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Can "Abandoned" IRAs Escheat to State Ownership? ...implications for banks, accountholders.

When issues of IRA ownership arise, they typically involve such things as marital property settlements, beneficiary considerations, or possibly the death of an intestate accountholder.

But within the framework of state property laws, it's also possible to have a situation in which there may be no accountholder or beneficiary interest to be considered in the disposition of IRA funds. There may be no accountholder.

For a variety of reasons, both personal property and financial assets are sometimes abandoned. If not intentionally, then overlooked or forgotten, and eventually presumed abandoned because their owner cannot be found. Such abandoned property may eventually come under the rules of the process known as "escheat," wherein property presumed to be abandoned becomes the property of a state government.

Though it would not be a common occurrence, could an IRA — regulated as it is by federal law under the Internal Revenue Code — become the property of a state government? And if so, must federal taxes be paid by the state in lieu of the former accountholder, who would have been potentially liable for federal taxes had these funds been distributed? How would such an escheat be reported? Could an escheated IRA later be reclaimed?

These and related questions prompted *The Pension Digest* to contact the IRS, and to review the uniform unclaimed property codes that have been adopted in some 38 states, the District of Columbia and the Virgin Islands. These slightly differing state statutes are based either on the 1954 or 1966 versions of the Uniform Disposition of Unclaimed Property Act, or the 1981 Uniform Unclaimed Property Act. The object of our contacts was to enable us to inform our financial

institution customers as to how the procedure works, and its potential — if rare — implications for the disposition of IRAs.

One State Example

The State of Minnesota is a fairly typical example. It was an adopter of the original Act, and has several times revised its statutes, most recently in 1981. In Minnesota as in many states, statute revisions gradually have decreased the period of time required to declare abandonment and enable escheat to take place. The 1969 Minnesota statute specified 20 years. The 1977 statute revised this downward to seven years, and in 1981 it was reduced to five. In Iowa, a 1984 act revised the period downward from 10 to 5 years.

Among its provisions — summarized and greatly abbreviated from section 345.32 of Minnesota statutes — is the following information relating to accounts held in financial institutions. Most of the adopting states have very similar provisions.

Presumption Of Abandonment —

Simply put, if within a five year period certain contacts or transactions do not take place between the owner of any "demand, savings or matured time deposit..." and the financial organization where it is on deposit, a presumption of abandonment may be made.

Some of the contacts or transactions that preclude abandonment, or prove ownership or interest in, include:

- * increase or decrease of deposit, or crediting of interest in a customer's passbook
- * correspondence in writing related to the deposit

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IRA Compliance Remains Hot Topic

As providers of a wide range of pension products and services to the financial industry, Collin W. Fritz and Associates has a good vantage point from which to gauge institutions' major concerns about IRAs, SEPs and Qualified Plans.

Based on recent inquiries at our compliance seminars, and from questions fielded by our customer service department, IRA compliance continues to be a hot topic. Financial institutions are beginning to understand and appreciate the degree of liability they're exposed to if plan administration is not handled properly.

The extent of the exposure is rarely comprehended until such account files are audited. The IRS usually gives advance warning of a planned audit of IRA files. But not always. Sometimes they arrive unannounced. In either case, it's important to have your records and procedures in order. Recent reports

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Your Customers Can Now Obtain An EIN By Phone

If you have business customers who are in need of an EIN (Employer Identification Number) for federal reporting purposes for their business or prototype plan filings, you can advise them of an IRS service that allows obtaining an EIN by telephone, rather than the long process of a written application.

EIN assignment is immediate, and the employer/taxpayer can begin using the number immediately. The employer must still, however, complete Form SS-4 and submit it to the IRS Service Center with which the business will be associated via computer. These centers include:

Andover, MA	(508) 474-9717
Atlanta, GA	(404) 455-2360
Austin, TX	(512) 464-7843
Brookhaven, NY	(516) 447-4955
Cincinnati, OH	(606) 292-5476
or	(606) 292-5472
Fresno, CA	(209) 456-5900
Kansas City, MO	(816) 926-5999
Memphis, TN	(901) 365-5970
Ogden, UT	(801) 625-7645
Philadelphia, PA	(215) 961-3980

Who Can Apply By Phone?

While a taxpayer's representative may generally apply for an EIN by mail, IRS rules limit those who may apply by phone. They include:

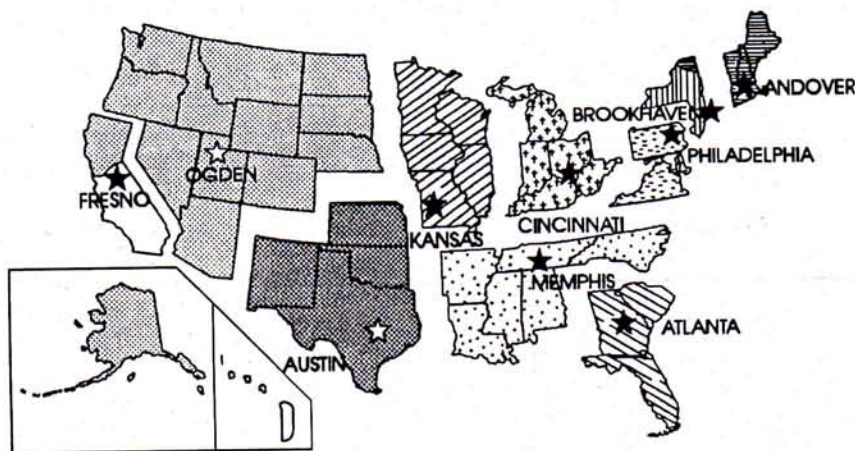
- An individual owner,
- A president, vice president or other principal officer of a corporation or non-profit organization,
- A partner or officer of a partnership,
- A fiduciary, executor or authorized agent of a trust or estate, and
- A taxpayer representative with Form 2848, Power of Attorney and Declaration of Representative, for Form SS-4 only.

1099-R Late Filing Penalty Higher Than Reported

In the November, 1991 issue of *The Pension Digest*, our article discussing IRA reporting stated that the penalty for failure to provide IRA accountholders with the Form 1099-R and Form 5498 in a timely fashion was \$50.00 per infraction, unless reasonable cause can be shown.

This is true for the Form 5498, but not the Form 1099-R, which has a penalty of \$25 per day, with a maximum of \$15,000 per year. There is no maximum to the Form 5498 penalty for late filing. We regret the error. *PD*

Employer ID #s ...



Who applies where?

Here's How To Prepare And Apply By Phone ...

- Do complete a Form SS-4 prior to calling,
- Do call an IRS Service Center,
- Do call only for issuance of an EIN,
- Don't wait until a payment or a return is due before obtaining an EIN,
- Don't utilize the Tele-TIN number for other than securing an EIN.

Here's What Will Happen When You Call ...

Upon calling, an IRS operator will issue a number and instruct you where to mail or fax the completed Form SS-4 and/or Form 2848, if applicable.

The Form SS-4 must be signed by:

1. The individual, if the entity is an individual;
2. The president, vice-president, or other principal officer, if the entity is a corporation;
3. A responsible and duly authorized member or officer having knowledge of its affairs, if the entity is a partnership or other unincorporated organization; or,
4. The fiduciary trustee or administrator, if the entity is a trust or estate. *PD*



Institutions Reminded of Form 5498 Reporting Deadline

Financial institutions are most likely well into the throes of processing and mailing IRS information Form 5498, which must be provided to both IRA accountholders, beneficiaries and the IRS. Whether by oversight or by design, the due dates to IRS vs. accountholder differ this year.

The IRS must be furnished the 5498 by June 1 for every person for whom a financial institution maintained an IRA or a SEP (which uses an IRA plan agreement) during 1991. But 5498s sent to accountholders must be furnished by May 31. Note that if a statement of an IRA's fair market value (FMV) was furnished to the accountholder by January 31, 1992, and there were no contributions made for 1991 — including carryback contributions between January 1 and April 15, 1992 — no 5498 need be furnished the accountholder. *PD*

* indication of an interest via customer memorandum

* received (mailed by bank and not returned) tax reports or regular statements

* the same customer having made similar contact regarding another account at the same institution

* claim made on funds or property stored in a safe deposit box

According to statute, if actions such as the foregoing do not occur and efforts to contact the owner fail, abandonment of the property is presumed, and the process of escheat may begin, wherein the asset(s) becomes the property of the state. In Minnesota, administration of this process is done by the office of the Commissioner of Commerce.

This does not mean that such escheated property cannot be reclaimed. But the process very likely will vary by state.

The Process Of Escheat

... Annual Report

In states governed by the uniform abandoned property acts, the escheat process begins with an annual report that is required of every person or entity holding funds or property that may be presumed to be abandoned. In Minnesota for example, this report is to be filed on or before November 1 each year, covering property deemed abandoned as of the prior June 30th, and is made to the Commissioner. Such information as name and last known address, identifying number (account number), date when property became payable — if applicable, etc., are to be included. A holder of property — in this case a financial institution — who willfully fails to report or deliver abandoned property may be subject to civil penalties.

...Notice & Publication Of Lists

In Minnesota, before such property passes to the State, a list describing it (covering all property valued above \$25) must be published on or before April 1 of each year, at least once but not more than twice, in an English language newspaper of general circulation in the county where the owner's last known address is located. The listing must be entitled "Notice of names of persons appearing to be owners of abandoned property." The notice lists and describes the items of property, and gives a time frame (65 days) within which the owner must give proof of claim to the property to prevent its being placed in the custody of the Commissioner.

... Payment Or Delivery Of Abandoned Property

Twenty days from the deadline specified in the statute for the claiming of such property, it is to be delivered to the Commissioner, except if the owner has established their right (to the satisfaction of the property holder), or if for some other reason it appears that the presumption of abandonment is erroneous.

How Does The IRS View This Escheat Procedure?

Mr. Larry Heben of the Internal Revenue Service divisional office in Washington, D.C. provided some answers as to how the Service views such state escheat procedures.

According to Heben, before action is taken that would be to the detriment of an IRA accountholder — which escheating of their account to the state would certainly be — there would have to be more due diligence than simply sending a notice to a "last known address" and finding it undeliverable. The proper state departmental unit should contact the IRS or the SSA (or perhaps their state revenue or taxation department, Heben suggested) for additional information on this person, and to learn whether there had been contact with that person.

Are Abandoned IRAs Escheated As Soon As They're Eligible?

This may vary by state. Alabama, for instance, does not seek to claim IRAs by escheat immediately. Their Unclaimed Property Section indicates that they DO NOT want IRA funds until just prior to the time the (unfound) accountholder would have turned 70-1/2. The reason given is that interest will continue to be earned by the IRA account if it remains in the possession of the financial institution, whereas it would earn no interest once escheated.

Whether this position is taken in anticipation of a possible later claim by the accountholder or an heir, and/or the view that an IRA presents special compliance concerns and should not be tampered with before this time, was not specified.

How Should An Institution Report An Escheated IRA?

Mr. Heben indicated that a financial institution would have to generate a 1099-R, listing the state as distributee. Further, he recommended that a notation be made that it was a distribution to the state under its escheat statutes, in the name of the unfound accountholder.

The institution should further send a 1099-R to the last known address of the accountholder as an indication of due diligence, in his opinion.

Can The Federal Government Tax The Escheat "Distribution"?

No, according to Heben, because the federal government does not tax the states.

How Would An Escheated IRA Be Reclaimed?

Though it may happen in only a minority of cases, abandoned escheated property IS sometimes reclaimed at a later time by its owner. This could conceivably happen to an IRA. How would it be done? Heben noted the likelihood that an accountholder would first probably approach their bank, which should have records on the escheat transaction. Once the escheat transaction was confirmed, the accountholder would make a claim to the appropriate state department.

How Would Such A Distribution Be Treated, Taxed?

Would the date of distribution be the date of escheat to the state, or the date when the "found" accountholder reclaimed the IRA? In Heben's opinion, it would be the latter.

But more ominously, he believes that such a return of funds from the state would constitute "a distribution of non-qualified money," and would not qualify for rollover treatment. Heben noted that there is nothing in writing on this subject, and it is not an IRS divisional position, but it is his interpretation of the governing regulations.

If the accountholder were over 59-1/2, this would only present the problem of being taxed on a lump sum IRA distribution. But if the accountholder were under 59-1/2, it could result in both a 10% premature distribution tax, and lump sum taxation in the year of distribution.

Heben acknowledged that if the IRS were approached and asked to make a ruling on such a set of facts, it might rule otherwise. But under the regulations as written, this would seem to be the expected result.

Summary

While escheat is a common occurrence, escheat of an IRA is not. Still, it's enlightening to know how such a situation might be handled according to state statute and IRS guidelines, and the consequences if such funds were later reclaimed. **B**

suggest stepped-up pension plan audits, so it may be well worth your while to take steps now to be ready.

What Happens In An IRS Audit?

1. An IRS auditor will want to meet with those who open IRAs, to find out just what is communicated to IRA prospects, and whether it is accurate in describing both the account, and the rights and responsibilities of the accountholder.

2. The IRA plan agreement and disclosure statement will be reviewed to be sure their provisions are current and in compliance. The auditor will look for evidence that plan documents have been amended to comply with law changes, and that customers have actually **received** copies of these amendments.

3. The institution's revocation procedures will be scrutinized, to make sure that customers are properly informed of their right to revoke an IRA. Now that the reporting of both contributions to, and distributions from, revoked IRAs is required, this will be a key focus of the examination.

4. Financial projections of anticipated IRA earnings, and disclosure of how the institution's fees and penalties might impact IRA values, are critically important. If these are not retained in customer files, your staff may have to demonstrate for the IRS examiner how they handle disclosures.

5. A review of customer files will also be made to see if adequate records are being kept to be able to handle IRS and customer reporting properly.

6. Close scrutiny of owners', directors' and officers' IRAs is almost certain to take place.

How To Be Prepared For An Audit ...

Here are some IRA administration procedures that should be followed on an ongoing basis, to give you some assurance of being able to weather an IRS audit successfully.

1. Complete the plan agreement **when** the IRA is opened, not later. Make sure the plan is kept up-to-date, and keep a copy of the plan in the customer's file.

2. Be sure the customer has a copy of the written disclosure statement (including institution penalties and fees). Not only must it be up-to-date, but also effectively explain the customer's right of revocation.

3. The financial disclosure (earnings projections) should be given to the accountholder, and kept in the customer's file at your institution.

4. Contributions should be documented with a contribution form. This information will be used to prepare the December 31 customer statement, and Form 5498. After generating, copies of these forms should be retained in the customer file.

5. Document distributions with a proper distribution form. This information is kept on file, and will be used to generate a Form 1099-R, a copy of which is also retained. Federal withholding regulations **must** be adhered to.

6. Transfers should only be executed using a proper transfer form. Before IRA funds are transferred *out* of your institution, be sure you have received such a form from the new custodian institution.

7. Don't accept a rollover contribution unless the customer has signed a rollover certification form, by which he or she takes responsibility for the validity of such a rollover.

8. For 70-1/2 accountholders, be sure you have — and keep — a copy of their elections (choices) for calculating their Required Minimum Distributions (RMDs).

9. IRA beneficiaries must also make elections on how they will have funds distributed to them from an inherited IRA. Always use a valid beneficiary election form.

10. Plan Amendment copies should be kept in each customer's file, or — at a minimum — in a master file with a list of all accountholders who received such an amendment.

11. Both the customer and the institution's customer file should contain a copy of the investment instrument(s) in which the IRA contribution(s) are invested.

12. Have a tickler file or timetable/calendar system to ensure that all proper reporting to customers and to the IRS is done, on-time and correctly.

Consider Conducting An Independent Audit

An IRS audit is no way to find out whether your institution has been doing its retirement plan administration and recordkeeping properly. If uncorrected errors or inadequate procedures are found, it may mean fines much higher than the cost of an independent audit.

If you have doubts, consider using the services of an independent retirement plan auditing firm, such as Collin W. Fritz and Associates, or one of several other firms that provide this service.

Now is an excellent time to conduct such a procedure. The rush and stress of

✓✓ Check It Out

Question: Our customer, age 53, has just terminated her senior management position with BCI, Inc. She has rolled over her pension distributions of \$185,546.26 and she wishes to set up a substantially equal payment schedule. How much would she receive under the three methods?

✓ **Answer:** The payment amount under the 70-1/2 method is \$5,928.00 for the first year. This amount will change in future years. The payment amount under the amortization method is \$13,907.61 if the reasonable earnings rate is 6.4% and \$15,416.39 if the reasonable earnings rate is 7.4%. The annual amount to be paid does not change under the amortization method once the elections are set. The payment amount under the annuity factor method is \$16,124.92 if the reasonable earnings rate is 6.4% and \$17,710.71 if the reasonable earnings rate is 7.4%. The annual amount to be paid also does not change under the annuity factor method once the elections are set. CWF's MINCAL or PRECAL software will perform these calculations. **PD**

The Pension Digest invites your questions and comments. Please address to "Check It Out," Collin W. Fritz & Associates, Ltd., P.O. Box 426, Brainerd, MN 56401.

Pension Conference Reminder ... CWF Conference Held at Two Sites in '92

June 28 - July 1, Okoboji, Iowa
August 9 - 12, Brainerd, Minnesota

Financial institutions wanting to give staff or management personnel a thorough indoctrination in a variety of key pension topics are reminded of the upcoming three-day pension conferences in both Iowa and Minnesota. Both are being held at exceptional resort conference centers, offering not only excellent learning facilities, but great recreational amenities for off-duty hours.

For a full and detailed agenda of conference topics, as well as information on costs and lodging options, contact CWF at 1-800-346-3961.

the pre-tax deadline period is over, and it makes sense to analyze the correctness of your procedures now, before beginning another year's administration of IRA accounts.

We would be happy to answer any audit questions you may have, on a strictly no-strings-attached basis. Just call us at 1-800-346-3961. **PD**