

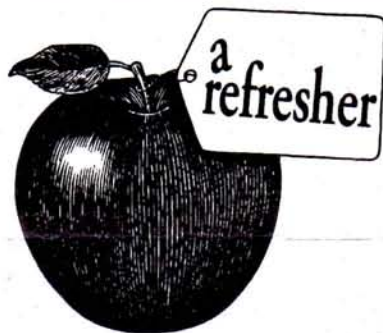


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IRA Reporting Requirements for IRA Decedents and IRA Beneficiaries

Paul Scarry and Ela Doyle visit your financial institution today. They inform you that their mother, Maura Scarry, died on November 17, 1995. They brought with them a certified copy of her death certificate and the "January IRA statement" which you had mailed to Maura's address on January 15, 1996. This statement showed the fair market value of her IRA as of December 31, 1995, to be \$89,780.50. Maura had taken a nonperiodic distribution of \$700 on September 10, 1995. Maura had established her IRA with your institution in March of 1977. Maura was born on February 17, 1927, and she was 68 when she died. Paul and Ela understood that their mother had designated the two of them to be her beneficiaries and that each was to receive 50% of her account. They were correct.

The purpose of this article is to discuss the governmental and customer reporting which the IRA custodian is required to do with respect to the IRA decedent (Maura) and the IRA beneficiaries (Paul and Ela) for 1995 and subsequent years. The required reporting, of course, is the preparation of the fair market value "January statement," Form 5498 and Form 1099-R. Whatever data processing system your institution uses, it must permit the preparation of this statement and the two reporting forms in the correct fashion.

Paul and Ela have come to your institution today well prepared. Both know that the law requires that distributions of a certain minimum amount be paid to them because this is an "inherited IRA." Paul informs you that he elects to use the five-year rule to withdraw his share. He wishes to withdraw \$10,000 on March 4, 1996, and he then would like to receive approximately four equal payments on each

March 4 commencing March 4, 1997. Ela has informed you that she will be using the life-distribution rule to withdraw her share. Ela was born on April 4, 1957.

The value as of the date of death was \$89,067.95. The value of the IRA today, February 29, 1996, is \$89,880.28.

What Reporting Must be Done With Respect to Maura?

1. The 1995 Form 1099-R and Subsequent Year 1099-Rs. You need to prepare the 1995 Form 1099-R using her name, address and social security number as she was paid \$700 from her IRA prior to her death. You will never again prepare a Form 1099-R using her name, address or social security number because subsequent distributions will be made to her children. A Form 1099-R is always issued to the person who received the distribution.

2. The December 31, 1995, Fair Market Value Statement and Subsequent Year Statements. The 1995 statement was prepared using the name, social security number and address of Maura and the fair market value as of December 31, 1995, because you had no knowledge of her death on January 15, 1996, when you prepared the statements. The IRS does not require an IRA custodian to issue a corrected statement unless one would be requested by the personal representative. The IRA custodian could elect to do this voluntarily. This is the last statement which your institution will be required to prepare. This statement may be needed so that the decedent's final income tax return may be prepared or possibly for estate tax purposes. The fair market value information will be needed if the decedent received a distribution prior to death and

if the decedent had ever made a nondeductible contribution. Maura had never made a nondeductible contribution so her personal representative will not need to know the actual value as of the date of death.

3. The 1995 Form 5498 and Subsequent Year 5498s. Because the due date for the 1995 form is May 31, 1996, you are required to prepare the 1995 form using Maura's name, address and social security number, and you will need to complete box 4 with either the fair market value as of the date of death or by inserting a zero. Most IRA custodians will complete box 4 with zero and then furnish the notice that the personal representative may request the actual date-of-death value if it is needed. A minority of IRA custodians choose to furnish the actual date-of-death value.

As with the 1995 statement, the 1995 Form 5498 for Maura is to be the final

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Form 5498 which your institution shall prepare using her name, address, etc.

What Reporting Must be Done With Respect to Paul?

As various reporting forms are discussed below, the critical fact to remember is that Paul now "owns" an inherited IRA. Special distribution rules apply to inherited IRAs.

1. The 1995 Form 1099-R and Subsequent Year Form 1099-Rs. Your institution will not prepare a 1995 Form 1099-R for Paul because he did not withdraw any funds from the IRA in 1995. Your institution will prepare a 1996 Form 1099-R for Paul using his name, address and social security number because he was paid \$10,000 from his "inherited IRA." Your institution will also prepare a 1997 Form 1099-R, 1998 Form 1099-R, 1999 Form 1099-R and a 2000 Form 1099-R for the subsequent distributions. The reason code for a distribution from an inherited account is always "4" (death). Since Paul had indicated he wanted four equal payments, and since you have given him a fixed interest rate of 6.5%, the amount he will be paid each installment in 1997-2000 will be approximately \$8,862.50.

Note that the creation of the inherited IRA on the data processing system should not have the result that a 1996 Form 1099-R is prepared in either Maura's name or Paul's name. That is, when the funds are moved from Maura's account to Paul's inherited account in 1996, this transaction must be treated as a nonreportable transfer and not as a reportable distribution.

2. The 1995 Fair Market Value Statement and Subsequent Year Statements. Your institution did not prepare a 1995 statement for Paul using the inherited title because you had not known about Maura's death at the time the statements were prepared. Your institution is not required by any IRS rule to issue a statement to Paul reflecting the December 31, 1995 value of his inherited IRA unless he would request one. Because this is an inherited IRA, the statement would be titled, "Paul Scarry as the IRA Beneficiary of Maura Scarry." Paul's address and social security number are to be used. The fair market value of Paul's inherited IRA as of December 31, 1995, is \$44,890.25 (50%). Your institution will be required to prepare a 1996 statement, a 1997 statement, a 1998 statement, and a 1999 statement reflecting the respective fair market values as of December 31. You will not need to prepare one for 2000 because the balance in the account as of December 31, 2000, will be zero.

3. The 1995 Form 5498 and Subsequent Year Form 5498s. You will be required to prepare a 1995 Form 5498 for Paul using the inherited title, his address, his social secu-

rity number and the fair market value of \$44,890.25, because you have knowledge that Maura died before the deadline for furnishing this form. The title of this account for reporting purposes should be, "Paul Scarry as the IRA Beneficiary of Maura Scarry." The deadline is May 31, 1996. You must report "his share" of Maura's IRA as of December 31, 1995. This would be true even if Paul had not yet decided the method he would use to take his required minimum distributions. As long as a balance remains within this IRA as of any December 31, you will be required to prepare a Form 5498 for it. Because Paul has instructed you that he will take this final distribution on March 4, 2000, you will prepare the 1995-1999 Form 5498s, but you will not need to prepare the 2000 Form 5498 because there will be no fair market value as of December 31, 2000.

What Reporting Must be Done With Respect to Ela?

Ela now "owns" her inherited IRA. The reporting which you must do for her will be very similar to that which is needed for Paul. The primary difference will arise because Ela wishes to use the life-distribution rule to satisfy the required minimum distribution rules whereas Paul chose the five-year rule.

1. The 1995 Form 1099-R and Subsequent Year Form 1099-Rs. The election of the life-distribution rule requires that Ela commence a distribution schedule over her life expectancy commencing not later than December 31 of the year after the year during which Maura died. December 31, 1996, is her deadline. She had the option of commencing distribution in 1995, but she either was not aware of her choice to commence distribution in 1995, or she chose not to commence distribution in 1995. You will not prepare a 1995 Form 1099-R for her because there was no distribution to her in 1995. You will need to prepare a 1996 Form 1099-R and one for every subsequent year during which she is paid a distribution. As with every distribution from an inherited IRA, the reason code will be Code "4" (death). This minimum amount which she is required to be paid in 1996 is \$1,032.99, which is the balance of \$44,890.25 (December 31, 1995) divided by the life expectancy factor of 43.5. The factor is determined by determining Ela's age in 1996 and then looking to the applicable life expectancy table (single) to determine what factor relates to that age. Ela is age 39.

2. The 1995 Fair Market Value Statement and Subsequent Year Statements. As with Paul, you will not need to prepare a 1995 statement for "Ela as the IRA beneficiary of Maura" unless she would request it, since you had no knowledge of Maura's death until after January 31, 1996. Her value of 50% was \$44,890.25. You will

be required to prepare a statement for each year in which there is a fair market value as of December 31. This could be for very many years as Ela has elected to use the life-distribution rule.

3. The 1995 Form 5498 and Subsequent Year Form 5498s. As with Paul, you will need to prepare a 1995 Form 5498 showing the value of \$44,890.25, because you had knowledge of Maura's death prior to the reporting deadline of May 31, 1996. You will be required to prepare a Form 5498 for each year in which there is a fair market value as of December 31.

An IRA custodian has special IRS reporting duties with respect to inherited IRAs. An administrative system needs to be established to make sure the Form 1099-R, January statement and Form 5498 are being prepared as required. The above example illustrates the reporting duties when the IRA owner had designated a nonspouse beneficiary or beneficiaries.

Example Illustrating the Reporting Duties When the IRA Owner Designates His or Her Spouse as the Sole Beneficiary

In this hypothetical, Carlos Scarry, Maura's husband, is the sole beneficiary of Maura Scarry, rather than Ela and Paul. He walks into your institution on February 29, 1996, and informs you that Maura died on November 17, 1995. He furnishes you with her death certificate. He informs you that he is electing to treat her IRA as his own. He also informs you that he wishes to withdraw \$6,000 today. Carlos' date of birth is May 15, 1929. What governmental and customer reporting must your institution, as the IRA custodian, prepare with respect to Maura and Carlos?

What Reporting Must be Done With Respect to Maura?

The same reporting as discussed above must be completed and for the same reasons.

What Reporting Must be Done With Respect to Carlos?

Note that Carlos did not elect to treat Maura's IRA as his own in 1995. Thus, for 1995 reporting and administrative purposes, this IRA is an inherited IRA. It will have the title, "Carlos Scarry as the IRA Beneficiary of Maura Scarry." The movement of the funds into this inherited IRA should not be reported as a rollover contribution. The funds were transferred in.

1. The 1995 Form 1099-R and Subsequent Year Form 1099-Rs. A 1995 Form 1099-R should not be issued to Carlos because there was no distribution to him. A 1996 Form 1099-R must be issued to Carlos Scarry since he has asked to be paid \$6,000 in 1996. A Form 1099-R

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will not be prepared because he has instructed you that he wishes to treat Maura's IRA as his own. The movement of the funds from Maura's account, or the inherited account (Carlos Scarry as the IRA Beneficiary of Maura Scarry) to Carlos' own IRA is a nonreportable transfer.

The reason code with respect to the payment of \$6,000 will either be "4" (death) or "7" (normal). Which code is the proper code depends upon whether he elected to treat the entire account as his own and then he took a distribution of \$6,000, or whether he first took the distribution of \$6,000 from the inherited IRA and then elected to treat the remainder as his own. Most IRA spousal beneficiaries and IRA custodians will find it simplest, from an administrative viewpoint, to elect to treat the entire account as his own, and then take the distribution from his own IRA.

2. The 1995 January Statement and Subsequent Year Statement. Again, the IRA custodian is not required to prepare and furnish Carlos with a 1995 statement for the inherited IRA unless he would request one, since the deadline for furnishing the statement has passed. Since he has elected to treat her IRA as his own in 1996, each and every statement commencing with the 1996 statement will be generated in his name and social security number, and not as an inherited IRA.

3. The 1995 Form 5498 and Subsequent Year Form 5498s. You, as the IRA custodian, will be required to prepare a 1995 Form 5498 for the inherited IRA as "Carlos Scarry as the IRA Beneficiary of Maura Scarry." The fair market value to be reported for 1995 is \$89,780.50. The 1996 Form 5498 and subsequent years' 5498s will need to be prepared using his name. That is, the IRA is no longer an inherited IRA once he has elected to treat it as his own.

Conclusion

When an IRA accountholder dies, there is an obvious change in the relationship. In essence, an IRA custodian enters into a new relationship with the inheriting IRA beneficiaries and ends a relationship with the IRA accountholder who died. The IRA custodian needs to report certain information to the IRS with respect to the decedent and with respect to the beneficiaries. The IRA custodian has the task of preparing a final statement, final Form 5498 and a final Form 1099-R, if applicable, using the name of the deceased IRA accountholder. The IRA custodian will now treat the beneficiary(ies) as its customers and will be required to prepare a statement, Form 5498 and Form 1099-R, as applicable, for each beneficiary, reflecting that particular beneficiary's distribution or fair market value. **BD**

Responding to Requests for Transfers or Direct Rollovers From a Conduit IRA to a 401(k) or Other QP or Section 403(b) Annuity/Account

By definition, a transfer may only occur if the remitting plan and the receiving plan are identical (e.g. IRA to IRA, QP to QP or 403(b) to 403(b)). Therefore, the movement of funds from an IRA to a QP can never be a transfer.

By definition, a direct rollover occurs only if the remitting plan is a section 401(a) qualified plan or a section 403(b) annuity/account. That is, a direct rollover does not occur when the money or assets are coming out of an IRA.

If the movement of funds from an IRA to a QP or a section 403(b) annuity/account cannot be a transfer or a direct rollover, what is it?

It can be a rollover from a conduit IRA. A rollover occurs when funds are paid from a certain type of plan to a person who redeposits them within 60 days to a qualifying type of plan.

You, as the IRA custodian, will report this distribution as you would any other distribution. As stated above, this transaction is not a transfer, and therefore the IRA custodian will need to prepare a Form 1099-R. This transaction is also not a direct rollover, and therefore Codes "G" and "H" are not to be used. The proper reason code will either be "1" - premature, no known exception - or "7" - post 59 1/2. These are the codes to be used regardless if the recipient rolls over the distribution to another IRA, a QP or a section 403(b). This person will need to complete lines 15(a), gross amount, and line 15(b), taxable amount, and explain that the amount distributed is not taxable because he or she rolled the funds over.

What concerns many people who receive an IRA distribution and then wish to roll it over to a 401(k), is that the 401(k) does not prepare an individual report on behalf of this person informing the IRS that this person made a rollover. In a nice way, tell this person that all he or she needs to do to satisfy the IRS is to attach a copy of the acknowledgment form which states that a rollover contribution was made. The QP administrator surely furnished this form to the individual to aid in the preparation of his/her 1040 tax return. That is, the QP administrator should have given this person a "receipt" when he or she accepted the funds.

An IRA custodian may consider the use of the enclosed special form (CWF's Form #69). Its purpose is self-evident. **BD**

March 1 or April 15???

When is the deadline for a farmer to make his or her IRA, SEP or QP contribution? Is it March 1, or is it April 15?

The deadline is April 15. Most people do not ask this question with respect to IRAs. Most people ask this question with respect to SEP and QP contributions.

The IRS has expressly stated that a person may file his or her tax return and claim the IRA deduction not yet made as long as such contribution is made before the April 15 deadline. This rule applies to QP and SEP contributions also.

The federal income tax laws provide two special types of penalty taxes relating to filing an income tax return late and paying the amount owing late.

A farmer who files his or her return on or before April 15, plus extensions, will not be subject to the late filing or late payment penalty taxes. April 15 is the filing deadline for a farmer.

Many farmers file their tax returns on or before March 1 in order to take advantage of a special exception to the estimated tax payment rules. Most taxpayers are required to file and pay quarterly estimated tax payments throughout the year. Penalties are assessed when a taxpayer fails to timely pay the amounts required. Farmers are permitted to not make these quarterly payments if they file their return on or before March 1 and pay any tax which is owing.

A farmer who fails to file his or her tax return by March 1 will owe the penalties associated with not complying with the estimated tax payment rules, if any, but he or she will not owe the penalty taxes associated with filing and paying the taxes owing late.

Although a farmer chooses to file his or her return by March 1 to take advantage of the special estimated tax payment rules, his or her deadline for filing their tax return and making his or her SEP or QP contribution is still April 15. **BD**

IRS Issues 1995 Publication 590

Generally the IRS made only minor changes to the 68 pages comprising the 1995 Publication 590. The IRS did add some statements discussing the RMD rules. These "new" statements discuss important rules which an IRA owner must consider in making decisions about his or her IRA.

The IRS did, of course, change the examples which had used the year 1994 to now use 1995. The following is a listing of the changes.

1. On page 2: Added a paragraph describing that now many forms and publications may be obtained from a personal computer via modem.

2. On page 3: Revised the paragraph describing the rule which governs the right to revoke a new IRA.

3. On page 8: Made clear that contributions for 1995 must be made by April 15, 1996.

4. On page 9: Revised the discussion of modified AGI which is used to determine what portion of an IRA contribution is deductible/nondeductible. If the individual files the 1995 Form 1040, the modified AGI is the amount on line 31, figured without taking into account any IRA deduction or any foreign earned income exclusion and foreign housing exclusion (deduction) or any series EE bond interest exclusion from Form 8815.

5. On page 14: Moved the illustration to the top of the page.

6. On page 19: Deleted two paragraphs that dealt with withholding. These paragraphs repeated statements already made.

7. On page 22: The following paragraph at the bottom of the right side was added.

"After age 59 1/2 and before age 70 1/2. Generally, you can withdraw assets from your IRA after you reach age 59 1/2 without penalty. However, if you withdraw more than \$150,000 in a year, you may have to pay a 15% excise tax on the amount that exceeds \$150,000. See Excess Distributions in chapter 7. Even though you can, you do not have to withdraw assets from your IRA until you reach age 70 1/2. See Required Distributions later in this chapter."

8. On page 23: Added the following sentence in the first paragraph discussing required distributions:

"If you do not, or if you withdraw an amount that is less than the required minimum distribution for a year, you may have to pay a 50%

excise tax on the amount not withdrawn as required."

9. On page 24: Added the following two paragraphs. The IRS obviously believed that they needed to give a better explanation of what happens when an IRA owner subject to the RMD rules changes his or her beneficiary.

"Changing the designated beneficiary. You can change your designated beneficiary before or after the required beginning date (defined later). If, after the distribution period has been determined, you name a new beneficiary with a shorter life expectancy than the individual you are replacing, you must refigure the period over which you must make withdrawals for subsequent years using the life expectancy of the new designated beneficiary. The new period that would have been the remaining joint life and last survivor expectancy of you and the new designated beneficiary if that beneficiary had been designated on the required beginning date. See, Determining Life Expectancy, later. If the new designated beneficiary has a longer life expectancy than the individual you are replacing, you cannot recalculate the period over which you must make withdrawals, except as provided under refiguring life expectancy later.

"Generally, if you name a trust to replace your designated beneficiary after the required beginning date, you must refigure the period over which you must make withdrawals for subsequent years using only your remaining life expectancy."

10. On page 26: The following paragraph was added at the very end to the topic of "Life Expectancy."

"If you die and your designated beneficiary is not your spouse. If your life expectancy is being refigured annually and you die, then only the life expectancy of the designated beneficiary is used to determine distributions for the years after the year in which your death occurs."

Comment

The IRS is correct to say that only the life expectancy of the designated beneficiary is used to determine distributions for the years after the year in which the IRA owner's death occurs. There should be an additional statement that the factor to be used for the year after the year of death will be the factor based upon the age of the beneficiary in the year the account holder attained age 70 1/2 and reduced by one for each year which has elapsed since that year until the year after the year of death and then for all subsequent years.

11. On page 28: The IRS added the following note. "Note: If you are required to file Form 8606, but you are not required to file an income tax return, you still must file Form 8606. Send it to the IRS at the time and place you would otherwise file an income tax return."

12. On page 31: Revised discussion of the withholding rules which apply to IRA distributions delivered outside the United States. "To choose exemption from withholding, you must certify to the payer under penalties of perjury that you are not a U.S. citizen, a resident alien of the United States, or a tax-avoidance expatriate."

13. On page 36: The IRS clarified its example of Tom who took a premature distribution. The statement is made that Tom is 35 years old and is not disabled. The disability statement was added.

14. On page 37: Some clarifying statements were added within the topic, "Reporting Additional Taxes."

First, an IRA owner who receives an early distribution (Code 1) is not required to file the Form 5329 if that is the only penalty tax which is owed. The IRA owner is to report this penalty tax on line 51 of Form 1040. The IRS added the following sentence, "Write 'No' on the dotted line next to line 51 to indicate that you do not have to file Form 5329."

Second, the IRS added some procedural instructions for an IRA owner who does not have to file a Form 1040, but who must file the Form 5329. "Be sure to include your address on page 1 and your signature and date on page 2. Enclose, but do not attach a check or money order payable to Internal Revenue Service for the tax you owe, as shown on Form 5329. Write your social security number and '1995 Form 5329' on your check or money order." **B**

Special Reminder

April 1, 1996 is the deadline for taking the required minimum distribution for 1995 for those IRA owners who attained age 70 1/2 in 1995. **B**