THE Pension Digest

Published Since 1984 Collin W. Fritz and Associates, Inc., *"The Pension Specialists"* October, 1996

Three Different Approaches for Furnishing the 1996 IRA Fair Market Value Statement and the 1996 Form 5498

The purpose of this article is to discuss the three methods which an IRA custodian/trustee may use to satisfy the IRA reporting requirements imposed by the IRS with respect to reporting contributions and the year end fair market value. The discussion is not only made with respect to the 1996 reporting year, but would apply for other years as well.

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

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

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

Why Must the IRA Custodian Furnish Reports to the Accountholder and to the IRS?

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

Deadlines and Requirements With Respect to the IRS

The IRA custodian must complete a 1996 Form 5498 (or its magnetic media equivalent) on or before June 2, 1997, as follows. The deadline is June 2 since the actual deadline of May 31, 1997, falls on a Saturday.

The IRS must be sent a completed Form 5498 for each IRA accountholder and certain beneficiaries. An IRA custodian/trustee must generate a Form 5498 if an accountholder or beneficiary has made a regular or spousal IRA contribution, a rollover contribution or has a fair market value balance as of December 31, 1996. With respect to an IRA accountholder who died during the year, the same rules apply to determine if a Form 5498 must be prepared, except timing for the fair market value is the date of death and not December 31, 1996. Remember that contributions to inherited IRA accounts are not permissible.

Deadlines and Requirements With Respect to IRA Accountholders and Beneficiaries

There are two items which the IRA custodian must report: (1) the fair market value as of December 31, 1996 or as of the date of death, and (2) the reportable contributions.

The fair market value as of December 31, 1996, information must be provided on or before January 31, 1997. The IRA custodian can furnish this information in any written format.

The contribution information can be provided on or before June 2, 1997. The IRA custodian can choose to use the IRS Form 5498, or a substitute Form 5498. The deadline is June 2, 1997, since the actual deadline of May 31, 1997, falls on a Saturday.

Discussion of the Three Approaches

APPROACH #1

Furnish the fair market value via a statement in January, and furnish the contribution information via the Form 5498 in May.

This is the most conservative approach. The January statement would reflect the fair market value. The accountholder would be informed what information (i.e. the fair market value amount) was being furnished to the IRS. The Form 5498 would be furnished after April 15, 1997, but on or before May 7, 1997, only to those IRA accountholders who had made a regular, spousal or rollover contribution.

Why use this approach? All the information which is required to be given is on the IRS form. By using the Form 5498, an IRA custodian knows it does not have a compliance problem, assuming the form has been completed correctly.

Note that under this alternative the IRS does not require a Form 5498 to be prepared for those IRA accountholders who did not make a reportable contribution. The IRS has rightfully concluded that the furnishing of a Form 5498 or a substitute statement with only box 4 completed, would simply duplicate the fair market value information which was reported on the customer statement furnished on or before January 30, 1997.

APPROACH #2

Furnish the 1996 5498 Form in January. This Form would reflect the amounts to be shown in Boxes 1, 2 and 4 as of 12-31-96. There would be an accompanying letter which would inform the IRA accountholder that if he or she made any carryback contributions in 1997 for 1996, then the IRA

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Published by Collin W. Fritz and Associates, Ltd.
Subscription Rate: $65 per year.

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custodian would be sending a "corrected" Form 5498 after April 15, 1997, but on or before June 2, 1997.

An IRA custodian wishing to use Approach #2 would need to make sure that its data processing system would allow this approach. We do not feel it would be permissible for the IRA custodian to send two "original" Form 5498's – one in January and then a later one in May. The individual must be able to know which form was furnished to the IRS.

APPROACH #3

Furnish a January statement with the intent that it serves as a substitute for the Form 5498.

The IRA custodian will use the January statement to handle both the fair market value requirement and the contribution requirement. Thus, the IRA custodian will prepare a statement (i.e. a substitute Form 5498) on or before January 31, 1997, that will reflect the December 31, 1996, fair market value and the reportable contributions.

However, if this alternative is used, the IRA custodian must understand that it must furnish a "corrected statement" if the IRA accountholder makes a contribution for 1996 in 1997. As discussed above in approach #2, if a carry back contribution has been made, a corrected statement or a "corrected" 1996 Form 5498 would need to be furnished. Presumably, by reporting contributions only once on the January statement for most IRA accountholders, some money can be saved in less form preparation and lower mailing costs. This is a sensible approach to reporting fair market value and contributions.

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

In addition, the IRS requires that the IRA custodian provide the recipient with applicable instructions similar to those that appear on the back of the recipient's copy of the Form 5498 so that the information may be properly used by the recipient in meeting his or her tax obligations.

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

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

Example of Form 5498 & Instructions

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

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

– informing the customer that the appropriate information has been submitted to the IRS,

– what reportable contributions were made, and

– describing the fair market value (FMV) and the possible handling of this entry in the event of accountholder death. PD

IRA Administrative Deadlines and Other Deadlines

Calendar year 1996 is almost over. The 1996 IRA administrative year has another seven months to run. The purpose of this article is to set forth the various deadlines which apply to IRAs, SEPs and Qualified Plans.

We believe that Internal Revenue Code section 7503 would apply in those situations where the deadline falls on a Saturday or Sunday or legal holiday. Internal Revenue Code section 7503 states that when the last day prescribed by the tax laws falls on a Saturday, Sunday or legal holiday, the performance of such act shall be considered timely if it is performed on the next succeeding day which is not a Saturday, Sunday or legal holiday (i.e. the next business day).

December 31, 1996 (A Tuesday)

1. The deadline for those IRA owners who attained age 70 1/2 in a year prior to 1996 to take their required minimum distribution for 1996.

2. The deadline for those IRA beneficiaries who elected the five-year rule to have the inherited IRA completely dis-

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 Regular IRA contributions made in 1996 and 1997 for 1996 $ 2 Rollover IRA contributions $	OMB No. 1545-0747 **1996** Form **5498**	**Individual Retirement Arrangement Information**
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** **File with Form 1096.** For Paperwork Reduction Act Notice and instructions for completing this form, **see Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Fair market value of account $		
Street address (including apt. no.)		5 Check for SEP ☐		
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

Instructions to Participant

The information in boxes 1, 2, 3, 4, and 5 is submitted to the Internal Revenue Service by the trustee or issuer of your individual retirement arrangement (IRA) to report regular or rollover contributions made to your IRA and the value of your IRA or simplified employee pension (SEP) account.

If you or your spouse was an active participant in an employer's pension plan, your IRA contributions may not be deductible. See the instructions for your tax return for details.

Caution: *If you are at least age 70½, you must take minimum distributions from your IRA. If you don't, you may be subject to a 50% excise tax on the amount that should have been distributed. If you inherited this IRA, certain minimum distribution rules apply. See* **Pub. 590,** *Individual Retirement Arrangements (IRAs), for minimum distribution methods.*

Box 1.—The amount shown is the contributions for 1996 made in 1996 and through April 15, 1997, to an IRA.

Box 2.—This is the amount of any rollover, including a direct rollover, you made in 1996. You must report the total distribution you received from your IRA on the appropriate line of your income tax return. Subtract the part of the distribution that was rolled over and enter the taxable remainder on the appropriate line of your income tax return. But if you have ever made any nondeductible contributions to your IRA, use **Form 8606,** Nondeductible IRAs (Contributions, Distributions, and Basis) to figure the taxable amount. If property was rolled over, see Pub. 590.

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

Box 4.—This is the fair market value (FMV) of your account at the end of the year. However, if a decedent is shown as the participant on this form, it may be the FMV on the date of death. If a decedent's name is shown as the participant and the FMV shown is zero, the executor or administrator of the decedent's estate may request a date-of-death valuation from the financial institution.

Box 5.—If the box is marked, the information on this form/statement is for a simplified employee pension (SEP).

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

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

Deadlines—*Continued from page 2*

tributed if the IRA owner had died during 1996.

3. The deadline for establishing a Qualified Plan for tax year 1996, if the business has a calendar year tax year.

4. Last day ever to establish a SAR-SEP.

5. The deadline for withdrawing an excess contribution made for a tax year prior to 1996, if the 6% excise tax for 1996 is to be avoided.

January 31, 1997 (A Friday)

1. This is the deadline for furnishing Form 945 (Annual Return of Withheld Federal Income Tax Return). However, the deadline changes to February 10, 1997, if you made deposits of all withheld taxes on time. Refer to the instructions to determine to which IRS office you must file.

2. This is the deadline for an IRA custodian to furnish a Form 1099-R to each IRA owner and each IRA beneficiary who was paid a "reportable" distribution during 1996. A fine of $25 per day may be assessed to a maximum of $15,000 for failing to timely furnish this form. For example, if you prepare a Form 1099-R in the name of a deceased IRA owner who was not paid, rather than the beneficiary who was paid, you most likely would face substantial fines.

3. An IRA custodian/trustee must furnish an IRA statement setting forth the fair market value of the IRA as of December 31, 1996, to each of the following: (1) every IRA owner who had an IRA with a fair market value on December 31, 1996; (2) every IRA beneficiary with an inherited IRA with a fair market value on December 31, 1996; and (3) each IRA owner who died in 1996.

In the case of the IRA owner who died in 1996, the IRS gives the custodian the choice of reporting either the fair market value as of the date of death, or a zero along with a note explaining that the custodian will furnish the fair market value as of the date death upon request.

We are still receiving many consulting calls regarding the proper reporting for decedents and beneficiaries of inherited IRAs. Please refer to the May 1994 newsletter for a detailed discussion of this subject. If you would like to receive a copy of this letter, please call us at 1-800-346-3961 and request one. Cost is $2.00.

February 28, 1997 (A Friday)

You must file the individual Form 1099-Rs and the transmittal Form 1096 or the magnetic media equivalents with the IRS .

March 3, 1997 (A Monday)

The deadline is March 3, 1997, since the actual deadline of March 1, 1997, falls on a Saturday.

This date is not a deadline for the IRA custodian/trustee.

This date is a deadline for certain farmers and fisherman who wish to take advantage of an exception to the estimated tax payment rules. If a farmer files his or her tax return on or before March l of the following year and pays all taxes owing, then he or she receives an exemption from having to pay estimated taxes throughout the year. A person normally must pay some penalty taxes if he or she does not file estimated returns and make the required payments by the quarterly deadlines. A farmer's filing deadline is still April 15th, and thus IRA, SEP and Keogh contributions can still be made through April 15th even though the tax return is filed on or before March 1st.

March 17, 1997 (A Monday)

The deadline is March 17, 1997, since the actual deadline of March 15, 1997, falls on Saturday.

A corporation with a calendar year tax year must file Form 1120 unless it has an extension. Thus, this is the last day for SEP and QP contributions for 1996 by such a corporation.

April 1, 1997 (A Tuesday)

1. This is the deadline for those IRA owners who attained age 70 1/2 in 1996 to make their elections and to take their required minimum distribution for 1996.

April 15, 1997 (A Tuesday)

l. Last day for IRA contributions for 1996.

2. Last day for 1996 SEP and QP contributions unless the person would have an extension.

3. Deadline for the IRA custodian/trustee to file the Form 990-T. Fiduciaries for certain self-directed IRAS and Qualified Plans that have $1,000 or more of unrelated business income must file Form 990-T.

4. Deadline for withdrawing or correcting an excess contribution made in 1996 or 1997, for tax year 1996. However, if the person had an extension, this deadline would be extended.

June 2, 1997 (A Monday)

The deadline is June 2, 1997, since the actual deadline of May 31, 1997, falls on a Saturday.

1. Deadline to furnish the Form 5498 or a qualifying substitute form to IRA owners and beneficiaries of inherited IRAs.

2. Deadline to furnish all of the individual 5498 forms and Form 1096 or their magnetic media equivalents to the IRS.

July 15, 1997 (A Tuesday)

A corporation with a calendar year tax year can receive an extension for four months, from March 15 to July 15. With such an extension, the deadline for SEP and QP contributions is changed.

July 31, 1997 (A Thursday)

This is the deadline for your customers with qualified plans with calendar year plan years to file the Form 5500C/R or Form 5500EZ, if applicable, unless an extension would apply.

August 15, 1997 (A Friday)

Individual taxpayers many times receive an extension to file their tax return (from April 15 to August 15). This is the first extension.

Remember that SEP and QP contributions are permissible through the extension date.

September 15, 1997 (A Monday)

This is the last day for a corporation to make a contribution for tax year 1996, if the IRS has granted a second extension on filing its return.

October 15, 1997 (A Wednesday)

This is the last day to make a contribution if the IRS grants a second extension for an individual taxpayer with a calendar year end. PD

Time Performance of Acts Where the Last Day Falls on a Saturday, Sunday or a Legal Holiday

The IRS has issued final regulations with respect to Code section 7503. It is effective August 14, 1996. When the last day for performance of a "tax" act by a taxpayer or an employee or administrator of the IRS falls on a Saturday, Sunday or a legal holiday, section 7503 of the Code extends the time for performing the act. Under the extension, the act must be performed by the next day that is not a Saturday, Sunday or legal holiday. Legal holiday is defined to be those

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Time Performance—*Continued from page 3*

legal holidays as specified in the District of Columbia and any statewide legal holiday of the state where the act is required to be performed.

The IRS stated that these regulations do not address the effect of a Federal government shutdown on the time allowed for the performance of a "tax" act. The IRS also stated that outlining the kinds of acts to which section 7503 applies was not within the scope of the current project. Thus, the IRS chose to not answer the following question, or similar questions, at this time — *If the 60th day of a rollover period ends on a Saturday, Sunday or legal holiday, will a rollover contribution made on the next business day be valid?* We will all have to wait for the IRS to state its position. PD

Effective Date Extension for Certain Payers Revising Their Substitute Forms W-9

In Rev. Proc. 96-26 the IRS created some new rules to be met by payors who used a substitute Form W-9, "Request for Taxpayer Identification Number and Certification," to obtain the required taxpayer identification number and "no backup withholding" certifications. This subject was discussed in the March, 1996 *Pension Digest*. Please remember that revenue procedures provided requirements for brokers and payors of interest, dividends. That is, it does not apply to IRAs. An IRA custodian may request the tax identification number of a prospective IRA accountholder and not have to comply with the substitute Form W-9 requirements. Such payors were to have new complying forms on or before January 1, 1997.

The IRS has now chosen to extend the deadline from January 1, 1997, to July 1, 1997, but only if the following conditions are satisfied: (1) the payor is required to obtain the approval of a governmental authority for changes to the format of its substitute Form W-9 as required by Rev. Proc. 96-26, (2) the payor applies, on or before September 30, 1996, for that approval, and (3) the payor thereafter actively pursues that approval.

Therefore, if the application was not made before September 30, 1996, then the deadline of January 1, 1997, will still apply. PD

✔✔✔ Check It Out ✔✔✔

Question: Have the IRA rules been changed so that a distribution from an IRA which will be used for a first-time home purchase will not be subject to the 10% pre-age 59 1/2 excise tax?

✔ Answer. The rules have not changed yet. The IRS would assess the 10% excise tax.

Question: Many of our IRA accountholders have their required minimum distribution amount paid to them once a year in December of each year. Do we need to give these IRA accountholders a withholding reminder notice?

✔ Answer. Yes. An IRA custodian must furnish a withholding form to such IRA accountholders so that they can change their previous withholding instruction if they would so choose. As a customer service, we would recommend sending out this notice 15-45 days before the actual distribution. However, the governing regulation would allow you to send this notice up to six months in advance.

Question: Is it always best from a federal income tax viewpoint that a participant of a qualified plan rollover or directly rollover his or her account to an IRA?

✔ Answer. No. Sometimes a person would be entitled to be distributed employer stock which has experienced substantial appreciation. This person, if he or she understood that taxation rules, may prefer to be distributed the stock rather than rolling over the stock to an IRA.

There are special tax rules which apply to employer stock. The concept is this: an employer sponsors a plan which permits investment in employer stock. Let's assume over a ten-year period that the value of the stock when contributed by the employer was $15,000. The value of this stock at time of distribution is $60,000. Thus there is appreciation of $45,000. Special tax laws provide that the participant in this situation would include in income the $15,000 (i.e. the cost basis) and would not pay any tax on the appreciation until he or she sells the stock. This person has a type of tax deferral without having to roll over the funds to an IRA. Such tax would be subject to taxation at capital gain rates rather than ordinary income rates.

Question: Did the Small Business Job Protection Act of 1996 make any changes to the rules governing SEP plans?

✔ Answer. No. The rules which apply to SEP plans in 1997 are the same rules which applied in 1996 prior to the Small Business Job Protection Act of 1996.

Question: Did the Small Business Job Protection Act of 1996 make any changes to the rules governing SAR-SEP plans?

✔ Answer. Yes, major changes. An employer who maintains a SAR-SEP as of December 31, 1996, may continue such plans. However, an employer who does not maintain a SAR-SEP as of December 31, 1996, may never maintain one unless the law would be changed to again authorize such plans.

Question: What will be the maximum SEP or profit sharing contribution which can be made for a person under a nonintegrated plan in 1997?

✔ Answer. $24,000. The reason is that the maximum compensation amount which has been $150,000 the past three years, will be $160,000 in 1997. The maximum contribution rate of 15% times $160,000 equals $24,000.

Question: What are the chances that there will be further legislation which will affect IRAs?

✔ Answer. Possibly quite good. President Clinton has expressed numerous times that he favors some IRA law changes. The Republicans have stated similar views. However, the Republicans appear to place a higher priority on the $500 per child credit and the change in the capital gain rules. Time will tell.

Question: Has the basic concept of spousal IRA changed?

✔ Answer. Yes. The concept of spousal IRAs from 1975-1996 was that one spouse made a contribution for his or her nonworking spouse. The concept of spousal IRAs from 1997 onward is that a spouse can make a spousal contribution for himself or herself within the limits set by law. 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.