it's a safe, non-confusing approach. Those who did not make a contribution will receive only one mailing.

4) A fourth approach is to use the customer statement to report to the accountholder both the FMV and annual contribution by January 31. This will satisfy all requirements for those customers who make no contributions in 1992 for 1991.

Then, send the Form 5498 or another substitute statement only to those customers who made 1991 contributions in 1992 (carrybacks). The percentage of a bank's total IRA customers needing this will vary by bank. But it will always be smaller than the total number of those making contributions for 1991. Thus, time, labor and mailing cost will be saved by this approach.

While we feel that approach #3 is safest, we are also comfortable with approach #4. Be aware that the special language which must be contained on the statement varies depending upon which approach is used. **B**

Example of Form 5498 Instructions

A financial institution sending IRA statements to customers may choose to use only those excerpts from the Form 5498 Instructions that are appropriate to explain its reports.

However, a more thorough approach may be to send the complete instructions—in any format—indicating which box number information applies or does not apply. In this way you will be sure to include key points of information such as:

- informing the customer that the appropriate information has been submitted to the IRS,*
- what reportable contributions were made, and*
- describing the fair market value (FMV) and the possible handling of this entry in the event of accountholder death.*

Instructions to Participant

The information in Boxes 1, 2, 3, and 4 has been submitted to the Internal Revenue Service by the trustee or issuer of your individual retirement arrangement (IRA) to report regular or rollover contributions made to your IRA and the value of your IRA or simplified employee pension (SEP) account.

If you or your spouse were an active participant in an employer's pension plan, your IRA contributions may not be deductible. See your Form 1040 or 1040A instructions for details.

Box 1.—The amount shown is the contributions for 1991 made in 1991 and through April 15, 1992, to an IRA.

Box 2.—This is the amount of any rollover you made in 1991. You must report the total distribution you received from your IRA on the appropriate line of your income tax return. Subtract the part of the distribution that was rolled over and enter the taxable remainder on the appropriate line of your income tax return. But if you have ever made any nondeductible contributions to your IRA, use **Form**

8606, Nondeductible IRA Contributions, IRA Basis, and Nontaxable IRA Distributions, to figure the taxable amount. If property was rolled over, see **Pub. 590**, Individual Retirement Arrangements (IRAs).

Box 3.—For endowment contracts only, this is the amount allocable to the cost of life insurance. Subtract this amount from your allowable IRA contribution included in Box 1 to compute the amount allowable for your IRA deduction.

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.

The trustee or issuer of the plan may use the other boxes on this form to give you more information about your IRA.

You are not required to attach a copy of Form 5498 to your income tax return. Keep this form for your records. For more information about IRAs, see **Pub. 590**.

SEPs Only Remaining Employer Option to Shelter 1991 Plan Funds

The deadline may have passed for your business customers to establish a traditional "qualified retirement plan", but there's still time for them to establish a plan that will provide tax benefits to their company, and retirement planning and tax advantages to employees.

That plan is a Simplified Employee Pension, better known as a SEP, and the deadline is the tax filing deadline (April 15), plus extensions, for a business entity with a calendar-year tax year.

A SEP is...?

A Simplified Employee Pension uses IRA documentation and permits an employer (or self-employed person) to make tax-deductible retirement contributions on behalf of those employees.

SEPs are especially attractive because they allow employees to make larger tax-deferred contributions than IRAs do, up to 15% of annual earnings, or \$30,000, whichever is less. (By a special adjusted calculation, the self-employed individual has a maximum 13.043% limit.) An IRA on the other hand, has a \$2,000 limit, or \$2,250 if a spousal IRA.

Your Institution Can Meet This Need

Your business customer may look elsewhere for their SEP plan document, such as an accountant, but your institution can serve their needs almost as easily as with an IRA, and can reap the benefits of completing the circle of service, by meeting one more important need for that customer.

Plan Options

A SEP prototype, custom designed SEP plan, or the IRS Model Form 5305-SEP can be used to open a SEP plan for your customer. The 5305-SEP approach is easy for any institution to offer, and may be obtained at no cost from the IRS. Pension services providers such as Collin W. Fritz and Associates can also meet this need for your institution. A SEP prototype, however, provides still greater flexibility, allowing such things as contributions favoring certain classes of employees such as the highly compensated (often the owners), or allowing a fiscal tax year.

Though your business customer bears ultimate responsibility for plan accuracy, you can help those customers who are not wise in the ways of pension plans. It's really as simple as:

Line 1 - filling in the name of the business

Line 2 - setting the age requirements for employees to participate in the plan; usually 21, or N/A if a one-person business

Line 3 - setting years-of-service minimum, if applicable

Line 4 - indicating whether the plan will include employees represented by a collective-bargaining agreement (union); most plans will not.


Line 5 - indicating whether the plan will include any employees earning less than \$300 for the current year; most businesses will not.

While most businesses may use the Form 5305-SEP to open a SEP plan, some cannot. These include:

- a) an employer currently maintaining another retirement plan.
- b) any employer who now—or has ever—maintained a defined benefit qualified plan.
- c) an employer who is part of a "controlled group," an affiliated service group, or who makes use of leased employees.

For these employer classes, a SEP prototype can be used to set up a SEP plan for their employees.

Next to IRA rollovers, a SEP plan is the best way for a financial institution to take advantage of the opportunity to receive large retirement plan contribution deposits. Considering its ease of administration and the potential benefits, it's a service no institution should be without.

For more information on how you can serve your business customers with a SEP plan, contact Collin W. Fritz & Associates at 1-800-346-3961. 



REVOKED IRAS NOW REQUIRE CONTRIBUTION, DISTRIBUTION REPORTING

On December 30, 1991, the IRS issued Revenue Procedure 91-70, to clarify contribution and distribution reporting requirements for IRAs that are revoked. A "revoked IRA" is one that is terminated within seven days of its opening.

Revocation a Customer Protection Option

Section 1.408-6(d)(4)(ii) of the income tax regulations provides some protections for customers opening an IRA. Either the custodian institution (where the IRA is opened) must provide IRA disclosure documents seven (7) days before the IRA is opened, or the account holder has seven days following its opening to change their mind and revoke or "cancel" the IRA.

No fee, loss of interest or other penalty may be assessed the customer revoking such an IRA.

New Rule for Reporting Revoked IRA Contributions

Prior to issuance of this Revenue Procedure there had been uncertainty about how or if the opening deposit (contribution) and the returned funds (distribution) were to be reported.

The prior position of Collin W. Fritz & Associates, Ltd. and most other pension consulting firms had been that the contributions and the distributions involved in a revocation did not need to be reported. The rationale had been that the IRA was treated as never having existed, and thus should not be reported.

There was one concern: an individual might transfer IRA funds from one institution to another and then exercise the revocation right. In this situation, if the new IRA custodian did not report the "refund" as a distribution, the IRS would not have had any idea that the recipient should pay income tax on this distributed amount. The old IRA custodian did not report the payment, as they properly handled it as a transfer. In this situation we formerly recommended the new IRA custodian prepare the Form 1099-R.

Reporting Contributions, Distributions on the 5498, 1099-R

The IRS therefore addressed this situation by issuing Revenue Procedure 91-70, which applies to contributions and distributions made after December 31, 1991. Despite the limited duration of such an IRA, contributions and distributions

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must still be reported by use of Form 5498 for contributions, and 1099-R for distributions.

With respect to contributions, the IRA custodian will need to prepare a Form 5498 for regular, spousal or rollover contributions, but not for transfer or SEP contributions.

With respect to distributions, the IRA custodian must prepare a Form 1099-R any time IRA funds are distributed to someone. Thus, when a person revokes his or her IRA, he or she is paid their money and the IRA custodian must prepare a Form 1099-R to report the distribution amount and the reason code.

What reason code is to be used? The Revenue Procedure does not address this question. We called the IRS and they said to use reason code "8" (withdrawal of a current year contribution) for 1992 reporting purposes. The IRS indicated that the 1992 1099-R instructions would further confirm this. For reporting years 1993 and onward, the IRS indicated that there would be a separate reason code number just for revocations.

Must Fair Market Value Be Reported?

In most cases of revoked IRAs, the period from establishing to revocation will be within the same calendar year. In such cases, the revoked IRA will have no account balance as of December 31, and thus no fair market value (FMV) to be reported. However, in those uncommon cases in which the opening/revocation of an IRA spans the year-end, the fair market value of the IRA must be reported on the Form 5498 along with contribution information.

For further information on this new Revenue Procedure, contact one of the retirement plan consultants at Collin W. Fritz and Associates, by calling 1-800-346-3961. **PD**

Just a Reminder —



August 9-12
Madden's Conference Center
Brainerd, Minnesota

Plan now to take advantage of extensive training in the pension topics of your choice, during this three-day workshop — held at one of Minnesota's finest resorts. Call 1-800-346-3961 for more information.

(Refer back to December's Pension Digest "Extra" for a more detailed conference summary.)

Check It Out

Question: A customer, age 37, has asked if she can withdraw funds for the purchase of a home without being subject to the 10% excise tax for a distribution prior to age 59-1/2.

✓Answer. Although Congress is considering changing the laws so that a first-time home buyer would not be assessed the 10% excise tax, such a law has not yet been passed.

Question: The interest rate we are paying some of our new IRA customers is 3.85%. The projection schedule contained in our IRA forms uses 4%, what must we do?

✓Answer. The IRA projection must be done using an interest rate no greater than what is offered that particular customer. Therefore, you must either switch to a new IRA form which uses an interest rate equal to or less than 3.85% (2% for example) or use some type of special amendment to your existing form. The amendment must also use an interest rate less than 3.85%. Most IRA forms vendors will make both alternatives available to their customers.

Question: Our customer has \$50,000 in his IRA account. He has just bought a condominium. He closes on it on January 31, 1992. He also just sold his house, but he does not close on it until March 20, 1992. He needs cash for the closing on the condominium. Can he withdraw \$45,000 from the IRA and use it to buy the condominium, but then contribute \$45,000 before the 60-day rollover limit expires. The source of the \$45,000 would be from the proceeds of the house sale.

✓Answer. This is a rollover question. The law permits a person to roll over a distribution if he complies with the 60-day rule and the once-per-twelve-month period rule. Under existing rules, the IRS does not examine how those funds were used during the 60-day period. Since the size of this transaction is quite large, the customer should be relying on the advice of his or her tax advisor.

Question: What should be our standard administrative procedure once we are aware that an IRA accountholder has died?

✓Answer. You should contact the beneficiaries as soon as possible after you are aware of the death. Preferably, this contact should be in writing. You need to inform the beneficiaries that they will need to furnish you with their individual instructions—how they will withdraw their respective shares. The beneficiaries need to be told their deadlines for making these elections. You can use a form such as CWF's #204N — Minimum Distribution Election Form for IRA Beneficiaries — to accomplish this task.

Question: We had an IRA accountholder age 74, with a husband age 72. She was having her required minimum distribution amount deposited into the joint checking account she maintains with her husband. She died on January 15, 1992. Should we continue to deposit these funds into the joint checking account?

✓Answer. No. You should make sure that your "automatic" or "scheduled" distributions will stop once you are aware of an accountholder's death. Why?

The beneficiary of her IRA is now entitled to receive the funds. This may or may not be her husband. If her husband is not the beneficiary, a continuation of the payments would mean that the wrong person would be receiving the funds.

If her husband is the beneficiary, he will need to decide how he will take his distributions. Remember that he must continue the schedule she set up, speed it up, or elect to treat her IRA as his own. If she had elected to recalculate her own life expectancy factor, then the schedule would be affected by her death. **PD**

The Pension Digest invites your questions and comments.

Please address to — "Check It Out," Collin W. Fritz & Associates, Ltd.,
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