The Pension Digest

February 2003
Published Since 1984

ALSO IN THIS ISSUE –

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

PRESIDENT BUSH PROPOSES BOLD CHANGES TO IRAS AND ELECTIVE DEFERRAL PLANS

On January 31, 2003, President Bush proposed a number of bold (radical) changes to the laws governing traditional IRAs, Roth IRAs, Coverdell Education Savings Accounts, Archer Medical Savings Accounts, Qualified Tuition Plans (section 529 Plans, 401(k) plans, 403(b) plans, and section 457 plans and SIMPLE IRA plans.

The President has requested quick action on these proposals along with his other 2004 Budget proposals because taxpayers would only have until December 31, 2003, to make various elections.

Here is our summary of President Bush's proposals as set forth in a public release by the U. S. Treasury on January 31, 2003.

His proposals themselves are an overview, and there is still much detail which is unknown. In some ways, these changes would bring simplification, and in other ways they would add complexity. You will have to decide for yourself. It is too early to know how many of these proposals will be enacted into law.

Three New Accounts are proposed—Retirement Savings Accounts (RSAs), Lifetime Savings Accounts (LSAs) and Employer Retirement Savings Accounts (ERSAs). The first two are individual savings plans, and the last one creates ERSAs to promote and vastly simplify employer plans with elective deferral provisions. Rather than having separate rules for 401(k) plans, 403(b) plans, SIMPLE IRA plans, and governmental section 457 plans, there will be just one set of rules as set forth for ERSAs.

The RSA

The purpose of the RSA is to provide funds for a person's retirement. As discussed in prior newsletters, the traditional IRA, over the years, has evolved into serving purposes more than just retirement. That progression would be stopped. This would be a retirement account. It would be very similar to the existing Roth IRA account. The annual contribution limit would be $7,500 per year, and a person would be required to have earned income to make the contribution. However, there would be no limitations based on age or amount of modified adjusted gross income. There would be no tax deduction granted for making the contributions, but the earnings of the account would be tax free if made to the accountholder when he or she was age 58 or older or disabled, or to a beneficiary after the accountholder died. Contributions would start in 2003. Presumably, the rules which mandate distributions to a Roth IRA beneficiary would apply to the new RSA accounts. However, this topic was not addressed in the President's proposals, as it primarily focused on contributions. The $7,500 limit would be indexed for inflation. The impact of the RSA on traditional IRAs and Roth IRAs would be as follows.

Traditional IRAs

Traditional IRAs would not be repealed or eliminated, at least not in 2003. As written, December 31, 2003 (and not April 15, 2004) would be the last day a person would be able to make a contribution (other than for rollovers and transfers) to a traditional IRA. To encourage people to convert or roll over their traditional IRA to the Retirement Savings Account before January 1, 2004, their distribution would be taxed over four years (2003-2006). For conversions on or after January 1, 2004, the tax on the distribution would be due for the year of the conversion. Unlike under existing law, all traditional IRA account holders would be eligible to convert their traditional IRA. That is, the eligibility requirement of having less than $100,000 of modified adjusted gross income would no longer apply.

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It does not appear that any traditional IRA accountholder would be required to convert his or her traditional IRA funds to the Retirement Savings Account. All existing traditional IRA distribution rules would continue to apply to both IRA accountholders and beneficiaries. The traditional IRA will continue to exist to handle rollovers from employer-sponsored retirement plans. Obviously, a later Congress could pass a law imposing a deadline by when all funds would either have to be withdrawn or converted into a Roth IRA.

Roth IRAs

They would continue to exist, but the account would be renamed to be a Retirement Savings Accounts. There would be new rules defining a qualified distribution. There will be only three qualifying events (age 58, disability, or death). It appears that the first-time home buyer exception would not exist after December 31, 2003. The five-year requirement has been repealed.

The LSA

The LSA is a non-retirement account and can be used for any type of savings purpose. For example, the LSA could be used for a child's education, a new home, healthcare needs, or for an individual to start their own business. It is clearly an account designed to encourage a person to save and invest. The annual contribution limit would be $7,500 per year and a person would not be required to have earned income to make the contribution. However, there would be no limitations based on age or amount of modified adjusted gross income. There would be no tax deduction granted for making the contributions, but the earnings of the account, when withdrawn, would be tax free regardless of the reason for the withdrawal. As with the Roth IRA, the earnings would come out of the IRA only after all contributions (annual or conversion) had been distributed. Contributions would start in 2003. The $7,500 limit would be indexed for inflation. The LSA will impact existing non-IRA tax-preferred accounts as follows.

Coverdell Education Savings Accounts (CESA)

A person with a CESA would be eligible to convert the funds within the CESA to the LSA, but would not be required to do so. This right to convert would exist only if exercised on or before December 31, 2003. The right to contribute to a CESA will continue to exist after December 31, 2003.

Archer Medical Saving Accounts (Archer MSA)

A person with an Archer MSA would be eligible to convert the funds within the Archer MSA to the LSA, but would not be required to do so. This right to convert would exist only if exercised on or before December 31, 2003. Under existing law, a new Archer MSA will, in general, not be able to be established after December 31, 2003, unless Congress would pass extending legislation. The right to contribute to an Archer MSA will continue to exist after December 31, 2003.

Qualified State Tuition Plans (QSTP)

A person with a QSTP would be eligible to convert the funds within the QSTP to the LSA, but would not be required to do so. This right to convert would exist only if exercised on or before December 31, 2003. The right to contribute to a QSTP will continue to exist after December 31, 2003.

The U.S. Treasury makes the following arguments as to why LSAs are good for average Americans:

- They can simply save more tax free.
- More low and moderate-income taxpayers will participate. Many do not participate now because they are more likely to face a penalty if they need the funds. Knowing they can access the money at any time for any purpose will encourage them to set money aside and allow them to receive tax-free earnings from their first dollar of savings.
- It takes away the hassle factor. The combination of universal eligibility and unrestricted tax-free withdrawals greatly simplifies the whole process, making it more likely that average taxpayers will participate, especially inexperienced savers. Many low- and moderate-income taxpayers will conveniently be able to put all their financial assets in one place; this will greatly simplify their taxes because they will no longer receive taxable investment earnings.

Set forth below is a Q & A for these two new accounts as provided by the U.S. Treasury

I have been contributing to IRAs for years. Will I have to stop?

After 2003, you will no longer be able to contribute to an IRA. However, your ability to contribute to both an LSA and an RSA will give you much more flexibility to save for your future. You will be able to save up to $7,500 (indexed in the future for inflation) in an LSA plus up to $7,500 (indexed in the future for inflation) in an RSA for a total of $15,000 in tax-preferred savings. In addition, you will have much more flexibility to take distributions for what you deem appropriate when you deem it appropriate.

Will there be any income limitations on making contributions to LSAs or RSAs?

There are no income limitations on making contributions to LSAs. You can make a contribution to an LSA even if you have no wage income. Thus, you can make contributions on behalf of your children or other family members, in order to help them save for home ownership, health emergencies, education, retirement, or other future costs. While there are no maximum income limitations on making contributions to RSAs, you may not contribute more than your compensation (wages) income to an RSA.

What tax benefits do I receive if contributions are not deductible?

While all contributions to LSAs and RSAs will be nondeductible, all distributions from LSAs and RSAs (except for RSA distributions prior to age 58, death or disability) will be excludable from taxable

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income. As a result, all investment earnings can be distributed tax free. This is the same tax treatment as current law Roth-IRAs.

Which tax treatment would be better for me: an old-style deductible IRA or a new Roth-style RSA?

For the vast majority of individuals it doesn't make a difference: After-tax income in retirement is the same whether contributions are tax free and distributions are taxed or contributions are taxed and distributions are tax free. The only exceptions to this rule are individuals who change tax brackets after they retire. If an individual's tax rate declines in retirement, deductible contributions are better; if an individual's tax rate increases in retirement, Roth treatment is better.

Will I continue to be able to contribute to Archer medical savings accounts, Coverdell education savings accounts and qualified state tuition programs?

Yes. The LSA/RSA proposal will not affect your ability to contribute to MSAs, ESAs, or QSTPs. Many taxpayers may prefer the increased flexibility of the new LSAs as their tax-preferred savings vehicle.

Can I convert my existing IRAs, MSAs, ESAs, and QSTPs to an LSA or RSA?

You may convert an MSA, ESA, or QSTP to an LSA anytime before January 1, 2004. In the case of a conversion of a QSTP or ESA, no amount would be taxable in the year of the conversion while a conversion of an MSA to an LSA will result in taxation of the total amount converted in the year of the conversion.

You may convert a traditional IRA to an RSA at any time. The amount converted will be taxable except to the extent that you have basis in your IRA. If you convert prior to January 1, 2004, you will be able to spread the tax on the conversion over a four-year period. For conversions on or after January 1, 2004, the total taxable amount will be included in your gross income for the year of the conversion.

Will the Saver's Credit still be available after the enactment of the LSA/RSA proposal?

Yes. The Saver's Credit will be available for elective deferrals and LSA/RSA contributions made prior to 2007.

What will happen to the new deemed IRA provision? Will employer plans still be able to offer them?

Deemed IRAs will become deemed RSAs and will be subject to the rules applicable to RSAs.

Who will be able to become trustees for the LSAs and RSAs?

The rules that now apply to IRAs regarding who can be a trustee will apply to LSAs and RSAs. Thus, the trustee will have to be a bank or another person who demonstrates to the IRS that the manner in which they will administer the trust will be consistent with the rules applicable to LSAs and IRAs.

Will LSAs and RSAs be permitted to be held in the form of an annuity?

Yes. LSAs and RSAs may be held in the form of a nontransferable annuity contract issued by an insurance company that meets the rules that currently apply to individual retirement annuities.

Can I make LSA or RSA contributions on behalf of other persons, such as my children or spouse?

Yes, you may make LSA or RSA contributions on behalf of any other individual. However, total contributions made on behalf of an individual may not exceed $7,500 for LSAs and $7,500 (or compensation income, if less) for RSAs. In the case of a married couple filing jointly, RSA contributions up to $7,500 can be made for each spouse (including, for example, a homemaker who does not work outside the home) if the combined compensation of both spouses is at least equal to the contributed amount.

Will catch-up contributions be available for LSAs or RSAs?

Catch-up contributions will not be available for LSAs or RSAs, but the limits applicable to all individuals in LSAs and RSAs will be significantly greater than the existing IRA limits, even with catch-up.

The ERSA

The purpose of the ERSA as with the RSA is to provide funds for a person's retirement. The difference is that the ERSA is established pursuant to an employer plan which authorizes elective deferrals. Under existing law, there are five types of plans which allow for elective deferral contributions—401(k) plans, 403(b) plans, SIMPLE IRA plans, and governmental section 457 plans. President Bush's proposal is that as of January 1, 2004, the ERSA would replace these five plans. ERSA would follow existing, but simplified rules for 401(k) plans. Set forth below is a Q & A for the ERSA as provided by the U.S. Treasury.

Which types of employer-sponsored plans would be replaced by the new ERSA?

The ERSA would replace all types of funded plans with employee contributions. Thus, ERSAs would replace 401(k) plans, SIMPLE 401(k) plans, 403(b) plans, governmental 457 plans, salary reductions simplified employee pensions (SARSEPs), and SIMPLE IRAs. The ERSA would not replace nongovernmental 457 plans.

Are there any types of employers who would not be able to sponsor an ERSA?

No. Any employer would be able to sponsor an ERSA.

Will the ERSA proposal have any effect on the amount that an employee will be able to defer under existing law?

The amount that an employee will be able to defer under an ERSA will be $12,000 (increasing to $15,000 in 2006) plus, once the employee reaches age 50, a catch-up contribution of $2,000 (increasing to $5,000 in 2006). This is the same that an employee may defer under a regular 401(k) plan, a 403(b) plan, a SARSEP or a 457 plan, but it is greater than the amount permitted under a SIMPLE 401(k) or SIMPLE IRA.

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Will after-tax contributions be permitted under an ERSA?

Yes. After tax contributions will be permitted to an ERSA, and accounts attributable to such contributions made after 2003 will be treated much like the new RSAs. Distributions from such accounts will generally be exempt from taxation and the accounts will not be subject to the required minimum distribution rules until after the death of the participant.

Will governments with grandfathered 401(k) plans and public schools with 403(b) plans still be able to allow deferrals up to the maximum under a 403(b) or 401(k) plan as well as the maximum under a 457 plan?

No. Once ERSAs are in place, all covered employees will be able to defer only the maximum applicable to ERSAs.

Will employers have to terminate their existing plans and transfer the assets to an ERSA?

No. Beginning in 2004, all 401(k) plans will become ERSAs. SIMPLEs, SARSEPs, 403(b) plans, and governmental 457 plans may continue in existence indefinitely, but may not accept any future contributions after 2004.

What nondiscrimination tests will apply to ERSAs?

The same simplified nondiscriminatory coverage requirement will apply to ERSAs (other than those covering only state and local government employees) that will apply to all other defined contribution plans. (See Q&A below). An ERSA will satisfy the nondiscriminatory benefit requirements if the average contribution percentage for nonhighly compensated employees is no greater than 6% and the average contribution percentage for highly compensated employees does not exceed 200% of the average contribution percentage for nonhighly compensated employees. If the average contribution percentage for nonhighly compensated employees is greater than 6%, then the average contribution percentage for highly compensated employees may be any amount.

Will state and local governments and charitable organizations be subject to the nondiscriminatory benefit requirement?

ERSAs covering only employees of state and local governments will be exempt from the nondiscriminatory benefit requirement. An ERSA covering only employees of a charitable organization will be subject to the nondiscriminatory benefit requirement only if it allows after-tax contributions. In any event, an ERSA covering employees of a charitable organization will be subject to a universal availability requirement regarding the ability of employees to make deferrals under the plan. That is, all employees of the organization must be permitted to elect to make deferrals of more than $200.

Is there a safe-harbor design under which an employer will not be required to apply the general nondiscriminatory benefit rule described above?

Yes. A plan can satisfy the nondiscriminatory benefit rule through any one of the following safe harbor employer contribution designs:

1. The employer makes a nonelective contribution on behalf of each participant in the plan equal to 3% of the employee's compensation,
2. The employer makes a matching contribution equal to 50% of each employee's deferrals (up to 6% of compensation), or
3. The employer makes a matching contribution that does not increase based on the level of an employee's deferrals and the match is equal to the amount that would be made under a 50% match (up to 6% of compensation), such as a match of 100% of each employee's deferrals (up to 3% of compensation).

Does the budget proposal related to ERSAs affect any other defined contribution plans?

Yes. The proposal includes the following provisions that would greatly simplify the administration of all defined contribution plans:

1. There would be a single test to show that the plan meets the nondiscrimination rules with respect to coverage — ratio-percentage coverage. Under this test, the percentage of an employer's nonhighly compensated employees covered under a plan would have to be at least 70% of the percentage of the employer's highly compensated employees covered under the plan. The other coverage testing alternatives would be repealed.
2. Permitted disparity and cross-testing would be prohibited for defined contribution plans.
3. The top heavy rules would be repealed for defined contribution plans.
4. There would be a uniform definition of compensation for all purposes for defined contribution plans of the amount reported on form W-2 for wage withholding, plus the amount of ERSA deferrals.
5. A simplified definition of highly compensated employee would be adopted under which all individuals with compensation for the prior year above the Social Security wage base for that year would be considered to be highly compensated employees.

Does the ERSA proposal have any effect on defined contribution plans that do not involve employee deferrals or employee after-tax contributions? In other words, does the proposal affect pure profit sharing plans, stock bonus plans, and money purchase pension plans?

Other than the simplifications discussed in the preceding question, the ERSA proposal would not affect the rules applicable to employer contributions to defined contribution plans, other than safe harbor nonelective contributions or matching contributions.

Does the ERSA proposal have any effect on defined benefit plans?

No, the proposal would not affect the rules applicable to defined benefit plans.

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In summary, President Bush has made a number of bold proposals to modify the rules governing IRAs, Roth IRAs and various elective deferral plans. Simplifying the rules so that more people will save is the stated goal. In September 1995, the Federal Reserve Bank of New York published "The Impact of Individual Retirement Accounts on Savings," written by Jonathan McCarthy and Han N. Pham. The authors concluded that the increase in 401(k) contributions for the period of 1987-1993 has, to some extent, counteracted the decline of IRA contributions after the 1986 law changes. However, the total contribution to targeted savings incentives as a percentage of GDP has remained less than in 1986. Time will tell to what extent Congress will adopt President Bush's proposals to increase the savings rate. It has been estimated that there would be tax gains if these proposals would be adopted for the first five years, and then there would be revenue losses thereafter. Congress is well aware that there is a big difference between tax-preferred accounts and tax-free accounts. We at CWF believe that many of the proposals deserve to be given serious consideration with one exception. We believe that many taxpayers will be better off if they retain their right to claim a tax deduction for their IRA contributions as allowed under existing law. It is still true that many taxpayers' incomes will decline after they retire and that their marginal tax rates will be lower at the time of withdrawal than at the time of contribution.

IRS AUTHORIZES AN AUTOMATIC WAIVER OF 60-DAY ROLLOVER RULE

An automatic waiver of the 60 day requirement is granted by the IRS if the following conditions have been met: (i) the financial institution received the funds from the individual before the end of the 60 day period; (ii) the individual followed all of the financial institution's procedures for making a rollover contribution into another eligible retirement plan; (iii) solely due to an error by the financial institution, the funds are not timely deposited into the other eligible retirement plan; (iv) the deposit must have constituted a valid rollover but for the delay and (v) the funds must be deposited within one year from the beginning of the 60-day rollover period (i.e. the day after the day of receipt). The source of authority for this automatic waiver is Revenue Procedure 2003-16. It is effective beginning January 23, 2003.

CWF has created special CWF Form #65-WR (Determination of Eligibility to Use the Automatic Waiver of the 60-Day Rollover Rule). It is now available as a standard carbonless form. Alternatively, you may purchase a license from CWF for $15, and then you will be able to make unlimited copies. This form will be added to CWF's IRA FormSystem in the very near future. Call CWF's customer service at 1-800-346-3961 to order.

IRS CREATES NEW APPLICATION PROCEDURE FOR WAIVER OF 60-DAY ROLLOVER RULE

The procedures to request the waiver are the same procedures for letter rulings set forth in Revenue Procedure 2003-4. The $90.00 user fee as set forth in Revenue Procedure 2003-8 must be paid.

The IRS will consider granting a waiver for distributions occurring after December 31, 2001, from IRAs, qualified plans, 403(b) plans and governmental 457 plans. The IRS has indicated it will issue a favorable ruling waiving the 60-day rollover requirement where it would be against equity or good conscience, including casualty, disaster or other events beyond the reasonable control of the taxpayer. The IRS will consider the following factors: (i) errors committed by a financial institution; (ii) the inability to complete the rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error, (iii) whether the taxpayer has used the distributed amounts, and (iv) the time elapsed since the distribution occurred. The source of authority for this new application procedure is Revenue Procedure 2003-16. It is effective beginning January 23, 2003.

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RECHARACTERIZING A 2002 CONTRIBUTION IN 2003

This time of year is the season for recharacterizations. People are visiting their tax accountants. The accountants will be telling some of your accountholders they were ineligible to convert their traditional IRA to a Roth IRA in 2002, or, if eligible to perform the conversion transaction, that it was not in their best interest to have done so. Or, they may tell the accountholder that they were ineligible to make a $2,000 contribution to their Roth IRA or that they do not wish to make their contribution to the traditional IRA, as it is non-deductible. The point is—you, as an IRA custodian or trustee, can expect to see some of your IRA accountholders instruct you that they want to recharacterize a contribution made in 2002, for 2002, before he or she files a 2002 federal income tax return in 2003. Most such accountholders will normally complete the recharacterization on or before the tax-filing deadline for 2002. This is April 15, 2003. However, a person will have until October 15, 2003, to recharacterize a contribution. A person who timely files his or her 2003 income tax return without having made a recharacterization may file an amended return and still make the recharacterization within six months of the due date of his or her return, excluding extensions.

This explanation focuses on how you can assist your customer(s) to understand how he or she will need to handle the recharacterization on his or her 2002 income tax return. Recharacterizations are confusing to everyone involved. This is especially true for 2002 contributions which are recharacterized in 2003, because, as with excess contributions, these recharacterization transactions will be reported on the 2003 Form 1099-R and the 2003 Form 5498, which are not furnished until January of 2004 and May 2004, which is obviously well after the time the accountholder needs the information to file his or her 2002 federal income tax return. <u>This is why the IRS requires an IRA custodian to furnish a written explanation to the accountholder</u>. Also, be aware that the IRS has not yet issued the 2003 versions of Forms 1099-R and 5498. For this article, we have used the "2002" forms and merely inserted the year "2003" over "2002" on these documents. The actual 2003 forms will be changed as the Coverdell ESA references will be eliminated. The concepts should still be correct.

Three situations are illustrated: (1) recharacterizing a Roth IRA contribution to be a contribution to a traditional IRA;
(2) recharacterizing a contribution to a traditional IRA to be a contribution to a Roth IRA and (3) recharacterizing a conversion contribution.

Situation #1. Annual Roth IRA Contribution Recharacterized to a Traditional IRA Contribution

Lisa Water made a $2,000 contribution to a Roth IRA on 1-10-02, for 2002. The fair market value of this IRA as of 12-31-02 was $2,100. Lisa is not married and she is not an active participant in an employer-sponsored plan. Her MAGI for 2002 was $123,000. Therefore, she has determined that she is not eligible to make a contribution to a Roth IRA. There were earnings of $180 related to the contribution of $2,000 as of 3-3-03. One of the methods to correct an excess contribution is to recharacterize it. She chose to recharacterize this contribution plus earnings on 3-3-03. The fair market value of this IRA as of 12-31-03 will be $2,400.

Step #1. Accountholder Must Instruct to Recharacterize

The individual must instruct you (the IRA custodian) to recharacterize. The individual is required to furnish you with very specific information. You can make his/her task easier by making available to your accountholder a form such as CWF's Notice of Recharacterization of IRA Contribution as set forth on page 9.

Step #2. You (the IRA Custodian) Must Furnish an Explanation to the Accountholder

You should furnish an explanation to your accountholder similar to the one below.

Special Explanation to Accountholder for an IRA Recharacterization for the 2002 Tax Year

____
(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You recharacterized a contribution which you made for the 2002 tax year. You will need to properly report and explain your recharacterization when you file your 2002 federal income tax return. We have furnished to you a copy of the *IRA Recharacterization Form* which you executed. You will also want to review the 2002 instructions for Form 8606. The IRS' instructions require you, as the IRA accountholder, to attach an explanation to your income tax return indicating the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized. You may attach a copy of the IRA Recharacterization Form for this purpose.

In some situations you will need to do more than just attach an explanatory statement. If both the original contribution and the recharacterization occurred during 2002, then you must also include on the 2002 tax return the amount deemed distributed from the one IRA on Form 1040, line 15(a) (or similar form). This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount, with zero. If the recharacterization of the contribution for 2002 occurred in 2003 then you only need to attach the explanatory statement.

Accountholder ____________________________ Date ____________

Custodian ____________________________ Date ____________

IRA #56-TREX (1/03) White — Custodian/Trustee Yellow — Accountholder

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Step #3. You Will Prepare the Various Reporting Forms

1. You will prepare a 2002 Form 5498 to report the original contribution to the Roth IRA of $2,000 as shown.

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–11) $ 2 Rollover contributions $	OMB No. 1545-0747 2002 Form 5498	IRA and Coverdell ESA Contribution Information
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2002 General Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name		5 Fair market value of account $ 2100.00	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)		7 IRA ☐ SEP ☐ SIMPLE ☐	Roth IRA ☒ Coverdell ESA ☐	
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	
Account number (optional)		10 Roth IRA contributions $ 2000.00	11 Coverdell ESA contributions $	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2. You will prepare a 2003 Form 1099-R to report the "deemed" distribution from the Roth IRA to the traditional IRA. It should be reported as follows. Box 2 is to be completed with the gross distribution amount ($2,180) and box 2a is to be completed with a 0.00. The reason code in box 7 is to be an "R" for recharacterization.

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution $ 2180.00 2a Taxable amount $ 0.00	OMB No. 1545-0119 2003 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2b Taxable amount not determined ☐	Total distribution ☐	Copy 1 For State, City, or Local Tax Department
PAYER'S Federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	
RECIPIENT'S name		5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.)		7 Distribution code(s) R IRA/SEP/SIMPLE ☐	8 Other $ %	
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions $	
Account number (optional)		10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
		13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form 1099-R Department of the Treasury - Internal Revenue Service

3. You will prepare a 2003 Form 5498 to report the recharacterized contribution (plus earnings) to the traditional IRA of $2,180. It should be reported as shown below.

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $ 2 Rollover contributions $	OMB No. 1545-0747 2003 Form 5498	IRA Contribution Information
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $ 2180.00	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2003 General Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name		5 Fair market value of account $ 2400.00	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)		7 IRA ☒ SEP ☐	SIMPLE ☐ Roth IRA ☐	
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	
Account number (optional)		10 Roth IRA contributions $	11 Check if RMD for 2004 ☐	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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Situation #2. Annual Traditional IRA Contribution Recharacterized to be a Roth IRA Contribution

Sara Roe made a $2,000 contribution to a traditional IRA on 2-10-02, for 2002 rather than a Roth IRA. The fair market value of this traditional IRA was $2,125 as of 12-31-02. Sara is not married. She is an active participant in an employer-sponsored plan. Her MAGI was $92,000. There were earnings of $190 related to the contribution of $2,000 as of 2-20-03. Sara has determined on 2-20-03 she will recharacterize her traditional IRA contribution to be a Roth IRA contribution because she is not able to claim a deduction for her $2,000 contribution to the traditional IRA. The fair market value of this IRA as of 12-31-03 will be $2,300.

Step #1. Accountholder Must Instruct to Recharacterize

The individual must instruct you (the IRA custodian) to recharacterize. The individual is required to furnish you with very specific information. You can make his or her task easier by making available to your accountholder a form such as CWF's Notice of Recharacterization of IRA Contribution as set forth on page 9, or a similar form.

Step #2. You (IRA Custodian) Must Furnish an Explanation to the Accountholder

You should furnish your accountholder an explanation similar to the one shown in Step #2 of Situation #1.

Step #3. You Will Prepare the Various Reporting Forms

1. You will prepare a 2002 Form 5498 to report the original contribution to the traditional IRA of $2,000. It should be reported as shown below:

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–11) $ 2000.00 2 Rollover contributions $	OMB No. 1545-0747 2002 Form 5498	IRA and Coverdell ESA Contribution Information
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2002 General Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name		5 Fair market value of account $ 2125.00	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)		7 IRA ☒ SEP ☐ SIMPLE ☐	Roth IRA ☐ Coverdell ESA ☐	
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	
Account number (optional)		10 Roth IRA contributions $	11 Coverdell ESA contributions $	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2. You will prepare a 2003 Form 1099-R to report the "deemed" distribution from the traditional IRA to the Roth IRA. It should be reported as follows. Box 1 is to be completed with the gross distribution amount ($2,190) and box 2a is to be completed 0.00. The reason code in box 7 is to be an "R" for recharacterization.

Continued on page 8

Recharacterizing, Continued from page 7

☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution $ 2190.00	OMB No. 1545-0119 2003 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
	2a Taxable amount $ 0.00		
	2b Taxable amount not determined ☐	Total distribution ☐	Copy 1 For State, City, or Local Tax Department
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	
RECIPIENT'S name	5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.)	7 Distribution code(s) R IRA/SEP/SIMPLE X	8 Other $ %	
City, state, and ZIP code	9a Your percentage of total distribution %	9b Total employee contributions $	
Account number (optional)	10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
	13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form 1099-R Department of the Treasury - Internal Revenue Service

3. You will prepare a 2003 Form 5498 to report the recharacterized contribution (plus earnings) to the Roth IRA of $2,000. It should be reported as shown below.

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $	OMB No. 1545-0747 2003 Form 5498	IRA Contribution Information
	2 Rollover contributions $		
TRUSTEE'S or ISSUER'S Federal identification no. / PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $2190.00	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2003 General Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name	5 Fair market value of account $2300.00	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)	7 IRA ☐ SEP ☐ SIMPLE ☐ Roth IRA X		
City, state, and ZIP code	8 SEP contributions $	9 SIMPLE contributions $	
Account number (optional)	10 Roth IRA contributions $	11 Check if RMD for 2004 ☐	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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Situation #3. Recharacterizing a Conversion Contribution from a Traditional IRA to a Roth IRA

Francoise Bell converted $30,000 from her traditional IRA to a Roth IRA on 1-15-02. The fair market value of this Roth IRA was $33,000 as of 12-31-02. She is not married. Her accountant has told her she was not eligible to make the Roth IRA contribution for 2002, as her MAGI was $103,000. There was income of $3,900 related to her conversion contribution as of 3-1-03. In order to eliminate this excess contribution, she elects to recharacterize this conversion contribution on 3-1-03. The fair market value of this IRA as of 12-31-03 will be $37,000.

Step #1. Accountholder Must Instruct to Recharacterize

The individual must instruct you (the IRA custodian) to recharacterize. The individual is required to furnish you with very specific information. You can make his or her task easier by making available to your accountholder a form such as CWF's Notice of Recharacterization of IRA Contribution set forth on page 9 or a similar form.

Step #2. You (IRA Custodian) Must Furnish an Explanation to the Accountholder

You should furnish your accountholder an explanation similar to the one shown in Step #2 of Situation #1.

Step #3. You Will Prepare the Various Reporting Forms

1. You will prepare a 2002 Form 5498 to report the original conversion contribution to the Roth IRA of $30,000 as shown below:

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code	1 IRA contributions (other than amounts in boxes 2–4 and 8–11) $	OMB No. 1545-0747 2002 Form 5498	IRA and Coverdell ESA Contribution Information
	2 Rollover contributions $		
TRUSTEE'S or ISSUER'S Federal identification no. / PARTICIPANT'S social security number	3 Roth IRA conversion amount $ 30000.00	4 Recharacterized contributions $	Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2002 General Instructions for Forms 1099, 1098, 5498, and W-2G.
PARTICIPANT'S name	5 Fair market value of account $ 33000.00	6 Life insurance cost included in box 1 $	
Street address (including apt. no.)	7 IRA ☐ SEP ☐ SIMPLE ☐	Roth IRA ☐ Coverdell ESA ☐	
City, state, and ZIP code	8 SEP contributions $	9 SIMPLE contributions $	
Account number (optional)	10 Roth IRA contributions $	11 Coverdell ESA contributions $	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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2. You will prepare a 2003 Form 1099-R to report the "deemed" distribution from the Roth IRA to the traditional IRA. It should be reported as follows. Box 1 is to be completed with the gross distribution amount ($33,900) and box 2a is to be completed 0.00. The reason code in box 7 is to be an "R" for recharacterization.

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PAYER'S name, street address, city, state, and ZIP code	1 Gross distribution $33900.00	OMB No. 1545-0119 2003 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
	2a Taxable amount $ 0.00		
	2b Taxable amount not determined ☐	Total distribution ☐	Copy 1 For State, City, or Local Tax Department
PAYER'S Federal identification number / RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	
RECIPIENT'S name	5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.)	7 Distribution code(s) R IRA/SEP/SIMPLE ☐	8 Other $ %	
City, state, and ZIP code	9a Your percentage of total distribution %	9b Total employee contributions $	
Account number (optional)	10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
	13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form 1099-R Department of the Treasury - Internal Revenue Service

Continued on page 9

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Recharacterizing, Continued from page 8

3. Prepare a 2003 Form 5498 to report the recharacterized contribution (plus earnings) of $33,900 to the traditional IRA. It should be reported as shown below:

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $ 2 Rollover contributions $	OMB No. 1545-0747 2003 Form 5498	IRA Contribution Information
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $ 33900.00	Copy A For Internal Revenue Service Center
PARTICIPANT'S name		5 Fair market value of account $ 37000.00	6 Life insurance cost included in box 1 $	File with Form 1096.
Street address (including apt. no.)		7 IRA X SEP ☐ SIMPLE ☐ Roth IRA ☐		For Privacy Act and Paperwork Reduction Act Notice, see the
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	2003 General Instructions for
Account number (optional)		10 Roth IRA contributions $	11 Check if RMD for 2004 ☐	Forms 1099, 1098, 5498, and W-2G.

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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Conclusion. You will certainly be receiving requests to recharacterize, in calendar year 2003, a contribution which was made in calendar year 2002. Taxpayers and their accountants are beginning to understand the concept of recharacterizing a contribution as a correction tool. The taxpayer (or accountant) will need to complete the Form 8606 to report the recharacterization. The instructions for the Form 8606 state the taxpayer is to attach a statement explaining the recharacterization. This explanation should indicate the total amount recharacterized, the original contribution, the earnings or loss and the amount that is now deductible, if applicable. The instructions also indicate that an IRA custodian has the duty to furnish this same information to the accountholder. CWF has recently revised its 2002 Form 56-TREX to incorporate the recent IRS changes and has also created the 2003 Form 56-TREX. Both are now available.

CWF'S Form 54-TR

Notice of Recharacterization of IRA Contribution

To: Current Custodian/Trustee
Name ________ Date: ________
Address: ________
City/State/Zip: ________
Phone: (____) ________

From: Depositor or Grantor
Name: ________ SSN ________
Address: ________ Date of Birth: ________
City/State/Zip: ________ Phone: – Home: ________
Work: ________

I hereby instruct you that I wish to irrevocably recharacterize my previous contribution. The successor IRA will be with the ☐ current custodian/trustee or ☐ a successor custodian/trustee as indicated below. If I have indicated a successor custodian/trustee, then you are to issue a check for the amount indicated below to the successor custodian or trustee. I understand I must provide the following information to have my previous contribution recharacterized:

The Original Contribution
Account Number: ________
Date of Contribution: ________
Amount: ________

The Recharacterized Contribution
Account Number: ________
Date of Contribution: ________
Amount: ________

Type of Original Contribution (Check only one)
☐ **1.** Conversion/Rollover to Roth IRA → **1.** Rollover to a traditional IRA
☐ **2.** Annual Contribution to a Roth IRA for _____ tax year → **2.** Annual contribution to a traditional IRA for the same tax year
☐ **3.** Annual contribution to a traditional IRA for _____ tax year → **3.** Annual Contribution to a Roth IRA for the same tax year

Type of Recharacterized Contribution

Instruction and Amount to Recharacterize

I elect to recharacterize $________
Which is ☐ all or ☐ a portion of my original contribution.
It is adjusted by:
a. Related Earnings (losses) ________
b. Interest Penalty Fee ________
c. Administrative Fee ________
d. Other ________
e. Recharacterized Net Amount ________

I instruct you to transfer the recharacterized net amount to the successor custodian/trustee. I want this recharacterized net amount to come from the following assets held within my referenced IRA and paid in the instructed manner. I understand that there may be various fees associated with liquidating and/or transferring such assets in kind. These fees are set forth above. I authorize you to deduct such fees from the IRA.

☐ Liquidate all of my accounts and transfer the cash proceeds by sending a check to the successor custodian/trustee;

☐ Liquidate the accounts I specify below and transfer the cash proceeds by sending a check to the successor custodian/trustee: ________

☐ Transfer all such assets "in kind" to the successor custodian/trustee:

☐ Transfer "in kind" the assets I specify below to the successor custodian/trustee: ________

I acknowledge that you have instructed me to consult with my legal or tax advisor because of the complexity and importance of this matter. This recharacterization is being made on or before the due date (including extensions) for filing my individual Federal income tax return for the taxable year for which the contribution was made. I expressly assume all responsibility for this recharacterization of IRA funds. I realize that my election to recharacterize my contribution is irrevocable.
Signature of Depositor or Grantor: ________ **Date:** ________

Acknowledgment of Current IRA Custodian/Trustee:
We acknowledge receiving your recharacterization instruction. We will report the original contribution on Form 5498, showing the character of the contribution (annual, conversion, etc.) and will report the distribution for recharacterization on Form 1099-R per the current IRS instructions. If your recharacterized contribution has been made into an IRA that you maintain with us, then we will also report the aforementioned contribution as a recharacterized contribution on a Form 5498 (Box 4).
Signature of Current Custodian/Trustee: ________ **Date:** ________

Acceptance by Successor IRA Custodian/Trustee:
We, the successor custodian/trustee, agree to report this recharacterized contribution as identified above as a recharacterized contribution on Form 5498 and agree to accept this contribution as if it had originally been made to us rather than the previous trustee/custodian.

Successor Custodian/Trustee: ________ Phone: ________
Address: ________
City/State/Zip: ________
Signature of Successor Custodian/Trustee: ________ **Date:** ________

IRA #54-TR (3/02) White — Original Custodian/Trustee Yellow — Successor Custodian/Trustee Pink — Depositor/Grantor © 2002 Collin W. Fritz & Associates, Ltd.

Special Explanation to Accountholder for an IRA Recharacterization for the 2002 Tax Year

____
(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You recharacterized a contribution which you made for the 2002 tax year. Y... explain your recharacterization when you file your 2002 f... *IRA Recharacterization* ...

Special Explanation to Accountholder for an IRA Recharacterization for the 2003 Tax Year

____
(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You recharacterized a contribution which you made for the 2003 tax year. You will need to properly report and explain your recharacterization when you file your 2003 federal income tax return. We have furnished to you a copy of the *IRA Recharacterization Form* which you executed. You will also want to review the 2003 instructions for Form 8606. The IRS' instructions require you, as the IRA accountholder, to attach an explanation to your income tax return indicating the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized. You may attach a copy of the IRA Recharacterization Form for this purpose.

In some situations you will need to do more than just attach an explanatory statement. If both the original contribution and the recharacterization occurred during 2003, then you must also include on the 2003 tax return the amount deemed distributed from the one IRA on Form 1040, line 15(a) (or similar form). This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount, with zero. If the recharacterization of the contribution for 2003 occurred in 2004 then you only need to attach the explanatory statement.

Accountholder ________ Date ________

Custodian ________ Date ________

IRA #56-TREX (1/03) White — Custodian/Trustee Yellow — Accountholder © 2003 Collin W. Fritz & Associates, Ltd.

HOW THE TAXPAYER REPORTS RECHARACTERIZATIONS FOR 2002

The IRS has recently issued the instructions for the 2002 Form 8606. These instructions discuss how the taxpayer is to handle a recharacterization on his or her tax return. We recommend that you make a copy of this article (or the Form 8606 instructions) available to any customer who has a recharacterization impacting the 2002 year. Refer to page 9 for an example of a statement which the accountholder may use to attach to the federal income tax return.

In the IRS' "Discussion of Reporting Recharacterizations" on page 3 of the Instructions for the Form 8606, the IRS provides:

Recharacterizations

Generally, you may recharacterize (correct) an IRA contribution or Roth IRA conversion by making a trustee-to-trustee transfer from one IRA to another type of IRA. Trustee-to-trustee transfers are made directly between financial institutions or within the same financial institution. You generally must make the transfer by the due date of your return (including extensions) and reflect it on your return. If necessary, file an amended return reflecting the transfer (see page 5). Write "Filed pursuant to section 301.9100-2" on the amended return.

Reporting Recharacterizations for Tax Year 2002

Any recharacterized conversion will be treated as though the conversion had not occurred. Any recharacterized contribution will be treated as having been originally contributed to the second IRA, not the first IRA. The amount transferred must include related earnings or be reduced by any loss. Any earnings or loss that occurred in the first IRA will be treated as having occurred in the second IRA. You may not deduct any loss that occurred while the funds were in the first IRA. Also, you cannot take a deduction for a contribution to a traditional IRA if the amount is later recharacterized. See below for how to report the three different types of recharacterizations, including the statement that must be attached to your return explaining the recharacterization. In most cases the CWF Form 54-TREX may be attached as the explanation.

Situation #1: You converted an amount from a traditional, SEP, or SIMPLE IRA to a Roth IRA in 2002, and later recharacterized all or part of the amount back to a traditional, SEP, or SIMPLE IRA. If you only recharacterized part of the amount converted, report the amount not recharacterized on Form 8606. If you recharacterized the entire amount, do not report the recharacterization on Form 8606. In either case, attach a statement to your return explaining the recharacterization and include the amount converted from the traditional, SEP, or SIMPLE IRA on Form 1040, line 15a; Form 1040A, line 11a: or Form 1040NR, line 16a. If the recharacterization occurred in 2002, also include the amount transferred back from the Roth IRA on that line. If the recharacterization occurred in 2003, report the amount transferred only in the attached statement, and not on your 2002 or 2003 tax return (you should receive a 2003 Form 1099-R by February 2, 2004, stating that you made a recharacterization of an amount converted in the prior year).

Example. You are married filing jointly and converted $20,000 from your traditional IRA to a new Roth IRA on May 22, 2002. On April 10, 2003, you determine that your 2002 modified AGI for Roth IRA purposes will exceed $100,000, and you are not allowed to make a Roth IRA conversion. The value of the Roth IRA on that date is $19,000. You recharacterize the conversion by transferring that entire amount to a traditional IRA in a trustee-to-trustee transfer. You report $20,000 on Form 1040, line 15a. You do not include the $19,000 on line 15(a) because it did not occur in 2002 (you also do not report that amount on your 2003 return because it does not apply to the 2003 tax year). You attach a statement to your 2002 Form 1040 explaining that you made a conversion of $20,000 from a traditional IRA on May 22, 2002, and that you recharacterized the entire amount, which was then valued at $19,000, back to a traditional IRA on April 10, 2003, because your 2002 modified AGI for Roth IRA purposes exceeded $100,000.

Situation #2: You made a contribution to a traditional IRA and later recharacterized part or all of it to a Roth IRA. If you recharacterized only part of the contribution, report the nondeductible traditional IRA portion of the remaining contribution, if any, on Form 8606, Part I. If you recharacterized the entire contribution, do not report the contribution on Form 8606. In either case, attach a statement to your return explaining the recharacterization. If the recharacterization occurred in 2002, include the amount transferred from the traditional IRA on Form 1040, line 15a; Form 1040A, line 11a; or Form 1040NR, line 16a. If the recharacterization occurred in 2003, report the amount transferred only in the attached statement.

Example. You are single, covered by a retirement plan, and you contributed $3,000 to a new traditional IRA on May 31, 2002. On February 24, 2003, you determine that your 2002 modified AGI will limit your traditional IRA deduction to $1,000. The value of your traditional IRA on that date is $3,300. You decide to recharacterize $2,000 of the traditional IRA contribution as a Roth IRA contribution, and have $2,200 ($2,000 contribution plus $200 related earnings) transferred from your traditional IRA to a Roth IRA in a trustee-to-trustee transfer. You deduct the $1,000 traditional IRA contribution on Form 1040. You are not required to file Form 8606, but you must attach a statement to your return explaining the recharacterization. The statement indicates that you contributed $3,000 to a traditional IRA on May 31, 2002; recharacterized $2,000 of that contribution on February 24, 2003, by transferring $2,000 plus $200 of related earnings from your traditional IRA to a Roth IRA in a trustee-to-trustee transfer; and that all $1,000 of the remaining traditional IRA contribution is deducted on Form 1040. You do not report the $2,200 distribution from your

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**Recharacterizations,
Continued from page 10**

traditional IRA on your 2002 Form 1040 because the distribution occurred in 2003. You do not report the distribution on your 2003 Form 1040 because the recharacterization related to 2002 and was explained in an attachment to your 2002 return.

Situation #3: You made a contribution to a Roth IRA and later recharacterized part or all of it to a traditional IRA. Report the nondeductible traditional IRA portion, if any, on Form 8606, Part I. If you did not recharacterize the entire contribution, do not report the remaining Roth IRA portion of the contribution on Form 8606. Attach a statement to your return explaining the recharacterization. If the recharacterization occurred in 2002, include the amount transferred from the Roth IRA on Form 1040, line 15a; Form 1040A; line 11a; or Form 1040NR, line 16a. If the recharacterization occurred in 2003, report the amount transferred only in the attached statement, and not on your 2002 or 2003 tax return.

Example. You are single and contributed $3,000 to a new Roth IRA on June 14, 2002. On December 26, 2002, you determine that your 2002 modified AGI will allow a full traditional IRA deduction. You decide to recharacterize the Roth IRA contribution as a traditional IRA contribution and have $3,200, the balance in the Roth IRA account ($3,000 contribution plus $200 related earnings), transferred from your Roth IRA to a traditional IRA in a trustee-to-trustee transfer. You deduct the $3,000 traditional IRA contribution on Form 1040. You are not required to file Form 8606, but you must attach a statement to your return explaining the recharacterization. The statement indicates that you contributed $3,000 to a new Roth IRA on June 14, 2002; recharacterized that contribution on December 26, 2002, by transferring $3,200, the balance in the Roth IRA, to a traditional IRA in a trustee-to-trustee transfer; and that $3,000 of the traditional IRA contribution is deducted on Form 1040. You include the $3,200 distribution on your 2002 Form 1040, line 15a.

THE REPORTING OF ROLLED OVER AFTER-TAX EMPLOYEE CONTRIBUTIONS

The IRS has made the following changes to the 2002 Form 8606. The first change was expected. The title of the form was changed to "Nondeductible IRAs" from Nondeductible IRAs and Coverdell ESAs."

The second change was to delete Part IV of the form (Distributions from Coverdell Education Savings Accounts (ESAs).

The third change is the interesting change. Commencing in 2002 a taxpayer is eligible to roll over after-tax employee contributions from a qualified plan to an IRA. These nondeductible contributions will have to be accounted for by the taxpayer or his or her tax preparer.

A rollover is certainly a type of contribution, but the IRS chose to not modify the "contribution" area of the form. Instead, the instructions inform the taxpayer to adjust their line 2 basis amount. A person's basis in a traditional IRA is the total of all of his or her nondeductible contributions minus the total of all of his or her nontaxable distributions and as adjusted in certain special situations. There are three special situations. The new situation is when the taxpayer rolled over any nontaxable portion of a distribution from a qualified employer plan. The taxpayer simply increases his or her basis by this amount. The other two situations requiring special adjustments also when there is a withdrawal of an excess contribution after the tax return has been filed but during the 6 month period when corrections are still authorized.

What records must a taxpayer keep? To verify the nontaxable part of distributions from IRAs, including Roth IRAs, a person must keep a copy of the following forms and records until all distributions are made.

- Page 1 of Forms 1040 (or Forms 1040A, 1040NR, or 1040-T) filed for each year he or she made a nondeductible contribution to a traditional IRA.
- Forms 8606 and any supporting statements, attachments, and worksheets for all applicable years.
- Forms 5498 or similar statements received each year showing contributions made to a traditional IRA or Roth IRA.
- Forms 5498 or similar statements he or she received showing the value of the traditional IRAs for each year a distribution was received.
- Forms 1099-R or W-2P for each year a distribution was received.

Note: Forms 1040-T and W-2P are forms that were used in prior years.

REPORTING REQUIREMENT FOR RMDS CLARIFIED

As you are aware, for years beginning after 2002, an IRA trustee must furnish IRA owners statements concerning the accountholders need to take an RMD for that year. There are two alternative which may be used by the trustee.

Alternative #1: The trustee will furnish the IRA owner a statement indicating the RMD amount for the IRA and the date by which such amount must be distributed.

Alternative #2: The trustee will furnish the IRA owner a statement showing that an RMD is required for the calendar year and the date by such RMD must be distributed, and will include an offer to calculate, upon request, the amount of the RMD.

Continued on page 12

REVISED PROCEDURES FOR REPORTING CESA CONTRIBUTIONS—2003

Beginning with the reporting for 2003, a new 5498-ESA will be used to report contributions to a Coverdell Education Savings Account. You will NOT use the Form 5498 "IRA Contribution Information."

In the past, it has been unclear whether this information should be furnished to the depositor, the responsible individual or the designated beneficiary. In the instructions for the 2003, 5498-ESA, it is very clear that this information is to be reported to the designated beneficiary. For any calendar year beginning with 2003, you must furnish Copy B of the 5498-ESA to the designated beneficiary by April 30 of the following year

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code

1 Coverdell ESA contributions $

2 Rollover contributions $

OMB No. 1545-1815

2003

Form 5498-ESA

Coverdell ESA Contribution Information

TRUSTEE'S or ISSUER'S Federal identification no. | BENEFICIARY'S social security number

BENEFICIARY'S name

Street address (including apt. no.)

City, state, and ZIP code

Account number (optional)

Copy A For Internal Revenue Service Center

File with Form 1096.

For Privacy Act and Paperwork Reduction Act Notice, see the **2003 General Instructions for Forms 1099, 1098, 5498, and W-2G.**

Form 5498-ESA Cat. No. 34011J Department of the Treasury - Internal Revenue Service

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Instructions for Beneficiary

The information on Form 5498-ESA is furnished to you by the trustee or issuer of your Coverdell education savings account (ESA) by April 30, 2004. Form 5498-ESA reports contributions and rollover contributions made for you for 2003. For more information about Coverdell ESAs, see **Pub. 970,** Tax Benefits for Education.

Box 1. Shows Coverdell ESA contributions made in 2003 and through April 15, 2004 on your behalf. **Do not** deduct these amounts on your income tax return.

If the total contributions made to **all** your Coverdell ESAs for 2003 exceeded $2,000, you must withdraw the excess, plus earnings, by May 31, or you may owe a penalty. You must keep track of your Coverdell ESA basis (contributions and distributions).

Box 2. Shows any rollover, including a direct rollover, you made in 2003. Generally, any amount rolled over from one Coverdell ESA to another Coverdell ESA for the benefit of the named beneficiary or a member of the beneficiary's family who is under age 30 (except for a beneficiary with special needs) is not taxable.

Instructions for Trustees or Issuers

General and specific form instructions are provided as separate products. The products you should use for 2003 are the **General Instructions for Forms 1099, 1098, 5498, and W-2G** and the separate specific instructions for each information return you file. Specific information needed to complete this form is given in the **2003 Instructions for Form 5498-ESA.** To order these instructions and additional forms, call 1-800-TAX-FORM (1-800-829-3676).

Caution: *Because the IRS processes paper forms by machine (optical character recognition equipment), you cannot file with the IRS Forms 1096, 1098, 1099, or 5498 that you print from the IRS Web Site.*

Due dates. Furnish Copy B of this form to the beneficiary (participant) by April 30, 2004.

File Copy A of this form with the IRS by May 31, 2004.

(furnish the 2003 Form by April 30, 2004). Copy A must be filed with the IRS by May 31 of the following year (furnish the 2003 Form by May 31, 2004). However, if no reportable contributions were made to the account, Form 5498-ESA does not need to be filed. Also, if there was a total distribution from the account and no reportable contributions were made, Form 5498-ESA does not need to be filed.

For the first time, transfers will be considered a reportable event. In the past, transfers were not reportable. Beginning with 2003 reporting, all rollovers, including a direct trustee-to-trustee transfer from one Coverdell ESA to another Coverdell ESA will need to be reported on Form 5498-ESA.

ARCHER MSA LIMITS

The IRS has recently released the Archer MSA Limits for 2003. For your convenience, we have reproduced both the 2002 and 2003 limits below. These tables show the limits for annual deductibles and the maximum out-of-pocket expenses for high deductible health plans.

2002

Type of coverage	Minimum annual deductible	Maximum annual deductible	Maximum annual out-of-pocket expenses
Self-only	$1,650	$2,500	$3,300
Family	$3,300	$4,950	$6,050

2003

Type of coverage	Minimum annual deductible	Maximum annual deductible	Maximum annual out-of-pocket expenses
Self-only	$1,700	$2,500	$3,350
Family	$3,350	$5,050	$6,150

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The statement required under either alternative must be provided by January 31 of each calendar year for which an RMD is required. The first statement must be provided to the accountholder by January 31 of the calendar year in which he/she attains age 70$^1/_2$.

The IRS has now clarified that an IRA trustee may use both alternatives. For example, a trustee may use Alternative #1 and decide it will calculate the amount for its accountholders who are already in distribution, but choose to use Alternative #2 (and merely offer to calculate the amount, upon request) for accountholders for whom 2003 is the first distribution year. In other words, one method is not required to be used to the exclusion of the other method. The trustee has the discretion to use one or both methods in meeting this requirement, as it deems best, for its various IRA accountholders.