



THE Pension Digest

Published Since 1984

Collin W. Fritz and Associates, Inc., "The Pension Specialists"

January, 1997

IRS Finally Issues Forms to be Used to Establish the SIMPLE-IRA Account

Form 5305-S (December 1996) Department of the Treasury Internal Revenue Service	SIMPLE Individual Retirement Trust Account		DO NOT File With the Internal Revenue Service
Name of participant	Date of birth of participant	Social security number	
Address of participant		Check if transfer SIMPLE IRA	<input type="checkbox"/>
Name of trustee		Check if amendment	<input type="checkbox"/>
Address or principal place of business of trustee			

Form 5305-SA (December 1996) Department of the Treasury Internal Revenue Service	SIMPLE Individual Retirement Custodial Account		DO NOT File With the Internal Revenue Service
Name of participant	Date of birth of participant	Social security number	
Address of participant		Check if transfer SIMPLE IRA	<input type="checkbox"/>
Name of custodian		Check if amendment	<input type="checkbox"/>
Address or principal place of business of custodian			

The IRS has finally issued Form 5305-SA, SIMPLE Individual Retirement Custodial Account, and Form 5305-S, SIMPLE Individual Retirement Trust Account. The Form 5305-SA will generally be the form which an employee signs to establish his or her SIMPLE-IRA which accepts the contributions or deposits made under the employer's SIMPLE plan. A sample of the Form 5305-SA is enclosed. The headings of both forms are set forth below. Most forms providers will develop a form to open a SIMPLE-IRA which is very similar to the forms presently used to open "regular" IRAs.

Two months ago the IRS issued the Form 5305-SIMPLE, which an employer executes as the SIMPLE plan document.

Here is our summary of Form 5305-S and Form 5305-SA.

1. The introduction makes clear that the

IRA custodian or trustee has a duty to furnish a summary description.

2. The only type of contribution which is permissible is a SIMPLE contribution which must be in cash. Exception: the custodian or trustee will accept transfers and rollovers from other SIMPLE-IRAs of the participant.

3. Articles II, III, IV and VII are identical to those same articles of Form 5305-A or Form 5305.

4. Article V contains the same two reporting requirements found in the Form 5305-A and Form 5305, but it also contains one additional requirement.

The custodian or trustee must provide the SIMPLE-IRA participant with the summary description unless this SIMPLE is a transfer SIMPLE-IRA. The instruc-

Continued on page 4

Also in this issue -

- ◆ IRS Issues 1997 Forms 1099-R and 5498 Page 2
- ◆ Changes to the IRA Distribution Form and the IRS Form 1099-R Page 4
- ◆ IRS Issues Another Model Form To Establish a SIMPLE Plan — 5304-SIMPLE Page 4
- ◆ IRS Issues Information Guidance on MSAs Page 4

© 1997 Collin W. Fritz and Associates, Ltd.
Copyright is not claimed in any material secured from official U.S. Government sources.
Published by Collin W. Fritz and Associates, Ltd.
Subscription Rate: \$65 per year.

IRS Issues 1997 Forms 1099-R and 5488

Form 1099-R and Instructions

The 1997 Form 1099-R and instructions are set forth below. These are the changes which impact an IRA custodian or trustee:

1. There is a new distribution code "S", early distribution from a SIMPLE-IRA, no known exception (under age 59 1/2) (may be subject to a 25% penalty, see Form 5329).
2. The checkbox at code 7 has been changed from IRA/SEP to IRA/SEP/SIMPLE. If this box is checked, then the recipient has received an IRA, SEP or SIMPLE-IRA distribution.

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution \$		GAB No. 1545-0-19	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2a Taxable amount \$		1997 Form 1099-R	
PAYER'S Federal identification number	RECIPIENT'S identification number	2b Taxable amount not determined <input type="checkbox"/>		Total distribution <input type="checkbox"/>	Copy B Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.
RECIPIENT'S name		3 Capital gain (included in box 2a) \$		4 Federal income tax withheld \$	
Street address (including apt. no.)		5 Employee contributions or insurance premiums \$		6 Net unrealized appreciation in employer's securities \$	
City, state, and ZIP code		7 Distribution code	IRA/SEP/SIMPLE <input type="checkbox"/>	8 Other \$	This information is being furnished to the Internal Revenue Service.
Account number (optional)		9a Your percentage of total distribution %	9b Total employee contributions \$		
		10 State tax withheld \$	11 State/Payer's state no.	12 State distribution \$	
		13 Local tax withheld \$	14 Name of locality	15 Local distribution \$	

Form 1099-R

Department of the Treasury - Internal Revenue Service

Instructions for Recipient

Generally, distributions from pensions, annuities, profit sharing and retirement plans, IRAs, insurance contracts, etc., are reported to recipients on Form 1099-R.

Qualified Plans.—If your annuity starting date is after November 18, 1996, generally, you must use the simplified general rule to compute your taxable amount. See Pub. 575, Pension and Annuity Income.

IRAs.—For distributions from an individual retirement arrangement (IRA), simplified employee pension (SEP) or savings incentive match plan for employees (SIMPLE), generally the payer is not required to compute the taxable amount. Therefore, the amounts in boxes 1 and 2a will be the same most of the time. See Pub. 590, Individual Retirement Arrangements (IRAs), SEP-IRAs, and SIMPLE IRAs and Form 8606, Nondeductible IRAs (Contributions, Distributions, and Basis), to determine the taxable amount. If you are at least age 70 1/2, 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. See Pub. 590 and Pub. 560, Retirement Plans for Small Business.

Loans Treated as Distributions.—If you borrow money from a qualified plan, tax sheltered annuity, or government plan, you may have to treat the loan as a distribution and include all or part of the amount borrowed in your income. There are exceptions to this rule. If your loan is taxable, Code L will be shown in box 7. See Pub. 575 for details.

Beneficiaries.—If you receive a plan distribution as the beneficiary of an employee who died before August 21, 1996, you may be entitled to a death benefit exclusion of up to \$5,000. See Pub. 575.

Box 1.—Shows the total amount you received this year. The amount may have been a direct rollover or received as periodic payments, as nonperiodic payments, or as a total distribution. Report this amount on your tax return on the line for "Total IRA distributions" or "Total pensions and annuities" (or the line for "Taxable amount"), whichever applies, unless this is a lump sum distribution and you are using Form 4972, Tax on Lump-Sum Distributions. However, if you have not reached minimum retirement age, report your disability payments on the line for "Wages, salaries, tips, etc." Also report on that line corrective distributions of excess deferrals, excess contributions, or excess aggregate contributions.

If you received a death benefit payment made by an employer because you are the beneficiary of a deceased employee and the payment was not made from the employer's pension, profit-sharing, or retirement plan report this amount, less any allowable death benefit exclusion on your tax return on the line for "Other income." See Pub. 525, Taxable and Nontaxable Income.

If a life insurance annuity or endowment contract has been transferred tax free to another trustee or contract issuer, an amount will be shown in this box and Code 6 will be shown in box 7. You need not report this on your tax return.

Box 2a.—This part of the distribution is generally taxable. If there is no entry in this box, the payer may not have all the facts needed to figure the taxable amount. In that case, the first box in box 2b

should be marked. You may want to get one of the following publications from the IRS to help you figure the taxable amount: Pub. 571, Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations, Pub. 575, Pub. 590, Pub. 721, Tax Guide to U.S. Civil Service Retirement Benefits, or Pub. 939, Pension General Rule (Nonsimplified Method). For an IRA distribution, see IRAs on this page. For a direct rollover, zero should be shown, and you must enter zero on the "Taxable amount" line of your tax return.

If this is a total distribution from a qualified plan and you were at least age 59 1/2 on the date of distribution (or you are the beneficiary of someone who had reached age 59 1/2, or someone born before 1936), you may be eligible for the 5- or 10-year tax option. See Form 4972 for more information. The 5- or 10-year tax option does not apply to IRAs or tax sheltered annuities.

Box 2b.—If the first checkbox is marked, the payer was unable to determine the taxable amount, and box 2a should be blank unless this is an IRA distribution. If the second checkbox is marked, the distribution was a total distribution that closed out your account.

Box 3.—If you received a lump-sum distribution from a qualified plan and you were born before 1936 (or you are the beneficiary of someone born before 1936), you may be able to elect to treat this amount as a capital gain. See the Instructions for Form 4972. For a charitable gift annuity, any long-term capital gain is shown.

Box 4.—This is the amount of Federal income tax withheld. Include this on your income tax return as tax withheld, and if box 4 shows an amount other than zero, attach Copy B to your return. Generally, if you will receive payments next year that are not eligible rollover distributions, you can change your withholding or elect not to have income tax withheld by giving the payer Form W-4P, Withholding Certificate for Pension or Annuity Payments.

Box 5.—Generally, this shows the employee's investment in the contract (after-tax contributions), if any, recovered tax free this year; the part of premiums paid on commercial annuities or insurance contracts recovered tax free; or the nontaxable part of a charitable gift annuity. This box does not show contributions to an IRA, SEP, or SIMPLE.

Box 6.—If you received a lump-sum distribution from a qualified plan that includes securities of the employer's company, the net unrealized appreciation (NUA) (any increase in value of such securities while in the trust) is taxable only when you sell the securities unless you choose to include it in your gross income this year. See Pub. 575 and the Instructions for Form 4972. If you did not receive a lump-sum distribution, the amount shown is the NUA attributable to employee contributions, which is not taxed until you sell the securities.

Box 7.—These codes identify the distribution you received: 1—Early distribution, no known exception (in most cases, under age 59 1/2) (See Form 5329. For a rollover of the entire taxable part of the distribution, do not file Form 5329. See Form 1040 or 1040A instructions.); 2—Early distribution exception applies (under age 59 1/2) (You need not file Form 5329.); 3—Disability (You need not file Form 5329.); 4—Death (You need not file Form 5329.); 5—Prohibited transaction; 6—Section 1035 exchange (a tax-free exchange of life insurance, annuity, or endowment contracts); 7—Normal distribution; 8—Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 1997;

9—PS 58 costs (premiums paid by a trustee or custodian for current insurance protection, taxable to you currently); P—Excess contributions plus earnings/excess deferrals taxable in 1996; A—May be eligible for 5- or 10-year tax option (See Form 4972.); B—May be eligible for death benefit exclusion (if employee died before August 21, 1996); C—May be eligible for both A and B; D—Excess contributions plus earnings/excess deferrals taxable in 1995; E—Excess annual additions under section 415 (Report on your tax return on the line for taxable pension or annuity income. You need not file Form 5329.); F—Charitable gift annuity; G—Direct rollover to IRA (You need not file Form 5329.); H—Direct rollover to qualified plan or tax sheltered annuity. (You need not file Form 5329.); L—Loans treated as distributions; S—Early distribution from a SIMPLE IRA in first 2 years, no known exception (under age 59 1/2) (May be subject to a 25% penalty. See Form 5329.)

If the IRA, SEP, or SIMPLE box is marked, you have received an IRA, SEP, or SIMPLE IRA distribution.

Box 8.—If you received an annuity contract as part of a distribution, the value of the contract is shown. It is not taxable when you receive it and should not be included in boxes 1 and 2a. When

you receive periodic payments from the annuity contract, they are taxable at that time. If the distribution is made to more than one person, the percentage of the annuity contract distributed to you is also shown. You will need this information if you choose the special 5- or 10-year tax option.

Box 9a.—If a total distribution was made to more than one person, the percentage you received is shown here.

Box 9b.—If this is the first year of a life annuity from a qualified plan or from a tax-sheltered annuity (with after-tax contributions), the amount shown is the employee's total investment in the contract. Use it if you choose to compute the taxable part of the distribution using a method different from the method used by the payer. See Pub. 575.

Boxes 10-15.—If state or local income tax was withheld from the distribution, these boxes may be completed. Boxes 12 and 15 may show the part of the distribution subject to applicable state and/or local tax.

Form 5498 and Instructions

The 1997 Form 5498 and instructions are set forth below. These are the changes which impact an IRA custodian or trustee:

1. Box 2 will be used to report IRA, SEP or SIMPLE rollovers.

2. Box 5 has been revised to include three boxes: one for an IRA; one for a SEP and one for a SIMPLE.

For 1996, Box 5 was optional, but we recommend that an IRA custodian/trustee complete it.

3. There is a new Box 6. This shows the SEP contributions made in 1997 on the IRA accountholder's behalf. The IRA accountholder is informed that he or she should not deduct this amount on his or her income tax return. The reason is that the contribution has not been included in income for income tax purposes.

4. There is a new box 7. This shows the SIMPLE contributions made in 1997 on the IRA accountholder's behalf. The SIMPLE IRA accountholder is informed that he or she should not deduct this amount on his or her income tax return. The reason is that the contribution has not been included in income for tax purposes.

<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		1 Regular IRA contributions made in 1997 and 1998 for 1997 \$		OMB No. 1545-0747 1997 Form 5498	IRA, SEP, or SIMPLE Retirement Plan Information
		2 IRA, SEP, or SIMPLE rollover contributions \$			
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	TRUSTEE'S or ISSUER'S Federal identification no.		PARTICIPANT'S social security number		Copy C For Trustee or Issuer For Paperwork Reduction Act Notice and instructions for completing this form, see the 1997 Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name			3 Life insurance cost included in box 1 \$		
Street address (including apt. no.)			4 Fair market value of account \$		
City, state, and ZIP code			5 Check for IRA <input type="checkbox"/> SEP <input type="checkbox"/> SIMPLE <input type="checkbox"/>		
Account number (optional)			6 SEP contributions \$ 7 SIMPLE contributions \$		

Form 5498

Department of the Treasury - Internal Revenue Service

Instructions to Participant

The information in boxes 1 through 7 is submitted to the Internal Revenue Service by the trustee or issuer of your individual retirement arrangement (IRA), simplified employee pension (SEP), or savings incentive match plan for employees (SIMPLE) to report contributions and the fair market value of the 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 income tax return for details.

Caution: If you are at least age 70 1/2, you must take minimum distributions from your account. If you don't you may be subject to a 50% excise tax on the amount that should have been distributed. If you inherited your IRA, certain minimum distribution rules apply. See Pub. 590, Individual Retirement Arrangements (IRAs, SEP-IRAs, and SIMPLE IRAs), for minimum distribution methods.

Box 1.—Shows the regular IRA contributions for 1997 you made in 1997 and through April 15, 1998. These contributions may be deductible on your income tax return.

Box 2.—Shows any rollover, including a direct rollover, you made in 1997 to your IRA, SEP, or SIMPLE. You must report the total distribution you received from your plan 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. 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 IRA, SEP, or SIMPLE 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.—Shows whether this Form 5498 is for your IRA, SEP, or SIMPLE.

Box 6.—Shows the SEP contributions made in 1997 on your behalf. Do not deduct on your income tax return.

Box 7.—Shows the SIMPLE contributions made in 1997 on your behalf. Do not deduct on your income tax return.

The trustee or issuer of the plan may use the other boxes on this form to give you more information about your IRA, SEP, or SIMPLE. For example, if you were an Operation Joint Endeavor (Bosnia Region) participant and you made an IRA contribution for a prior year, box 7 may show "JE" for Joint Endeavor, the year for which the contribution was made, and the amount of the contribution.

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, SEPs, or SIMPLEs, see Pub. 590, and Pub. 560, Retirement Plans for Small Business. **1D**

Changes to the IRA Distribution Form and the IRS Form 1099-R

Most IRA distribution forms are designed to collect the information which an IRA custodian or trustee will need to prepare the Form 1099-R. In general, the Form 1099-R reports to the IRS and the recipient the gross distribution amount, the taxable portion and the "reason" for the distribution from IRAs, pension plans and certain annuities. The federal government (i.e. the IRS) wants to collect the tax dollars which it is due. One of the primary purposes for the "reason" code is to inform the IRS and the recipient whether or not the individual is liable to pay a special 10% excise tax because the individual received the distribution before he or she had attained age 59 1/2, and no exceptions applied.

Legislation enacted in 1996 could have required IRA distribution forms to be revised. The legislation was the Health Insurance Portability and Accountability Act (HIPPA) and the Small Business Job Protection Act (SBJPA).

Under HIPPA, two new exceptions to assessing the 10% excise tax were created. First, withdrawals used to pay for medical expenses exceeding 7.5% of adjusted gross income would not be assessed the 10% excise tax. Second, withdrawals by certain unemployed individuals used to pay premiums for health insurance would not be assessed the 10% excise tax. An IRS official has stated that the IRS will not be developing new reason codes for such distributions. The IRS will not require an IRA custodian or trustee to determine whether the IRA accountholder's withdrawal met the medical expense or insurance exceptions. Thus, the IRS instructions will direct the IRA custodian or trustee to ignore these two new exceptions. Code 1, early (premature) distribution, no known exception, should still be used for early withdrawals. Because of this IRS determination, IRA distribution forms will not need to be revised. The IRS stated that corresponding changes in IRS Form 5329, Additional Taxes Attributable to Qualified Retirement Plans (including IRAs), Annuities, and Modified Endowment Contracts, would be made.

Under the SBJPA, the 10% excise tax was increased to 25% for certain early (first two years) distributions from a SIMPLE. The IRS has created a new Reason code "S" to handle the situation when the 25% excise tax applies. We have added this "S" to our IRA distribution form. We like the code on our form (number, alpha, or a combination) to be the same as the code which the IRS uses. Using the same code on the distribution form is desirable, but not mandatory. After 10 days, we will publish a revised distribution form which includes the 25% reason. **B**

SIMPLE-IRA—Continued from page 1

tions define a "transfer SIMPLE-IRA" as one which is not the original recipient of contributions under any SIMPLE plan.

5. Article VI is virtually identical to Article VI of the Form 5305-A or Form 5305. The only difference is that Code section 408(p) is referenced, as it should be, since subsection (p) contains the rules for SIMPLE-IRA plans.

Summary

The IRS has finally issued the last forms needed for a business and its employees to start their SIMPLE-IRA plan. CWF now has the SIMPLE folders available and the SIMPLE-IRA individual administrative forms. **B**

IRS Issues Another Model Form to Establish a SIMPLE Plan — The Form 5304-SIMPLE

On December 30, 1996, the IRS released News Release IR-96-55.

The IRS has now released Form 5304-SIMPLE in addition to the Form 5305-SIMPLE which was issued in October.

The primary difference in these two forms is that the Form 5304-SIMPLE allows the employer to grant to each employee the right to choose the financial institution which will be the IRA custodian or trustee for his or her SIMPLE-IRA, whereas the Form 5305-SIMPLE required that all SIMPLE-IRAs be initially established with a designated financial institution.

An insert is enclosed — it is comprised of the first two pages of the Form 5305-SIMPLE. This form is actually six pages long including all the various election forms and instructions.

An employer will now be able to choose between using the Form 5305-SIMPLE (requires all IRAs initially with the same financial institution), or Form 5304-SIMPLE (allows employees to initially establish their SIMPLE-IRA with a financial institution of their choosing).

If the Form 5304-SIMPLE is used, then for each year the SIMPLE plan is in effect, the financial institution acting as the custodian for the SIMPLE-IRA of each eligible employee must provide the employer with a summary description. The IRS instructions state that this requirement is satisfied by providing the employer with a current copy of the Form 5304-SIMPLE (including instructions) together with the financial institution's procedures for withdrawals from SIMPLE-IRAs, including the institution's name and address.

A financial institution should be able to comply with the requirement to disclose its procedures for withdrawals quite easily. In general, the procedure is — the SIMPLE-IRA accountholder will complete a distribution from an IRA. The IRA accountholder needs to know the location of the IRA Department; he or she will need to go there and the IRA Department will perform the distribution task.

Observation. A financial institution which is not the primary IRA custodian of the SIMPLE will prefer it if the employer has used the Form 5305-SIMPLE rather than the Form 5304-SIMPLE because it has no duty to furnish the summary description and withdrawal procedures when the 5304-SIMPLE is used. An institution may even wish to consider imposing a fee when the Form 5304-SIMPLE has been used.

IMPORTANT POLICY STATEMENT. The IRS makes an important policy statement within this news release, "For the 1997 calendar year, model SIMPLE plans using either Form 5304-SIMPLE or Form 5305-SIMPLE can be made effective as late as October 1, 1997." **B**

IRS Issues Informal Guidance on Medical Savings Accounts

An IRS official has indicated that at least three reporting forms will be required by the IRS for a custodian or trustee of Medical Savings Accounts (MSA). Two of the forms will be very similar to those required for IRA accounts. The Form 1099-MSA will report the gross amount of a distribution. The Form 5498 will be used to report contributions, including rollovers and presumably, account balances. The Form 8851-MSA will be the trustee report required to be prepared and furnished to the IRS. **B**