The Pension Digest

November 2002
Published Since 1984

ALSO IN THIS ISSUE –

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

IRS EXTENDS QP DEADLINE—SEPTEMBER 30, 2003

Good news! On November 19, 2002, the Internal Revenue Service issued Revenue Procedure 2002-73 and extended the deadlines for certain employers to adopt a GUST amended and restated plan document and also the Good Faith EGTRRA amendment. In general, the new deadline is September 30, 2003.

The certain employers are those employers who in prior years were using a pre-approved prototype plan whose sponsor had filed the revised prototype with the IRS on or before December 31, 2000, or who had certified on or before February 28, 2002, (or the end of the plan year beginning in 2001, if later) that they intended to adopt such a pre-approved plan. There has been no extension of the deadline for individually designed plans except for one technical change. The deadline for individually designed plans was the later of February 28, 2002, or the last day of the first plan year beginning on or after January 1, 2001.

Impact on Financial Institutions Adopting CWF's Prototypes

The new deadline of September 30, 2003, does apply to the employers of those financial institutions using one or more of CWF's qualified plan prototypes, since we filed our revised prototypes just before the deadline of December 31, 2000. Many other prototype filers had filed their revised prototypes as early as possible—April 2000. The IRS issued such filers their favorable opinion letters in July of 2001. This meant that the adopters of such prototypes had to sign the revised adoption agreements by August 31, 2002. Previously, the IRS had been asked to extend this deadline and they did so—until December 31, 2002. And now the IRS has once again been asked to extend the deadline because the QP industry was saying that they were not going to be able to meet the December 31, 2002 deadline. The IRS has chosen to give one more extension. The new deadline is the later of September 30, 2003, or the end of the 12th month following the month in which the IRS issued the favorable opinion letter with respect to the prototype.

There are three technical amendment requirements in addition to those required by GUST. First, certain plans were required to be amended to include the 1994 GAR mortality table. The deadline had been December 31, 2002. It has also been changed to the end of the plan's GUST remedial amendment period. Second, it was permissible for an employer to operate its plan to include in the definition of

Continued on page 2

POSSIBLE DELAY FOR RMD NOTICE

We created six versions of the 2003 RMD Notice because the IRS, in Notice 2002-27 (April 2002) stated that all IRA custodians would be required to furnish an RMD Notice with respect to 2003 on or before January 31, 2003.

In a recent BNA, Inc. publication, there is an article which states that a key employee of the IRS has recently stated that it is likely there will be a delay in the effective date; therefore, there may well be a delay. If there is a delay, you will then need to decide if you will go ahead and furnish the Notices and be finished with the project, or whether you will put off furnishing the Notices until later in 2003. We will keep you informed.

IRS Extends Deadline of September 30, 2003,
Continued from page 1

compensation for section 415(c)(3) purposes any deemed compensation under section 125 of the Code. If so, the plan was required, under Rev. Rul. 2002-27, to actually be so amended by December 31, 2002. This deadline has also been changed to the end of the plan's GUST remedial amendment period. Third, section 314(e) of CRA made changes to the definition of compensation found in Code sections 414(s)(2) and 415(c)(3) to require that a plan consider as compensation the amount of compensation reduction elected for qualified transportation fringes that was not included in a person's compensation because of Code section 132(f)(4).

Since CWF filed its GUST revised prototypes near the deadline, our revised prototypes include the two "compensation" technical changes. The inclusion of the mortality table is not required for defined contribution prototypes.

Impact on EGTRRA Amendment Deadline

There were two types of amendments with respect to EGTRRA—those which are mandatory and those which are optional. In IRS Notice 2001-42 the IRS stated that a plan must adopt an EGTRRA good faith amendment no later than the latest of (1) the end of the plan year in which the amendment is required; (2) the end of the plan year in which the amendment is put into effect if it is optional; or (3) the end of the GUST remedial amendment period.

The application of (2) meant that the deadline was December 31, 2002. With Rev. Proc. 2002-73, the deadline technically is also now September 30, 2003. However, the Code section 411(d)(6) anti-cutback rules must still be met. In many situations the law is not well defined as to when an impermissible cut-back occurs. Therefore, the most conservative approach is to adopt the EGTRRA amendment on or before December 31, 2002.

Conclusion

Adopting employers now have until September 30, 2003, to sign the revised adoption agreement and the good faith EGTRRA amendment. We recommend that you do not suspend your project to have these businesses sign the revised adoption agreement and the EGTRRA good faith amendment. We recommend that you complete this task as soon as possible.

ARCHER MSA CUTOFF EXTENDED

If the number of Medical Savings Account (MSA) returns filed for 2001 or a statutorily specified projection of the number of MSA returns that will be filed for 2002 exceeds 750,000, then October 1, 2002, would be a "cutoff" date for the Archer MSA pilot project. However, the IRS has determined that the number of Archer MSA returns will be substantially less than 750,000. Therefore, October 1, 2002, is not a "cutoff" date, and 2002 is not a "cutoff" year for the Archer MSA pilot project.

ROLLOVER OF NONTAXABLE AMOUNTS FROM 401(k) PLANS INTO AN IRA—MANDATORY OR PERMISSIVE?

In the February 2002 newsletter, we surmised that the effect of the pro rata cost recovery rules in conjunction with the new rule allowing the rollover of nontaxable amounts lead to the result that a person was strongly induced to roll over the entire distribution. That is, the rollover of nontaxable amounts was almost mandatory because the person no longer could choose to withdraw "just" the after-tax dollars, as could be done prior to 2002, since after-tax dollars were not eligible to be rolled over.

The IRS has spoken. The IRS has recently issued the 2002 version of Publication 575 (Pension and Annuity Income). The following paragraph can be found in the 2002 version, and it was not present in the 2001 version.

> "**Rollover of nontaxable amounts.** You may be able to roll over the nontaxable part of a distribution (such as your after-tax contributions) made to another qualified retirement plan or traditional IRA. The transfer must be made either through a direct rollover to a qualified plan that separately accounts for the taxable and nontaxable parts of the rollover or through a rollover to a traditional IRA.
>
> **If you roll over only part of a distribution that includes both taxable and nontaxable amounts, the amount you roll over is treated as coming first from the taxable part of the distribution." p 24** (emphasis added).

The second paragraph is the key statement. We construe this paragraph to say that a person who receives a distribution from a qualified plan which includes both taxable and nontaxable amounts is not required to roll over the entire distribution. The person may chose to roll over only a portion, and the amount which is rolled over is treated as coming first from the taxable part of the distribution. The effect of this is that it allows a person to roll over the taxable portion and have paid to himself or herself the nontaxable portion (i.e. no rollover).

We don't believe Code section 72 or the related regulation supports this new approach, but it is an approach on which many QP participants will benefit.

The IRS has again chosen to give special treatment to QP participants when they do not give such treatment to IRA accountholders. Wouldn't it be nice if the IRS would allow IRA accountholders or beneficiaries to withdraw their nondeductible contributions first so that the pro rata calculations for Form 8606 would not need to be made? This is, in effect, the right the IRS has granted QP participants.

For purposes of the above article, the 401(k) plan is meant to represent all qualified plans which allow nondeductible contributions.

CWF does have concerns that important rules such as this one are to be found in an IRS publication before the related regulation has been amended to support such a position.

THE Pension Digest

ROLLOVER OF NONTAXABLE AMOUNTS FROM 401(k) PLANS INTO AN IRA AND THEN INTO A ROTH IRA—POSSIBLE OR NOT?

We are aware that some tax advisors are instructing their clients that they are allowed to roll over their nondeductible contributions from a 401(k) plan to an IRA, and then roll over these nondeductible contributions, via a conversion to a Roth IRA, where at some time they would be able to earn tax-free income. CWF does not believe the Internal Revenue Code supports this result. Note that the IRS did NOT revise Publication 575 to authorize such a rollover of just the nondeductible contributions. As seen above though, sometimes the lack of authority does not prevent the IRS from adopting certain positions.

If you have clients who wish to make such a conversion, you have two courses of action. Inform them that you will not accept such a contribution. Alternatively, you will accept such contribution only if they acknowledge that they are relying on the advice of their tax advisor, that you have informed them of your serious doubts, and that they must hold you harmless if the IRS would ever assess tax penalties for the excess contributions.

UNDERSTANDING THE SPECIAL 2002/2003 TRANSITIONAL RULE FOR IRA BENEFICIARIES

One would think the IRS would be happy when an IRA beneficiary uses the five-year rule and closes out the IRA he or she has inherited within the five/six year period. Tax revenue is collected sooner. However, in the final RMD regulations, the IRS chose to make it a harder for a beneficiary to use (elect) the five-year rule. The IRS, apparently, wants an IRA beneficiary to use the life-distribution rather than the five-year rule.

In 2003, a non-spouse beneficiary is deemed to elect the life-distribution rule (and must commence distribution over his or her life-distribution period on or before December 31 of the year after the year of death) unless he or she expressly elects the five-year rule. The rule was just the opposite prior to 2003. A non-spouse beneficiary was deemed to have elected the five-year rule unless he or she elected the life-distribution rule and commenced distributions over his or her life expectancy on or before December 31 of the year after the year of death. Consequently, many current IRA beneficiaries are using the five-year rule to comply with the RMD rules for beneficiaries. Some may wish they had elected the life-distribution rule. Note that the five-year rule is an option available to a beneficiary only when the IRA accountholder has died before his or her required beginning date.

The IRS is giving such beneficiaries a second chance. You, as their IRA custodian or trustee, may wish to point out this special transition rule along with their right to designate their own beneficiary(ies). A beneficiary who is using the five-year rules has the right to switch to the life-distribution rule if two rules are met. First, he or she must make the switch either by December 31, 2002, or December 31, 2003, as applicable. Second, he or she must take whatever distributions would have been made if the life-distribution rule applied rather than the five-year rule. The deadline to make this switch is 12-31-02, if the accountholder died during 1997, since the modified five-year period will end on 12-31-02, for death occurring in 1977. If the accountholder died after 1997, then the deadline is 12-31-2003

For example, Patti Hines, an IRA accountholder, died on November 6, 1999, at the age of 67. Her IRA balance was $52,000 on the date of her death. The current IRA balance is $70,000. She had designated her son (George) as her beneficiary. George did not set up a life-distribution payout schedule by December 31, 2000, and therefore he needs to close out his inherited IRA on or before December 31, 2004. He, however, has not yet taken any distributions. Right now he has three tax years (2002-2004) remaining to spread out the distribution of the $65,000, and soon there will be only two tax years. George's date of birth is 3-17-54. George may well want to switch to the life-distribution rule in order to lower the taxes to be paid over the next three years. The balance in the IRA has been as follows: (1) December 31, 1999—$ 56,000; (2) December 31, 2000—$62,000; (3) December 31, 2001—$66,000; and it is assumed it will be $70,000 as of 12-31-02. If George decides to switch to the life-distribution rule in 2002, he will need to be distributed the aggregate amounts he has not taken for 2000-2002 is $4,996 and is calculated as follows:

<u>Required Distribution Amount for 2000</u>:

George's age in the year after the year of Patti's death (2000):	46
George's initial distribution period from the single life table.	37.9
Balance as of preceding 12-31	$56,000
RMD Amount	$1,478

<u>Required Distribution Amount for 2001</u>:

George's age in 2001:	47
George's distribution period factor (37.9-1.0)	36.9
Balance as of preceding 12-31	$62,000
RMD Amount	$1,680

Continued on page 4

Understanding the Special Transitional Rule, Continued from page 3

Required Distribution Amount for 2002:

George's age in 2002:	48
George's distribution period factor (37.9-2.0)	35.9
Balance as of preceding 12-31	$66,000
RMD Amount	$1,838

Total Amount to Be Distributed:

($1,478+$1,680+$1,838) =	$4,996

Summary. Beneficiaries currently using the five-year rule will have until 12-31-02 or 12-31-03 to elect to switch to the life-distribution rule. CWF's Form #204 now allows this special election. An IRA custodian or trustee may well wish to inform these beneficiaries of this special rule. We do not see the IRS extending these deadlines.

SPECIAL RELIEF FOR SOME BENEFICIARIES WHO HAVE MISSED TAKING ONE OR MORE DISTRIBUTIONS

As discussed in the preceding article, under the new RMD rules, an IRA beneficiary is deemed to have elected the life-distribution rule unless he or she expressly elects the five-year rule. In the case of a non-spouse beneficiary, or a spouse beneficiary who is not the sole beneficiary, the deadline for making this election is December 31 of the year following the year of death, because the first payment under the life-distribution rule must be made by such date. If the payment is not made, then the general rule is that the beneficiary owes the 50% excise tax for the missed distribution.

For various reasons, you will have IRA beneficiaries who are in this situation—they miss taking their first or second distribution. For example, an IRA accountholder dies in November of 2002, but you are not notified of the death until January of 2004. The first distribution's deadline was December 31, 2003, and it was missed. The 50% tax will be owed unless the IRS will accept the beneficiary's explanation or unless the following special rule applies.

The IRS has created a special rule to partially deal with this situation. The 50% excise tax will automatically be waived if: (1) the beneficiary is an individual who is the sole beneficiary; and (2) the beneficiary's entire IRA benefit is distributed by December 31 of the year containing the fifth anniversary of the accountholder's death. The beneficiary who has missed one or more required distributions can now decide if they will be better off to use the five-year rule rather than the life-distribution rule. That is, are they better off by paying the 50% excise tax for those missed years and closing the IRA within the five/six year period, or are they better-off if they pay the 50% excise tax to retain the right to have the distributions under the life-distribution rule? The answer to this question will also be fact specific and depend on how the beneficiary thinks.

At first glance, this special exception gives the impression that it is no big deal if one does not elect the five-year rule by December 31 of the year following the year of the accountholder's death, because it can be elected later. The following should be noted. The automatic waiver applies only to a beneficiary who is a sole beneficiary. Secondly, the automatic waiver does not apply if the IRS decides it should not apply. At this point, the IRS has not indicated those situations when the automatic waiver would not apply. It is still best to have the five-year rule be expressly elected, if that is the rule the beneficiary wishes to use to satisfy the beneficiary RMD rules.

ROLLOVER RIGHTS AFTER AN FDIC CLOSURE OF AN INSURED BANK

Economic times are not the best. The FDIC has recently closed a number of distressed financial institutions. The FDIC moves very quickly. Many times the FDIC will furnish a Deposit Insurance Check to the owners of deposit accounts within the failed institution with balances less than $100,000. Some of the accounts are IRA accounts.

The FDIC has recently furnished the following Notice regarding distributions from IRAs.

"Notice Regarding Distributions From Individual Retirement Arrangements

"On __________, 2002 (the "Closing Date"), the Office of Comptroller of the Currency closed __________ (the "Failed Institution") and appointed the Federal Deposit Insurance Corporation as Receiver (the "Receiver"). The Federal Deposit Insurance Corporation, in its capacity as the Receiver, is liquidating the Failed Institution and the Federal Deposit Insurance Corporation, in its capacity as the insurer of deposits ("FDIC"), is paying deposit insurance to depositors for certain account(s) held at the Failed Institution. The FDIC protects depositors up to $100,000 and is providing the funds to pay your insured deposits.

"If you receive a deposit insurance check that represents a distribution from an Individual Retirement Arrangement ("IRA"), you should consult IRS Publication 590 and/or your tax advisor concerning the possible tax consequences of such distribution. The following information does not constitute tax advice and, if you have any questions concerning the possible tax consequences of such distribution, you should contact the IRS. IRS Publication 590 may be obtained and the IRS may be contacted at your local IRS office or via the Internet at www.irs.gov.

"Generally, a distribution from a traditional IRA can be rolled over tax-free into another traditional IRA for a limited period of time (usually 60 days) following the date the distribution is received. Amounts not rolled over within the 60-day period will generally be

Continued on page 5

The Pension Digest

Rollover Rights After an FDIC Closure, Continued from page 4

treated as a taxable distribution subject to income tax and may be subject to a 10% penalty.

"Please also note that, generally, you can receive a distribution from a traditional IRA and make a rollover contribution (of all or part of the amount received) to another traditional IRA only once in any one-year period. To the extent that such waiting period might otherwise apply to you and result in a taxable distribution because you have made a tax-free rollover within the past year, you should know that an exception to the one-year waiting period rule has been granted by the IRS for distributions made from a failed financial institution by the Federal Deposit Insurance Corporation.

"The FDIC will be providing all IRS reporting requirements (1098 for interest paid, 1099 for interest earned and IRA-related forms) for Hamilton Bank for the tax year of 2001. It will be mailed to your address of record at the bank.

"Again, should you have any tax-related questions, please contact the IRS or your tax advisor."

There are two things to observe about this Notice.

First, the distributions discussed within this Notice are generally those made to an IRA accountholder. Note the fourth paragraph of this Notice. Because an accountholder may have already made a rollover in the previous 12 months, the FDIC's involuntary payment to the accountholder could have the effect that the accountholder would not be able to roll over this distribution and would have undesired adverse tax consequences. The FDIC states that they have discussed this situation with the IRS, and the IRS has created a failed institution exception to the one-per-year rollover rule.

Second, this Notice does NOT address those distributions which were made to an IRA beneficiary who has an inherited IRA. The law is clear that a nonspouse beneficiary is not eligible to roll over an inherited IRA. One would think that if the IRS has created an exception to the once-per-year rule for accountholders, they might be willing to create an exception for an IRA beneficiary who has inherited an IRA. We asked the IRS if they would be willing to allow a beneficiary who had been paid an involuntary distribution by the FDIC to roll over the distribution. The IRS said no. We admit that the person we talked with may have superiors who may decide otherwise, but you should be aware that the IRS's initial decision was to not allow such a rollover. The FDIC's payout to a beneficiary certainly has very adverse tax consequences. We are aware of some situations where the FDIC has reissued a transfer check after being requested to do so.

IRS REQUIREMENTS FOR SUBSTITUTE FORMS

This article discusses the requirements for providing substitute forms (1099-Rs & 5498s) to the individual IRA accountholder. It does not discuss the requirements for providing substitute forms to the IRS. However, if certain rules are met, a substitute form can be designed that will be acceptable for IRS submission. This topic is not discussed here because most IRA custodians/trustees will file this information via magnetic media or by e-mail.

Substitute Form 1099-R

The IRS Revenue Procedure 2002-57, Publication 1179, states the requirements for substitute forms. Those include, but are not limited to, the following:

- The substitute form must clearly be identified by the IRS form number and IRS title for which it is substituting.
- All applicable money amounts and information, including box numbers, must be titled in substantially the same manner as the official IRS form.
- The caption "Federal Income Tax Withheld" must be in bold print.
- The correct number of copies must be provided.
- Appropriate instructions, similar to the IRS instructions must be provided.

Can substitute 1099-Rs be prepared with multiple distribution codes? For instance, could the same substitute 1099-R form for the same individual include an amount of $1,000 with a code #1 AND an amount of $2,000 with a code #7.

Based on our research, we do not find any specific language that would disallow this practice. The IRS Revenue Procedure 99-34 is the most recent position by the IRS on this topic. It appears that as long as the individual box numbers are noted and the specific instructions for the form are included with the substitute form to the recipient, this practice would not be a violation, as long as the other IRS procedures are followed.

2002 IRS Publication 1179—Additional Discussion of Substitute IRA Forms

The IRS has recently issued Revenue Procedure 2002-57. It will be reproduced in the next revision of Publication 1179. Rev. Proc. 2001-50 is now superseded. Revenue Procedure 2002-57 provides the 2002 requirements for:

1. Using official Internal Revenue Service (IRS) forms to file certain information returns with the IRS.
2. Preparing acceptable substitutes of the official IRS forms to file information returns with the IRS, and
3. Using official or acceptable substitute forms to furnish information to a recipient.

The information returns covered by Revenue Procedure 2002-57 are 1096, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-DIV, 1099-G, 1099-INT, 1099-LTC, 1099-MISC, 1099-MSA, 1099-OID, 1099-PATR, 1099-R, 1099-S, 5498, 5498-MSA and W-2G.

The rules differ depending upon the form being filed or furnished. This article discusses the rules for the IRA forms. You will need to refer to the Revenue Procedure for the rules for the non-IRA forms.

Continued on page 6

IRS Requirements for Substitute Forms, Continued from page 5

Section 4.1.3 sets forth the following rules for—Substitute Statements for Recipients—for Certain Forms 1098, 1099, 5498 and W-2G.

Statements to form recipients for Forms 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-C, 1099-G, 1099-LTC, 1099-MISC, 1099-MSA, 1099-R, 1099-S, 5498, 5498-MSA, W-2G, 1099-DIV (only for section 404(k) dividends reportable under section 6047), and 1099-INT (only for interest of $600 or more made in the course of a trade or business reportable under section 6041) can be copies of the official forms or an acceptable substitute. To be acceptable, a substitute form recipient statement must meet the following requirements.

1. The tax year, form number, and form name must be the same as the official form and must be displayed prominently together in one area on the statement. For example, they may be shown in the upper right part of the statement.

2. The filer's and the form recipient's identifying information required on the official IRS form must be included.

3. Each substitute recipient statement for Forms W-2G, 1098, 1098-E, 1098-T, 1099-A, 1099-B, 1099-DIV, 1099-G (excluding state and local income tax refunds), 1099-INT, 1099-LTC, 1099-MISC (excluding fishing boat proceeds), 1099-OID, 1099-PATR, and 1099-S must include the direct access telephone number of an individual who can answer questions about the statement. **You may include the telephone number conspicuously anywhere on the recipient statement.** Although not required, payers reporting on Forms 1099-C, 1099-MSA, 1099-R, 5498 and 5498-MSA are encouraged to furnish telephone numbers.

4. All applicable money amounts and information, including box numbers, required to be reported to the form recipient must be titled on the form recipient statement in substantially the same manner as those on the official IRS form. The box caption **"Federal income tax withheld"** must be in boldface type on the form recipient statement.

Exception. If you are reporting a payment as "Other income" in box 3 of Form 1099-MISC, you may substitute appropriate language for the box title. For example, for payments of accrued wages and leave to a beneficiary of a deceased employee, you might change the title of box 3 to "Beneficiary payments" or something similar.

Note: *You cannot make this change on **Copy A.***

5. You must provide appropriate instructions to the form recipient, similar to those on the official IRS form, to aid in the proper reporting on the form recipient's income tax return. For payments reported on Form 1099-B, the requirement to include instructions substantially similar to those on the official IRS form may be satisfied by providing form recipients with a single set of instructions for all Forms 1099-B statements required to be furnished in a calendar year.

Note: *If Federal income tax is withheld and shown on Form 1099-R or W-2G, Copy B and Copy C must be furnished to the recipient. If Federal income tax is not withheld, only Copy C of Form 1099-R or W-2G must be furnished. However, for Form 1099-R, instructions similar to those on the back of the official Copy B and Copy C of Form 1099-R must be furnished to the recipient. For convenience, you may choose to provide both Copies B and C of Form 1099-R to the recipient.*

6. If you use carbon to produce recipient statements, the quality of the carbon must meet the following standards:

- All copies must be **clearly legible,**
- All copies must be able to be photocopied, and
- Fading must not diminish legibility and the ability to photocopy.

In general, black chemical transfer inks are preferred, but other colors are permitted if the above standards are met. Hot wax and cold carbon spots are not permitted on any of the internal form plies. The back of a mailer top envelope ply may contain these spots.

7. A mutual fund family may state separately on one document (e.g., one piece of paper) the Form 1099-B information for a recipient from each fund as required by Form 1099-B. However, the gross proceeds, etc., from each transaction within a fund must be stated separately. The form must contain an instruction to the recipient that each fund's (not the mutual fund family's) name and amount must be reported on the recipient's tax return. The form cannot contain an aggregate total of all funds.

8. You may use a Uniform Settlement Statement (under the Real Estate Settlement Procedures Act of 1974 (RESPA)) for Form 1099-S. The Uniform Settlement Statement is acceptable as the written statement to the transferor if you include the legend for Form 1099-S below and indicate which information on the Uniform Settlement Statement is being reported to the IRS on Form 1099-S.

9. For reporting state income tax withholding and state payments, you may add an additional box(es) to recipient copies as appropriate.

Note: *You cannot make this change on **Copy A.***

10. On Copy C of Form 1099-LTC, you may reverse the location of the policyholder's and the insured's name, street address, city, state, and ZIP code for easier mailing.

11. Logos are permitted on substitute recipient statements for the forms listed in this section (Section 4.1.3). Section 4.3.2 sets forth the legend requirements for the Form 1099-MSA and the Form 1099-R as follows:

- **Form 1099-MSA**—"This information is being furnished to the Internal Revenue Service"
- **Form 1099-R**

Copy B—"Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return. This information is being furnished to the Internal Revenue Service."

Continued on page 7

The Pension Digest

IRS Requirements for Substitute Forms, Continued from page 6

Copy C—"This information is being furnished to the Internal Revenue Service."

Section 4.3.3 sets forth the legend requirements for the Form 5498-MSA and the Form 5498 as follows:

• **Form 5498**—"This information is being furnished to the Internal Revenue Service."

Note: *If you do not furnish another statement to the participant because no contributions were made for the year, the statement of the fair market value of the account must contain this legend and a designation of which information is being furnished to the Internal Revenue Service.*

• **Form 5498-MSA**—"The information in boxes 1 through 6 is being furnished to the Internal Revenue Service."

Section 4.2.2 sets forth the rules for composite substitute statements for recipients for forms specified in section 4.1.3 as follows:

A composite form recipient statement for the forms specified in **Section 4.1.3** is permitted when one filer is reporting more than one type of payment during a calendar year to the same form recipient. A composite statement is not allowed for a combination of forms listed in **Section 4.1.3** and forms listed in **Section 4.1.2**.

Exceptions. Form 1099-B information may be reported on a composite form with the forms specified in **Section 4.1.2** as described in **Section 4.2.1**. In addition, royalties reported on Form 1099-MISC or 1099-S may be reported on a composite form only with the forms specified in **Section 4.1.2**.

Although the composite form recipient statement may be on one sheet, the format of the composite form recipient statement must satisfy the requirements listed in **Section 4.2.1** as well as the requirements in **Section 4.1.3**. A composite statement of Forms 1098 and 1099-INT (for interest reportable under section 6049) is **not** allowed.

OMB Requirements

The Section 5.2.2 of Revenue Procedure 2002-57 sets forth the OMB requirements for substitute IRS forms. They are as follows:

• Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.

• For Copy A, the OMB number must appear exactly as shown on the official IRS form.

• For any copy other than Copy A, the OMB number must use one of the following formats.

1. OMB No. XXXX-XXXX (preferred) or
2. OMB #XXXX-XXXX (acceptable).

Miscellaneous Instructions for Copies B, C, D, 1, and 2

Copies B, C and in some cases, **D, A, and 2** are included in the official assembly for the convenience of the filer. You are not legally required to include all these copies with the privately printed substitute forms. Furnishing Copies B and, in some cases, C will satisfy the legal requirement to provide the statement of information to form recipients.

Note: *If an amount of Federal income tax withheld is shown on* ***Form 1099-R*** *or* ***W-2G, Copy B,*** *(to be attached to the tax return) and* ***Copy C*** *must be furnished to the recipient.* ***Copy D (Forms 1099-R and W-2G)*** *may be used for filer records. Only* ***Copy A*** *should be filed with the IRS.*

MOVING COVERDELL EDUCATION SAVINGS ACCOUNT (CESA) FUNDS (530 PLAN) TO A 529 PLAN

Normally when funds are moved, without tax consequences, from one tax-preferred plan to another tax preferred plan, there must be a qualifying rollover or a transfer. However, a different approach exists for moving funds from a CESA to a qualified state tuition program (section 529 plan).

Code section 530(b)(2) defines a "qualified higher education expense." Subsection (B) states that "such term shall include amounts paid or incurred to purchase tuition credits or certificates, or to make contributions to an account under a qualified state tuition program (as defined in section 529(b)) for the beneficiary of the account." Thus, withdrawing funds from the CESA for payment to the section 529 plan is a qualifying expense as long as the beneficiary of the CESA and the section 529 plan are the same person.

The general rule is that contributions to a section 529 plan on behalf of any beneficiary cannot be more than the amount necessary to provide for the qualified higher education expenses of the beneficiary.

The effect of withdrawing the money from the CESA and then contributing it to the section 529 plan has the same tax result as a rollover or a transfer, in that no income taxes will be owing on account of the moving of the funds. However, because this movement is not a rollover, CWF believes the CESA custodian will need to prepare Form 1099-R to report the distribution to the designated beneficiary. The Form 8606 will then need to be completed for the child and filed with the IRS, as is required whenever a distribution is received as a beneficiary of a Coverdell ESA, unless the distribution was rolled over or was the return of excess contributions. The Form 8606 will either need to be attached to the Form 1040 or 1040A, or it will need to be filed separately, if the child is otherwise not required to file a tax return. In such case, line 28 of Form 8606 would be completed with the total amount of the distribution; line 29 would be completed with the amount or "qualified expense," and this would be the amount moved to the section 529 plan, since it is a qualified expense. Line 30 (taxable amount) would be zero because the amount on line 29 (the expenses) equals the amount of the distribution.

Continued on page 8

Moving Coverdell Education Savings Account,
Continued from page 7

At some point in time, the IRS may change the instructions so that the Form 8606 would not need to be filed for the above situation. The present instructions do not indicate that the Form 8606 need not be completed for this situation.

It is doubtful that the IRS would ever change the Form 1099-R instructions to allow the CESA custodian to not prepare the Form 1099-R for this situation, as in the case of a transfer.

Because CESA accounts have only been in existence since 1998, many issues still need to be settled. CWF will keep you up to date on the newest developments in this area.

ROTH IRA TAX TIPS

As you are aware, a Roth IRA is an IRA funded with after-tax dollars. The great benefit arises when, if funds are withdrawn from the account for a “qualified distribution,” no taxes will ever be owing on the accumulated earnings. The following is some general information concerning Roth IRAs.

✶ If an individual is a participant in a 401(k) plan (or other type of employer-sponsored plan), such participation does NOT make the individual ineligible to make a Roth IRA contribution. The two actions are totally independent of each other.

✶ An individual who has compensation and who attains age 70 1/2 or older during 2001, is ineligible to make a contribution to a traditional IRA. However, this person IS ELIGIBLE to contribute to a Roth IRA, as long the applicable MAGI is met.

✶ If an individual contacts your institution because they have realized that their traditional IRA contribution is not deductible, you will need to discuss the option of recharacterizing the contribution to be a Roth IRA contribution.

✶ A married couple may encounter the situation where one spouse is an active participant in a pension plan, and the other spouse is not. The spouse who is not an active participant in a pension plan will most likely be able to make a deductible traditional IRA contribution. The spouse who is an active participant will want to make a Roth IRA contribution.

✶ A person is not eligible to roll over funds from a 401(k) plan directly to a Roth IRA. The funds must first be rolled over to traditional IRA and then be converted to a Roth IRA from the traditional IRA.

✶ In a conversion from a Roth IRA to a traditional IRA, an individual is not required to convert all of the funds within the traditional IRA. It is permissible to convert only a portion of the traditional IRA.

✶ As you are aware, there is a rule which states that IRA funds can only be rolled over once per year. However, this does not mean that an individual cannot convert funds from a traditional IRA to a Roth IRA—the “once-per-year-rule” does not apply to conversion contributions to a Roth IRA.

IRA PROJECTION SCHEDULES AT 1%

The Federal Reserve recently dropped its federal funds rate to 1.25%. This means many banks are now paying an interest rate of less than 2% on certain savings, money market and time deposits. Antiquated or not, the governing IRA regulation requires an IRA Disclosure Statement be furnished to a person when he or she opens an IRA. One of the requirements of this Disclosure Statement is that it include a financial projection of the estimated or guaranteed growth, if it is reasonable to do so. Many current IRA forms used to establish an IRA include projection schedules based on an interest rate of 2% or higher. If the rate you will pay your accountholder is less than 2%, then you will have a compliance problem. The governing IRA regulations require that the projection be based on an earnings rate no greater than the amount actually to be paid to the accountholder. Every bank will want to review the forms it uses to open IRAs. A bank will be required to add an addendum or amendment to show the projection at a complying interest rate, be it 1% or .70%, if the printed form contains a projection using an interest rate larger than what will initially be paid to the new accountholder. Your forms IRA vendor should have inserts or addendums to make your existing inventory useable and should have revised IRA forms available with the 1% rate.

YEAR 2003 BRINGS A BRAND NEW NOTICE REQUIREMENT

On or before January 31, 2003, an IRA custodian is required to furnish an RMD notice to its IRA accountholders who are subject to the required distribution rules. This includes those attaining age 70 1/2 in 2003, and those who attained age 70 1/2 in an earlier year. Every financial institution will want to check with its IRA software vendor/processor to see if it will be using the new life-expectancy tables which the IRS issued in April of 2002. Many vendors and processors chose to continue to use the old life-expectancy tables for 2002 calculations even though the accountholder would have benefitted by using the new tables. Use of the new tables is mandatory for 2003.