THE Pension Digest

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ALSO IN THIS ISSUE –

COMPLYING WITH IRA STATEMENT AND MAILING REQUIREMENTS

Any business is always looking for ways to reduce its expenses. Financial institutions which serve as IRA custodians or issue IRA annuities are no different than any other business when it comes to trying to reduce expenses. Financial institutions have reporting requirements for non-IRA accounts as well as for IRA accounts. The rules are not the same.

Set forth at the end of this article are the pertinent portions of the IRS instructions on statement and mailing requirements.

We read these instructions as follows. A reporting entity is subject to different rules for furnishing statements. It is the type of payment which determines the rules for furnishing the statement.

The rules are very stringent for the following types of reporting forms: 1099-DIV, 1099-INT, 1099-OID and 1099-PATR. These stringent rules cover what can be enclosed and whether there must be the legend, "Important Tax Return Document Attached or Enclosed" printed on the statement and/or the envelope.

In contrast, the furnishing statement rules are NOT very stringent for the IRA forms (Form 1099-R, the January fair market value statement and the Form 5498). The IRA forms come under the category of "Other Payments" for purposes of determining the statement requirements. Note that the very strict statement mailing requirements which apply to the 1099-DIV and 1099-INT do NOT apply to the 1099-R, the January fair market value statement and the Form 5498. The IRA custodian MAY COMBINE these IRA statements with OTHER REPORTS OR FINANCIAL OR COMMERCIAL NOTICES or expand them to include other information to the recipient.

Because the statement mailing requirements do NOT apply to the IRA forms, we also conclude that the envelope rules do NOT apply since they are one of the statement mailing requirements. However, being conservative, we would suggest that an IRA custodian place some notice on an envelope containing IRA tax reporting forms stating that various IRA tax reporting forms are enclosed. But this notice is not required.

A financial institution (which is also an IRA custodian) wants to create a customer newsletter discussing general banking subjects and desires to mail it to all of its customers in January of 2000. They would like to send to their IRA accountholders the applicable IRA forms. *Is it permissible to do this? Or, must they send the IRA forms by themselves in a separate mailing?*

IRA forms can be combined with other enclosures. Obviously, non-IRA customers would not be sent any IRA forms. Such a mailing would NOT include any Form 1099-DIV or Form 1099-INT or any such substitute form. A financial institution will comply with the rules for furnishing the Form 1099-R, the January fair market value statement and the Form 5498 if it would add these IRA forms to the other contents of a mailing.

The pertinent portion of the IRS instructions follow:

H. Statements to recipients (borrowers, debtors, insureds, participants, payers/borrowers, policyholders, students, transferors, or winners on certain forms). If you are required to file a return discussed in these instructions, you also must furnish statements to recipients containing the information furnished to the IRS and, in some cases, additional information. Be sure that the statements you provide to recipients are clear and legible.

If you are not using the official IRS form to furnish statements to recipients, **see Pub. 1179,** Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099, 5498, and W-2G, for specific rules about providing "substitute" statements to recipients. Generally, a substitute is any statement other than Copy B (and C in some cases) of the official form. You may develop them yourself or buy them from a private printer. However, the substitutes must comply with the format and con-

Continued on page 2

IRA Mailing Requirements, Continued from page 1

tent requirements specified in Pub. 1179.

You are required to include the **telephone number** of a person to contact on the following statements to recipients: W-2G, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-DIV, 1099-G (excluding state and local income tax refunds), 1099-INT, 1099-LTC, 1099-MISC (excluding fishing boat proceeds), 1099-OID, 1099-PATR, and 1099-S. You may include the telephone number in any conspicuous place on the statements. This number must provide direct access to an individual who can answer questions about the statement. Although not required, it you report on other Forms 1099 and 5498, you are encouraged to furnish telephone numbers. The telephone number is not required on Copy A of paper forms nor on magnetic media filed with the IRS.

Different rules apply to furnishing statements to recipients depending on the type of payment (or contribution) you are reporting and the form you are filing. See the heading below for the type of payment you are reporting. The headings are (1) **interest, dividend, and royalty payments;** (2) **Real estate transactions;** and (3) **Other payments.**

Interest, dividend, and royalty payments. For payments of dividends under section 6042 (reported on Form 1099-DIV) or patronage dividends under section 6044 (reported on Form 1099-PATR), interest (including original issue discount) under section 6049 (reported on Form 1099-INT or 1099-OID), or royalties under section 6050N (reported on Form 1099-MISC or 1099-S), you are required to furnish an official or acceptable substitute Form 1099 to a recipient either in person or in a statement mailing by First-Class Mail to the recipient's last known address. Statements may be sent by intraoffice mail if you use intraoffice mail to send account information and other correspondence to the recipient.

Statement mailing requirements for Forms 1099-DIV, 1099-INT, 1099-OID, and 1099-PATR, and forms reporting royalties only. The statement mailing requirements apply only to Forms 1099-DIV (except for section 404(k) dividends), 1099-INT (except for interest reportable in the course of your trade or business under section 6041), 1099-OID, 1099-PATR, and royalties reported under section 6050N (on Form 1099-MISC or 1099-S). The mailing must contain the Form 1099 or acceptable substitute and may also contain the following **enclosures:** (1) Forms W-2, W-8, W-9, or other Forms W-2G, 1098, 1099, and 5498 statements; (2) a check from the account being reported; (3) a letter explaining why no check is enclosed; (4) a statement of the person's account shown on Form 1099; and (5) a letter explaining the tax consequences of the information shown on the recipient statement.

A statement of the person's account (year-end account summary) that you are permitted to enclose in a statement mailing may include information similar to the following: (1) tax-exempt interest (including accrued OID) and the part of such interest exempt from the alternative minimum tax or from statement or local income tax; (2) the part of a mutual fund distribution that is interest on U.S. Treasury obligations; (3) accrued interest expense on the purchase of a debt obligation; and (4) the cost or other basis of securities and the gain/loss on the sale of securities.

No additional enclosures, such as advertising, promotional material, or a quarterly or annual report, are permitted. Even a sentence or two on the year-end statement describing new services offered by the payer is not permitted. Logos are permitted on the envelope and on any nontax enclosures.

Note: *The IRS intends to amend the regulations to allow the use of certain **logos** and identifying slogans on substitute statements to recipients that are subject to the statement mailing requirements. Until the new regulations are issued, the IRS will not assess penalties for the use of a logo (including the name of the payer in any typeface, font, or stylized fashion and/or a symbolic icon) or slogan on a statement to a recipient if the logo or slogan is used by the payer in the ordinary course of its trade or business. In addition, use of the logo or slogan must not make it less likely that a reasonable payee will recognize the importance of the statement for tax reporting purposes. See Notice 96-62, 1996-2 C.B. 228.*

A recipient statement may be perforated to a check or to a statement of the recipient's specific account. The check or account statement to which the recipient statement is perforated must contain, in a bold and conspicuous type, the legend "Important Tax Return Document Attached."

The legend "Important Tax Return Document Enclosed" must appear in a bold and conspicuous manner on the outside of the envelope and on each letter explaining why no check is enclosed, or on each check or account statement that is not perforated to the recipient statement. The legend is not required on any tax form, tax statement, or permitted letter of tax consequences included in a statement mailing. Further, you need not pluralize the word "document" in the legend simply because more than one recipient statement is enclosed.

Note: *If you provide recipient statements in a "separate mailing" that contains only recipient statements. Forms W-8 and W-9, and a letter explaining the tax consequences of the information shown on a recipient statement included in the envelope, you are not required to include the legend "Important Tax Return Document Enclosed" on the envelope.*

Substitute forms. You may furnish to the recipient Copy B of the official form, or you may use substitute Forms 1099-DIV, 1099-INT, 1099-OID, or 1099-PATR, if they contain the same language as the official forms and they comply with the rules in Pub. 1179, relating to substitute Forms 1099. Applicable box titles and numbers must be clearly identified, using the same wording and numbering as the official form. However, for Form 1099-INT, if your substitute does not contain box 3, "Interest on U.S. Savings Bonds and Treas. obligations," you may omit "not included in box 3" from the box 1 caption. For information on substitute Forms 1099-MISC and 1099-S, see **Other payments** below.

Note: *All substitute statements to recipients must contain the tax year, form number, and form name prominently displayed together in one area of the statement. For example, they could be shown in the upper right part of the statement.*

If you are using substitutes, the IRS encourages you to use boxes so that the substitute has the appearance of a form. The substitute form must contain the applicable instructions as on the front and back of Copy B of the official form. See Pub. 1179 for additional requirements.

Certain "composite" statements are permitted. See Pub. 1179.

Real estate transactions. You must furnish a statement to the transferor containing the same information reported to the IRS on Form 1099-S. You may use Copy B of Form 1099-S or a substitute form that complies with Pub. 1179 and Regulations section 1.6045-4(m). You may use a Uniform Settlement Statement (under RESPA) as the written statement if it is conformed by including on the statement the legend shown on Form 1099-S and by designating which information is reported to the IRS on Form 1099-S. You may furnish the statement to the transferor in person or by mail. Furnish the statement at or after closing but by January 31 of the following year. The statement mailing requirements explained earlier do not apply to statements to transferors for proceeds from real estate transactions reported on Form 1099-S. However, the statement mailing requirements do apply to statements to transferors for timber royalties reportable under section 6050N on Form 1099-S.

Other payments. Statements to recipients for Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-G, 1099-LTC, 1099-MISC, 1099-MSA, 1099-R, 5498, 5498-MSA, W-2G, 1099-DIV only for section 404(k) dividends reportable under section 6047, 1099-INT only for interest reportable in the course of your trade or business under section 6041, or 1099-S (for royalties) need not be, but can be, a copy of the paper form filed with the IRS. If you do not use a copy of the paper form, the form number and title of your **substitute** must be the same as the official form. All information required to be reported must be numbered and titled on your substitute in substantially the same manner as on the official form. However, if you are reporting a payment as "Other income" in box 3 of Form 1099-MISC, you may substitute appropriate explanatory language for the box title. For example, for payments of accrued wages to a beneficiary of a deceased employee required to be reported on Form 1099-MISC, you might change the title of box 3 to "Beneficiary payments" or something similar.

Note: *All substitute statements to recipients must contain the tax year, form number, and form name prominently displayed together in one area of the statement. For example, they*

Continued on page 3

THE Pension Digest

IRA Mailing Requirements, Continued from page 2

could be shown in the upper right part of the statement.

Appropriate instructions to the recipient, similar to those on the official form, must be provided to aid in the proper reporting of the items on the recipient's income tax return. For payments reported on Form 1099-B, rather than furnish appropriate instructions with each Form 1099-B statement, you may furnish to the recipient one set of instructions for all statements required to be furnished to a recipient in a calendar year.

The statement mailing requirements explained earlier do not apply to statements to recipients for information reported on Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-G, 1099-LTC, 1099-MISC (except for royalties), 1099-MSA, 1099-R, 5498, 5498-MSA, W-2G, 1099-DIV for section 404(k) dividends only, and 1099-INT for interest reportable in the course of your trade or business under section 6041 only. You may combine the statements with other reports or financial or commercial notices, or expand them to include other information of interest to the recipient. Be sure that all copies of the forms are legible.

Certain "composite" statements are permitted. See Pub. 1179, **Time for furnishing forms or statements.** Generally, you must furnish Form 1098, 1099, and W-2G information by January 31, 2000. However, you may issue them earlier in some situations, as provided by the regulations. For example, you may furnish Form 1099-INT to the recipient on redemption of U.S. Savings Bonds at the time of redemption. Brokers and barter exchanges may furnish Form 1099-B anytime but not later than January 31.

Trustees or issuers of IRAs or SEPs must furnish participants with a statement of the value of the participant's account by January 31, 2000. Education IRA contribution information must also be furnished to the participant by January 31, 2000. Traditional IRA, Roth IRA, SEP, or SIMPLE contribution information must be furnished to the participant by May 31, 2000.

Trustees of a SIMPLE must furnish a statement of the account balance and the account activity during the year by January 31, 2000.

For real estate transactions, you may furnish the statement to the transferor at closing or by mail on or before January 31, 2000.

Filers of Form 1099-G who report state or local income tax refunds, credits, or offsets must furnish the statements to recipients **during** January 2000.

You will meet the requirement to furnish the statement if it is properly addressed and mailed on or before the due date. If the regular due date falls on a Saturday, Sunday, or legal holiday, the due date is the next business day. A business day is any day that is not a Saturday, Sunday, or legal holiday.

Extension. You may request an extension of time to provide the statements to recipients by sending a letter to IRS-Martinsburg Computing Center, Information Reporting Program, Attn: Extension of Time Coordinator, P.O. Box 1359, Martinsburg, WV 25402-1359 or to your district director. The letter must include (a) your name, (b) your TIN, (c) your address, (d) type of return, (e) a statement that your extension request is for providing statements to recipients, (f) reason for delay, and (g) the signature of the payer or authorized agent. Your request must be postmarked by the date on which the statements are due to the recipients. If your request for an extension is approved, generally you will be granted a maximum of 30 extra days to furnish the recipient statements. ◆

QUICK SUMMARY OF OPTIONS TO FURNISH THE JANUARY STATEMENT AND/OR THE 1999 FORM 5498

Back in May, many IRA custodians finished sending out the 1998 Form 5498 to their IRA accountholders.

The purpose of this article is to summarize for you various procedures which can be used to satisfy your IRA FMV and contribution reporting duties. Now is the time for each financial institution to determine if you want to keep doing your reporting as you have or if you might not like to adopt a new approach. A new approach might save you money.

Option #1. Furnish a complying FMV statement to all required recipients in January of 2000 and then mail the 1999 Form 5498 to all applicable IRA accountholders in May of 2000. There is much duplication under this option. Duplicate mailings are expensive.

Option #2. Furnish a complying FMV statement to all required recipients in January of 2000 and then mail the 1999 Form 5498 in May of 2000 to only those IRA accountholders who had made a reportable contribution. That is, the 1999 Form 5498 would not be mailed to those IRA accountholders who had not made any reportable contribution because they had already been informed of their 12-31 balance on the statement. There is still some duplication because you are reporting twice those contributions made during the calendar year because most FMV statements furnish the calendar year transactions even though the rules do not require it.

Option #3. Furnish the fair market value information to all required recipients in January of 2000, but furnish all other reportable contribution information known as of December 31 by furnishing a 1999 Substitute Form 5498. Accountholders would be notified by a SPECIAL NOTE that a "corrected" statement will be sent in May of 2000 if they would make a carryback contribution (one for 1999) during the period January 1, 2000 to April 17, 2000.

We called the IRS centralized call site (1-304-263-8700) and were told that the second substitute Form 5498 to be furnished to the recipient must be marked "corrected" because it is different from the first. However, because the Form 5498 information is not filed with the IRS until the end of May, all of the forms going to the IRS will be "originals," whether being sent on magnetic media or by paper.

A sample Substitute Form 5498 is set forth on page 4. ◆

IRAs AT BRANCHES BEING SOLD

These days, financial institutions are more frequently selling branches to other financial institutions. These branches generally have IRA accounts. We realize that IRAs are not usually a major factor in senior management's decision to buy or sell the branch. Nevertheless, there are concerns about IRAs which should be handled so that major problems do not develop. The purpose of this article is to address the various issues we believe any financial institution will want to consider to ease the sale or purchase of IRAs within a branch transaction. Be aware these are our own opinions, as very little

Continued on page 4

THE Pension Digest

IRAs Being Sold, Continued from page 3

guidance has been given by the IRS or other federal agencies about what to do in situations such as this. These opinions and suggestions are based on the rules that govern IRAs and, in particular, on the responsibilities of an IRA custodian. These suggestions are given to try to insure that all IRS rules governing IRAs are met at a time of transition such as this.

One viewpoint of a purchase/sale situation is—the sale of branches to another financial institution entity is very similar to having a large number of IRA transfers. That is, you would furnish the information which you normally furnish in any IRA transfer. In a transfer situation, the receiving entity is generally not relying on your files (i.e. the files of the sending entity). The new entity will have a new IRA plan agreement form signed and obtain new beneficiary designations. The new entity will ask for certification on required minimum distribution issues. To the extent you can, you would like the new entities to acknowledge in writing that these are standard IRA transfers.

The other point of view of a purchase/sale situation is—the new entity is going to rely to a certain extent on the file information which you provide. You want to define the extent of their reliance. You also want to know what information you have sent and you want the new entity to acknowledge in writing what they have received. You want to keep a copy of what you have provided.

To begin with, the purchase agreement governing the sale and purchase of the branch location should define what the selling entity will furnish the buying entity. This agreement should describe what will be furnished to the purchasing entity, when it will be furnished by, and in what format it will be furnished. This is the best possible scenario. Unfortunately, IRAs are often forgotten in purchase/sale situations such as this. When they are, we need to consider the questions discussed below.

IRS Reporting Is a Critical Issue in Scenarios Such as This

Who will do the IRS reporting for the IRA? Will the purchasing entity be responsible for reporting only transactions that occur after they purchase the locations, or for all the IRA transactions that occur in the year? The answers to these questions lead to understanding and deciding what needs to be provided to the purchasing entity and what they should wish to receive.

Continued on page 5

1999 - Substitute Form 5498

IRA Contribution Information

OMB No 1545-0747

☐ Corrected (if checked)

Institution FEIN Date S.S.N. Plan #	

Please Examine At Once
Check your Statement and notify us of any Discrepancy within Ten Days. Please Direct any Phone or Written Inquiries regarding your account to the IRA Manager at the above address.

This information is being furnished to the Internal Revenue Service.

Box 1 IRA contributions (other than amounts in boxes 2, 3, and 7-10	Box 6 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA ☐ Rechar. ☐ Ed IRA ☐
Box 2 Rollover contributions	Box 7 SEP contributions
Box 3 Roth conversion amount	Box 8 SIMPLE contributions
Box 4 Fair market value of account	Box 9 Roth IRA contributions
Box 5 Life insurance cost included in box 1	Box 10 Ed IRA contributions

Special Note: We have furnished you this 1999 Substitute Form 5498 in January of 2000. Be advised that if you make a regular or spousal contribution to your traditional IRA or Roth IRA for tax year 1999 during the the period of January 1, 2000 to April 17, 2000 that we will be sending you a "corrected" 1999 Substitute Form 5498 in May of 2000.

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 rollover 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 exceed $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.

Department of the Treasury - Internal Revenue Service

The Pension Digest

IRAs Being Sold, Continued from page 4

Obviously the entity that is responsible for reporting IRA transactions is going to need the information relating to the transactions that need to be reported. Contribution, rollover and transfer documentation for 5498 reporting is needed. Along with this would be investment and deposit vehicle information. This will be needed in order to report the fair market value of the IRA on the year-end statement and the Form 5498. Distribution documentation would be required for 1099-R reporting. The institution responsible for the various reporting will obviously need the appropriate documentation to insure accurate and timely reporting.

Another Issue

• *What does the purchasing entity intend to do with the IRAs from the standpoint of providing amendments or new plan agreements to the IRA accountholders? • Will they amend the documents at all? • If so, how will they amend them? • With a new plan agreement or an amendment document that does not require a signature?* The answer to these questions will tell us what the purchasing entity should be furnished in the way of plan agreements, beneficiary designations and amendments the selling institution may have furnished in the past.

It has always been our strong suggestion that new plan agreements be completed in situations like this. New plan agreements insure that the acquiring entity has accurate and complete information on the accountholder. It insures that the custodian will be able to administer all the IRA accounts under the same contractual provisions. It also serves to insure that all IRA accountholders have an up-to-date and complying IRA document. That said, this recommendation is often not followed. In many cases an amendment that is not signed is provided. In others, nothing at all relating to the IRA plan agreement and disclosure statement is provided. If either of these latter courses of action is adopted, you will need to furnish the purchasing entity a copy of the IRA plan, disclosure statement and beneficiary designation you have on file. The documents you have would then serve as the governing plan agreement, subject to any amendments they sent out, and the new custodian would have to have a copy of that executed document. Of particular importance in this latter situation is the need for the acquiring entity to have copies of the beneficiary designation each accountholder made. If the acquiring entity plans to have new IRA plan agreements executed as the means to amend these IRAs, it is probably not a legal or compliance requirement that you furnish them copies of the old plan agreement. It is our feeling however, that the conservative and safe course of action to follow is to provide the new custodian a copy of the plan and disclosure executed with you. As any new document will likely be viewed as an amendment to the document entered into with you, the new institution should have copies of the old documents that are being amended. Along these lines, we also feel it would be a good idea to furnish them with a copy of any past amendments you may have sent to these accountholders. This would allow the acquiring entity to document past amendments in the same manner as you have.

Other information the purchasing entity will need includes things like "70 1/2" required distribution elections, beneficiary distribution elections, pre-59 1/2 substantially equal periodic payment elections, and any periodic distribution instructions, just to name a few. These types of things are related to the day-to-day administration of the IRA and will be needed by the purchasing entity.

What this gets down to is not whether or not you need to furnish information to the new custodian, but rather, exactly what do you need to furnish and what, if anything, should you retain copies of? As is illustrated by the discussion above, there is a great deal of information you may need to provide the purchasing entity. As we see it, you basically have three options: (1) provide them with the entire customer file and retain nothing for yourself; (2) provide them with the entire file and retain exact copies of everything for yourself; and (3) provide them with the part of the documentation in each file that they will need to administer the accounts. We do not see the first option as being viable. Providing the entire file to them and retaining nothing for your own records would not be prudent. While this purchasing entity will be the new custodian and responsible for the IRA from this time forward, you still have some responsibility for this IRA. You have generated IRS reporting in the past, handled IRA distributions and the related income tax withholding, and have executed transactions for the IRA customers. Regardless of who the custodian may now be, you have some responsibility, and as such, liability for what has occurred in the past. When it comes to IRS reporting you have done in the past, you are responsible. If corrections needed to be made, it would be your responsibility to do so. You need to maintain adequate records related to past transactions and reporting. As such, furnishing the entire file and keeping no copies for yourself is not a good option.

The second option, providing the entire file and retaining an exact copy is the most conservative course of action. It insures that you and the purchasing entity both have the documents and records needed to properly administer the IRA. We realize that copying entire files can be a great deal of work.

As such, the third option may also be viable. Providing the purchasing entity the documents they need from the file and retaining copies for yourself as well is a viable alternative to providing the entire file. There is, after all, documentation in many files that the new custodian would not need. What, then, should be provided and retained? It is our feeling that the IRA plan agreement, beneficiary designations, and any amendments should be provided to the new custodian. We recommend providing any information related to reportable transactions over the past three years.

Continued on page 6

IRAs Being Sold, Continued from page 5

This is due to the fact that most IRS questions relating to reporting would go back over a three-year period. Related to this, it would be prudent to furnish the new custodian with copies of the last three years' IRS reports, i.e. customer statements, 5498s and 1099-Rs. Any information and documentation related to "70 1/2" required distributions, beneficiary distributions, and pre-59 1/2 distributions should be furnished to the new custodian. Additionally, while we have mentioned a number of topics that require you to furnish documentation, this is not a complete listing. Basically, if there is anything that makes an IRA special or unusual, the related documentation should be furnished. Documentation relating to scheduled distributions, to whether or not an IRA is a conduit, and things such as these need to be provided. We do recommend you retain copies as well. ◆

CONDUIT IRAs—ABILITY TO USE FOR QP RESTORATION

The IRS has adopted the position that funds within a conduit IRA can be used by a qualified plan participant who is rehired by a former employer to restore his or her nonvested account balance. Sometimes the term "purchasing credit for prior years of services" is used.

The Internal Revenue Code mandates that certain former qualified plan employees/participants have the right to restoration. Restoration is related to the concept of vesting. For example, Joan White was a participant in her employer-sponsored profit sharing plan. She had an account balance of $15,000 at the time she quit. She was 20% vested. The plan distributed $3,000 to her. Under the law, she does not immediately lose her rights to the other $12,000. The law provides she will regain her rights to this $12,000 (i.e. the nonvested portion), if she meets two requirements. First, she must be reemployed before she has incurred five consecutive one-year breaks in service following the date of the distribution of the $3,000. Second, she must repay the $3,000.

Joan was rehired by her former employer seven months after she quit. The employer discovered how valuable she was.

If Joan has kept this $3,000 in a conduit IRA, then she could roll it over to the qualified plan to restore her right to the nonvested balance of $12,000.

If Joan had not kept this $3,000 in a conduit IRA because she had added it to her "regular" traditional IRA, then she would not be able to roll over the $3,000 from her nonconduit IRA to restore her rights. She then would have to use "after-tax" dollars to restore her right in the $12,000. These after-tax dollars could either come from her checking account, her savings or investments, or she could take a sufficient distribution from her IRA so that after paying her taxes she could pay $3,000 to the plan.

The point: retaining restoration rights is one of the primary reasons individuals should maintain a conduit IRA.

A typical qualified plan may furnish the following explanation to a rehired employee/participant. "You must make payment by cash, check, money order, or bank draft payable at par to the plan. The IRS allows the plan to accept rollovers or direct rollovers as payment so that a participant can restore his or her nonvested portion. This right exists only if the money is an "eligible rollover distribution" from a 401(a) qualified plan, a 403(a) qualified annuity plan or a conduit IRA containing amounts only from a qualified 401(a) or 403(a) plans. If your funds qualify, then contact the plan administrator for a "Rollover Certification Form." Funds cannot be rolled over from a 403(b) plan or a 457 plan. Any required minimum distribution cannot be rolled over.

General Discussion of Conduit IRAs

What is a conduit IRA?

A conduit IRA is a holding tank for funds that originally came from a qualified plan and are or may be on their way to another qualified plan. An example of a qualified plan is a 401(k) plan. A conduit IRA is beneficial for those leaving one employer with a qualified plan, who need a temporary fund shelter as they seek reemployment. If the new company you join has a qualified plan, then you can roll the funds from your conduit IRA to the new employer's qualified plan. (Ex. Qualified plan (QP)-IRA-QP).

The purpose of the conduit IRA is to allow a participant who was paid a distribution from the qualified plan of the old employer to roll it over temporarily to a conduit IRA. Since the accountholder may not be reemployed within the allowable 60-day rollover period, the tax rules allow for a conduit IRA. When the individual is rehired, the person may move these funds to the new employer's qualified plan.

An example: Todd leaves the service of Toyco, and receives a lump-sum distribution of $10,000 from Toyco's qualified, noncontributory plan. Todd puts all of the $10,000 into a conduit IRA. Five years later, Todd goes to work for Rivaltoy. Todd can receive the assets of his conduit IRA tax-free and transfer part or all of them to Rivaltoy's qualified plan if he does so within 60 days after receiving them and Rivaltoy's plan accepts the assets. If Todd wants to contribute to an IRA during the years after Toyco and before Rivaltoy, he can set up a separate IRA account.

You may also wish to use your conduit IRA as a way to restore a prior distribution from a qualified plan so that you would regain rights in your nonvested account balance. The situation where this normally arises is – you quit working for an employer and then later return to work for that same employer. At the time you quit you had an account balance of $16,000. Since you were only 40% vested, you were paid (or deemed paid if you did a direct rollover to an IRA) the amount of $6,400. The other 60% or $9,600 will be forfeit-

Continued on page 7

The Pension Digest

Conduit IRAs,
Continued from page 6

ed after you have incurred five consecutive breaks in service or if you do not repay the $6,400 within five years from the date you were reemployed. If you had rolled over the $6,400 from the qualified plan into a conduit IRA, then you could roll over the $6,400 from the IRA back to the qualified plan. That is, you can use the funds within a conduit IRA for the repayment and then you would regain your rights to the $9,600. Note, however, the conduit IRA could arise from a different employer and still be used to restore a prior distribution.

May 403(b) funds also constitute a conduit IRA?

A conduit IRA is also a holding tank for funds that originally came from a section 403(b) plan or account and are on their way to another section 403(b) plan or account. 403(b) plans and accounts are a special type of retirement plan generally established by schools and hospitals. A conduit IRA is beneficial for those leaving one employer with a 403(b) plan, who need a temporary fund shelter as they seek reemployment. If the new company you join has a 403(b) plan, then you can roll the funds from your conduit IRA to the new employer's 403(b) plan. (Ex: (403(b)-IRA-403(b)).

How is a conduit IRA created?

The individual must establish an IRA by signing an IRA Plan Agreement. It is not required that the IRA be designated a "conduit" IRA as long as the non-commingling rule is met and as long as the funds originated from a qualifying rollover or direct rollover from a qualified plan or section 403(b) plan.

Must I affirmatively elect to call or name my IRA a conduit IRA?

No. As long as there has been no impermissible mixing within the IRA, your IRA established with a rollover contribution from a qualified plan qualifies as a conduit IRA whether or not you expressly informed the IRA custodian or trustee to label the IRA a conduit IRA.

Must all the funds in the qualified plan distribution be rolled over into the IRA?

No. A conduit IRA is created even if the individual does not roll over 100% of the amount eligible to be rolled over.

Example: Erica Peret, age 38, receives a distribution of $42,000 from her former employer's 401(k) plan. She retains $12,000 to pay off some credit card balances and rolls over $30,000. The $30,000 that is rolled over qualifies as a conduit IRA.

What governmental reporting takes place if funds are distributed from a qualified plan to the person, and then he or she recontributes the distribution amount?

If a recipient receives any money from the qualified plan that was eligible to be rolled over, 20% federal withholding will be withheld from the distribution check. The distribution will be reported on Form 1099-R showing the 20% withholding amount and the amount the customer received in check form.

If the recipient decides to roll over the funds after the check is received, they may roll over any portion of the amount of the check received, or they can roll over the entire amount of the withdrawal from the qualified plan.

Example: Tracy Turner had $10,000 in her qualified plan that was eligible for rollover. Because she did not make a direct rollover, $2,000 was withheld for federal taxes; the check she received was for $8,000. Tracy can roll over all or any portion of the $8,000 check she received, or roll over the full $10,000 by replacing the $2,000 with funds from another source (i.e. checking or savings). Tracy will receive a 5498 from the custodian/trustee of the IRA plan showing the rollover contribution.

What records should I maintain with respect to my rollovers?

Before the distribution is made from the qualified plan, the plan administrator for the qualified plan is required by law to give recipients of distributions eligible to be rolled over to IRAs, a general explanation of their rollover rights. Because this rule is found in Internal Revenue Code section 402(f), this is sometimes referred to as a "402(f) Notice." The 402(f) Notice explains what distributions can and cannot be rolled over. This notice should be kept, as well as the annual statements from the conduit IRA. With these documents, you can show proof that the rollover was eligible, and that no other funds were ever combined with the original deposit.

If the funds are later directly rolled to a new qualified plan, then also keep a copy of the request and the receipt received from the qualified plan administrator showing the deposit amount.

What is the non-commingling requirement?

Code section 408(d)(3)(A)(ii) is the statutory authority which authorizes the rolling over of certain funds within an IRA to a section 401(a) qualified plan. The statute reads, "no amount in the account…is attributable to any source other than a rollover contribution (as defined in section 402) from an employee's trust described in section 401(a) which is exempt under section 501(a)…and the entire amount received (including property and other money) is paid (for the benefit of such individual) into another trust not later than the 60th day on which the individual receives the payment or distribution." It is clear that the commingling of any type of IRA funds (regular, spousal, SEP, or SIMPLE) with the funds which originally came from a 401(a) qualified plan will mean that the funds within this IRA are no longer eligible to be rolled to another 401(a) qualified plan or 403(b) plan. It is not as clear whether funds from multiple section 401(a) qualified plans can be combined within the same conduit IRA. We construe this section as NOT imposing a requirement that a conduit IRA cannot receive funds from more than one section 401(a) qualified plan. You must act on the advice of your own attorney for this issue. The most conservative administrative approach would be to establish separate conduit IRAs when you are paid distributions from more than one qualified plan.

Is the determination as to whether an IRA has been commingled determined at the IRA plan agreement level or at the

Continued on page 8

Conduit IRAs,
Continued from page 7

time deposit or investment level?

It is determined at the IRA plan agreement level. For example, a person maintains an IRA #001. Within this IRA she has a CD for $12,000 which arose from annual contributions of $2,000 for four years plus related earnings. Within this IRA there is a second CD which arose from a rollover of $30,000 from a profit sharing plan. This IRA does NOT qualify as a conduit IRA. There has been an impermissible mixing. There needs to be two IRA plan agreements.

Is there a limit on how many times I can roll over funds from a QP plan into a conduit IRA?

No. The rules for IRAs permit only one rollover per IRA per 12-month period. No such rule exists for distributions from qualified plans.

What distributions are eligible to be rolled over?

Generally, the distribution of any portion of your qualified plan or a tax-sheltered annuity will be eligible to be rolled over. Three exceptions are discussed in the following paragraph.

Once you reach age 70 1/2, you must start taking distributions from your account each year. These are not eligible to be rolled over or transferred. Also, you are not eligible to roll over annuities paid over life, or life expectancy (single or joint) or any distribution which is one of a series of substantially equal periodic payments (i.e. installments) for a period spanning ten years or more. Also, a distribution which would not be taxable is not eligible to be rolled over.

How long can an IRA qualify as a conduit IRA?

There is no time limit. For example, in 1988 you rolled over $10,000 into an IRA from your former employer's profit sharing plan. The $10,000 has increased to $33,000 in 1999. Your present employer has a 401(k) plan which is written to accept rollover contributions from conduit IRAs. Even though 11 years have elapsed, you could roll over the $33,000 from the conduit IRA to the 401(k) plan. You could do so even if 30 years had elapsed.

Is there a minimum time restriction?

No. Funds can sit in a conduit IRA for 8 days, 35 days, 75 days or 9 months and still qualify to be rolled over to another qualified plan or section 403(b) plan as applicable. That is, funds can sit in a conduit IRA for a very short period of time before being withdrawn from the IRA and recontributed to the qualified plan (i.e. a rollover) or section 403(b) plan.

Can a person set up multiple conduit IRAs with regard to one or more distributions from a qualified plan?

Yes. There is no limit on how many conduit IRAs may be established. For example, a person receiving a distribution of $160,000 could roll over $20,000 to eight different conduit IRAs.

Is there any limit on the number of conduit IRAs a person may maintain?

No.

Why might a person want to move funds from his or her IRA to a qualified plan or section 403(b) plan?

There can be a number of reasons.

1. A distribution from a qualified plan may qualify for 5- or 10-year averaging. A distribution from an IRA will never qualify for 5- or 10-year averaging.
2. By combining your conduit IRA funds with other qualified plan funds you may maximize your investment return.
3. Funds within a qualified plan are more secure from creditors than assets within an IRA.
4. Funds within a qualified plan may be borrowed if the plan permits loans to participants. IRA funds may not be borrowed.

Must the entire distribution from a conduit IRA be rolled over, or may a partial amount of a distribution be rolled over?

The entire portion of a distribution from a conduit IRA must be rolled over. It is not permissible to roll over only a portion of the distribution and retain the rest.

Must a person withdraw the entire amount within his or her conduit IRA?

No. A person may withdraw just a portion of the balance in his or her conduit IRA. Whatever portion is withdrawn must be totally rolled over or not rolled over at all.

Is there a limit on how many times I can roll over funds from a conduit IRA into a qualified plan?

No. The "one rollover per 12-month" rule applies only if the funds are rolled over into an IRA. This rule does not apply because the conduit IRA funds are being rolled over to a qualified plan.

What governmental reporting takes place if the funds in the qualified plan are directly rolled over?

Funds that are directly rolled over are handled like a transfer, but reported like a rollover. A 1099-R will be generated for the distribution from the qualified plan using reason code "G." A form 5498 will be generated for the rollover contribution into the IRA.

What government reporting takes place if the funds are withdrawn from the conduit IRA and rolled over (or transferred) to a qualified plan?

A 1099-R will be generated from the IRA custodian/trustee. The reason code used will be "H." The administrator of the qualified plan will issue no Form 5498, but they will give a receipt for the contribution. The accountholder should attach a copy of the receipt to their 1040 tax form for verification that the amount was actually deposited into the qualified plan.

Can a person decide to terminate a conduit IRA?

Yes. An IRA ceases to be a conduit IRA if any impermissible commingling occurs. A person might wish to do this if there are fees associated with maintaining the IRA and the person knows he or she will never move the funds to another qualified plan or section 403(b).

Should a person consult with a tax advisor before deciding to roll over or directly roll over a distribution?

Yes. Because of the complexity of the tax rules, you are strongly advised to consult with your tax advisor to determine the most favorable course of action for you with respect to your distribution. What is right for you may not be right for another person or vice versa. ◆