THE Pension Digest

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ALSO IN THIS ISSUE –

GOOD NEWS—IRS ISSUES NEW PROCEDURES TO REPORT IRA RECHARACTERIZATIONS

The IRS has finally adopted revised procedures for an IRA custodian/trustee to report recharacterizations. The revised procedures should mean that recharacterizations will be more easily understood by IRA accountholders and by IRA personnel. IRA accountholders and IRA personnel have certainly found the reporting rules for recharacterizations to be extremely confusing. Part of the confusion may have been caused because the IRS authorized various alternative methods. The alternative methods set forth in Announcements 99-5 and 99-106 will no longer be able to be used. The new procedures are set forth in IRS Notice 2000-30 and apply to recharacterizations taking place after 12-31-2000 (i.e. to the 2001 reporting year and not for the 2000 reporting year). We believe the IRS would have liked to have had the new procedures be used to report recharacterizations for the 2000 reporting year, but the 2000 Form 5498 and the 2000 Form 1099-R have already been finalized.

Everyone who works in the IRA field should now be very happy because the IRS has developed some very good and workable procedures. One naturally wants to ask the IRS, "Why did it take you so long?"

When a recharacterization occurs, two events happen. First, the IRA accountholder changes the type of his or her contribution. For example, he or she changes it from being a contribution to a Roth IRA to being a contribution to a traditional IRA. Second, the funds are considered transferred from the one IRA type to the second IRA type. For tax purposes, the recharacterized contribution is treated as if it had been made to the other type of IRA (e.g. a traditional IRA).

When a recharacterization occurs, the IRA custodian/trustee of the First IRA must issue a Form 1099-R to report the deemed distribution. The gross amount transferred (original contribution amount plus related earnings) is reported on Form 1099-R.

When a recharacterization occurs, the IRA custodian/trustee of the Second IRA must issue a Form 5498 to report the recharacterization contribution which is the same gross amount (contribution plus earnings). The IRS made four critical changes.

Changes 1 & 2—New Code N and Combined Reporting

The IRS has created a new reason code "N" for box 7 which is to be used to report the deemed distribution from the First IRA when the original contribution occurred in one year (e.g. 2000) and the recharacterization of that contribution occurs in the same year (e.g. 2000). This is called a "same-year recharacterization." All same-year recharacterizations from the same First IRA must be reported together on a single Form 1099-R using code N in box 7.

The IRS changed the description of reason code "R." Prior to the rules change, reason code "R" was used for both types of recharacterizations. It will now be used to only report the deemed distribution from the First IRA when the original contribution and the recharacterization occur in the different years. This is called a "prior-year recharacterization." All prior-year recharacterizations from the same First IRA must be reported together on a single Form 1099-R using code R in box 7.

Example #1 from Notice 2000-30.

(i) On December 15, 2000, Taxpayer B makes an initial contribution of $2,000 to a traditional IRA (the FIRST IRA). On January 16, 2001, B makes another contribution to this IRA in the amount of $1,000 for the year 2001. On February 15, 2001, B makes another contribution to this IRA, again in the amount of $1,000 for the year 2001.

Pursuant to B's election, all three contributions are recharacterized as

Continued on page 8

RMD PLANNING TIP—POSSIBLE PARTIAL SOLUTION TO THE JOINT RECALCULATION SITUATION

Many IRA accountholders have expressly elected to redetermine their joint life-expectancy factor by using the recalculation method or have been deemed to have elected this method under the "70 1/2" default provisions of the IRA plan agreement. Remember that the recalculation method is only available to an accountholder and his or her spouse beneficiary. The recalculation method is not available with respect to nonspouse beneficiaries.

As should now be well known, there is a risk to electing the recalculation method. If either the accountholder or the spouse beneficiary dies, then the applicable factor is determined by using the current age of the surviving spouse, and the age of the deceased spouse is changed to zero. This means the required distribution amount will increase substantially. See Year 2005 in the Chart #1 illustration as set forth below. If both spouses die, then the entire interest of the IRA must be distributed before the last day of the year following the year of the second death. See Year 2007 in the Chart #2 illustration as set forth below.

Chart #1 is based on the situation where the IRA accountholder is age 71 and the spouse beneficiary is age 65. That is, they are relatively the same ages. Chart #2 is based on the situation where the IRA accountholder is age 71 and the spouse beneficiary is age 45. It is assumed the beginning balance is $100,000, the earnings rate is 6%, and the RMD distribution takes place on the last day of the year immediately after the addition of the earnings.

Chart #1

Year		Previous Year's Account Balance	Age(s) AcctH/Ben	Life-Expectancy Factor	Required Distribution
2000		100,000.00	71/65	22.8	4,385.96
2001		101,614.04	72/66	21.9	4,639.91
2002		103,070.97	73/67	21.0	4,908.14
2003		104,347.09	74/68	20.2	5,165.70
2004	1st death	105,442.22	75/69	19.3	5,463.33
2005		106,305.42	76/0 *	11.9	8,933.23
2006	2nd death	103,750.52	77/0 *	11.2	9,263.44
2007		100,712.11	0/0 **	1.0	106,754.84
Total Amount Distributed					$149,574.55

Note that joint recalculation is used for years 2000-2004, single recalculation for years 2005-2006 (see *), and the account must be paid out by 12-31-2007 (see **).

Chart #2

Year		Previous Year's Account Balance	Age(s) AcctH/Ben	Life-Expectancy Factor	Required Distribution
2000		100,000.00	71/45	38.2	2,617.80
2001		103,382.20	72/46	37.3	2,771.82
2002		106,813.49	73/47	36.3	2,942.52
2003		110,279.78	74/48	35.4	3,115.25
2004	1st death	113,781.32	75/49	34.5	3,298.01
2005		117,310.19	76/0 *	12.0	9,859.00
2006	2nd death	114,490.80	77/0 *	11.2	10,222.39
2007		111,137.86	0/0 **	1.0	117,806.13
Total Amount Distributed					$152,632.92

Note that joint recalculation is used for years 2000-2004, single recalculation for years 2005-2006 (see *), and the account must be paid out by 12-31-2007 (see **).

Continued on page 3

The Pension Digest

RMD Planning Tip,
Continued from page 2

Chart #1 and Chart #2 illustrate the fact that either $106,754.84 or $117,806.13 will need to be distributed within only two tax years (i.e. the year of the second death and the year after the second death). Consequently, the tax bite will be more substantial than most people would like.

Any solution for this situation/problem?

One solution has been discussed for many years. If the IRA accountholder dies first, then in almost all situations, the surviving spouse beneficiary should elect to treat the decedent's IRA as his or her own. New elections may then be made, and presumably a joint nonrecalculation schedule will be elected.

There is a possible second solution which has not been frequently discussed. The proposed IRA RMD regulation requires that the RMD calculation be changed in some situations when the beneficiary is changed after the required beginning date. The general rule is—if the change in beneficiary will result in a larger required distribution amount (i.e. because the new beneficiary is older), then the RMD calculation must be made for all future years by using the new beneficiary.

So, what happens with Chart #1 if, in 2001, the IRA accountholder changes his or her beneficiary to be a brother or sister who is two years older than his or her spouse beneficiary?

We construe the IRA regulation as providing that the special six-step hybrid method would be used to calculate the life expectancy factor for all years after the year of the change of the beneficiary to the older sister or brother. A revised Chart #1 as modified appears below.

Modified Chart #1

Year		Previous Year's Account Balance	Age(s) AcctH/Ben	Life-Expectancy Factor	Required Distribution
2000		100,000.00	7/165	22.8	4,385.96
2001	Change in Beneficiary	101,614.04	72/66	21.9	4,639.91
2002		103,070.97	73/69 *	20.5	4,908.14
2003		104,347.09	74/70 *	19.6	5,165.70
2004		105,442.22	75/71 *	18.8	5,463.33
2005		106,305.42	76/72 *	17.5	8,933.23
2006	Accountholder Dies	103,750.52	77/73 *	16.7	9,263.44
2007		100,712.11	0/74 **	11.4	8,834.40
2008		97,920.44	0/75 **	10.4	9,415.43
2009		94,380.24	0/76 **	9.4	10,040.45
2010		90,002.60	0/77 **	8.4	10,714.60
2011		84,688.16	0/78 **	7.4	11,444.35
2012		78,325.10	0/79 **	6.4	12,238.30
2013		70,786.31	0/80 **	5.4	13,108.58
2014		61,924.91	0/81 **	4.4	14,073.84
2015		51,566.56	0/82 **	3.4	15,166.64
2016		39,493.91	0/83 **	2.4	16,455.80
2017		25,407.74	0/84 **	1.4	18,148.39
2018		8,783.81	0/85 **	1.0	9,712.84
Total Amount Distributed					$191,711.33

Note that joint recalculation is used for years 2000-2001, the six-step method (i.e. recalculation for the accountholder and non-recalculation for the beneficiary) will be used for years 2002-2006 (see *), since the change in beneficiary occurred in 2001 and since the accountholder died in 2006. Consequently, the required distribution amount increases slightly because of the change in beneficiary to the older brother or sister. However, because a nonspouse is required by law to use the nonrecalculation method, then a total distribution will NOT be required upon the death of the accountholder, the former spouse beneficiary or the new brother/sister beneficiary. There will be a payout schedule for years 2007-2018 (see **) as the nonspouse beneficiary will be

Continued on page 4

RMD Planning Tip,
Continued from page 3

allowed to continue the six-step method as modified by the accountholder's death.

The proposed regulation indicates the beneficiary will be able to continue the schedule determined as follows: determine the age of the oldest beneficiary in the year the accountholder attained age 70 1/2 and then decrease by one for each elapsed year. The brother or sister was age 67 in the year the accountholder was age 70 1/2 and 71.

The effect of this beneficiary change has been to partially undo the "joint recalculation" election. A total distribution of the inherited IRA is not required within two years. Rather than having to be paid out by 12-31-2007 and to include $100,712.11 in two tax years, there is a "stretched-out" payout schedule until 12-31-2018. Presumably the tax liability will be less because of the longer payout time period. In addition, because the IRA continues to exist, the opportunity for deferral of taxes on the earnings also continues. The total amount to be paid out under the Modified Chart #1 is $191,184.30, compared with a total payout of $143,471.82 to be paid out under Chart #1.

We do not believe the IRS would contest the change in the RMD calculation (either before the IRA accountholder's death or thereafter) as a result of the above-discussed change in the beneficiary (i.e. spouse to older brother or sister), but we are not confident the IRS would not contest the change if younger children would subsequently be named. For example, is it permissible for an IRA accountholder at some later point (i.e. five years, two years, one year, six months, three months, etc.) to change his or her beneficiary a second time (i.e. from his or her sister or brother to one or more of his or her children) and gain the benefit of the six-step RMD calculation method for his or her children?

We believe the answer is "Yes," but this is a "caveat" situation. There is no law which imposes any limits as to how many times an accountholder may change his or her beneficiary(ies).

If the accountholder may at a later time designate his or her children as the IRA beneficiary, then the IRA accountholder will have been able to accomplish the partial undoing of the joint recalculation election, and gain the ability for his children to have a distribution period other than being required to liquidate the IRA by December 31 after the year of the second death. Caveat: we expect the IRS may try to argue that an IRA accountholder should not be able to do indirectly what he or she could not do directly. That is, the children, as beneficiaries, would have had to use the joint recalculation method if they have been the immediate successor beneficiary rather than their uncle or aunt.

What if there is a younger spouse beneficiary?

If the spouse beneficiary is sufficiently younger than the IRA accountholder, it may well be possible that the IRA accountholder could now designate a child to be the new IRA beneficiary as long as such a child is older than the spouse. Assume the child is age 47 in 2000. Modified Chart #2 is set forth below:

Modified Chart #2

Year		Previous Year's Account Balance	Age(s) AcctH/Ben	Life-Expectancy Factor	Required Distribution
2000		100,000.00	71/45	38.2	2,617.80
2001	Chg Ben	103,382.20	72/46	37.3	2,771.64
2002		106,813.49	73/49 *	33.7	3,169.54
2003		110,052.76	43/50 *	32.8	3,355.27
2004		113,300.66	75/51 *	31.8	3,562.91
2005		116,535.78	76/52 *	30.9	3,771.38
2006	Accth Dies	119,756.55	77/53 *	30.0	3,991.88
2007		122,950.05	0/54 **	28.9	4,254.33
2008		126,072.73	0/55 **	27.9	4,518.74
2009		129,118.36	0/56 **	26.9	4,799.94
2010		132,065.52	0/57 **	25.9	5,099.05
2011		134,890.40	0/58 **	24.9	5,417.29
2012		137,566.54	0/59 **	23.9	5,755.92
2013		140,064.61	0/60 **	22.9	6,116.36
2014		142,352.12	0/61 **	21.9	6,500.10
2015		144,393.15	0/62 **	20.9	6,908.76
2016		146,147.98	0/63 **	19.9	7,344.12

Continued on page 5

The Pension Digest

RMD Planning Tip,
Continued from page 4

2017	147,572.74	0/64 **	18.9	7,808.08

Modified Chart #2 (Continued)

Year	Previous Year's Account Balance	Age(s) AcctH/Ben	Life-Expectancy Factor	Required Distribution
2018	148,619.02	0/65 **	17.9	8,302.74
2019	149,233.43	0/56 **	16.9	8,830.38
2020	149,357.05	0/57 **	15.9	9,393.53
2021	148,924.95	0/58 **	14.9	9,994.96
2022	147,865.48	0/59 **	13.9	10,637.80
2023	146,099.61	0/60 **	12.9	11,325.55
2024	143,540.03	0/61 **	11.9	12,062.19
2025	140,090.25	0/62 **	10.9	12,852.32
2026	135,643.35	0/63 **	9.9	13,701.35
2027	130,080.60	0/64 **	8.9	14,615.80
2028	123,269.64	0/65 **	7.9	15,603.75
2029	115,062.06	0/66 **	6.9	16,675.66
2030	105,290.13	0/67 **	5.9	17,845.78
2031	93,761.75	0/68 **	4.9	19,135.05
2032	80,252.40	0/69 **	3.9	20,577.54
2033	64,490.01	0/70 **	2.9	22,237.93
2034	46,121.47	0/71 **	1.9	24,274.46
2035	24,614.30	0/72 **	1.0	26,091.16
Total Amount Distributed				361,921.86

Note that joint recalculation is used for years 2000-2001; the six-step method (i.e. recalculation for the accountholder and non-recalculation for the beneficiary) will be used for years 2002-2006 (see*), since the change in beneficiary occurred in 2001 and since the accountholder died in 2006. Consequently, the required distribution amount increases slightly because of the change in beneficiary to the older child. However, because a nonspouse is required by law to use the nonrecalculation method, then a total distribution will NOT be required upon the death of the accountholder, the former spouse beneficiary or the child beneficiary. There will be a payout schedule for years 2007-2018 (see **) as the nonspouse beneficiary will be allowed to continue the six-step method as modified by the accountholder's death. The proposed regulation indicates the beneficiary will be able to continue the schedule determined as follows: determine the age of the oldest beneficiary in the year the accountholder attained age 70 1/2 and then decrease by one for each elapsed year. The brother or sister was age 67 in the year the accountholder was age 70 1/2 and 71.

The effect of changing one's beneficiary from a spouse to nonspouse in Chart #2 is certainly more pronounced because of the younger age of the original spouse beneficiary. Again, the effect is to undo the "joint recalculation" election. A total distribution of the inherited IRA is not required within two years. Now the stretch-out period is until 12-31-2035. The tax liability will presumably be less because of the longer payout time period. In addition, because the IRA continues to exist, the opportunity for deferral of taxes on the earnings also continues. The total amount to be paid out under the Modified Chart #2 is $361,921.06, compared with a total payout of $152,632.92 to be paid out under Charge #2.

Conclusion. There will be times when IRA accountholders (and their beneficiaries) will be worse off if the joint recalculation method is the RMD schedule which will apply to distributions to the accountholder and his or her beneficiary(ies). It is generally believed that once the joint recalculation method is elected that it can never be changed unless the accountholder would die first. We believe this is incorrect. We believe that the joint recalculation method is replaced by the six-step hybrid method if the accountholder changes his or her beneficiary designation by naming a person who is older than his or her spouse beneficiary. This must be done while both the accountholder and his or her spouse beneficiary are alive. ◆

ADMINISTRATIVE PROCEDURES FOR "CERTAIN" QUALIFIED PLAN DEPOSITS

This article was originally printed in the April 1995 edition of the *Pension Digest*. However, because of the great demand we have had for this information, we are reprinting it for your review. Even though five years have passed, the rules have not changed regarding the situations discussed herein.

More and more financial institutions are being asked to accept deposits from various types of qualified plans and Keogh plans (a Keogh plan is a qualified plan which covers self-employed individuals) — 401(k) plans, profit sharing plans, money purchase plans, defined benefit pension plans. Why is this happening? Many businesses with employees are establishing 401(k) plans which allow the individual participants to self-direct their plan account balances. Many plans established as one-person Keogh plans are now being written to allow the owner/employee to invest his or her plan funds in many different investment entities.

Your financial institution will have people who are currently customers with checking and savings/time deposit accounts who are also participants in a qualified plan at work. Many of these people will want a portion of their qualified plan account balance invested in a fixed-interest-rate instrument or a variable-interest-rate instrument which is entitled to insurance from the FDIC or similar insurance. Your financial institution should at least be aware that this is a deposit category for which there may be more demand than there has been in the past. If your financial institution has not already done so, you should establish the necessary procedures to seek out such deposits and to service them well.

Here is a typical situation. Mary Martinez comes to your financial institution. She is employed by ABC National Corporation as a senior computer programmer. She is an excellent customer of your institution. She currently has $80,000 of non-IRA/pension time deposits with your financial institution. She now comes to your financial institution and states that her employer maintains a 401(k) plan which allows her to direct the plan trustee how to invest her plan account balance. She tells you that she would like to have some of her 401(k) elective deferrals ($400 per month) invested in one or more time deposits as offered by your institution. She asks you if your institution will be able to accommodate her and the plan trustee. If you are willing, then she wants you to tell her what she and the plan trustee need to do to commence such deposits. She asks what "terms" will apply to her deposits.

Many institutions would probably tell Mary Martinez one of two things. First, she would be told, "We don't handle QP plans or deposits; we quit doing that years ago." Many institutions terminated their sponsorship of Keoghs (one-person qualified plans) during the period of 1986-1995. They apparently did so because they concluded that there were not sufficient business reasons (low profits, perceived higher liability exposure, or not necessary for customer retention) to seek and service such deposits. Many thought that the rules were too complex.

Secondly, the institution's personnel might tell Mary that pension deposits may only be made in the trust department.

We would suggest that if a financial institution establishes and follows the proper administrative procedures, then most financial institutions (including the non-trust/retail side) should be willing and able to accept a pension deposit.

We would also suggest that financial institutions consider the following options in establishing its procedures with respect to pension deposits. The options are:

1. The institution decides to never accept any qualified plan deposits;

2. The institution decides to accept qualified plan deposits, but it makes very clear its policy that it will render no other services.

3. In order to encourage the making of qualified plan deposits, the institution decides to sponsor one or more qualified plan prototypes, but it also decides to require the business customer to consult with his or her own attorney, accountant, or pension consultant for all of the administrative requirements.

4. In order to encourage the making of qualified plan deposits, the institution decides to sponsor one or more qualified plan prototypes and decides that it will assist the business customer with some of the administrative tasks, but the employer will retain primary responsibility. For example, the institution will prepare Form 1099-Rs as based upon information furnished by the employer, plus the institution will assist with the preparation of the Form 5500-C/R/EZ. The financial institution could either do the administrative service itself, or contract with a pension consulting firm to have such services performed.

Obviously, the administrative procedures which a financial institution adopts will vary depending upon which option it elects.

Purpose of This Article

The purpose of this article is to discuss option #2 — the institution will accept qualified plan deposits, but will render no other services. A financial institution may certainly accept deposits from the trustee of a qualified plan without rendering any plan document or administrative services. What should be the procedures for handling deposits and contributions when this option has been selected?

The Policy Considerations and Procedures With Respect to Accepting Deposits

<u>Topic # 1. Understand Who Your Depositor or Customer Is</u>

Your customer is the trustee of the qualified plan. The only person authorized to sign on this account will be the trustee. This is true even if the deposit is made on behalf of a specific person. The financial

Continued on page 7

The Pension Digest

Administrative Procedures, Continued from page 6

institution should never deal with the named plan participant, but should only deal with the trustee. When the trustee withdraws the funds, he or she will be doing so in their status as a trustee. Thus, the financial institution has no responsibility to prepare a Form 1099-R and the withholding rules do not apply.

For example, Jane Doe, trustee of the ABC Corporation 401(k) profit sharing plan, purchases a time deposit in the amount of $25,000 for the benefit of John Smith, a plan participant. The owner of the time deposit is Jane Doe as trustee of the ABC Corporation Profit Sharing Plan and Trust. The tax identification number used with respect to the time deposit should be the TIN of the trust related to the plan. Your financial institution should never deal directly with the participant, John Smith. This is true even if the trustee would want you to make a distribution directly to John Smith. Based upon your service agreement (see discussion immediately below), you would inform Jane Doe, trustee that such an action is administrative and is not your task, and that you will not pay the funds directly to John Smith but that you will issue the check to her as trustee.

This same situation can occur with a one-person Keogh plan. Many financial institution personnel are confused in this situation. For example, Tom Mills has signed a profit sharing prototype document with First Investment Corporation which allows him, as the employer/plan sponsor, to invest his QP funds in numerous financial institutions. He now comes to your financial institution, First State Bank. Your institution does not sponsor a QP prototype. He wishes to purchase an $80,000 time deposit from you because you have excellent terms on a five-year CD. Note that he buys the time deposit in his status as the plan trustee. Again, when he comes in to withdraw the funds, you will deal with him in his status as being a trustee and not a participant. If you issue the check to him as trustee, then you will have no responsibility to prepare any Form 1099-R or to comply with the withholding rules.

Topic #2 - Formalize and Establish Your Relationship With the Depositor/Trustee

We recommend that your financial institution and your customer (the trustee) sign a contract or service agreement wherein the depositor as the trustee formally acknowledges that he or she is making this deposit in their capacity as a trustee and not as a participant, and that the financial institution has no plan document or administrative duties. This will not generally be a problem when the trustee is acting on behalf of a plan with multiple participants. If a problem arises, it normally arises with respect to the one-person plans. Many times the doctors, dentists, etc. who establish these plans don't understand that there is a very important and critical difference in their respective roles of trustee or participant. The purpose of the service agreement is to emphasize that your financial institution is dealing with them because they are the trustee. Thus, when the person withdraws his or her deposit, you make the payee on the check, "Tom Mills as trustee of the Tom Mills profit sharing plan."

Topic #3 - Decide What Type of Time Deposit, Savings Accounts and Checking Accounts You Are Going to Offer Your Pension Depositors

What type of time deposit will you offer Mary Martinez and the plan's trustee since the plan will be depositing $400 every month on her behalf? Do you want to sell the trustee 12 different CDs? Will you only offer a variable interest rate time deposit? Or, would your financial institution be willing to give a fixed rate?

Financial institutions may need to be more creative than they have been with this special type of deposit. As long as the plan trustee, on behalf of Mary Martinez, contractually promises that the subsequent monthly contributions over the term of the deposit account will be made, and that there would be defined penalties if they were not made, then it seems reasonable that a fixed rate could be offered.

Topic #4 - Furnish the Required Pass-Through Insurance Notices As Required by FDIC Rules

A financial institution which is subject to FDIC regulation is required in various situations to furnish one of the various pass-through notices. A financial institution will need to furnish a notice in the following three situations:
(1) when an account is first opened;
(2) when a depositor requests one; and
(3) when the capital status of the financial institution deteriorates so that current deposits would not be entitled to pass-through coverage.

Topic #5 - Data Processing and Governmental Reporting Considerations

This is where many financial institutions experience problems because most data processing systems are written to handle only two types of deposits: (1) a non-IRA deposit which requires, in most cases, the generation of a Form 1099-INT or (2) an IRA deposit which requires the generation of Form 5498.

The problem is that a qualified plan deposit is a unique third type of deposit. The income or interest earned by a qualified plan deposit is not subject to current income taxation under the Internal Revenue Code. In that sense, a qualified plan is very similar to an IRA. The difference is that a financial institution must report IRA contributions to the IRS on the Form 5498, but there is no similar form used to report the qualified plan contributions made by the sponsor of a qualified plan. Thus, the financial institution must be able to "shut-off" or not generate a Form 5498 for any QP/Keogh deposits.

On the other hand, a financial institution should not generate a Form 1099-INT to report any interest earned since the pension trust does not currently pay taxes on its income. If the trustee can substantiate for your financial institution that he or she is acting on behalf of a qualified plan by furnishing you with a copy of the favorable IRS opinion or determination letter, then you should not generate a Form 1099-INT.

The employer who sponsors

Continued on page 8

GOOD NEWS—NEW REPORTING PROCEDURES APPLY FOR RECONVERSIONS ALSO

The new procedures discussed above for recharacterizations will also apply for reconversions.

Reconversions are reported on Forms 1099-R and 5498 in the same manner as other conversions. The alternative method described in Announcements 99-5 and 99-106 will not be available for reconversions occurring in 2001 and thereafter. Each conversion and reconversion will need to be reported separately.

A conversion occurs when IRA assets or money moves from a traditional IRA to a Roth IRA either by rollover or by transfer. A conversion is treated as a distribution for income tax purposes, except the 10% additional tax for not being age 59 1/2 does not apply.

A reconversion is a conversion from a traditional IRA to a Roth IRA of an amount which had previously been recharacterized to be a traditional IRA rollover contribution after having been previously converted to a Roth IRA. ◆

IRS Issues New Procedures, Continued from page 1

contributions to a Roth IRA (the SECOND IRA) on April 2, 2001. As of April 2, 2001, the earnings attributable to the initial contribution are $300, the earnings attributable to the second contribution are $200, and the earnings attributable to the third contribution are $150.

(ii) The trustee of the FIRST IRA issues B a 2001 Form 1099-R for the prior year recharacterization of the initial contribution. The gross amount of the transfer ($2,300) made in connection with the recharacterization of the initial contribution is shown in Box 1 and Code R is used in Box 7.

The trustee of the FIRST IRA also issues B a second 2001 Form 1099-R for the two same year recharacterizations. This Form 1099-R will show $2,350 (the combined gross amount of the transfers made in connection with the recharacterization of the two 2001 contributions ($1,000 + $200 + $1,000 + $150) in Box 1 and will use the new Code N for same year recharacterizations in Box 7.

Special Note: Because prior-year recharacterizations and same-year recharacterizations will be separately coded, these amounts may not be reported together on the same Form 1099-R. Similarly, because a recharacterization will have a different code than other reportable distributions, a recharacterization may not be reported together with another reportable distribution on the same Form 1099-R.

Changes 3 & 4—New Recharacterization Box on Form 5498 and Elimination of Requirement to Report Each Recharacterization Separately

Under current procedures, the amount recharacterized is reported in box 2 (rollovers) and there must be a separate reporting of each recharacterization. There will be a new box on the 2001 Form 5498 devoted solely to reporting the amount of one or more recharacterizations. A single Form 5498 is permitted to be used to report all contributions (including recharacterization contributions) made to an IRA (i.e. a plan agreement) in the same year. Alternatively, the IRA custodian can choose to report each recharacterization contribution on a separate Form 5498.

Example #2 from Notice 2000-30.

(ii) Taxpayer C has made two contributions to her traditional IRA (the FIRST IRA). The first contribution, in the amount of $2,000, was made on November 1, 2000. The second contribution, also in the amount of $2,000, was made on February 1, 2001, for 2001.

Pursuant to C's election, the November 1, 2000 contribution is recharacterized as a contribution to a Roth IRA (the SECOND IRA) on April 2, 2001, at which time the earnings attributable to the November 1, 2000 contribution are $100. Then, pursuant to C's election, the February 1, 2001, contribution is recharacterized as a contribution to the SECOND IRA on December 12, 2001, at which time the earnings attributable to the February 1, 2001, contribution are $850.

(ii) The trustee of the SECOND IRA issues C a single 2001 Form 5498 on which both recharacterizations are reported. That Form 5498 will show, in a new box, $4,950 ($2,000 + $100 + $2,000 + $850). Alternatively, consistent with Notice 98-49, the trustee of the SECOND IRA may issue two 2001 Forms 5498, one reporting $2,100 and one reporting $2,850. ◆

Administrative Procedures, Continued from page 7

a plan covering many participants will report the aggregate total of its contributions on the IRS Form 5500-C/R or Form 5500. This employer, in most situations, will claim as a tax deduction, the amount of its contribution on its tax form.

The sponsor of a one-person plan will claim the amount of his or her contribution on Form 1040 and will also report it on Form 5500-EZ, if required to file such a form because the $100,000 threshold amount is exceeded.

Topic #6 - Be aware that the Truth-In-Savings Rules Do Not Apply to QP Deposits

The Truth-In-Savings rules apply only to consumers, and deposits made by businesses (even one-person businesses) are not covered by TISA.

Policy Considerations and Procedures When the Deposit Is Withdrawn

This subject has already been briefly discussed. Again, your institution must only deal with the plan trustee. If your financial institution is dealing with a one-person plan, you must make sure you deal with this one person in his or her capacity as a trustee and not as a participant.

A standard qualified plan distribution form must not be used, as this payment of funds is not a distribution. The trustee has simply decided that he or she wishes to change how the funds are invested. A special withdrawal form should be used — a request for a withdrawal by a plan trustee. Your financial institution must issue the check to the trustee, and not to any participant. By issuing the check to the trustee this means that there has been no distribution of assets (at least not yet) from the plan, and therefore, the withholding rules do not apply, and there is no need to prepare a Form 1099-R. If there is to be a distribution to a participant, then the trustee will have the duty to comply with all of the distribution rules — furnish the section 402(f) notice, furnish the withholding notice, and comply with the withholding rules and prepare the Form 1099-R to report the amounts distributed and withheld, if any.

Summary

With proper procedures, a financial institution should feel very comfortable accepting qualified plan deposits even though it does not sponsor any qualified plan prototypes or perform any administrative services. ◆