THE Pension Digest

March, 1999
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ALSO IN THIS ISSUE –

1999 FORM 5498

The IRS has issued the 1999 version of Form 5498. The form and the IRS' instructions to the IRA participant are set forth below.

Changes in the Form

Box 6 has changed. In 1998 there was a box for a Roth IRA and a box for Roth Conversions. The 1999 form deleted the Roth Conversion box. All Roth contributions, whether annual, rollover, or conversion, are reported as going into a Roth IRA.

A new box entitled "Recharacterization" has been added. When this box is checked, you must also check the box that identifies the type of IRA involved.

Completion of Form

The completion of the form is the same as the 1998 form. The type of IRA is indicated in box 6, and the information regarding the IRA is furnished in the other boxes.

For a traditional IRA, the boxes that need to be completed, if applicable, are 1, 2, 5, and 6.

For a SEP-IRA, the boxes that need to be completed, if applicable, are 1, 2, 4, 6, and 7. Keep in mind that a SEP participant may make his or her traditional IRA contribu-

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2, 3, and 7–10) $ 2 Rollover contributions $	OMB No. 1545-0747 1999 Form 5498	**IRA Contribution Information**
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Roth conversion amount $		**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the **1999 Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Fair market value of account $	5 Life insurance cost included in box 1 $	
Street address (including apt. no.)		6 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐ Rechar. ☐ Ed IRA ☐		
City, state, and ZIP code		7 SEP contributions $	8 SIMPLE contributions $	
Account number (optional)		9 Roth IRA contributions $	10 Ed IRA contributions $	

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

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Instructions to Participant

The information on Form 5498 is submitted to the Internal Revenue Service by the trustee or issuer of your individual retirement arrangement (IRA) to report contributions and the fair market value of the account. For information about IRAs, see **Pub. 590,** Individual Retirement Arrangements (IRAs), and **Pub. 560,** Retirement Plans for Small Business.

Reminder: *If you converted from a traditional IRA, SEP, or SIMPLE to a Roth IRA in 1998 and you elected to spread the taxable income over 4 years, you must include one-fourth of the taxable amount converted in your income in 1999. See* ***Form 8606,*** *Nondeductible IRAs.*

Box 1. Shows traditional IRA contributions for 1999 you made in 1999 and through April 17, 2000. These contributions may be deductible on your Form 1040 or 1040A. However, if you or your spouse was an active participant in an employer's pension plan, these contributions may not be deductible. This box does not include amounts in boxes 2, 3, and 7-10.

Box 2. Shows any rollover, including a direct rollover to a traditional IRA, you made in 1999. It also shows amounts recharacterized from one type of IRA to another. However, it does not show any amounts you converted from your traditional IRA, simplified employee pension (SEP), or savings incentive match plan for employees (SIMPLE) to a Roth IRA. They are shown in box 3. See the Form 1040 or 1040A instructions for information on how to report rollovers. If you have ever made any nondeductible contributions to your traditional IRA, SEP, or SIMPLE and you did not roll over the total distribution, use Form 8606 to figure the taxable amount. If property was rolled over, see Pub. 590.

Box 3. Shows the amount converted from a traditional IRA, SEP, or SIMPLE to a Roth IRA in 1999. Use Form 8606 to figure the taxable amount.

Box 4. Shows the fair market value of your account at year end.

Box 5. For endowment contracts only, shows the amount allocable to the cost of life insurance. Subtract this amount from your allowable IRA contribution included in box 1 to compute your IRA deduction.

Box 6. May show the kind of IRA reported on this Form 5498. If "Rechar." is checked, the contribution is a recharacterization of a prior contribution from one type of IRA to another.

Box 7. Shows simplified employee pension (SEP) contributions made in 1999. If made by your employer, **do not** deduct on your income tax return. If you made the contributions as a self-employed person (or partner), they may be deductible. See Pub. 560.

Box 8. Shows the savings incentive match plan for employees (SIMPLE) contributions made in 1999. If made by your employer, **do not** deduct on your income tax return. If you made the contributions as a self-employed person (or partner), they may be deductible. See Pub. 560.

Box 9. Shows Roth IRA contributions you made in 1999 and through April 17, 2000. **Do not** deduct on your income tax return.

Box 10. Shows education IRA (Ed IRA) contributions made in 1999 on your behalf. **Do not** deduct on your income tax return. If the total of all contributions made to all your Ed IRAs this year exceeded $500, you should withdraw the excess, plus earnings, generally by April 17, or you may owe a penalty. You must keep track of your Ed IRA basis (contributions and distributions). See Pub. 590.

1999 Form 5498
Continued from page 1

tion to the same SEP-IRA that receives "employer" contributions.

For a SIMPLE-IRA, the boxes that need to be completed, if applicable, are 2, 4, 6, and 8.

For a Roth IRA, the boxes that need to be completed, if applicable, are 3, 4, 6, and 9.

For an Education IRA, the boxes that need to be completed, if applicable, are 2, 4, 6, and 10.

Deadlines

- January 31, 2000 – Furnish the fair market value to participants in all types of IRAs.
- January 31, 2000 – Furnish 5498 to beneficiaries and responsible parties of Education IRAs.
- May 31, 2000 – Furnish 5498 to accountholders of all IRAs except the Education IRA.
- May 31, 2000 – IRS deadline for 5498s for all types of IRAs. ◆

1999 FORM 1099-R

The IRS has issued the 1999 version of the Form 1099-R. The format of the form is identical to the 1998 form, but Code R is new, and Code K is eliminated.

Box 1 – Shows the gross amount received during the year that relates to the distribution code in box 7.

Box 2a – Shows the amount that is generally taxable. For a traditional, SEP or SIMPLE-IRA, report the same amount that is reported in box 1, but you may mark the "Taxable amount not determined" in box 2b. For a Roth or Education IRA, leave box 2a blank. For an excess contribution, enter only the earnings.

Box 2b – If the taxable amount is not known, the first checkbox should be checked. If the distribution was a total distribution that closed out the IRA, the second checkbox should be checked.

Box 4 – Shows the amount of federal income tax withheld.

Box 7 – Shows the distribution code for the type of distribution being reported. The primary codes are listed below. Also, a box must be checked if the distribution was from a traditional IRA, SEP or SIMPLE-IRA. there is no box to check if the distribution is from a Roth or Education IRA.

Distribution Codes

1 – Early Distribution (no known exception). This code is used to report distributions for a traditional IRA, SEP-IRA or SIMPLE-IRA accountholder who is under age 59 1/2, when no other distribution code applies. This code is also used when the distribution is exempt from the 10% excise tax because it was used for education, first-time home purchase, certain medical expenses or payment of certain health insurance premiums when unemployed.

2 – Early Distribution (exception applies). This code is used for a distribution from a traditional IRA for conversion to a Roth IRA when the accountholder is under age 59 1/2. It is also used to report substantially equal periodic payments.

3 – Disability. This code is used when the accountholder is under age 59 1/2, but whose doctor has signed a form stating the accountholder is disabled under the definition of Code section 72(m)(7). It can be paraphrased—a physical or mental impairment that can be expected to result in death or to be of a long-continued and indefinite duration.

4 – Death. This code is used when the payments are made to the beneficiary, due to the death of the accountholder.

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PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution $	OMB No. 1545-0119	1999 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
	2a Taxable amount $			
	2b Taxable amount not determined ☐	Total distribution ☐		Copy A For Internal Revenue Service Center
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $		File with Form 1096.
RECIPIENT'S name	5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $		For Privacy Act and Paperwork Reduction Act Notice and instructions for completing this form, see the 1999 Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)	7 Distribution code / IRA/SEP/SIMPLE ☐	8 Other $ %		
City, state, and ZIP code	9a Your percentage of total distribution %	9b Total employee contributions $		
Account number (optional)	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 Cat. No. 14436Q Department of the Treasury - Internal Revenue Service

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1999 form 1099-R
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5 – Prohibited Transaction. When a prohibited transaction occurs, the entire amount in the IRA must be distributed immediately. Because prohibited transactions are so complex, we recommend you discuss all potential prohibited transactions with legal counsel before completing the distribution and reporting process.

7 – Normal. This code is used for distributions from a traditional IRA, SEP-IRA or SIMPLE-IRA when the accountholder is over age 59 1/2. This code is also used for a distribution from an IRA that is being converted to a Roth IRA, if the accountholder is age 59 1/2 or older.

8 – Excess. Code 8 is used when a contribution is made and withdrawn in the same tax year (1999), or a prior year contribution is made in one year (2000) for the previous year (1999), but withdrawn in the current year (2000). The earnings on the excess must also be withdrawn.

H – Direct Rollover to Qualified Plan. This code is used for a distribution from a conduit IRA that is directly rolled over or transferred to a qualified plan. This code is not used for a distribution from an IRA if it is being deposited into another IRA.

J – Distribution from a Roth IRA. All distributions from Roth IRAs are coded with a "J." (Code K is no longer used.) The accountholder must complete Form 8606 to calculate the taxes owed.

M – Distribution from an Education IRA. All distributions from an Education IRA are coded with an "M." The accountholder must complete Form 8606 to calculate the taxes owed.

P – Excess Contribution Plus Earnings Taxable in 1998. This code is used for a contribution that was made in one year (1998), and withdrawn as an excess in the following year (1999).

R – Recharacterized IRA Contribution. This code is used when a contribution is being recharacterized from one type of IRA to another. The accountholder must also complete Form 8606.

S – Early Distribution from a SIMPLE-IRA in the First Two Years, no Known Exception. If an accountholder is under age 59 1/2, withdrawing from a SIMPLE-IRA in the plan's first two years, and no other exception applies, this code is used. The distribution is subject to a 25% tax.

Box 9a – If a total distribution was made to more than one person, the percentage received by this taxpayer is shown here.

Box 10-15 – If state or local income tax was withheld from the distribution, these boxes may be completed. ◆

DISCUSSION OF 1998 FORM 5500-EZ AND SCHEDULE P

Purpose of Form 5500-EZ

Qualified Retirement Plans, either defined contribution or defined benefit pension plans, have annual filing requirements. Employers with more than one participant are required to file either the Form 5500-C/R or Form 5500. A one-participant retirement plan may file Form 5500-EZ. A one-participant plan covers only the owner and his or her spouse, or one or more partners and their spouses.

Form 5500-EZ is required for a one-participant plan that held more than $100,000 at the end of any plan year, beginning on or after January 1, 1994. Form 5500-EZ must be filed 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.

Who May File Form 5500-EZ?

Form 5500-EZ is a simpler form than Form 5500 or Form 5500 C/R and can be used if all of the following five conditions are met.

1. The plan is a one-participant plan.

2. The plan meets the minimum coverage requirements of section 410(b) without being combined with any other plan you may have that covers other employees of your business.

3. The plan provides no benefits for anyone other than the owners and their spouses.

4. The plan does not cover a business that is a member of:

• An affiliated service group,

• A controlled group of corporations, or

• A group of businesses under common control.

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

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

There are no 5500 reporting requirements if you:

• Meet the five conditions above, and

• You have a one-participant plan that had total plan assets of $100,000 or less at the end of every plan year beginning on or after January 1, 1994; or you have two or more one-participant plans that together had total plan assets of $100,000 or less at the end of every plan year beginning on or after January 1, 1994. Note: All one-participant plans must file a Form 5500-EZ for their final plan year even if the total plan assets have always been less then $100,000. The final plan year is the year in which distribution of all plan assets is completed. If this is the final year, check the "final return" box at the top of Form 5500-EZ.

When to File

File Form 5500-EZ by the

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ROTH IRA QUESTIONS

Now that the final Roth IRA regulations are out, let's ask some questions to see how well we understand the rules.

Questions:

Q1. When a customer converts a conduit IRA to a Roth IRA, it is not considered a conduit Roth. If the customer subsequently recharacterizes it back to a traditional IRA, can it again be considered a conduit IRA?

Answers:

A1. A conduit IRA that is converted to a Roth IRA, and subsequently recharacterized back to a traditional IRA, retains its status as a conduit IRA. The effect of the recharacterization is to treat the amount recharacterized as though it had been transferred directly from the original conduit IRA into another conduit IRA.

Q2. Joe Schneider converts an IRA in June of 1998 and then dies in September of 1998. When the executor of his estate is doing his taxes for 1998, he discovers that Joe would have been better off if he had not made the conversion. Is Joe's executor allowed to recharacterize the contribution?

A2. The election to recharacterize an IRA contribution may be made by the executor, administrator, or other person charged with the duty of filing the decedent's final Federal income tax return.

Q3. The final Roth IRA regulations continue the interim rules of Notice 98-50 regarding reconversions applicable for 1998 and 1999. Are the interim rules effective for years 2000 and beyond?

A3. The reconversion rules for 2000 and subsequent years differ from the rules that are effective for 1998 and 1999. The final regulations continue the interim rules of Notice 98-50 for 1998 and 1999.

Q4. Carol Rhodes is the beneficiary of her grandfather's Roth IRA. Carol wants to combine these inherited funds with her own individual Roth. Is this OK?

A4. A beneficiary's inherited Roth IRA may not be aggregated with any other Roth IRA maintained by the beneficiary (except for other Roth IRAs that the beneficiary inherited from the same decedent). The only exception to this would be if the beneficiary is the spouse of the decedent, sole beneficiary of the Roth IRA, and elects to treat the Roth IRA as his or her own.

Q5. John Newberg made a $2,000 Roth IRA contribution in January 1998. He had some unexpected expenses and had to close out his entire Roth IRA in December 1998. When he makes a new contribution, sometime in 1999, he will have to start all over as far as the five-year period goes. True or False?

A5. If the entire account balance in a Roth IRA is distributed before the Roth IRA owner makes any other Roth IRA contributions, the five-taxable year period does not start over for the new contribution. The three situations where this does not apply are:

- If an initial Roth IRA contribution is made and subsequently revoked with seven days.
- If an initial Roth IRA contribution is recharacterized, the initial contribution does not start the five-year period.
- An excess contribution that is distributed in accordance with section 408(d)(4) does not start the five-year period.

Q6. Jimmy Jackson is a twelve-year-old boy that has a paper route. Jimmy's mom comes in with Jimmy, and wants to establish a Roth IRA for him. Is this OK?

A6. A parent or guardian of a minor child may establish a Roth IRA on behalf of the minor child. However, in the case of any contribution to a Roth IRA, the compensation of the child for the taxable year for which the contribution is made must satisfy the compensation requirements of section 408A{c} and section 1.408 A.3. The parent should sign all the documents as the parent or legal guardian of the child. The child can sign the documents when they attain the age of majority.

Q7. Becky Munson, IRA specialist at 1st National Savings just waited on a customer who requested a recharacterization of his Roth IRA contribution to a traditional IRA contribution. Becky thought she had all the necessary paperwork to complete the transaction, but after the accountholder left, she realized she did not have a withholding election. Must she get the withholding election prior to making the recharacterization?

A7. No. A recharacterization is not a designated distribution under section 3405 and therefore, is not subject to withholding.

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Q8. When money is transferred from a traditional IRA into a Roth IRA as a conversion contribution, is withholding required?

A8. Yes. All Roth conversions are treated as distributions from the traditional IRA regardless of whether they were rolled over or transferred. Therefore, the distributions from the traditional IRA are subject to withholding.

Q9. Lynn Novak converted her SIMPLE-IRA into a Roth IRA in 1998. Lynn decided she did not want the Roth IRA and wants to recharacterize it back into the SIMPLE. Is this possible, and does she have to redesignate the money back as employer and employee contributions?

A9. Roth IRA conversion contributions from either a SEP or SIMPLE-IRA may be recharacterized to a SEP or SIMPLE-IRA (including the original SEP or SIMPLE-IRA). It is not necessary to track the source of assets, i.e., as employer or employee contributions.

Q10. Carla Reed made a traditional IRA contribution in April of 1998. She wasn't working at the time, but was planning on getting a job. She made the contribution early so the account would earn more interest. Carla did get a job in January, 1999, so she applied the 1998 excess against her contribution limit for 1999. She is also considering recharacterizing the contribution as a 1999 Roth IRA contribution, rather than a traditional IRA contribution. Is this allowed?

A10. No. An excess contribution to an IRA made in a prior year and applied against the contribution limits in the current year, under section 4973, cannot be recharacterized. Only actual contributions may be recharacterized. Excess contributions actually made for a prior year and deemed to be current-year contributions for purposes of section 4973, are not contributions that are eligible to be recharacterized (unless the recharacterization would still be timely with respect to the taxable year for which the contributions were actually made). This rule applies to any excess contribution, whether made to a traditional or a Roth IRA.

Q11. Mike Griffin converted $100,000 into a Roth IRA in 1998. It was deposited into ABC Financial, and Mike was paying the taxes over the four-year spread. Mike also had made a $2,000 1998 contribution into his Roth IRA at XYZ Savings. Mike died on 2/15/1999. Ann Griffin is the sole primary beneficiary of her husband's Roth IRA at ABC Financial. Mike's daughter, Mary Griffin, is the sole primary beneficiary of her father's Roth IRA at XYZ Savings. Ann wants to treat Mike's Roth at ABC Financial as her own, and pay the remaining taxes owing on the $100,000 conversion over the remaining four-year period. May she do this?

A11. No. The IRS language of section 408A(d) (3) (E)(ii)(ll) provides that the surviving spouse must acquire the "entire interest" in any Roth IRA. Under the aggregation and ordering rules of section 408A(d)(4) all of a Roth IRA owner's Roth IRAs are treated as a single Roth IRA, and a conversion contribution is therefore allocable to all the owner's Roth IRAs. Thus, a surviving spouse must be the sole beneficiary of all of a Roth IRA owner's Roth IRAs in order to acquire the entire interest in any Roth IRA to which a 1998 conversion contribution is properly allocable.

Q12. Tom Kirsch converted $86,000 during 1998, and was using the four-year spread to pay the taxes. Tom and his wife divorced in 1999. Must he accelerate the remaining payments or may he continue paying the taxes over the remaining four-year period?

A12. Tom may continue paying the taxes over the remaining four-year period. A change in filing status or a divorce does not affect the application of the four-year spread for 1998 conversions.

Q13. Matthew Boyer set up a substantially equal periodic payment schedule in 1997, when he was age 55. In 1998 he converted the traditional IRA to a Roth using the four-year spread to pay the taxes. Was this conversion allowed, and what about the substantially equal payment schedule that is already in effect?

A13. A conversion of a traditional IRA to a Roth IRA is allowed even though the accountholder is on a substantially equal periodic payment schedule. The withdrawal schedule must continue as before, however, or the 10% penalty will be assessed back to the first payment under the schedule.

Q14. Jon Busch converts his IRA in February 2000. If, in March 2000, he recharacterizes the amount back to the traditional IRA, what is the first day on which he may reconvert the amount again?

A14. January 1, 2001. He may not reconvert the amount before the later of the beginning of the taxable year following the taxable year in which the amount was converted, or the end of the 30-day period beginning on the day on which the IRA owner transfers the amount by means of a recharacterization.

Q15. Frank Simons will be age 70 l/2 in 1999. He wants to convert most of his traditional IRA to a Roth IRA now, leaving only the RMD amount in the traditional IRA for withdrawal in December. Is this OK?

A15. No. The final regulations retain the rule that the required minimum distribution (RMD) amount is ineligible for rollover. Whether the conversion amount is accomplished by a transfer or rollover, it is reported as a distribution and the first money out is considered the RMD amount.

1998 Form 5500-EZ
Continued from page 3

last day of the seventh month following the end of the plan year, unless you were granted an extension of time to file.

For a short plan year, file a return by the last day of the seventh month following the end of the short plan year. Modify the heading of the form to show the beginning and ending dates of your short plan year, and check the box for a short plan year. If this is also the first or final return, check the appropriate box.

Extension of Time to File

A one-time extension of up to 2 1/2 months will be automatically granted if Form 5558, Application for Extension of Time To File Certain Employee Plan Returns, is filed before the return/report's normal due date. A photocopy of the Form 5558 must be attached to the Form 5500-EZ, and the box above line 1b must be checked. Exception: One-participant plans are not required to file Form 5558 and are automatically granted an extension of time to file Form 5500-EZ until the extended due date of the Federal income tax return of the employer, if all of the following conditions are met:

• The plan year and the employer's tax year are the same,

• The employer has been granted an extension of time to file its income tax return to a date later than the normal due date for filing the Form 5500-EZ, and

• A copy of the IRS extension of time to file the Federal income tax return is attached. The box above line 1b must also be checked.

An extension granted by using this exception CANNOT be extended further by filing a Form 5558 after the normal due date (without extension) of Form 5500-EZ.

Where to File Form

5500-EZ is filed with the Internal Revenue Service Center, Memphis, TN 37501-0024.

Penalties

The penalty for not filing the correct Form 5500 by the required due date is $25 a day, up to $15,000.

Form Completion

The IRS has provided a completed sample form and supplemental explanation that are set forth on the enclosure along with the Schedule P. The format of the 1998 Form 5500-EZ is basically identical to the 1997 form, and there is complete line-by-line instructions for its completion. Most of the items are self explanatory, but here are a few comments on some of the lines.

• Line 1d: The business activity codes that you enter in line 1d are different this year, so do not use the same code you used in 1997. Choose the appropriate code from page six of the instructions.

• Line 4(a): The person must furnish the opinion letter number that the IRS 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.

• Line 7(a): This line about fully insured plans will not apply to most plan sponsors unless they have established the plan with an insurance company.

• Line 7(b) & 7(c): Plan contributions should be in cash. Question 7(c) is asking if there were any non-cash contributions (an audit question).

• Line 7(e): Asks for the amount of distributions that are nontaxable. Examples would be the return of nondeductible employee contributions or payments that qualify for the death-benefit exclusion.

• Line 7(f): The IRS means "transfers" under Code section 414(1) and not direct rollovers which are treated as distributions.

• 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 earnings on plan investments.

• Line 10: 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.

• Line 11(b): The form of payment must be a QJSA (qualified joint and survivor annuity) 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." Examples: 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; a person was paid a partial distribution from a profit sharing plan; or a person was paid a partial distribution from a money purchase plan after receiving the spouse's waiver.

Line 11©: 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.

Purpose of Schedule P

The purpose of the Schedule P is to start the statute of limitations, which means the period of time the IRS can come back and examine the return.

Even though an employer is not required to file a Form 5500, it is still to the employer's advantage to file the Form 5500-EZ. The Schedule P is only filed as an attachment to the Form 5500-EZ, and cannot be sent in by itself.

The Schedule P is signed by the fiduciary (trustee or custodian) of the plan.

Suggestion

If your financial institution does not assist with the preparation of the Form 5500-EZ, then we suggest you send a reminder notice to your business customer that he or she will need to determine if the Form 5500-EZ must be filed. ◆

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IRS 1999 PRIORITY GUIDANCE FOR IRAs AND RETIREMENT BENEFITS

1. Guidance relating to plan loans under section 72(p).

2. Guidance relating to consolidated employee plans compliance resolution system (EPCRS).

3. Guidance on methods of correcting plan qualification violations relating to section 401(a)(17) and other qualification provisions.

4. Guidance relating to rollovers involving qualified plans under section 401(a)(31).

5. Final regulations relating to remedial amendment periods under section 401(b).

6. Guidance relating to cash or deferred arrangements under section 401(k).

7. Guidance on automatic enrollment relating to salary reduction contributions.

8. Guidance under section 401(m).

9. Guidance on methods of correcting failures to satisfy the section 401(k) and (m) average deferral percentage and actual contribution percentage tests.

10. Guidance relating to the use of electronic technologies in the administration of qualified plans.

11. Update of Notice 92-48 relating to the model notice under section 402(f).

12. Guidance on methods of determining and allocating earnings in connection with correction of a failure to make timely plan contributions.

13. Final regulations relating to Roth IRAs under section 408A. (Completed. See T.D. 8816)

14. Guidance relating to reporting with respect to Roth IRAs under section 408A.

15. Guidance relating to the determination of earnings on excess IRA contributions.

16. Guidance on methods of correcting plan qualification violations relating to the exclusion of eligible employees from participation in a profit sharing plan or in a cash or deferred arrangement under section 401(k).

17. Guidance relating to the application of section 411(a).

18. Proposed regulations relating to the application of the anti-cutback rules in certain circumstances under section 411(d)(6).

19. Final regulations under sections 411 and 417 relating to cashouts of benefits.

20. Guidance relating to funding issues under section 412.

21. Announcement relating to review of mortality tables under section 412(1)(7)(c)(ii)(III).

22. Guidance relating to the definition of highly compensated employee under section 414(q).

23. Guidance on methods of correcting plan qualification violations relating to amounts in excess of the limits under section 415.

24. Guidance relating to the effect of the repeal of section 415(e).

25. Guidance relating to the application of the retroactive annuity starting date provisions under section 417(a)(7).

26. Guidance relating to the application of plan qualification rules to certain duplicate pension accruals.

27. Guidance providing a one-year extension of the remedial amendment period for plan amendments relating to recent legislation.

28. Revenue procedure regarding the determination letter program for plan amendments relating to recent legislation.

29. Revised master and prototype program procedures for qualified plans.

30. Guidance relating to the application of section 1042(e) to transfer to partnerships.

31. Guidance on waiver of section 4971(b) excise tax in standard terminations of defined benefit plans.

32. Announcement relating to electronic transmittal of Form W-4P. (Completed. See Ann. 99-6.) ◆

DELAY IN EFFECTIVE DATE(S)—WITHHOLDING OF TAX ON NONRESIDENT ALIENS

On March 22, 1999, the IRS issued a revision to the regulations relating to the withholding of tax on certain U.S. source income paid to foreign persons and related collection refunds and credits. The reason for the change—the IRS believes it is in the best interest of tax administration to delay the effective date of these regulations so that the taxpayers, entities which must withhold, and the government, can make the necessary changes.

The first change to the final withholding regulations is that payments to nonresident aliens will apply to payments made after December 31, 1999, (and not after December 31, 1998, as provided in the final regulation).

The second change is that the use of the new withholding certificates and statements will be mandatory after December 31, 2000, (and not after December 31, 1999, as provided in the final regulation).

Background. In April of 1996, the IRS proposed to modify extensively the withholding rules for payments to nonresident aliens. In October of 1997, the IRS adopted the final regulations. In general, the IRS changed the rules and procedures so that payers of distributions to nonresident aliens would be required to withhold from IRA/pension distributions in accordance with the rules of section 1441 rather than the rules of Code section 3405 as has been the previous approach. On April 13, 1998, in Notice 98-16, the IRS gave notice of their decision to extend the effective date of the final regulations and to make related changes to the transition rules for obtaining new withholding certificates, statements containing the necessary information and representations as required by the final regulation. The May 1999 newsletter will discuss thoroughly these new withholding rules for IRA/pension payments to nonresident aliens. This regulatory change is the extension which the IRS had said was forthcoming in April, 1998. ◆

CORRECTIONS AND CLARIFICATIONS FOR FORM 8606

The January newsletter contained a comprehensive discussion of the 1998 Form 8606. The IRS rightfully concluded it should clarify and correct some errors which were contained in the instructions. Therefore, the IRS issued Announcement 99-18 on March 17, 1999.

Announcement 99-18 is set forth below in its entirety. There are four main sections to this Announcement.

1. A comprehensive example of how to complete the 1998 Form 8606 for a conversion, recharacterization and reconversion. All transactions occurred in 1998. CWF comment—it would have been nice if the IRS had discussed an example where the conversion occurred in 1998 and the recharacterization occurred in 1999.

2. IRS "corrects" the note which is found after line 26 of Form 8606. The IRS describes the note on the Form 8606 as incomplete. The note as written reads, "If you receive a Roth IRA distribution before age 59½, you "will" be subject ..." The IRS has changed the "will" to "may," because the 10% additional tax will not be owed if the recipient qualifies for any of the Code section 72(t) exceptions.

3. IRS corrects the Roth worksheet. On page 2 of the instructions for the Form 8606, there should be a reference to Form 1040A, line 10b for item 1 under modified adjusted gross income for purposes of Roth IRAs.

4. IRS corrects the Education IRA worksheet. Line 2 of the worksheet on page 3 of the Form 8606 instructions is corrected by deleting the referenced amount for a married person filing separately. Remember there are only two categories for Education IRAs: (1) $150,000-$160,000 for married filing jointly and (2) $95,000-$110,000 for all other filers.

Announcement 99-18

This announcement provides supplemental instructions for the proper completion of Form 8606, Nondeductible IRAs, for Roth IRA conversions and recharacterizations. It also clarifies the proper computation of the 10% additional tax for early distributions in the case of Roth IRA conversions and subsequent withdrawals from Roth IRA accounts. Finally, it corrects the computation of modified AGI for purposes of Roth IRAs on page 2 and the Ed IRA Contribution Worksheet on page 3 in the separate instructions for Form 8606.

I. Reporting Roth IRA Conversions and Recharacterizations

Holders of traditional IRAs may convert these accounts to Roth IRAs if they meet the eligibility requirements and include any previously untaxed amounts converted in their gross income for the year of conversion. For conversions in 1998, the includible amount may be spread over 4 years, at the election of the taxpayer. A conversion may be undone by recharacterizing the converted amounts back to the traditional IRA.

Some questions have arisen about the proper reporting of conversions, recharacterizations, and reconversions to Roth IRAs, particularly regarding the reconciliation of amounts on Forms 1099-R issued by account trustees with amounts to be entered in Form 8606 and Form 1040.

The following comprehensive example clarifies this reporting.

Example: Mr. Smith has the following IRA activity in 1998:

Date	Activity
2/19/98	Mr. Smith contributes $2,000 to a Roth IRA.
2/19/98	Mr. Smith converts the entire $8,000 balance in his traditional IRA to a Roth IRA. The converted amount was placed into an account separate from the Roth contribution account. His total basis in the traditional IRA was $2,000 (from a nondeductible contribution in an earlier year).
9/10/98	The fair market value of Mr. Smith's conversion account decreased from $8,000 to $7,000. Mr. Smith recharacterizes the entire remaining balance of $7,000 to a traditional IRA.
9/10/98	Mr. Smith reconverts the $7,000 from the traditional IRA back to a Roth IRA.

In 1999 Mr. Smith receives three Forms 1099-R: one for the original conversion of $8,000, another for the $7,000 recharacterization, and a third one for the subsequent reconversion of $7,000.

Completion of Form 8606: Mr. Smith should complete the identifying information above Part I. He should leave Part I blank. Mr. Smith completes Part II of Form 8606 as follows:

Line 14a. Mr. Smith enters $15,000 on this line. This is the sum of the amounts reported to him in box 1 of the Forms 1099-R he received for the $8,000 conversion on February 19,1998, and the $7,000 reconversion on September 10, 1998.

Line 14b. Although Mr. Smith recharacterized $7,000 from his Roth conversion account to his traditional IRA, he reports $8,000 on line 14b. This is because line 14a includes $8,000 from his original conversion and he recharacterized the entire remaining balance of $7,000. He enters $8,000 on line 14b to "zero out" the conversion and subsequent recharacterization. Otherwise, Mr. Smith would be taxed on the $1,000 decline in market value in his Roth conversion account before the recharacterization.

Line 14c. Mr. Smith reports $7,000 on this line ($15,000-$8,000).

Line 15. Mr. Smith refers to the chart on page 5 of the Form 8606 instructions to determine the amount to enter on this line. As a result, he enters $2,000, which is his prior year nondeductible contribution to a traditional IRA.

Line 16. The taxable amount of the conversion is $5,000 ($7,000-$2,000).

Line 17. Mr. Smith elects to have the taxable amount spread over 4 years. In 1998 and in each of the next 3 years, Mr. Smith is taxed on $1,250.

Part III. Mr. Smith does not complete Part III. Although he received a Form 1099-R for his recharacterization of $7,000 from the Roth IRA to a traditional IRA, the recharacterization is not a distribution that is to be reported on line 18 of Part III. It is merely a trustee-to-trustee transfer of funds between IRA accounts.

Completion of Form 1040: Mr. Smith includes $22,000 on line 15a. This is the total IRA distributions that were reported to him in box 1 of the Forms 1099-R he received. Mr. Smith includes $1,250, the amount of the conversion that is taxable in 1998, on line 15b. This is the amount from line 17 of Form 8606.

II. Clarification of Amount Subject to 10% Additional Tax

The **Note** after line 26 of Form 8606 is incomplete. Regardless of whether you have an amount on line 22 or 25 of Form 8606, you may be subject to an additional 10% tax. The **Note** should read as follows:

> "**Note:** If you receive a Roth IRA distribution before reaching age 59 1/2, you may be subject to an additional 10% tax. See Form 5329. Include on line 1 of Form 5329 the **smaller** of the amount on line 20 **or** the sum of the amounts on lines 16 and 25."

Please disregard the paragraph headed **Lines 22 and 25–Additional 10% Tax** on page 6 of the instructions for Form 8606, as well as the first complete paragraph in the middle column of page 3 of the instructions for Form 5329.

III. Correction to Computation of Modified AGI for Purposes of Roth IRAs

Under **Roth IRAs** on page 2 of the Form 8606 instructions, item **1** under **Modified AGI for purposes of Roth IRAs** should include a reference to Form 1040A, line 10b.

IV. Correction to Ed IRA Contribution Worksheet

Line 2 of the worksheet on page 3 of the Form 8606 instructions should read: "Enter $150,000 if married filing jointly; or $95,000 for all other filers." The referenced amount for married filing separately should be deleted. ◆