



# THE Pension Digest

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



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## REVIEW— COMPLETING THE 2000 FORM 5498

Here are some excerpts from the IRS' instructions and/or our observations for filing the 2000 Form 5498.

1. The filing deadline is on or before May 31, 2001.
2. The IRS makes clear in the instructions that a separate Form 5498 must be filed for each separate IRA plan agreement. If there are three CDs held under one plan agreement, then only one Form 5498 needs to be prepared. If a person has a regular IRA and a conduit IRA, then the IRA custodian will need to prepare two separate Form 5498s. You will want to point this change out to your software vendor or to your internal programmers, since many IRA software programs aggregate all information related to the same Social Security Number onto one Form 5498. This is no longer permissible.

3. With respect to inherited IRAs, the IRS makes the statement that "an IRA holder must be able to identify the source of each IRA he or she holds for purposes of figuring the taxation of a distribution from an IRA."

**Observation:** This is a very important statement. The IRS is saying that an IRA custodian must prepare a separate Form 5498 for each IRA plan agreement a persons owns, either in his own right or as a beneficiary. For example, if a person has a regular IRA, has inherited an IRA from her father, another from her mother, and one from her grandmother, then the IRA custodian will need to prepare four separate Form 5498s. Your institution will have compliance problems if your computer system would locate all accounts associated with the same Social Security Number and then aggregate the information onto one form.

4. The IRA custodian must report the receipt of a direct rollover in Box 2 – "Rollover IRA Contributions." Note that the IRS does not distinguish

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## PROCEDURES TO HANDLE A MISSED RMD

What can be done if your accountholder did not take their required minimum distribution on time? As you are aware, the penalty is 50% of the amount which should have been taken but was not.

The IRS does have the authority to waive this severe penalty tax if the accountholder follows two steps: (1) the accountholder must have the RMD amount distributed from the IRA as soon as possible after the mistake is discovered, and (2) the accountholder must have a reasonable explanation of why the RMD amount was not distributed in a timely manner.

In this article we discuss two real-life situations —

**Situation #1:** The customer's date of birth was entered into your institution's computer system as 10/2/29, when it should have been entered as 2/10/29, and therefore this customer was not flagged as one who should have been notified that they were required to begin distributions from their IRA account. Therefore the 4/1/00 deadline for distributing the customer's first RMD amount was missed. However, by 12/31/00, the 1999 and 2000 RMD were distributed.

Continued on page 6

2828 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0047	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than rollovers) in 2000	
		2 Rollover contributions	
		3 RMD contribution amount	
4 Fair market value of account		5 Life insurance cost included in Box 7	
PARTICIPANT'S name		6 IRA SEP SIMPLE ROTH IRA ROTH IRA	
Street address (including apt. no.)		7 SEP contributions	
City, state, and ZIP code		8 SIMPLE contributions	
Account number (if any)		9 ROTH IRA contributions	
		10 ROTH IRA contributions	
Form 5498		Department of the Treasury - Internal Revenue Service	
Do NOT Cut or Separate Forms on This Page — Do NOT Cut or Separate Forms on This Page			







## Completing Form 5498, Continued from page 2

On the other hand, if the custodian or trustee had less than 250, 5498 corrections for a given reporting year (240 for 1998 and 200 for 1999), then it can choose to do the reporting via magnetic media or paper.

**Type of Error #1 – You issue the form to the right person, but with the wrong information on the form.** For example, the dollar amounts are wrong or a rollover or SEP contribution was reported as a regular IRA contribution.

This is the easiest type of error to correct since it involves the preparation of only one form. To make the correction, you simply prepare corrected form (placing an "X" in the "corrected box") using the same name, address and Social Security Number, but now complete the boxes as they should have been completed.

**Type of Error #2 – You issue the form to the wrong person.**

Step #1 is to correct the form which you prepared for the wrong person. You will need to issue the correct form to the same person/address/Social Security number, etc. and you must place an "X" in the "corrected" box. You need to complete the applicable

boxes with 0.00 to show that the form should not have been prepared.

Step #2 is to now prepare the form using the name/address/Social Security Number of the person who should have received the form. Note that when you prepare this form, you are preparing an original and not a correction. In the eyes of the IRS, a correction can only be done if an original has been filed previously. Do not check the "corrected box" in this situation.

Since you will, in all likelihood, be preparing such an original well after the submission deadline, you may want to submit a cover letter to the IRS explaining the situation; making your case for not being fined for this late submission. (This new "original" should be sent with a separate transmittal from the transmittal for the true corrections.) Potential penalties are recapped below.

### Penalties for Late Filing

**Form 5498 – Per IR Code** section 6693(a), the penalty for failure to file Form 5498 with the IRS in a timely fashion and/or failure to furnish the accountholder with the information to be reported on Form 5498 is \$50 per failure, unless reasonable cause for such failure can be

shown. There is no maximum to the amount that can be assessed against the custodian/trustee in a case of multiple accounts.

**Type of Error #3 – You issue the form to the right person, but there is an error in the Social Security Number.**

Step #1 is to correct the form you prepared with the wrong Social Security Number. You do this by preparing a form with an "X" in the "corrected" box, showing the name, address, incorrect Social Security Number, and \$0.00 in the applicable boxes, an indication that the original form should not have been prepared.

Step #2 is to then prepare a new form – an "original" – using the same name, address, and the CORRECT Social Security number.

Step #3 is to prepare separate transmittal forms for each, one for the "corrected" form and one for the new "original" form.

The "corrected" 5498 must be submitted on a "corrected" 1096 transmittal and the "original" 5498 must be submitted on an "original" 1096 transmittal.

### IRS Forms 1040 and 8606

If an individual makes an IRA contribution, in most cases

he or she needs to inform the IRS of this fact on the Form 1040 and/or the Form 8606. This is the responsibility of the individual.

Line 23 of Form 1040 is used to report deductible contributions. The Form 8606 is used to report nondeductible contributions. Line 29 of Form 1040 is used by a self-employed person to report his or her SEP/IRA contribution.

Excerpts from the 2000 Form 1040 are set forth below.

Note that the IRS does not ask the taxpayer (i.e. a Roth IRA accountholder) to report on his or her tax return that a contribution has been made to a Roth IRA. There is no need since the taxpayer is not allowed a tax deduction for the contribution. The IRA custodian does inform the IRS of the "reportable" contributions on the Form 5498.

A Form 8606 is to be prepared by the taxpayer/IRA participant in the following situations:

- You made nondeductible contributions to a traditional IRA for 2000.
- You received distributions from a traditional or SIMPLE-IRA in 2000 and you have ever made nondeductible contributions to a traditional IRA.
- You received distributions from a Roth IRA in 2000.
- You recharacterized a 2000 Roth IRA contribution as a traditional IRA contribution, or vice versa.
- You are the beneficiary of an Ed IRA and you received distributions from an Ed IRA in 2000. ♦

## Adjusted Gross Income

23	IRA deduction (see page 27)	23		
24	Student loan interest deduction (see page 27)	24		
25	Medical savings account deduction. Attach Form 8853	25		
26	Moving expenses. Attach Form 3903	26		
27	One-half of self-employment tax. Attach Schedule SE	27		
28	Self-employed health insurance deduction (see page 29)	28		
29	Self-employed SEP, SIMPLE, and qualified plans	29		
30	Penalty on early withdrawal of savings	30		
31a	Alimony paid b Recipient's SSN ▶	31a		
32	Add lines 23 through 31a	32		
33	Subtract line 32 from line 22. This is your adjusted gross income ▶	33		



## SELF-AUDIT OF 5498 REPORTING FOR 2000

As an IRA custodian/trustee, you hopefully will be preparing the 5498 forms and the magnetic media equivalent correctly.

If you'd like to conduct a self-audit of your 5498s, ask yourself the following questions:

**Question #1: "Did I prepare the form for as many IRA accountholders and beneficiaries as the rules require?" The IRS can assess a penalty for each Form 5498 that you missed.**

An IRA custodian must prepare a Form 5498 for any IRA accountholder who falls into one of the following classifications. (Note that the IRS is concerned with getting certain contribution information and the IRA's fair market value (FMV) as of 12-31-xx, or the date of death. Regular, spousal, rollover, SEP, and SIMPLE contributions are reported, but transfer contributions are not.)

To audit 2000, the classifications are:

- A regular or spousal contribution made on behalf of an accountholder during the period of 1-1-00, to 4-16-01, but only if such contribution was made for the 2000 tax year;
- A rollover contribution made by the accountholder during the period of 1-1-00, to 12-31-00;
- A Roth conversion contribution by the

accountholder during the period of 1-1-00, to 12-31-00;

- An accountholder or a beneficiary who had an account balance as of 12-31-00, or a deceased accountholder who had an account balance as of their date of death in 2000.

- A SEP contribution made during the period of 1-1-00, to 12-31-00;

- A SIMPLE contribution made during the period of 1-1-00, to 12-31-00;

- A Roth IRA contribution made on behalf of the accountholder during the period of 1-1-00, to 4-16-01, but only if such contribution was made for the 2000 tax year; or

- An Education IRA contribution made on behalf of the accountholder during the period of 1-1-00, to 12-31-00.

If a person falls into any of these classifications, then a 2000 Form 5498 must be generated for that person. Later, an example will be helpful in illustrating the application of these rules.

### **A Special Rule**

A Form 5498 must be generated for each source of an IRA account. If a person has his or her own IRA, and then, as a beneficiary, inherits another IRA, the IRA custodian must generate two Form 5498s. If a person has a beneficiary's interest in his deceased mother's IRA, a beneficiary's interest in his deceased father's IRA, plus his own IRA, then the IRA custodian must generate three Form 5498s.

This separate IRA for each separate source of IRA funds also applies to surviving spouses. That is, if Jane Doe

has her own IRA and she also is the sole beneficiary of her just-deceased husband's IRA (John Doe), then the IRA custodian must be able to generate two Form 5498s for her. One will be for her personal IRA and the other will be "Jane Doe as beneficiary of John Doe." Both forms will list her Social Security Number.

Note that the data processing departments and software vendors must devise systems which will generate these separate forms, or you must generate them manually. There will need to be some code in addition to the Social Security Number to instruct the computer system to generate separate forms.

**An Example** — How many 5498 forms must be prepared?

First Test Bank of Midtown, USA had 1,800 IRAs as of 1-1-00. 1,570 of these were traditional IRAs, 150 were Roth IRAs, 65 were Education IRAs, 10 were SEP-IRAs and 5 were SIMPLE-IRAs.

The following events took place in 2000, and between 1-1-00 and 4-16-01.

### **With Respect to the Traditional IRAs:**

1. 100 IRAs were closed out in 2000. Of these 100, 25 had made contributions for 2000 before closing out. (Keep in mind that these 100/25 figures are included in the 1,570.)

2. Of the 1,570 accounts, only 450 made regular contributions for 2000, and only 95 made a rollover contribution.

3. 85 new IRAs with regular contributions were established in 2000, for 2000;

4. 135 new IRAs with regular contributions were established in 2001, for 2000.

5. 15 IRA accountholders died in 2000. Each had two IRA beneficiaries. 10 of the beneficiaries withdrew their shares (account balances) before 12-31-00.

6. 20 Keogh accountholders made contributions to their Keoghs for 2000.

How many 2000 Form 5498s is First Test Bank required to generate with respect to the traditional IRAs?

### **The Calculation**

The answer is 1,735. How did we arrive at this number? There were 1,570 accounts to start with. This number is reduced by 75 because these accountholders closed out their accounts and made no other contributions. Result, 1,495. (A Form 5498 must be prepared for the 25 who made a 2000 contribution before closing out the account.) A Form 5498 must be prepared for each of the new IRAs — so add 220 (135 + 85). Result, 1,715.

The 15 deceased IRA accountholders were included in the original 1,000, and the rule is that you must always generate a Form 5498 for the year of death. So, there is nothing to be added or subtracted with respect to the decedents.

Finally, add 20 5498s for the beneficiaries who still had an account balance as of 12-31-00. Result, 1,735. There is no need or requirement to prepare a Form 5498 for those beneficiaries who have no account balance as of 12-31-00. Furthermore, the Form 5498 is for IRA reporting, so Keogh contributions or year-end balances should not be included on a Form 5498.



**Self-Audit of 5498,  
Continued from page 4**

**With respect to the  
Roth IRAs:**

1. No Roth IRAs were closed out in 2000.
2. Of the 150 accounts, 100 made regular contributions for 2000, and only 20 made a rollover contribution.
3. 50 new Roth IRAs with regular contributions were established in 2000, for 2000;
4. 75 new Roth IRAs with regular contributions were established in 2001, for 2000.
5. One Roth IRA account-holder died in 2000. There were three beneficiaries.

How many 2000 Form 5498s is First Test Bank required to generate with respect to Roth IRAs?

**The Calculation**

The answer is 278. How did we arrive at this number? There were 150 accounts to start with. A Form 5498 must be prepared for each of the new IRAs — so add 125 (50 + 75). Result, 275.

The one deceased Roth IRA accountholder is included in the original 150, and the rule is that you must always generate a Form 5498 for the year of death. So, there is nothing to be added or subtracted with respect to the decedents.

Finally, add three 5498s for the beneficiaries who still had an account balance as of 12-31-00. Result, 278. There is no need or requirement to prepare a Form 5498 for those beneficiaries who have no account balance as of 12-31-00.

**With Respect to  
Education IRAs:**

1. 10 Education IRAs were closed out in 2000. Of these

10, 5 had made contributions for 2000 before closing out. (Keep in mind that these 10/5 figures are included in the 65.

2. Of the 65 accounts, only 45 made regular contributions for 2000, and only 15 made a rollover contribution.

3. 20 new Education IRAs with regular contributions were established in 2000, for 2000;

4. 25 new Education IRAs with regular contributions were established in 2001.

5. No IRA accountholders died in 2000.

How many 2000 Form 5498s is First Test Bank required to prepare with respect to Education IRAs?

**The Calculation**

The answer is 80. How did we arrive at this number? There were 65 accounts to start with. This number is reduced by five because these accountholders closed out their accounts and made no other contributions. Result, 60. (A Form 5498 must be prepared for the five who made a 2000 contribution before closing out the account.) A Form 5498 must be prepared only for the new IRAs established during 2000. Do not add the contributions made in 2001. So add 20 (20 + 0). Result, 80.

The "0" deceased IRA accountholders were included in the original 65.

**With Respect to SEP-IRAs:**

1. 2 SEP-IRAs were closed out in 2000 with no other contributions.

2. 5 new SEP-IRAs were funded in 2000.

3. 8 new SEP-IRAs were funded in 2001.

How many 2000 Form 5498s are required to be

generated with respect to SEP-IRAs?

The answer is that 13 SEP-IRAs are reported on a calendar year basis.

**With Respect to the  
SIMPLE-IRAs:**

1. Additional contributions were made to all five of the SIMPLE-IRAs;

2. No SIMPLE-IRAs were closed out in 2000;

3. 3 SIMPLE-IRAs were transferred out during 2001;

4. 8 new SIMPLE-IRAs were set up in September of 2000.

5. 4 new SIMPLE-IRAs were set up in 2001.

How many 2000 Form 5498s are required with respect to SIMPLE-IRAs?

Thirteen. SIMPLE-IRAs are also reported on a calendar year basis. Transactions taking place in 2001 (even if for 2000) are not reported on the 2000 form.

**Summary**

A total of 2,119 Form 5498s must be prepared. This is the sum of:

Traditional	1,735
Roth	278
Education	80
SEP	13
SIMPLE	13
	<hr/> 2,119

**Question #2. "Did I prepare the forms correctly?" If not, you may be subject to a fine of \$50 for each incorrect form.**

**Box 1.** The amount in Box 1 should never be more than \$2,000. If there is more than \$2,000, that means the customer has either made an excess contribution, or you have erred by reporting a SEP, Keogh, or rollover contribution in the wrong box. (If an excess contribution was

made, it must be reported on the 5498, even if already corrected.)

The fact that the amount in Box 1 is less than or equal to \$2,000 does not necessarily mean the information is correct. The amount in Box 1 must be the exact amount of the actual contribution made by or on behalf of that person.

An IRA custodian/trustee should have a procedure to verify that the amount in Box 1 is the actual contribution amount. This can be done by comparing the amount against one or more contribution forms. Obviously, you may not find it cost effective to check every single account, but you should test a meaningful number so that you can conclude that your error rate is minimal.

Note that the sum of Box 1 and Box 9 should also be less than \$2,000. Otherwise, most likely there has been an excess contribution.

**Box 2.** The amount in Box 2 is any rollover contribution made by an accountholder during the period January 1 to December 31 with respect to a traditional IRA. A reportable rollover or direct rollover occurs when the customer was paid money from a pension plan or IRA, and then redeposits this amount into an IRA in compliance with all rollover rules. An IRA custodian/trustee should check such an amount against the rollover certification form/contribution form, which it should have in its file. Transfers are not to be reported in Box 2.

**Box 3.** This box applies only to a Roth IRA.

Continued on page 6



**Self-Audit of 5498,  
Continued from page 5**

Conversion contributions are reported in this box.

**Box 4.** The amount in box 4 of the Form 5498 (the fair market value as of 12-31) must match the amount you disclosed to the accountholder on the January statement. An IRA custodian/trustee needs a procedure to check these amounts. If they do not match, the IRA custodian/trustee must determine which is wrong, and correct that one.

In addition to boxes 1, 2 and 4, the IRA custodian/trustee must also correctly complete its name, address, and tax identification number, along with the same information for the

accountholder or beneficiary.

**Box 5.** This box does not apply to noninsurance IRAs.

**Box 6.** Indicate the type of IRA.

**Box 7.** Reports SEP contributions made during the period of 1-1-00 to 12-31-00 regardless of the tax years for which contributed. Maximum contribution amount is \$25,500.

**Box 8.** Reports SIMPLE contributions. The sum of the employee's elective deferrals plus the employer's match are reported in this box. Again, only report contributions made during the period of 1-1-00 to 12-31-00 regardless of the tax year for which contributed. Maximum contribution amount is \$11,100 for 2000.

**Box 9.** Reports regular Roth contributions. The amount in Box 9 should never be more than \$2,000. If there

is more than \$2,000, then there is an excess contribution. And the sum of Box 9 and Box 1 should also be less than \$2,000. These contributions are for the 2000 tax year or 1-1-00 to 4-16-01.

**Box 10.** Reports Education IRA contributions. The amount in Box 10 should never be more than \$500. If there is more than \$500, then there is an excess contribution. ♦

**Handling Missed RMD,  
Continued from page 1**

**Situation #2:** A customer had transferred a portion of his/her IRA account to another institution. Your institution, however, coded the transfer as a distribution. The amount transferred was greater than the customer's RMD for this account. Therefore, your institution considered the RMD amount to have been distributed, when, in fact, it had not been. The RMD amount was taken from the amount at the other institution, but nothing was taken from the amount which remained at your institution. The result is that the deadline for taking the RMD from the funds left at your institution (12-31-00) was missed. In early January 2001, the correct RMD amount was distributed from the funds left at your institution.

The answer to both situations is the same; there are two possible courses of action as described below.

**Option #1**

Under this option, the accountholder files his Form 1040 and attaches Form 5329 (see excerpt). Form 5329 is the form the accountholder uses to calculate and inform the IRS of the missed RMD amount. The accountholder should enclose payment of the 50% penalty tax with Forms 1040 and 5329.

Then, the accountholder should file an amended tax return (1040X), including a letter of explanation for the missed RMD amount, and requesting a refund of the 50% tax which was paid with the original 1040.

The 1040X could be filed immediately after filing the 1040 and 5329. However, if a refund is due from the filing of the original 1040, we suggest the accountholder wait until the refund is received before filing the 1040X. The reason for this is that upon receipt of the amended return, the IRS would put a "hold" on the refund from the original return.

**Option #2**

Under this option, the accountholder would file Form 1040, attach Form 5329, and attach the letter of

explanation. The accountholder would not send payment of the 50% penalty tax. Using this option is operating under the assumption that the IRS will indeed waive the penalty tax.

Option #1 is the IRS-recommended approach. However, it is up to the accountholder and their tax and/or legal advisor to decide which approach to use.

In both of these situations, the 2000 1099-R was already prepared and sent to the customer prior to the discovery of the mistake. The question which then arises is whether or not the 2000 1099-R can be "redone" to show the corrected distribution of funds. The answer is "No." The 1099-R was prepared correctly for 2000 because it showed the amount which was actually distributed to the accountholder. You cannot change the 1099-R to show distributions made in 2001 which corrected mistakes made in the RMDs for 2000. The rule is that income is taxable when received. Therefore, the result of such RMD mistakes is that the accountholder will have to pay taxes on two distributions in one year.

Continued on page 7

**Excerpt from Form 5329**

**Part VII Tax on Excess Accumulation in Qualified Retirement Plans**

Complete this part if you did not receive the minimum required distribution from your qualified retirement plan (including an IRA other than an Ed IRA or Roth IRA)

42	Minimum required distribution. See page 4	42	
43	Amount actually distributed to you	43	
44	Subtract line 43 from line 42. If zero or less, enter -0	44	
45	Tax due. Enter 50% (.50) of line 44. Also include this amount on Form 1040, line 54	45	



**Handling Missed RMD, Continued from page 6**

**BELOW ARE EXAMPLES OF SAMPLE LETTERS TO SEND TO THE IRS.**

**SAMPLE LETTER —  
BANK TO CUSTOMER TO  
SEND TO IRS (Birth dates  
transposed — Situation #1)**

Dear Accountholder:

It has been discovered that ABC Institution, as your IRA custodian, has made a mistake concerning your IRA account. We have found that in entering your data on our computer system, the month and date of your birth was transposed. The result of this error is that we calculated your age incorrectly, and therefore did not notify you in a timely manner that you were required to begin required distributions from your IRA account by 4-1-00.

We realize that not taking your RMD in a timely manner can have severe tax penalties. However, because the mistake is that of ABC Institution, please enclose this letter along with your tax forms. The IRS has the authority to waive the penalty tax if they believe the explanation for the mistake is reasonable. We hope this letter serves that purpose.

We apologize for the error and any inconvenience it has caused you.

*Sincerely,  
ABC Institution*

**SAMPLE LETTER —  
CUSTOMER TO IRS  
(Birth dates transposed —  
Situation #1)**

Dear IRS:

It was recently discovered that I failed to take my 1999 required minimum distribution (RMD) by 4-1-2000 from my IRA account (\$1,000). The reason for this mistake is that the financial institution incorrectly entered my date of birth in their system, and therefore did not correctly calculate my age and did not notify me of my required beginning date. As soon as this mistake was discovered, the financial institution distributed both my 1999 and 2000 RMD amount to me by 12-31-00.

I realize that the penalty for failing to take a required distribution is 50% of what was required to be taken but was not. In this case, I understand the penalty to be \$500.

Because this was a mistake made by the IRA custodian (see attached letter), I request that you waive the 50% penalty tax. I have filed my 2000 Form 1040 and Form 5329, and have sent payment of the penalty tax. I now ask that you refund the amount of this tax to me (\$500).

Thank you for your consideration.

*Sincerely, John Doe  
IRA Accountholder*

**SAMPLE LETTER —  
BANK TO CUSTOMER TO  
SEND TO IRS (Partial  
transfer — Situation #2)**

Dear Accountholder:

It has been discovered that we (ABC Institution), as your IRA custodian, have made a mistake concerning your IRA account. We have found that the partial transfer of funds which you made to XYZ institution was interpreted by our institution as a distribution rather than a transfer. Because the amount transferred was greater than the amount of your RMD for this account, we assumed that your RMD for the year 2000 had been removed. We recently discovered that the RMD amount had indeed been taken for the portion of the funds which you transferred to XYZ institution. However, no RMD was taken from the funds left on deposit at our institution (ABC).

We realize that not taking your RMD in a timely manner can have severe tax penalties. However, because the mistake is that of ABC Institution, please enclose this letter along with your tax forms. The IRS has the authority to waive the penalty tax if they believe the explanation for the mistake is reasonable. We hope this letter serves that purpose.

We apologize for the error and any inconvenience it has caused you.

*Sincerely,  
ABC Institution*

**SAMPLE LETTER —  
CUSTOMER TO IRS  
(Partial transfer —  
Situation #2)**

Dear IRS:

It was recently discovered that I failed to take my 2000 required minimum distribution (RMD) by 12-31-2000 in the amount of \$400 from my IRA account at ABC Institution. The reason for this mistake is that ABC Institution from which I transferred the funds, coded this partial transfer as a distribution. Because the amount which I transferred was greater than my RMD amount for 2000, they considered my RMD amount to have been taken. As soon as this mistake was discovered, the appropriate RMD amount was removed from what remained in my IRA at ABC Institution. For your information, the correct RMD amount was distributed by 12-31-00 from the amount which I had transferred to XYZ institution.

I realize that the penalty for failing to take a required distribution is 50% of what was required to be taken but was not. In this case, I understand the penalty to be \$200.

Because this was a mistake made by the IRA custodian (see attached letter), I request that you waive the 50% penalty tax. I have filed my 2000 Form 1040 and Form 5329, and have sent payment of the penalty tax. I now ask that you refund the amount of this tax to me (\$200).

Thank you for your consideration.

*Sincerely, John Doe  
IRA Accountholder ♦*





## QUESTIONS AND ANSWERS

### **I KNOW OUR INSTITUTION HAS FOLLOWED THE IRS' INSTRUCTIONS FOR PREPARING THE FORM 1099-R. EVEN SO, I HAVE AN ACCOUNTANT WHO IS SURE WE HAVE MADE AN ERROR. HOW SHOULD I DEAL WITH HIM?**

Most often, your writing a professional letter will resolve the matter. For example, we recently wrote the following letter.

I have talked with Ms. Andrea Ray of EBANCO. She has informed me of your complaint. I am writing you because we provide IRA data processing and governmental reporting services for EBANCO.

You have an accountant/tax client who withdrew funds from a traditional IRA and used such funds to pay education expenses. This client was not age 59 1/2 or older at the time of the distribution.

EBANCO, as the IRA custodian (i.e. the payer), furnished a Form 1099-R showing a reason code "1" in box 7. As you know, a "1" is to be used when there is a premature distribution, with no known exception. Normally, a "1" tells the IRS the 10% additional tax may be owing. A "2" is to be used if there is a "known" exception meaning the 10% additional tax is not owed.

You believe quite strongly that the bank is not to insert a "1" as the reason code in box 7 of the Form 1099-R. You believe a code "2" should be inserted and you have asked that the form be corrected.

I do not believe the IRS has authorized an IRA custodian to do what you have requested. The IRS has written instructions for both the Form 1099-R and the Form 5329. The pertinent portion of the 1099-R instructions states:

*"1— Early distribution, no known exception. Use Code 1 only if the employee/taxpayer has not reached age 59 1/2, and if none of the exceptions under section 72(q), (t), or (v) are known to apply. For example, if a distribution is made for medical or qualified higher education expenses, you probably will not know if any medical or qualified higher education expense exception under section 72(t) applies. Therefore, use Code 1."*

I believe these instructions clearly reflect the concept that the IRA custodian will not generally know if the qualified higher education expenses exception under Code section 72(t) applies. Thus, Code "1" is to be used.

I would observe that it would be very rare if EBANCO would have the knowledge it would need to know that the education exemption requirement had been met.

For example, EBANCO does not really know if the funds were used for the accountholder or family member; EBANCO does not determine if the expenses were "qualifying

expenses;" EBANCO bank does not determine if the school at which they were used is a "qualifying" school, and EBANCO does not determine if there were any scholarships or educational assistance programs which would reduce the amount of expenses which could be claimed.

Consequently, it is the accountholder (or his accountant) who will need to complete the Form 5329 to indicate that the education expense exception applies. It is the accountholder who has the facts to be able to determine whether or not the requirements for the exception have been met. Why else does the IRS have the Form 5329 with a reason 08? See the following.

*"The 10% additional tax does not apply to the distributions described below. Enter on line 2 the amount that can be excluded. In the space provided, enter the applicable exception number (01-11) Exception 08 — Distributions made for higher education expenses (applies only to IRAs)."*

In summary, it is clearly not the bank's job to determine whether or not all the requirements have been met to claim exemption from the 10% additional tax under the education expense exemption. Making this determination is the accountholder's job. That is why it is correct for the bank to insert code "1" in box 7 of the Form 1099-R.

### **WE HAVE FOUND THAT THERE ARE NO RMD ELECTIONS IN OUR FILES FOR ACCOUNTHOLDERS AGE 70 1/2 AND OLDER. WHAT DOES THE BANK NEED TO DO?**

As you know, the IRS has issued some revised proposed regulations governing RMD's. The revised rules have the result that there will no longer be any need for a person to make such elections. Simply put, your institution has "lucked out." You will need to monitor IRS law changes to make certain these proposed regulations are indeed adopted as final regulations. This should happen in late 2001, or early 2002.

The revised rules apply for 2001. Most likely they will apply to subsequent years also.

Most IRA forms contain "default" provisions. The default in most IRA forms is "recalculation," and "nonrecalculation" applies only if expressly elected, because that is the approach within the IRS Model Form 5305-A.

One does NOT elect single or joint. This is determined solely by who the beneficiary is.

I would recommend that if you do not have any elections, then there needs to be a memorandum or note in the file stating that recalculation must be used because it was the default.

You should also indicate who the beneficiary was as of the required beginning date, as well as his or her date of birth along with that of the accountholder. ♦