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ALSO IN THIS ISSUE –

IRAs AND THE MARRIAGE PENALTY

A tax topic receiving a fair amount of discussion in Washington, DC, by the members of both political parties the past few years has been to what degree, if any, should the federal tax laws be changed to reduce the "marriage penalty." The "marriage penalty" is a term which has been created to describe the fact that two people many times will pay more in federal income taxes if they are married than if they are unmarried, or they will not be treated as favorably.

The IRA laws contain numerous rules which impose a negative tax consequence for being married. The IRA rules which demonstrate a marriage penalty are these:

1. Conversion from a traditional IRA to a Roth IRA.

2. Eligibility to deduct an IRA contribution—*The Income Phaseout Ranges.*

3. Eligibility to deduct an IRA contribution—*The Active Participant Rule.*

4. Eligibility to make a Roth IRA contribution—*The Income Phaseout Ranges.*

5. Prohibited transaction rules.

The IRA laws also contain some rules which favor a person who is married. These favorable rules are discussed in a companion article in this newsletter.

1. Conversion from a Traditional IRA to a Roth IRA

The rules governing converting a traditional IRA to a Roth IRA illustrate very well this marriage penalty discrimination. There are two rules which must be met for a person to be able to convert his or her traditional IRA to a Roth IRA. First, the person must have adjusted gross income of $100,000 or less in the year of the conversion. For this purpose, if the person is married, the person must aggregate his or her income with that of his or her spouse to see if they exceed the $100,000 limit. The second rule is that an individual who is married must file a joint return. He or she may not file a separate income tax return.

Examples of the first rule.

Example #1. Ben Kin, age 45, earns $65,000 and Jamie Peters, age 46, earns $38,000. Their combined incomes of $103,000 just exceed the $100,000 limit. If they are not married, each is eligible to convert his or her traditional IRA to a Roth IRA. If they are married to each other, neither may convert their traditional IRA to a Roth IRA.

Example #2. Vincent Sollee, age 55, has adjusted gross income of $98,000 and Susan Kraus, age 57, has adjusted gross income of $99,000. Their combined incomes of $197,000 exceed greatly the $100,000 limit since each alone almost exceeds the limit. If they are not married, each is eligible to convert his or her traditional IRA to a Roth IRA. If they are married to each other, neither may convert their traditional IRA to a Roth IRA.

It appears the primary purpose of the joint return requirement is to increase the assurance of collecting taxes. As with a loan, it is always better to have two people responsible to pay a loan or a debt rather than just one person. When a joint income tax return is filed, both spouses become responsible to pay the "joint" income tax debts of both of them. There is an "innocent spouse exception," but there are severe limits to this exception.

2. Eligibility to Deduct an IRA Contribution—*The Income Phaseout Ranges*

If a person is an active participant in an employer-sponsored pension plan, he or she may not be entitled to deduct the full amount of his or her IRA contribution. This has been the rule since January 1, 1987. As long as a person's adjusted gross income is less than the low amount of the phaseout range, the individual is entitled to deduct 100% of his or her IRA contribution. If the person's adjusted gross income exceeds the high amount of the phaseout range, then the individual is not entitled to deduct any portion of his or her IRA contribution. If

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the person's adjusted gross income is found within the phaseout range, he or she is entitled to a partial deduction.

One might expect that the phaseout range for a married couple would simply be the range which applies for a single person multiplied by two. The law is not this fair. Chart I on page 3 illustrates the favoritism given to unmarried individuals.

3. Eligibility to Deduct an IRA Contribution—*The Active Participant Rule*

Up until 12-31-97, a severe marriage penalty existed with respect to a married person being able to make a deductible IRA contribution. If one spouse was an active participant, then the other spouse was also treated as an active participant even though he or she might not have been. For example, assume that Jamie was an active participant in her employer's pension plan, but Ben was not. Prior to 1998, Ben was not eligible to make a deductible contribution to his IRA because his wife, Jamie, was an active participant and their combined adjusted gross income exceeded $50,000. If Ben had not been married to Jamie, he would have been eligible to make a $2,000 deductible contribution.

Effective as of January 1, 1998, the laws were changed to PARTIALLY eliminate this marriage penalty. The new rule provides that a married person who is not an active participant (but whose spouse is) is entitled to make a deductible contribution of $2,000 as long as their combined adjusted gross incomes do not exceed $150,000. The phaseout rules apply if their combined adjusted gross income is in the range of $150,001 - $160,000. No deduction is available for the spouse who is not an active participant if their combined incomes exceed $160,000.

There apparently are thousands of taxpayers who are not aware of this favorable law change.

The Joint Committee on Taxation has issued a chart which shows the following for various combined income ranges.

$50,000 - $75,000

1. 24.3% of couples in this category are eligible to deduct the entire contribution of $4,000.

2. 26.1% of couples in this category have one spouse who is eligible to deduct a contribution of $2,000.

3. 23.1% of couples in this category are entitled to deduct a portion of their contributions, as they are in the phaseout range.

4. Only 17.4% of couples in this category are not entitled to deduct any portion of their $4,000 of contributions.

$75,000 - $100,000

1. 13.7% of couples in this category are eligible to deduct the entire contribution amount of $4,000.

2. 40.7% of couples in this category have one spouse who is eligible to deduct a contribution of $2,000.

3. 45.7% of couples in this category are not entitled to deduct any portion of their $4,000 of contributions.

$100,000 - $200,000

1. 19.6% of couples in this category are eligible to deduct the entire contribution amount of $4,000.

2. 27.0% of couples in this category have one spouse who is eligible to deduct a contribution of $2,000.

3. 50.7% of couples in this category are not entitled to deduct any portion of their $4,000 of contributions.

Over $200,000

1. 15.7% of couples in this category are eligible to deduct the entire contribution amount of $4,000.

2. 84.3% of couples in this category are not entitled to deduct any portion of their $4,000 of contributions.

These charts show that many married people who are not active participants are eligible to make deductible contributions even though their spouses are active participants in an employer-sponsored retirement plan. However, a person who is married and is not an active participant is still discriminated against. He or she is required to aggregate his or her income with that of a spouse and if it exceeds $160,000, they become ineligible to make a deductible IRA contribution.

Observations. In this age of immediate communications, it still takes time for the majority of the American public to act after there has been favorable law changes.

Note that the IRS has estimated for married couples with combined AGIs in the range of $50,000-$200,000, that at least one of the spouses will be eligible approximately 40% of the time to make a $2,000 deductible contribution, and approximately 20% of the time both will be eligible to make $2,000 deductible IRA contributions. Most IRA custodians will acknowledge that they presently are not seeing such contributions being made. They might be, if the new rules would be understood by your customers.

4. Eligibility to Make a Roth IRA Contribution—*The Income Phaseout Ranges*

The concept of the law is—a person or married couple whose adjusted gross incomes are "too high" will become ineligible to make a Roth IRA contribution. As with the deductibility of a traditional IRA contribution, the phaseout concept applies to Roth IRAs. As long as a person's adjusted gross income is less than the low amount of the phaseout range, the individual is entitled to make a full contribution to his or her Roth IRA. If the person's adjusted gross income exceeds the high amount of the phaseout range, then the individual is not entitled to make any contribution to his or her Roth IRA. If the person's adjusted gross income is found within the phaseout range, he or she is entitled to make a partial contribution.

One might expect that the phaseout range for a married couple would simply be the range which applies for a single person, multiplied by two. The law is not this fair. Chart II on page 3 illustrates the favoritism given to unmarried individuals.

Example #1. Rita Vaughn has adjusted gross income of $95,000, as does Marcel Tino. If they are married to each other, neither one of them may make a contribution to a Roth IRA. If they are not married to each other, both will be able to contribute $2,000 to his or her Roth IRA, assuming there is earned income to support

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such contributions.

Example #2. This time Rita Vaughn has adjusted gross income of $50,000 and Marcel Tino has adjusted gross income of $20,000. They are well under the income limits. However, Rita wants to file a separate return. Consequently, neither one of them is eligible to make a Roth IRA contribution of any amount since each has compensation in excess of the $10,000 limit.

5. Prohibited Transaction Rules

There are rules which prevent the IRA accountholder from taking certain actions with respect to his or her IRA. Such rules also apply to the IRA accountholder's spouse and other family members. For example, there cannot be any direct or indirect–

1. sale or exchange, or leasing, of any property between the IRA and a disqualified person;

2. lending of money or other extension of credit between an IRA and a disqualified person;

3. furnishing of goods, services, or facilities between an IRA and a disqualified person;

4. transfer to or use by or for the benefit of a disqualified person of the income or assets of an IRA; and

5. act by a disqualified person who is a fiduciary whereby he deals with income or assets of an IRA in his own interest or for his own account.

For IRA purposes, a disqualified person is defined to be any fiduciary. The IRS has concluded that an IRA accountholder who has the right to self-direct his or her own IRA is a fiduciary and is a disqualified person. So are the following family members—his or her spouse, ancestor, lineal descendent and spouse of a lineal descendent. In some situations the IRS and Department of Labor have expanded the definition of family to include brothers and sisters and spouses of such brothers and sisters.

For example, the law expressly prohibits an IRA accountholder from making a loan to his or her spouse or to a child. The law does not expressly prohibit a loan to a "significant other."

Another example—the law prohibits an individual from selling stock which he or she owns within his or her IRA to his spouse. The law does not prohibit such a sale to a "significant other."

Summary. There are numerous situations under the federal income tax laws where a person who is married is treated less favorably than if he or she were not married. The "marriage penalty" is the term which has been created to describe the fact that two people many times will pay more in federal income taxes if they are married than if they are unmarried or they will not be treated as favorably. This unfavorable treatment certainly exists with respect to making deductible contributions to a traditional IRA, making any contribution to a Roth IRA and having certain investment activities be prohibited transactions. The tax laws passed in 1997 by Congress and the President actually enlarged the marriage penalty in some instances—Roth conversions, Roth IRA contributions and the income limits when a married person is an active participant. The marriage penalty was reduced in the situation where a married person is not an active participant but his or her spouse is. The most recent law changes appear to be a case of one step forward and three steps back with respect to the marriage penalty. ◆

Chart I

Year	Unmarried Filers	Unmarried Filers Multiplied by Two	Married—Filing Joint	Difference (Amount Less Favorable)	Married Filing Separate
1987 to 1997	$25,000 - 35,000	$50,000 - 70,000	$40,000 - 50,000	$10,000 - 20,000	0 - $10,000
1998	$30,000 - 40,000	$60,000 - 80,000	$50,000 - 60,000	$10,000 - 20,000	0 - $10,000
1999	$31,000 - 41,000	$62,000 - 82,000	$51,000 - 61,000	$11,000 - 21,000	0 - $10,000
2000	$32,000 - 42,000	$64,000 - 84,000	$52,000 - 62,000	$12,000 - 22,000	0 - $10,000
2001	$33,000 - 43,000	$66,000 - 86,000	$53,000 - 63,000	$13,000 - 23,000	0 - $10,000
2002	$34,000 - 44,000	$68,000 - 88,000	$54,000 - 64,000	$14,000 - 24,000	0 - $10,000
2003	$40,000 - 50,000	$80,000 - 100,000	$60,000 - 70,000	$20,000 - 30,000	0 - $10,000
2004	$45,000 - 55,000	$90,000 - 110,000	$65,000 - 75,000	$25,000 - 35,000	0 - $10,000
2005	$50,000 - 60,000	$100,000 - 120,000	$70,000 - 80,000	$30,000 - 40,000	0 - $10,000
2006	$50,000 - 60,000	$100,000 - 120,000	$75,000 - 85,000	$25,000 - 35,000	0 - $10,000
2007 and later	$50,000 - 60,000	$100,000 - 120,000	$80,000 - 100,000	$20,000 - 20,000	0 - $10,000

Chart II

Year	Unmarried Filers	Unmarried Filers Multiplied by Two	Married—Filing Joint	Difference (Amount Less Favorable)
All Years	$95,000 - 110,000	$190,000 - 220,000	$150,000 - 160,000	$40,000 - 60,000

Observations. These schedules show the favoritism which has existed since January 1, 1987, and which will continue to exist. In fact, the law changes made in 1997 will only increase the favoritism given to unmarried individuals. Note that there was no change in the income limits which applied to a married person filing a separate return.

UNDERSTANDING BEFORE & AFTER DEATH RMD CALCULATIONS—A CHILD BENEFICIARY

The purpose of this article is to illustrate the RMD calculations when an IRA accountholder designates a child as his or her beneficiary or designates any other nonspouse beneficiary who is at least 10 years younger than he or she is.

For purposes of this illustration, we will assume the existence of Nina Premo. Her date of birth is 10-22-28. The date of birth of the oldest child is 12-20-55. She attained age 70 1/2 and 71 in 1999, and the oldest child beneficiary is 44 in 1999. The fair market value of her IRA as of 12-31-98, was $97,545.87. An earnings rate of 6% is assumed. Nina wants to understand what her options are and what difference it makes if she elects recalculation versus nonrecalculation for herself and her beneficiaries. She indicates her children are in high marginal income tax brackets. She expects them to continue to be, so her goal is to allow them, after her death, to maintain her IRA funds within inherited IRA accounts as long as the law permits.

When there is a nonspouse beneficiary more than 10 years younger than the accountholder, there are actually two required distribution calculations each year: (1) the MDIB calculation which

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Table 1

Years/Ages	Factor from Joint Method MDIB Table	Factor from Joint Method (Nonrecalculation)	Factor from Joint Method (6-Step)	Factor to be Used to Determine RMD
1999 (71/44)	25.3	39.1	39.1	25.3
2000 (72/45)	24.4	38.1	38.2	24.4
2001 (73/46)	23.5	37.1	36.3	23.5
2002 (74/47)	22.7	36.1	35.4	22.7
2003 (75/48)	21.8	35.1	34.5	21.8
2004 (76/49)	20.9	34.1	33.5	20.9
2005 (77/50)	20.1	33.1	32.6	20.1
2006 (78/51)	19.2	32.1	31.7	19.2
2007 (79/52)	18.4	31.1	30.7	18.4
2008 (80/53)	17.6	30.1	29.8	17.6
2009 (81/54)	16.8	29.1	28.9	16.8
2010 (82/55)	16.0	28.1	28.0	16.0
2011 (83/56)	15.3	27.1	26.3	15.3
Etc.				

Table 2

Year	Joint Life—Both With One-Year Reduction/MDIB	Fair Market Value as of 12-31 of the Prior Year	Recipient	Required Distribution Amount
While Nina is Alive				
1999	39.1/25.3	$97,545.87	Nina	$ 3,855.57
2000	38.1/24.4	99,396.04	Nina	4,073.61
2001	37.1/23.5	102,688.81	Nina	4,369.74
2002	36.1/22.7	105,941.38	Nina	4,667.02
2003	35.1/21.8	109,218.27	Nina	5,010.01
2004	34.1/20.9	112,511.12	Nina	5,383.31
2005	33.1/20.1	115,799.97	Nina	5,761.19
2006	32.1/19.2	119,083.71	Nina	6,202.28
2007	31.1/18.4	122,350.55	Nina	6,649.49
2008	30.1/17.6	125,573.63	Nina	7,134.87
Subtotal - Amounts paid to Nina				$53,107.09
2009 (yr. of death)	29.1/16.8	128,750.56	Child	7,663.72
After Nina's Death				
2010	28.1	131,865.27	Child	4,692.71
2011	27.1	134,917.37	Child	4,978.50
2012	26.1	137,852.14	Child	5,281.69
2013	25.1	140,643.99	Child	5,603.35
2014	24.1	143,264.62	Child	5,944.59
2015	23.1	145,682.82	Child	6,306.62
2016	22.1	147,864.22	Child	6,690.69
2017	21.1	149,771.00	Child	7,098.15
2018	20.1	151,361.62	Child	7,530.43
2019	19.1	152,590.51	Child	7,989.03
2020	18.1	153,407.71	Child	8,475.56
2021	17.1	153,758.51	Child	8,991.73
2022	16.1	153,583.08	Child	9,539.32
2023	15.1	152,816.03	Child	10,120.27
2024	14.1	151,385.93	Child	10,736.59
2025	13.1	149,214.89	Child	11,390.45
2026	12.1	146,217.95	Child	12,084.13
2027	11.1	142,302.57	Child	12,820.05
2028	10.1	137,368.00	Child	13,600.79
2029	9.1	131,304.63	Child	14,429.08
2030	8.1	123,993.27	Child	15,307.81
2031	7.1	115,304.41	Child	16,240.06
2032	6.1	105,097.37	Child	17,229.08
2033	5.1	93,219.47	Child	18,278.33
2034	4.1	79,505.06	Child	19,391.48
2035	3.1	63,774.50	Child	20,572.42
2036	2.1	45,833.09	Child	21,825.28
2037	1.1	25,469.88	Child	23,154.44
2038	1.0	2,456.45	Child	2,456.45
Subtotal of Amounts Distributed to Child				$336,422.80
Total Amount Distributed from the IRA				$389,529.89

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amounts to taking the divisor (i.e. the factor) from the MDIB table each year, and (2) the regular joint method. The method to be used is the one which requires the larger distribution amount. This almost always will be the MDIB method.

There can be two ways to calculate the regular joint method: (1) joint with one-year reduction for both the accountholder and the beneficiary, or (2) the special six-step method because the accountholder has elected recalculation. When there is more than one beneficiary, the oldest beneficiary is almost always used.

Table 1 is a chart which compares the factors from both of the joint methods and also the MDIB divisors.

The MDIB table is a special table which the IRS has created to ensure that distributions from pension plans and IRAs to the IRA accountholder or pension participant are sufficiently large so that the funds are used for retirement and not just as a way of transferring wealth to one's beneficiary. The MDIB schedule almost always requires a larger distribution amount than the regular joint schedule. The use of the MDIB table is not elected by the accountholder. In certain situations the law requires that it be used. Special note—even if the accountholder has elected to use the one-year reduction method with respect to his or her regular election, the original MDIB factor of 26.2 (for those age 70 in the first year) or 25.3 (for those age 71 in the first year) is NOT reduced by one to determine the divisor for future years. One must return to the table with the current age and use the associated divisor. So, it is not 26.2, 25.2, 24.2, 23.2, etc. It is the numbers from the table—26.2, 25.3, 24.4, 23.5, etc.

The MDIB table is no longer used once the accountholder dies. That is, the required distribution for the beneficiaries for all years following the year of the accountholder's death will be calculated using the applicable joint method. The MDIB is still used for the year of death. For our example, it is assumed that Nina dies on 8-5-2009.

If Nina had elected nonrecalculation for both herself and her child beneficiary, then the joint schedule which had always been overridden by the MDIB factor will now continue to be used as shown in Table 2.

If Nina had elected recalculation for herself, then the joint schedule is changed after she dies even though it was always overridden by the MDIB schedule while she was alive. Determine the age and single life-expectancy factor of the beneficiary in the year the accountholder attained age 70 1/2. Thus, the schedule to be used by her children would be as illustrated in Table 3. This is pursuant to regulation 1.401(a)(9). The IRS has indicated in Publication 590 that a different method is to be used—the six-step method is to be continued to be used as modified by the accountholder's death.

Table 3

Year	Joint Life—Both With One-Year Reduction/MDIB	Fair Market Value as of 12-31 of the Prior Year	Recipient	Required Distribution Amount
While Nina is Alive				
1999	39.1/25.3	$97,545.87	Nina	$3,855.57
2000	38.2/24.4	99,396.04	Nina	4,073.61
2001	36.3/23.5	102,688.81	Nina	4,369.74
2002	35.4/22.7	105,941.38	Nina	4,667.02
2003	34.5/21.8	109,218.27	Nina	5,010.01
2004	33.5/20.9	112,511.12	Nina	5,383.31
2005	32.6/20.1	115,799.97	Nina	5,761.19
2006	31.7/19.2	119,083.71	Nina	6,202.28
2007	30.7/18.4	122,350.55	Nina	6,649.49
2008	29.8/17.6	125,573.63	Nina	7,134.87
Subtotal - Amounts paid to Nina				$53,107.09
2009 (yr. of death)	28.9/16.8	128,750.56	Child	7,663.72
After Nina's Death				
2010	27.7	131,865.20	Child	4,760.48
2011	26.7	134,845.40	Child	5,050.39
2012	25.7	137,699.53	Child	5,357.96
2013	24.7	140,401.17	Child	5,684.26
2014	23.7	142,921.17	Child	6,030.43
2015	22.7	145,227.39	Child	6,397.68
2016	21.7	147,284.44	Child	6,787.30
2017	20.7	149,053.41	Child	7,200.65
2018	19.7	150,491.59	Child	7,639.17
2019	18.7	151,552.14	Child	8,104.39
2020	17.7	152,183.72	Child	8,597.95
2021	16.7	152,330.14	Child	9,121.57
2022	15.7	151,929.98	Child	9,677.07
2023	14.7	150,916.11	Child	10,266.40
2024	13.7	149,215.27	Child	10,891.63
2025	12.7	146,747.56	Child	11,554.93
2026	11.7	143,425.86	Child	12,258.62
2027	10.7	139,155.33	Child	13,005.17
2028	9.7	133,832.70	Child	13,797.19
2029	8.7	127,345.68	Child	14,637.43
2030	7.7	119,572.18	Child	15,528.85
2031	6.7	110,379.56	Child	16,474.56
2032	5.7	99,623.81	Child	17,477.86
2033	4.7	87,148.64	Child	18,542.26
2034	3.7	72,784.51	Child	19,671.49
2035	2.7	56,347.60	Child	20,869.48
2036	1.7	37,638.74	Child	22,140.43
2037	1.0	16,442.15	Child	16,442.15
Subtotal of Amounts Distributed to Child				$331,631.47
Total Amount Distributed from the IRA				$384,738.56

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RMD Calculations,
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Comments & Observations

1. The general rule always stated is that a distribution schedule cannot be slowed down. But the distribution schedule which is continued by a child beneficiary does slow down compared with what the accountholder had, because the MDIB schedule was used while the accountholder was alive, but no longer applies commencing with the year after the accountholder's death. So this situation is a type of exception to the general rule.

2. The tax benefit of deferred taxation on the earnings and the original contribution amount continues even after the IRA accountholder has died. This deferral of taxation until funds are distributed is a very valuable tax right.

3. Nina had a balance of $97,545.87 when she commenced her required distributions. She will be paid $53,107.09 while she is alive. Nevertheless, the balance of her IRA at the time of her death will approximate $131,865.27. That is, her balance has grown substantially even with the required distributions to her and a 6% earnings rate.

4. Her beneficiary will be paid $336,422.80 after her death if she had elected the nonrecalculation method for herself, and the beneficiary only withdraws the minimum amount. Her beneficiary will be paid $331,402.28 after her death if she had elected the recalculation method for herself. This difference of $5,020.52 is probably not material. It arises because the factors for future years are .4 less each year if Nina had elected recalculation versus nonrecalculation and because there is one additional year if nonrecalculation applies.

It appears an accountholder should elect nonrecalculation for himself or herself if he or she designates a child or children as the primary beneficiary(ies).

5. As long as Nina (or any other accountholder) designates the child as a beneficiary on or before her required beginning date, Nina's child beneficiary should have a relatively long distribution/tax deferral period. The life-expectancy factor for a person 40 years old is 42.5, for a person 50 years old is 33.1 years, and for a person 30 years old is 52.2.◆

THE MARRIAGE BONUS AND IRAs

There are a few IRA rules which give more favorable treatment to a married person than to an unmarried person.

Spousal Contributions

As discussed in the April newsletter, the concept of spousal contributions changed a few years ago. At one time the concept was—the spouse with compensation could make a contribution for his or her spouse who did not have any compensation or had little compensation. The lawmakers must have thought this was paternalistic. The concept now is—the spouse with the lower compensation (even 0) can make a contribution for himself or herself if his or her spouse has sufficient compensation.

An unmarried person is not able to use someone else's compensation to make an IRA contribution for himself or herself.

Spousal contributions may be made to either a traditional IRA and/or a Roth IRA.

Beneficiary Options

A spouse beneficiary is given more favorable treatment than a nonspouse beneficiary in two ways. First, the spouse has the right to elect to treat the deceased spouse's IRA as his or her own IRA. This right by a spouse beneficiary to elect to treat a deceased spouse's IRA as their own (i.e. a rollover right) is a very valuable right. Nonspouse beneficiaries do not have this right.

Second, a spouse who elects to use the life-distribution rule when the accountholder had died before or on his or her required beginning date need not commence the distribution schedule until December 31 of the year the accountholder would have attained age 70 1/2, and the spouse may elect to use the recalculation method to redetermine his or her life-expectancy factor. In this last situation, the spouse beneficiary has the right to designate a beneficiary, and such beneficiary will have the same options as if the spouse beneficiary was the accountholder. ◆

IRS ISSUES THE 1999 IRA PUBLICATION 590

Publication 590 has now grown to be 83 pages. This publication covers traditional IRAs, Roth IRAs, Education IRAs, SEPs and SIMPLEs. As with any writing, it is interesting at times to observe what the writer does not say as well as what the writer does say. A substantial history has developed with respect to traditional IRAs. The IRS is starting to indicate that it will not in all cases adopt the history or rules which apply for traditional IRAs to Roth IRAs. In many situations the IRS has not yet made it clear if the rules which apply to traditional IRAs will also apply to Roth IRAs. As we have stated previously, the IRS has started to state positions in the Publication 590, but they have not yet revised their regulations to adopt the same changes.

Publication 590 is written to include five sections or chapters: (1) Traditional IRAs, (2) Roth IRAs, (3) Education IRAs, (4) SEPs and (5) SIMPLES.

With Respect to Traditional IRAs, We Have Chosen the Following Excerpts to Highlight

1. Contribution Deadline for the traditional IRA for most people for 1999 is April 17, 2000.

2. Cost basis. You will have a cost basis in your traditional IRA if there are nondeductible contributions. Your basis is the sum of the nondeductible contributions to your IRA less any distributions of those amounts. When you withdraw (or receive distributions of) these amounts, you can do so tax free.

Generally, you cannot withdraw only your basis. If deductible contributions have been made to any of your traditional IRAs, your withdrawals from any of your IRAs will generally include both taxable and nontaxable (basis)

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amounts.

3. Inherited IRAs.

a. If you inherit a traditional IRA, that IRA becomes subject to special required distribution rules.

b. Unless you are the decedent's surviving spouse, you cannot treat an inherited traditional IRA as your own. This means you cannot make contributions (including rollover contributions) to the IRA and you cannot roll it over. You also cannot convert this inherited IRA to a Roth IRA. But, like the original owner, you generally will not owe tax on the assets in the IRA until you receive distributions from it. You must withdraw the IRA assets within a certain period.

c. If you inherit a traditional IRA from a person who had a basis in the IRA because of nondeductible contributions, you inherit his or her basis. Unless you are the decedent's spouse and choose to treat his or her IRA as your own, you cannot combine this basis with any basis you have in your own traditional IRAs or any basis in traditional IRAs you inherited from other decedents. If you take a distribution from an inherited IRA and your IRA, and each has basis, you must complete separate Forms 8606 to determine the taxable and nontaxable portions of these distributions.

d. The IRS in Notice 88-38 authorized that an IRA accountholder and/or beneficiary must calculate his or her required distribution for each IRA, but may aggregate these separate amounts and take a distribution from just one of these IRAs which may be an inherited IRA.

Comment: This aggregation rule applies to traditional IRAs only. Aggregation of traditional IRAs, qualified plans and Roth IRAs is not permitted.

e. If you are a surviving spouse, you can elect to treat a traditional IRA inherited from your spouse as your own. You will be treated as having made this election if: (1) contributions (including rollover contributions) are made to the inherited IRA, or (2) required distributions are not made from it. If you treat the IRA as your own, you may make regular or rollover contributions to it and you may roll it over or convert it to a Roth IRA.

Comment: As discussed in the Roth IRA section, the above rule will not be fully adopted for Roth IRAs.

f. A traditional IRA is included in the estate (for federal estate tax purposes) of the decedent accountholder.

Comment: This same rule should apply to the Roth IRA.

g. Generally, the value of an annuity or other payment receivable by any beneficiary of a decedent's traditional IRA that represents the part of the purchase price contributed by the decedent (or by his or her former employer(s)), must be included in the decedent's gross estate. For more information, see the instructions for Schedules I and S, Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return.

Comment: This same rule should apply to the Roth IRA.

h. Federal Estate Tax Deduction. Your beneficiary may be able to claim a deduction for estate tax resulting from certain distributions from your traditional IRA after you die. The beneficiary can deduct the estate tax paid on any part of a distribution that is income in respect of a decedent. He or she can take the deduction for the tax year the income is reported. For information on claiming this deduction, see Other Tax Information in Publication 559, Survivors, Executors and Administrators. Any taxable part of a distribution that is not income in respect of a decedent is a payment the beneficiary must include in his or her income. However, the beneficiary cannot take any estate tax deduction for this part.

Comment: This same rule should apply to the Roth IRA.

4. Filing Requirements for Form 8606

a. You must file Form 8606 if any of the following applies. Obviously, this IRS instruction applies to the Roth IRA in addition to the traditional IRA, but for whatever reason, the IRS only put it in the traditional IRA section.

1. You made nondeductible contributions to a traditional IRA for 1999.

2. You received distributions from a traditional IRA in 1999 and you have ever made nondeductible contributions to a traditional IRA.

3. You converted part or all of the assets in a traditional IRA or a SIMPLE-IRA to a Roth IRA during 1999.

4. You recharacterized amounts that were converted to a Roth IRA.

5. You received distributions from a Roth IRA in 1999.

6. You have a recharacterization involving a Roth IRA contribution.

7. You are the beneficiary of an Education IRA and you received distributions from an Education IRA in 1999.

IRS Tip. You are not required to file Form 8606 to report contributions to Roth or Education IRAs.

b. Not Filing Form 8606. If you make nondeductible contributions to a traditional IRA and you do not file Form 8606, Nondeductible IRAs, with your tax return, you may have to pay a $50 penalty.

c. Failure to Report Nondeductible Contributions. If you do not report nondeductible contributions, all of the contributions to your traditional IRA will be treated as deductible. When you make withdrawals from your traditional IRA, the amounts you withdraw will be taxed unless you can show, with satisfactory evidence, that nondeductible contributions were made.

5. Although interest earned from your IRA is generally not taxed in the year earned, it is not tax-exempt interest. Do not report this interest on your return as tax-exempt interest. This interest will be taxed when distributed in the future.

Comment: This same rule should apply to the Roth IRA.

6. Brokers' Commissions. Brokers' commissions paid in connection with your traditional IRA are subject to the contribution limit and are not deductible as a miscellaneous deduction.

Comment: This same rule should apply to the Roth IRA.

7. Trustees' Fees. Trustees' administrative fees are not sub-

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ject to the contribution limit. A trustee's administrative fees that are billed separately and paid in connection with your IRA are deductible. They are deductible if they are ordinary and necessary as a miscellaneous deduction.

Comment: This same rule should apply to the Roth IRA.

8. Transfer Incident to Divorce. The two commonly used methods that you can use to make the transfer: (1) changing the name on the IRA, and (2) making a direct transfer of IRA assets.

Comment: This same rule should apply to the Roth IRA.

9. Disabled. A physician must determine that your condition can be expected to result in death or to be of long continued and indefinite duration. The IRS again indicates that 12 months is not necessarily sufficient.

Comment: This same rule should apply to the Roth IRA.

10. Naming a Trust as a Beneficiary. If you name a trust to replace your designated beneficiary after your required beginning date, you must refigure the period over which you must make withdrawals for subsequent years using only your remaining life expectancy. Comment #1: The IRS does not mention the new rules which allow the beneficiaries of a trust to be considered to be the IRA's beneficiaries if certain rules are met.

Comment #2: This same rule should apply to the Roth IRA.

11. In determining the IRA account balance for required distribution calculations, the amount in the IRA at the end of the preceding year is increased by any contributions for the preceding year that were made in the year for which the required distribution is being figured.

With Respect to Roth IRAs, the Following Excerpts are Highlighted

12. Contribution Deadline for the Roth IRA for 1999 for most people is April 17, 2000.

13. Roth Conversions. Conversions made with the same IRA custodian/trustee can be made by redesignating the traditional IRA as a Roth IRA rather than opening a new IRA plan agreement or issuing a new annuity. Comment: If redesignation takes place, it should be confirmed in writing. The IRS has given no guidance as to what duty there is to furnish an updated Roth IRA disclosure statement, if any.

14. A failed conversion is when you have made a conversion from a traditional IRA to a Roth IRA but you were not eligible because you did not satisfy the modified AGI limit of $100,000 or you were married and filed a separate return.

15. A person's election to recharacterize and the actual transfer must both take place on or before the due date (including extensions) for filing your tax return for the year for which the contribution was made to the first IRA.

This election to recharacterize can be made by the executor, administrator, or other person responsible for filing the decedent's final income tax return.

16. Inherited IRAs

a. If you inherited a Roth IRA, that IRA becomes subject to special required distribution rules.

b. The IRS has apparently chosen to limit when a surviving spouse may elect to treat the deceased spouse's IRA as his or her own. This right will exist only if the spouse was the sole beneficiary.

c. A nonspouse beneficiary and a spouse beneficiary who was not the sole beneficiary cannot make contributions (including rollover' contributions) to the Roth IRA and cannot roll it over. A nonspouse beneficiary and a spouse beneficiary who was not the sole beneficiary cannot aggregate an inherited Roth IRA with another Roth IRA maintained by the beneficiary unless he or she inherited another Roth IRA from the same decedent.

d. The beneficiary inherits the same tax attributes as the decedent had. Determination must be made whether or not the distributions are qualified distributions.

With Respect to Education IRAs, We Have Chosen the Following Excerpts to Highlight

17. Contribution deadline for the Education IRA is December 31.

18. An individual (including the designated beneficiary) can contribute to a child's Education IRA if the individual's modified adjusted gross income for the tax year is less than $110,000, or $160,000 for a married taxpayer filing jointly. Note: A married person who files a separate return is entitled to make an Education IRA contribution as long as his or her income is less than $110,000.

With Respect to SEP-IRAs We Have Chosen the Following Excerpts to Highlight

19. Contribution Deadline. To deduct contributions for a year, the employer must make the contributions by the due date (including extensions) of the employer's return for the year.

With Respect to SIMPLE-IRAs We Have Chosen the Following Excerpts to Highlight

20. For whatever reason, in Publication 590 the IRS does not discuss the contribution deadline. It may be because this is discussed in the Publication 560.

21. Two-Year Rule. Generally, rollovers and trustee-to-trustee transfers are not taxable distributions. To qualify as a tax free rollover (or a tax-free transfer) a rollover distribution (or a transfer) made from a SIMPLE-IRA during the two-year period beginning on the date on which you first participated in your employer's SIMPLE plan must be contributed (or transferred) to another SIMPLE-IRA. The two-year period begins on the first day on which contributions made by your employer are deposited in your SIMPLE-IRA. After the two-year period, amounts in a SIMPLE-IRA can be rolled over or transferred tax free to an IRA other than a SIMPLE-IRA.

Summary. Every IRA custodian/trustee should have the most recent copy of the IRS Publication 590 as a research tool. This is now the 1999 version. For those of you who have purchased an IRA Procedure Manual with an update service, your service provider should be furnishing you a copy shortly. If you wish to purchase individual copies of the IRS Publication 590, you may complete the enclosed order form and return it as instructed. ◆