THE
Pension Digest

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IRS Issues 1996 Form 5498

The IRS has added a fifth box to the 1996 Form 5498. This box is provided so that the IRA custodian will place a mark in the box if the information on this form is for a SEP, if applicable.

Otherwise the 1996 version is the same as the 1995 version. With respect to the 1996 Form 5498, the IRS has made completion of this box OPTIONAL. Apparently, the box 5 will need to be completed for the 1997 year and subsequent years.

Although the IRS has given some time to make programming changes, your programmers, or software vendor, will need to make the changes which are necessary so that this SEP box can be checked, when applicable, and also to handle the "new" rules summarized below. Keep in mind that the IRS may assess a $50 penalty for each failure to prepare a required Form 5498.

A copy of the 1996 Form 5498 is set forth below:

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 Regular IRA contributions made in 1996 and 1997 for 1996 $	OMB No. 1545-0747	**Individual Retirement Arrangement Information**
		2 Rollover IRA contributions $	**1996** Form **5498**	
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Life insurance cost included in box 1 $		**Copy A For Internal Revenue Service Center**
PARTICIPANT'S name		4 Fair market value of account $		**File with Form 1096.**
Street address (including apt. no.)		5 Check for SEP ☐		For Paperwork Reduction Act Notice and instructions for completing this form, **see Instructions for Forms 1099, 1098, 5498, and W-2G.**
City, state, and ZIP code				
Account number (optional)				

Form **5498** Cat. No. 50010C Department of the Treasury - Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

The IRS has made changes to its instructions for completing this form. Here are some excerpts from the IRS' instructions and/or our observations. Although this discussion

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What are the Chances for IRA Tax Legislation?

Very slim if the Republicans and Democrats continue with their respective political war strategies.

The irony is that both President Clinton and the Republicans have endorsed very similar proposals for changing IRAs, yet no legislation has been enacted. One of the things the electorate will be deciding indirectly in the fall elections will be to what extent IRAs will be changed.

With the political climate in Washington, one never knows. It might be that a small tax bill including IRA changes will be addressed as the Republicans and Democrats finalize the Fiscal Year 1996 Budget Reconciliation Bill. As you know, the President has furnished Congress with his proposed budget for 1997. This proposed budget contains the same IRA and other pension law changes he proposed in the spring/summer of 1995. PD

Rules Revised for a Substitute Form W-9

In February, the IRS issued Rev. Proc. 96-26. The IRS sets forth some new rules for designing a substitute Form W-9 which is used to obtain a TIN (tax identification number) and which is used to obtain the backup withholding certifications.

Some financial institutions have asked if they need to revise any of their IRA forms to comply with the new rules set forth in Rev. Proc. 96-26.

Our answer is "no."

Internal Revenue Code section 6109(a)(2) is the authority which requires a person (or business) to furnish his or her tax identification number to another person or business. It reads,

"(2) Furnishing number to other persons. Any person with respect to whom a return, statement, or other document is required under the authority of this title to be made by another person or whose identifying number is required to be shown on a return of another person shall furnish to such other person such identifying number as may be prescribed for securing his proper identification."

Internal Revenue Code section 3406 sets forth the backup withholding rules. In general, a payee is required under this section to certify that its TIN is correct and that it is not subject to backup withholding.

The purpose of the Form W-9 is — a person can use it to furnish his or her correct

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Also in this issue –

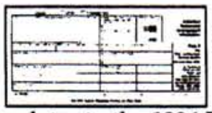
Two Court Cases on Anti-Alienation Issues

The first case is United States of America v. Ali H. Sawaf, et al (CA-6, 1-26-96). The decision in this case should not come as a surprise to anyone. A person who was a participant of a qualified plan had not paid his tax assessments. The IRS had sent a writ of garnishment to a bank. This bank acted as trustee of a profit sharing plan of which the taxpayer was a participant.

The court ruled that the IRS had the authority to collect the amount it was owed. Although ERISA contains a rule that the funds of a qualified plan cannot be alienated, the court ruled that this rule did not supersede an existing IRS regulation that plainly provided that the ERISA anti-alienation rule would not prevent enforcement by the IRS. In addition, ERISA section 514(d) states that ERISA may be subject to other federal laws.

The second case is in re Wilker S. Conner, et al, (CA-9, 1-11-96). This case very clearly show that funds within a qualified plan are exempt from all creditors other than the IRS, including a bankruptcy trustee. In this case a participant had contributed her own after-tax funds to the plan. She had the right to withdraw them at any time. Even so, the bankruptcy could not reach these funds because of the ERISA rule which says that funds within a qualified plan are not subject to alienation. The ninth circuit court based its decision on the U.S. Supreme Court's decision in Shumate.

Observation: A person should want a QP plan rather than a SEP if he or she has, or may have, some concerns about the enforcement of legal judgments. The law is not settled as to whether money in a SEP can be reached by creditors. The law is settled for QP plans unless Congress chooses to amend it. ℞



Form 5498—
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relates to the 1996 Form, these instructions do set forth IRS policy and should be used to complete the 1995 Form 5498, as appropriate.

1. Since May 31, 1997, falls on a Saturday, the filing deadline is on or before June 2, 1997. The filing deadline for the 1995 Form 5498 is May 31, 1996.

2. The IRS makes clear in the instructions that a separate Form 5498 must be filed for each separate IRA plan agreement. If there are three CDs held under one plan agreement, then only one Form 5498 needs to be prepared. If a person has a regular IRA and a conduit IRA, then the IRA custodian will need to prepare two separate Form 5498s. You will want to point this change out to your software vendor or to your internal programmers since many IRA software programs aggregate all information related to the same social security number onto one Form 5498. This is no longer permissible.

3. With respect to inherited IRAs, the IRS makes the statement that "an IRA holder must be able to identify the source of each IRA he or she holds for purposes of figuring the taxation of a distribution from an IRA." Observation: This is a very important statement. The IRS is saying that an IRA custodian must prepare a separate Form 5498 for each IRA plan agreement under which he or she has inherited. For example, if a person has a regular IRA, has inherited an IRA from her father, another from her mother and one from her grandmother, then the IRA custodian will need to prepare four separate Form 5498s. Your institution will have compliance problems if your computer system would locate all accounts associated with the same social security number and then aggregates the information onto one form.

4. For all SEPs, the IRA custodian is instructed to complete box 4 (fair market value) and mark the checkbox in box 5, but do not report employer SEP contributions or employee salary reduction salary deferral contributions in box 1. Observation: If the IRA owner makes a regular or rollover contribution, the IRA custodian will be required to report the regular contribution in box 1 and the rollover in box 2. Observation: A self-employed person may have a SEP. In this case, the IRA custodian needs to determine if the person's contribution is his or her SEP contribution or his or her regular or rollover contribution.

5. The IRA custodian must report the receipt of a direct rollover in box 2 – "Rollover IRA Contributions." Note that the IRS does not distinguish between rollovers and direct rollovers on the Form 5498.

6. The IRA custodian need not furnish the IRA owner (or a beneficiary of an inherited IRA) a Form 5498 if it furnished a statement of the fair market value to this person by January 31, 1997, and if no contributions were made to the IRA for 1996. The IRS makes it very clear that this statement must contain a legend designating which information is being furnished to the IRS.

In addition, if this statement is with respect to an inherited IRA, and the IRA custodian has chosen to use the alternative method (i.e. not report in box 4 the fair market value as of the date of death), there must be a legend or notice informing the executor or administrator of the decedent's estate of his or her right to request a date-of-death valuation. If you use either the language for box 4 on the back of the official copy B, or you use the official copy B, you will have met this notice requirement.

7. Until a spouse beneficiary elects to treat a deceased spouse's IRA as his or her own, the IRA custodian is to treat the IRA in the same way it treats an inherited IRA of a nonspouse beneficiary (i.e. Brian Young as beneficiary of Joan Smith).

8. The IRS again points out the rule that a spouse who fails to take a required minimum distribution from the inherited IRA by a set deadline automatically elects to treat the inherited IRA as his or her own.

9. All contributions must be reported in box 1. If the IRA owner made an excess contribution and withdrew it, it is still reported. You are never to "net" an excess contribution.

10. If an IRA owner intentionally or unintentionally elects to leave an excess contribution within an IRA and use it as a contribution for a subsequent year, the IRA custodian is not to report this "carry-over" on the Form 5498 for the subsequent year. The IRS has adopted the position that the contribution has already been reported and should not be reported a second time. This explanation is questionable, but at least the IRS has taken a position on a policy question which had been unaddressed for a long time.

11. With respect to reporting <u>rollovers of property</u> in box 2, the instructions very clearly state that the IRA custodian is to enter the fair market value of the property as of the date you receive it, even though this value may be different from the value of the property on the date it was distributed (i.e. as it was reported on the Form 1099-R). Observation: The duty of your financial institution is to report "gross" transactions to the IRS and not necessarily prepare reports in such a way that the IRS will not need to ask the taxpayer for an explanation.

12. If the IRA is not a SEP, box 5 is to be left blank. Again, completing this box is optional for 1996. ℞

Single Recalculation – What Happens Once the IRA Owner Dies?

We have discussed this situation numerous times in past newsletters. Set forth below is the text of IRS letter ruling 9604027, November 1, 1995. The IRS' analysis is quite concise. This letter illustrates the risk of electing the recalculation method (or not electing the one-year reduction method).

This letter is in response to a request, dated June 5, 1995, for a ruling on the proper required distributions from the individual retirement accounts (IRAs) owned by the decedent.

According to the information submitted, the decedent commenced withdrawing from his IRA upon attaining age 70 1/2. The permissive recalculation rule of Section 401(a)(9)(D) of the Internal Revenue Code ("Code") was used to determine the amount to be distributed from the IRA. The decedent's estate was named as the beneficiary of the IRA, and his daughter was named the sole heir and beneficiary of his estate. The decedent died on September 18, 1994.

Section 401(a)(9) of the Code provides rules for determining required distributions from trusts and plans.

Proposed Regulation section 1.401(a)(9)-IE-8A provides guidance on recalculating life expectancies under Code section 401(a)(9)(D). It states that an employee's life expectancy is recalculated annually by redetermining the employee's life expectancy in each distribution calendar year using the employee's attained age as of the employee's birthday in that distribution calendar year. Upon the death of the employee, the recalculated life expectancy of the employee will be reduced to zero in the calendar year following the calendar year of death. In any calendar year in which the last applicable life expectancy is reduced to zero, the plan must distribute the employee's entire remaining interest prior to the last day of such year in order to satisfy section 401(a)(9) of the Code.

Section 401(a)(9)(B) of the Code provides that if distributions have begun from a trust prior to the death of a person, and upon the death of that person there are still assets in the trust, then the assets of the trust will be distributed at least as rapidly as under the method of distribution being used prior to his death.

Proposed Regulation section 1.401(a)(9)-ID provides rules for determining an individual's designated beneficiary. Proposed Regulation section 1.40(a)(9)-ID2A provides that a person who is not an individual, such as the employee's estate, may not be considered as the designated beneficiary. Proposed Regulation section 1.401(a)(9)-ID-2A also provides that if a person other than an individual is designated as a beneficiary of an employee's benefit, then the employee will be treated as having no designated beneficiary for purposes of section 401(a)(9) of the Code.

Proposed Regulation section 1.401(a)(9)-ID-3 states that the designated beneficiary will be determined as of the employee's required beginning date.

Proposed Regulation section 1.401(a)(9)-ID-5 states that if certain conditions are satisfied a trust can be designated as a beneficiary. In accordance with Proposed Regulation section 1.401(a)(9)-ID-3 the trust must be established as of the required beginning date. In the case of a testamentary trust, it is not irrevocably established until the date of death, which is after the required beginning date. Therefore, the testamentary trust does not satisfy the requirements of Proposed Regulations 1.401(a)(9)-ID-3 and 1.401(a)(9)-ID-5, and cannot be designated beneficiary.

The decedent died after starting to receive payments, using the recalculation rule, from his IRAs, without a designated beneficiary. Distributions from his IRAs must be made at least as rapidly as under the method being used prior to his death. Since he was using the recalculation rule, his life expectancy is reduced to zero in the year after his death. Therefore the entire balance of his IRAs must be distributed in 1995 which is the year after his death.

Sincerely yours, Katheryn Marticello, Chief, Actuarial Branch 2

Rev. Proc. 96-26—*Continued from page 1*

TIN and, when applicable, to make the backup withholding certifications.

Rev. Proc. 96-26 clearly states its scope as: "applies to payors that choose to obtain the required certifications by using a substitute Form W-9 incorporated into business forms the payor customarily uses." Emphasis added. An IRA custodian is not required to modify its IRA forms to comply with this Rev. Proc. because the goal of the IRA is to obtain the TIN and not to obtain the required certifications. IRAs are exempt from the backup withholding rules.

The new rules set forth in Rev. Proc. 96-26 will apply to non-IRA signature cards and other non-IRA forms. These rules do not apply to IRAs. Because this Rev. Proc. has general interest, it is set forth below.

Rev. Proc. 96-26

SECTION 1. PURPOSE

This revenue procedure clarifies the certification requirements for a substitute Form W-9, Request for Taxpayer Identification Number and Certification, and amplifies Rev. Proc. 83-89, 1983-2 C.B. 613, which provides guidelines for payors of interest, dividends, and patronage dividends and brokers that want to design and provide their own substitute Forms W-9.

SECTION 2. BACKGROUND

.01 Under §§ 6109(a)(2) and 3406(a)(1)(A) of the Internal Revenue Code, a payee of a reportable payment must provide its Taxpayer Identification Number (TIN) to a person who is required to file an information return with respect to the payment. In addition, under § 3406(a)(1)(A) the payee of a reportable interest or dividend payment generally must certify that its TIN is correct and that it is not subject to backup withholding under § 3406(a)-(1)(C) for failure to include interest and dividend income on its tax return (required certifications). Section 3406(a)(1)(A) and (D) requires the imposition of backup withholding on a reportable interest or dividend payment to a payee if the payee does not provide its TIN or make the required certifications.

.02 The Internal Revenue Service provides an official Form W-9 for a payee to provide the required certifications to the payor. A payor may use a substitute Form W-9 to obtain the TIN and the required certifications provided the certification requirements in the substitute Form W-9 comply with section 4 of Rev. Proc. 83-89. A payor may incorporate the required certifications into other business forms customarily used, such as account signature cards, provided the required certifications are clearly set forth. See section 5.01 of Rev. Proc. 83-89.

SECTION 3. SCOPE

This revenue procedure applies to payors that choose to obtain the required certifications by using a substitute W-9 incorporated into business forms the payor customarily uses, as set forth in section 2.02 of this revenue procedure.

SECTION 4. FORMAT FOR MAKING THE REQUIRED CERTIFICATIONS

.01 *Required certifications clearly set forth.* For a payor to be treated as having provided a taxpayer with a valid substitute Form W-9, the required certifications must be clearly set forth. The Service will treat the required certifications as being clearly set forth only if they meet the provisions of section 4.02 or 4.03 of this revenue procedure.

.02 *Separate signature for required certifications.* A substitute Form W-9 is valid if a separate signature line is provided just for the required certifications.

.03 *Single signature for required certifications and other provisions.* A substitute Form W-9 is valid if:

(1) a single signature line is provided for the required certifications as well as other provisions unrelated to the required certifications;

(2) the language of the required certifications is highlighted, boxed, printed in bold-face type, or presented in some other manner that distinguishes and causes the language to stand out from all other information contained on the substitute Form W-9 and

(3) the following statement is provided in the same manner prescribed in section 4.03(2) and appears immediately above the single signature line on the substitute Form W-9: "The Internal Revenue Service does not require your consent to any provisions of this document other than the certifications required to avoid backup withholding."

SECTION 5. IMPERMISSIBLE USE OF THE CERTIFICATIONS

.01 A payor may not (1) require a payee to agree to provisions included on a substitute Form W-9 other than the required certifications in order to avoid backup withholding, or (2) threaten backup withholding in order to secure a payee's acceptance of provisions included on a substitute Form W-9 that are unrelated to the required certifications.

.02 If a payor contravenes the provisions of section 5.01 of this revenue procedure, the payor may be subject to civil or criminal penalties under 31 U.S.C. § 333. That section generally prohibits the use of any words, titles,abbreviations, etc. in connection with a business solicitation or activity in a manner that could reasonably be interpreted to convey a false impression that such activity is approved, endorsed, sponsored, or authorized by the Service.

SECTION 6. EFFECT ON OTHER DOCUMENTS

This revenue procedure amplifies Rev. Proc. 83-89.

SECTION 7. EFFECTIVE DATE

Except for section 5, the provisions of this revenue procedure apply to substitute Form W-9 completed by payees after December 31, 1996. The provisions of section 5.02 of this revenue procedure apply to violations occurring after March 31, 1995, the effective date of 31 U.S.C. § 333.

DRAFTING INFORMATION

The principal author of this revenue procedure is Renay France of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Renay France on (202) 622-4910 (not a toll-free call).

Discussion of 1995 Form 5500-EZ and Schedule P

Who Uses the Form 5500-EZ?

The Form 5500-EZ can be used for a one-person retirement plan if the person sponsoring the plan meets all of the following conditions:

1. The plan is a one-participant plan. If the sponsoring business is a sole proprietorship, then the plan may cover only the owner of the business and his or her spouse. If the sponsoring business is a partnership, then the plan may cover only one or more partners (and spouses).

2. The plan meets the section 410(b) coverage rules without having to be combined with any other plan sponsored by the same sponsor.

3. The plan does not provides benefits for anyone who is not a participant.

4. The plan does not cover a business that is a member of a group of business under common control, a controlled group of corporations or an affiliated service group.

5. The plan does not cover a business which leases employees.

If all five of these conditions are not met, then the sponsoring business must file the Form 5500-C/R.

Who Does Not Need to File the Form 5500-EZ or the Form 5500-C/R?

No filing is necessary if the plan sponsor meets the five requirements listed above and if the plan sponsor had one or more plans that had total plan assets of $100,000 or less at the end of every plan year ending after January 1, 1994.

Which One-Participant Plans Must File the Form 5500-EZ?

A one-participant plan must file the Form 5500-EZ if the plan sponsor had one or more plans that had total combined plan assets of more than $100,000 at the end of any plan year ending after January 1, 1994.

A one-participant plan which is required to file the Form 5500-EZ must complete and file it for the first year which is required and then for every year thereafter. That is, it is no longer possible to file a Form 5500-EZ and then not file one for the next year.

A special rule applies to terminating plans. All one-participant plans must file a Form 5500-EZ for their final plan year even if total plan assets have always been less than $100,000. The final plan year is the year in which distribution of all plan assets is completed.

Changes in Filing Rules Summarized

For 1994 and prior years, one-participant plans that held $100,000 or less in total plan assets at the end of any plan year did not have to file the Form 5500-EZ (or any other information return) for that plan year. For 1995 and later years, one-participant plans that held more than $100,000 at the end of any plan year beginning on or after January 1, 1994, must file a Form 5500-EZ for the year the assets exceeded $100,000 and for each year thereafter, even if total plan assets were reduced to $100,000 or less at a later date. For example, if plan assets in a plan that otherwise satisfies the requirements for filing the Form 5500-EZ totaled $110,000 at the end of the 1994 plan year, and a distribution occurred in 1995 so that total plan assets were $85,000 at the end of the 1995 plan year, a Form 5500-EZ must be filed for the 1995 plan year.

Penalties for Failing to File

The IRS imposes a penalty of $25 a day (up to $15,000) for not filing this form.

Where to File

This form is filed with the IRS Service Center in Memphis, Tennessee 37501-0024.

Filing Deadline

For most people, the deadline is July 31, 1995. Technically, the deadline is the last day of the seventh month following the end of the plan year. It is possible to obtain an extension by filing Form 5558. A 2 1/2 month extension may be obtained.

Explanation

The IRS has furnished a sample and a supplemental explanation. These are set forth on the enclosure along with the Schedule P. The 1995 form is very similar to the previous years' forms. Most items on the form are self-explanatory. But here are a few comments for those "newer" items.

1. Line 4(a). The person must furnish the opinion letter number which the IRS has issued to the financial institution if the person is using an institution's prototype. This is an audit question. If the institution has an "old" prototype (i.e. one with an opinion letter before June of 1990), the IRS will be contacting the person. Remember, plans must be updated in a timely fashion by both the institution sponsoring the prototype and also by the business person. The institution must update its prototype, and the customer must timely adopt this updated prototype.

2. Line 4(b) asks if this plan covers self-employed persons, partners or a 100% owner of a corporation. The IRS wants to be able to determine to which of these categories the person belongs.

3. Line 7(a), about fully-insured plans, will not apply to most plan sponsors unless they have established the plan with an insurance company.

4. Line 7(b) and 7(c) deal with contributions. Plan contributions should be in cash. Question 7(c) is asking if there were any noncash contributions. An audit question.

5. Line 7(e) asks for the amount of those distributions which are nontaxable. Examples would be — the return of nondeductible employee contributions, and payments which qualify for the death-benefit exclusion.

6. Line 7(f) asks for the amount of transfers to other plans. The IRS means "transfers" under Code section 414(l) and not direct rollovers which are treated as distributions.

7. Line 7(g) asks for the amounts received by the plan for reasons other than the standard employer contributions. Examples are – rollover contributions, direct rollover contributions, transfers and the receipt of earnings on plan investments.

8. Line 10 asks if there are other employees. Having additional employees is not necessarily a sign the plan sponsor is doing anything wrong. The IRS might check later to see if the plan sponsor has covered this employee properly.

9. Line 11(b) asks if there were any distributions in a form other than a QJSA (qualified joint and survivor annuity). The form of payment must be a QJSA unless special waivers are executed or the plan is a profit-sharing plan which is not subject to the QJSA rules. Many people will need to answer this question "yes." Example, a person was paid a lump-sum distribution from a profit-sharing plan, a person was paid a lump-sum distribution from a money-purchase plan after receiving the spouse's waiver or a person was paid a partial distribution from a profit-sharing plan or was paid a partial distribution from a profit-sharing plan or was paid a partial distribution from a money-purchase plan after receiving the spouse's waiver.

10. Line 11(c) asks if there were any loans to married participants. Although most people with profit-sharing and money-purchase Keoghs understand that they themselves cannot borrow from their plan, sometimes they are unaware that they cannot make loans to their spouses.