THE Pension Digest

Published Since 1984 Collin W. Fritz & Associates, Inc., *"The Pension Specialists"* April, 1992

Rollovers Transfers After 70-1/2

Some of the most common questions our IRA consultants get deal with the issues raised when a rollover or transfer transaction is being made by a person who is 70-1/2 or older. These transactions present some special and unique problems that often are confusing and are not handled correctly.

The first issue is "Can a person who is over 70-1/2 make a rollover or transfer from a Qualified Plan or IRA to another IRA." The answer is that they definitely can. There is no age limit placed on rollovers or transfers. The only limitation that exists is that the required minimum distribution amount for the year may not be rolled over or transferred to an IRA. The rules for each type of transaction are slightly different however.

Post 70-1/2 Rollovers

The IRS attempted to simplify the situation with rollovers by stating in Treasury Regulation 1.401(a)(9)-1 that any distribution made in a required distribution year will be treated first as a required minimum distribution for the year the rollover is occurring. The problem many institutions encounter is that people are rolling over entire account balances without first subtracting the required minimum distribution amount as is required by the rules.

What is the result when this happens? The accountholder has made an excess contribution to the receiving IRA. As with all excess contributions, this will be subject to a 6% excise tax if it is not corrected by that year's tax filing deadline. The required minimum distribution amount for the year will also be taxable in the year it was supposed to have been taken, even if it was not. According to the regulations it does not appear that this money would be subject to the excess accumulations tax of 50%, since the funds are taxable in the year of the distribution even though they were rolled over.

As is readily apparent, this could be a costly mistake. The easiest way to avoid this situation is to make sure the individual has removed their required minimum distribution amount from the rollover before accepting the contribution. If the rollover is being made in the first or second distribution year but before the individual's required beginning date, the required distribution amount may be calculated based on the beneficiary as documented at the receiving institution. The only problem this presents is that the receiving institution does not have the necessary account balances to aid the individual's calculation of the required distribution amount. This should not be a problem for the receiving institution because — even though the beneficiary at the receiving institution is used — the distributing institution is still the institution that calculates the required distribution amount for these years. The distributing institution will have to ascertain the proper beneficiary to use. In summary, when receiving a rollover from a person 70-1/2 or older, the required minimum distribution amount must be removed before the remaining funds are deposited into the IRA. If they are not, the accountholder faces income tax and possible excess contribution penalty taxes.

Post 70-1/2 Transfers

The rules for transfers made by an individual that is 70-1/2 or older are similar to the rollover rules, but are handled a bit differently since the individual never has possession of the funds. Just as with rollovers, a required minimum distribution cannot be transferred to another IRA. Treasury Regulation 1.408-8 says that in the case of a transfer, the transferor IRA must distribute the required minimum distribution amount in the year of the transfer. The distribution can be made at the time of the transfer or left in the transferor IRA and removed any time before the end of the year of the transfer. In contrast to rollovers, if the minimum distribution is not removed from the transfer amount, the accountholder who has not taken their required distribution faces the 50% penalty tax for excess accumulations.

Handling The Transaction

Slightly different from rollovers, is the fact that the regulation, 1.401(a)(9)-1, does not say this is an excess contribution. The reason for this appears to be that no distribution has ever been made. As such, the accountholder has not made a contribution that constitutes an excess. It does appear, however, that the excess accumulation penalty tax of 50% applies automatically if the transfer includes the required minimum distribution amount from the transferor IRA. Again, a very severe result.

Handling the Transaction

The discussion above deals with the rules as they are written in the Regulations. We realize that for various reasons the rules are not always strictly followed. What should be done in such circumstances, and how can an IRA custodian or trustee protect themselves when they are accepting a transfer or rollover from someone that is 70-1/2 or older? First, written documentation should be obtained and used in both types of transactions.

For transfers, the institution that will receive the transfer should be preparing a form requesting the transfer. These transfer forms should instruct the current custodian/trustee not to transfer any required minimum distribution amounts. Additionally, the form should contain a request for the 70-1/2 elections the individual has made, and beneficiary information for the transferor IRA.

For rollovers the individual should be required to sign a rollover certification document. This document should contain a provision by which the individual certifies that the rollover contribution does not contain any required minimum distribution amount. Remember that in the rollover situation, the individual will have to provide you with 70-1/2 election information.

Correcting Improper Transactions

What should you do if you are told a rollover or transfer has been made and the 70-1/2 distribution had not been taken? With transfers we recommend that if the check has not yet been cashed, it be sent back to the transferor IRA to make the calculation and remove the distribution amount. If it has been cashed, the required distribution amount should be calculated based on the amount that was transferred. This is not strictly in accordance with the regulations, but we feel this may alleviate the 50% excess accumulation penalty. With rollovers, the required distribution amount (an excess contribution as we saw earlier in the discussion) should be removed, along with earnings, prior to the year's tax filing deadline. Additionally, the individual will have to claim the required distribution amount as income in the year the initial distribution was made. PD

IRS Publication 590 Clarifies Numerous IRA Questions

. . . with further commentary by CWF

The IRS' Publication 590 contains several clarifications that are worthy of mention to those who administer IRAs. This information is valuable on a year-long basis, not just during the prime January 1-to-April 15 period. This is true at a growing number of financial institutions, as IRA rollover and transfer transactions, and "installment" IRA deposits, are recognized as offering important potential in the overall IRA picture.

The most noteworthy of this year's clarifications may be those concerning IRA rollover rules.

■ "Waiting period between rollovers" clarified:

(We'll begin with the actual Publication 590 language, **with new(as of 1991) language indicated in bold type**.)

"You can take (receive) a distribution from an IRA and make a rollover contribution (of all or part of the amount received) to another IRA only once in any one-year period. The one-year period begins on the date you receive the IRA distributions, not on the date you roll it over into another IRA.

This rule applies separately to each IRA you own. For example, if you have two IRAs, IRA-1 and IRA-2, and you roll over the assets of IRA-1 into a new IRA-3, you may also make a rollover from IRA-2 into IRA-3, or into any other IRA within one year after the rollover from IRA-1. These are both rollovers because you have not received more than one distribution from either IRA within one year. **However, you cannot, within the one-year period, again roll over the assets you rolled over into IRA-3 into any other IRA.**

Later distributions from any IRA within a one-year period will not qualify as rollovers. They are taxable and may be subject to the 10% tax on premature distributions **and the 15% tax on excess distributions.**"

Further commentary:

Can any IRA accept incoming rollovers more than once within a 12-month period?

Yes. There is actually no limit on the number of deposits — incoming funds — via rollover that any IRA account may accept. But such funds (or property) rolled over may only be moved from one account to another once in a 12-month period, commencing on the date distributed, as 590 language specifies.

Can separate deposit instruments within the same IRA be rolled over — an outgoing transaction — to other accounts at different times in less than a 12-month period?

Our position is "No." The confusion sometimes arises when a deposit instrument, such as a CD, is thought of as being a distinct IRA. It is not. "IRA" is synonymous with "plan agreement." If an accountholder chose to roll over only part of the total assets in an IRA, the rest of the assets in that IRA are not eligible for rollover again until the 12-month waiting period has elapsed. (See examples in accompanying charts.)

■ Compensation defined:

While the general definition of compensation is "... amounts you receive for providing personal services," the key phrase in the new Publication 590 is . . . "For 1991 the IRS treats as compensation any amount properly shown in Box 10 of Form W-2 . . ."

This means that in addition to wages, salaries, tips, professional fees, bonuses, and other specifically named items such as taxable alimony and separate maintenance, then by inference, other applicable items include such things as disability pay, unemployment compensation, accrued annual leave, sick leave, incentive pay and termination pay. This is the legacy of IRS Revenue Procedure 91-18, issued in March of 1991. See the April, 1991 issue of *The Pension Digest* for a further discussion.

■ Seven-day IRA Disclosure/ Revocation Privilege

The new 590 makes clear that those opening an IRA must be given one of the following:

A. an IRA disclosure statement at least seven (7) days prior to when the IRA is officially established, or

B. be allowed to revoke the IRA within a seven-day period after it is established.

If revoked within this period, the sponsor (custodian) is required to pay the accountholder "... the entire amount ... paid." The 590 does not say that interest must be returned. This, in the case of a transfer or rollover account, could be signficant. See further commentary on this matter on page four in this issue of *The Pension Digest*.

■ Movement of Retirement Plan (QP) Assets . . . deductibility; tax-withheld QP rollovers

Although IRA administrators will be familiar with the question, the new 590 makes clear that rollover contributions may not be listed as a tax deduction. Instead, they're reported on an accountholder's tax return, and their tax-deferred status noted by means of entries on lines 16a and 16b of tax Form 1040, or lines 10a and 10b, Form 1040a.

In the area of qualified plan rollovers, the new 590 makes clear that if a distribution is received from which federal income tax has been withheld, the employee may make up the difference with their own financial resources and roll over the entire amount into a receiving IRA account. The employee has in effect received two amounts — the amount of the distribution check plus the amount withheld and paid to the IRS on his or her behalf (in effect a pre-payment).

This presumes that the employer plan was in every other way a "qualified" plan.

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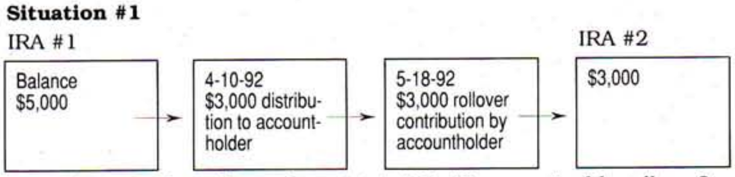
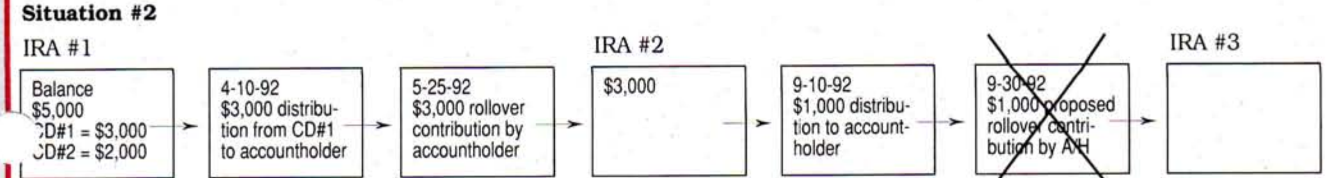
The following charts describe four situations in which IRA rollover transactions are attempted. Take special note of the dates these transactions are attempted. As situations #2 and #3 make clear, while rollover privileges are limited by the one-per-12-month rule, IRS rules allow transfers at any time, subject to custodian's plan agreement language.

Situation #1



Question: Is the rollover deposit into IRA #2 a permissible rollover?
Answer: Yes. The 60-day rule has been met and it is assumed that there has been compliance with the one rollover within a 12-month period rule.

Situation #2



Question: Is the proposed rollover contribution of $1,000 on 9-30-92 a permissible rollover?
Answer: No. The proposed rollover was attempted to be made within 12 months of a prior distribution which was rolled over. Note that it would be permissible to move the funds of IRA #2 to IRA #3 via a transfer, but not a rollover.

Situation #3

Transaction #1

IRA #1			IRA #2
Balance $5,000 CD#1 = $3,000 CD#2 = $2,000 →	4-10-92 $3,000 distribution from CD#1 to accountholder →	5-25-92 $3,000 rollover contribution by accountholder →	$3,000

Proposed Transaction #2

IRA #1			IRA #3
Balance $2,000 →	8-15-92 $1,000 distribution from CD#2 to accountholder →	~~9-10-92 $1,000 proposed rollover contribution by A/H~~ →	

Question: Is the proposed rollover contribution on 9-10-92 a permissible rollover?
Answer: No. The proposed rollover was attempted to be made within 12 months of a prior distribution which was rolled over. Note that it would be permissible to move the $2,000 of IRA #1 to IRA #3 via a transfer but not as a rollover.

Situation #4

IRA #1		IRA #4
3-10-92 $5,000 distribution to accountholder →	4-15-92 $5,000 rollover contribution by accountholder →	$5,000

IRA #2		IRA #5
10-11-92 $8,400 distribution to accountholder →	12-5-92 $8,400 rollover contribution by accountholder →	$8,400

IRA #3		IRA #6
11-3-92 $7,000 distribution to accountholder →	12-2-92 $7,000 rollover contribution by accountholder →	$7,000

Question: Are all three rollover contributions permissible?
Answer: Yes. The one per 12-month rule applies separately to each IRA plan agreement.

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■ Substantially Equal Periodic Payment Payout Caution

IRA accountholders who have chosen to begin taking distributions from their IRAs before the "normal" age 59-1/2, take these distributions at regular intervals over their life expectancy under the Substantially Equal Periodic Payments (SEPP) option. Three methods for calculating the distributions are allowable, including the Required Minimum Distribution (70-1/2) method, and also annuity and amortization methods.

To clear up any potential confusion, especially in the case of calculations made using the Required Minimum Distribution formula, such distributions are not minimums, but exact distributions to be taken each period. The reference to "minimum" is only with regard to the calculation method. The whole philosophy behind the SEPP option is to extend payments over the accountholder's life expectancy, not allow the taking of larger distributions, without appropriate penalty (if any) for doing so.

■ Simplified Employee Pension Clarifications

Some degree of confusion has existed among employers, employees and even within financial institutions concerning the concept of a "SEP account." The new 590 makes clear that employer contributions are made to an employee's IRA account. There is no such thing as a SEP account, only a SEP plan, with the employee's IRA the repository for those contributions.

On a related topic, Publication 590 further clarifies that employers cannot prohibit employees from taking SEP distributions (withdrawals) from these accounts.

An employee is immediately and fully vested in any employer contribution through a SEP plan to their IRA account.

■ The new Publication 590 contains a great deal of additional information, that will be worth familiarizing yourself with. PD

Marketing
Pension Products and Services

IRA Marketing Miscellany

More Evidence Of Movement Of Money Away From Fixed-Return CDs

Last month we discussed the merits of financial institutions offering self-directed IRAs as a means to combat loss of IRA deposits due to dropping interest rates paid on CDs in regular custodial accounts. Though they're not without their own administrative headaches, self-directed IRAs are one way to provide customers with a retirement plan option having the potential for greater earnings than the fixed-return savings instruments found in most custodial IRAs.

This is a growing trend that has proven to be bad news for many banks, and good news for brokerage houses offering individual stock and bond issues, as well as mutual funds providing varying degrees of risk, and varying prospects for earnings.

Reports are being heard from many quarters verifying this phenomenon, including sources such as Money Magazine, The Wall Street Journal Report, Boston Business Reports and others.

One Boston area banker commented "I'm staying at work 'til 8 o'clock at night sending money out."

Focus on Rollovers?

The population segment most likely to be part of the crowd leaving CDs for stocks, bonds and mutual funds is the young-to-middle age group, who feel they must earn more on their savings to have a comfortable retirement, and who are in an age bracket where they can afford to take some risks.

That's the average "regular IRA" investor, in a nutshell. But there are still those out there in the population who are — and who need to be — concerned with safety. These are people in an older age bracket, people who are approaching or already into retirement, who want their nest egg exposed to limited risk, whether already in an IRA or in an employer's pension plan.

These are desirable customers for two reasons. They want less risk, and are content to trade some earnings for safety. And, they often have substantial account balances if you secure a rollover or transfer. Even if you don't offer a self-directed account option, your bank probably has a higher fixed-interest rate on deposits in the five- and six-figure range.

This rate may be sufficient to get and keep these important deposits, when it's proving more difficult to attract smaller

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deposits with your interest rates. But you have to target this market, and promote to it.

ıcus on SEPs?

The same may be said for SEPs — Simplified Employee Pensions. The deposit amounts may vary tremendously, depending on the salary level of the participant, and the degree to which his or her employer contributes to the plan. But SEP contributions can be as high as $30,000 per year, certainly a level that will earn a premium interest rate at most institutions.

Again, if you want the business, you need to market the product, and the service that backs it up at your institution.

Some Banks Clearly Aggressive in Seeking IRA Transfers

Consumer advertising ranges all the way from the polite to the vicious. We're all familiar with the hard-hitting — sometimes below-the-belt hitting — of comparative advertising, with fast food and political campaigns among the first to come to mind.

Even though rate advertising is common, bankers have mostly tended toward the polite end of the spectrum. But some are beginning to take a more aggressive approach in a very competitive marketplace.

In a recently heard radio spot for IRA ansfer contributions, "Bank A" claimed to .fer a half percentage point of interest above any competitor in its market. The spot then discussed what it describes as the accountholder's right to move their money via transfer whenever they wish, and informed listeners that bank staff would gladly show them how to complete such a transaction. This may or may not be the case. While the IRS will allow an unlimited number of transfers, the plan document used by the custodian institution may not. Some documents read ". . . at the custodian's discretion," or something similar. It may be a privilege, not a right.

This strategy will bear watching. PD

IRA Revocations Revisited: Must Earnings Be Returned?

In the January, 1992 issue of *The Pension Digest*, we discussed new rules for handling revoked IRAs. Since December 30, 1991 and the issuance of IRS Revenue Procedure 91-70, IRAs revoked or canceled in the seven-day revocation period require the reporting of both contributions and distributions. This is a departure from the prior common practice of treating the revoked IRA as if it had never existed, and doing no reporting at all. This was a loophole-tightening move by the IRS. Under prior practices, it was possible that an IRA transfer transaction, followed by a revocation, could result in a distribution that the IRS had no knowledge of, and which therefore would not be recognized as taxable.

The CWF position prior to Rev. Proc. 91-70 had been that banks *should* generate a 1099-R in cases where an IRA contribution had been made via transfer, in order to protect itself and limit any potential for liability.

Just What "Return" Is The Accountholder Entitled To?

Regulation 1.408-6 of the Internal Revenue Code states that upon revocation, the accountholder . . . "is entitled to a return of the entire amount of the consideration paid by him for the account, annuity or endowment contract without adjustment for such items as sales commissions, administrative expenses or fluctuation in market value."

Revenue Procedure 91-70 states it somewhat differently: "This revocation option permits the buyer to remove the entire contribution and close the IRA without being charged a fee for opening or closing the IRA."

How About The Payout Of Interest, Or Other Expenses?

In most revocation situations, which are typically "regular" IRAs with a maximum deposit limit of $2,000, the interest will be negligible, and usually not an issue of significance.

But what about a rollover or transfer? These could be six figure deposits, or more, which — with daily compounding — could conceivably have meaningful earnings. Is the financial institution required to pay these to a customer revoking such an IRA?

The Regulation does not clearly require it. Revenue Procedure 91-70 generally supports the Regulation, inasmuch as the words ". . . remove the entire contribution" make no specific mention of interest.

Did The IRS Anticipate A Payout Of Earnings With A Revocation?

. . . per the 1099-R instructions.

The instructions to the 1992 distribution Form 1099-R suggest that the IRS *did* anticipate this possibility, inasmuch as it states — under instructions for IRA Revocation — that "If no earnings are distributed, enter 0 in Box 2a and Code 8 in Box 7. If earnings are distributed, enter the amount of earnings in Box 2a. Such earnings could be subject to the early distribution tax under section 72(t). If they are subject to that tax, enter Code 1 in Box 7; if the earnings are not subject to that tax, enter Code 8."

Are Institutions Required By The IRS To Return Earnings?

Since the Regulation and the Rev. Proc. do not address it, how much weight must be given to the reference in the 1099-R instructions? In a discussion with the Rev. Proc.'s principal author Karen Field of the IRS' Employee Plans Technical and Actuarial Division, we learned that — once again — a conservative interpretation of the language applies.

From our conversation, it's clear that the key word in the 1992 1099-R instructions (see above) concerning the return of earnings is "If." The IRS will not require institutions to return interest upon revocation of an IRA, but is simply telling them how to report these earnings if they do.

Look To The Plan Document And Deposit Form

This pronouncement from Ms. Fields may not let every institution off the hook on the return-of-earnings issue, however. Look to your plan document, to be sure that it does not commit you to the return of earnings with a revoked IRA.

Look also to your time deposit form, which is signed by your customer. A sentence such as the one that follows (CWF Form #406) is recommended: "If this time deposit was made in conjunction with the establishment of the IRA and the seven-day revocation period has not elapsed, then my withdrawal will be subject to your penalty equal to the interest earned on the amount withdrawn."

If you do not have such language in your form, your customer may claim — with justification — that it is owed.

No 1992 Form 5498 Revocation Instructions?

Interestingly, there is no mention in the 1992 Form 5498 instructions as to procedures to be followed when an IRA is revoked. This leaves only the instructions of Revenue Procedure 91-70 for guidance. Per the Rev. Proc., a form 5498 must be generated for regular, spousal and rollover IRA contributions. Transfers do not require completing a 5498, since the amount was already reported as a contribution by the institution from which it was transferred.

(For further discussion of the responsibilities of a financial institution and/or accountholder upon revocation of an IRA, refer to the January, 1992 issue of *The Pension Digest*.) PD