THE Pension Digest

June 2006
Published Since 1984

ALSO IN THIS ISSUE –

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

Correctable or Not? Funds Placed in Wrong IRA

This article is a "be aware" article. More and more financial institutions are calling us because an IRA accountholder has come to them with an explanation as to why their traditional IRA should be a Roth IRA or vice versa. One can expect that the IRS is not going to be inclined to be nice to people with respect to Roth IRAs, because of the tax-free income treatment. If the IRS can argue that some rule has been violated so the income will not be tax free, one should expect the IRS will do so. Keep in mind that the IRS administrative approach with respect to traditional IRAs is simple—any amount distributed from a traditional IRA will be included in the recipient's income unless he or she can demonstrate why such amount is not taxable. An opposite approach will be adopted with respect to Roth IRAs. The taxpayer will need to be able to demonstrate he or she qualifies for the tax-free income treatment. One can expect the IRS will adopt an approach of trying to "disqualify" Roth IRAs.

Set forth below is a situation which recently faced an IRA custodian. The question is—does the IRA custodian help the individual correct the error or must it or should it leave the correcting up to the individual and his or her tax advisor?

Situation: In 2001, an institution accepted a transfer from an IRA at another institution. The transfer form indicated

Continued on page 2

President Signs IRA Bill

President Bush signed the Heroes Earned Retirement Opportunities Act (H.R. 1499) on May 29, 2006, making it Public Law No. 109-227. The Senate on May 18, and the House, on May 9, had passed the bill by unanimous consent.

This Act amends the Internal Revenue Code to allow the military to include their combat zone compensation in their calculation of federal earned income for IRA contribution purposes. To be eligible to contribute to an IRA, one must have earned and taxable income. By current definition, combat zone compensation is not taxable and is, therefore, not counted as earned income for IRA purposes. Under current law, if that is the only earned income the armed forces member has, he or she could not contribute to an IRA. With tours of duty lasting more than a year, it is now quite possible that a military man or woman could not contribute to an IRA, because all of his or her earnings for a particular year are non-taxable combat zone pay. This bill changes that. While combat zone pay remains non-taxable, it is now includible as compensation for IRA purposes.

Further, the bill is retroactive for tax years beginning in 2004. Individuals affected are allowed to make retroactive IRA contributions no later than 3 years after the enactment of this law. What this means is, military men and women can now make an IRA contribution for tax years 2004 and 2005, even if previous law did not allow it. They have three years to make up this contribution.

Continued on page 8

The Pension Digest

Correctable or Not? Funds Placed in Wrong IRA,
Continued from page 1

that the funds were from a traditional IRA. The customer and the institution completed a new traditional IRA plan agreement to establish the IRA into which the transferred funds were deposited. The check from the former IRA custodian did not indicate the type of account from which the funds were being distributed.

The customer has recently come in and said that the funds were Roth IRA funds, and should have been transferred into a Roth IRA with your institution. She has even brought a statement from the former institution which shows the IRA as a Roth IRA. She has now asked the current IRA custodian to correct this mistake.

Is it permissible to accommodate this customer and change the IRA custodian's records to show that the IRA is a Roth IRA? Obviously, from 2001 to the present, the IRA custodian has prepared numerous statements and governmental reporting forms showing this IRA as a traditional IRA.

Initial Discussion

This is a complex problem, and cannot necessarily be corrected by simply retitling the account, or moving the funds from a traditional IRA to a Roth IRA. Unfortunately, the IRS has given little formal written guidance on such situations. However, there are some general rules to be followed and assessments to be made; this must be done on a case-by-case basis, as each situation is unique.

1. There must be some authority to support the correction activity or movement of funds from one IRA to another.

2. The situation must be assessed to determine whether or not the excess contribution rules apply.

3. The institution must determine to what degree (if any) it is at fault, as the customer may well expect the institution to bear all or a portion of the burden for the mistake, if it results in adverse tax consequences or loss of earnings for the individual.

4. The institution will want to determine to what degree the former IRA custodian and/or the customer is at fault.

Your institution will want to have procedures in place under which management and legal counsel are notified of these types of situations, in order to determine how the mistake occurred, and to decide how fault should be allocated between the parties.

It is also imperative that the facts are clearly understood. Your institution will want documents to support how the original contribution was made — was it an annual contribution, a transfer, a rollover, conversion, or recharacterized contribution? For example, was a transfer form correctly completed?

If your institution did not contribute to the error, or only contributed to the error in a minor way, the institution should not accommodate her request to correct this problem. The customer will need to somehow correct her error, or the error of the prior custodian. The customer should receive written direction from the IRS.

However, if your institution was a major contributor to the error, then you will have to decide if the error is one for which the law provides a way of correction. There is really no authority unilaterally allowing an IRA custodian to correct its errors. There is only one court case of which CWF is aware in which the custodian was allowed to correct its error. This is certainly the exception, not the rule.

Additional Discussion

The funds, in this situation, were transferred to a traditional IRA because the transfer form was completed to say that the funds originated in a traditional IRA. In addition, the customer signed a traditional IRA plan agreement and accepted statements and governmental reporting for five years which clearly indicated the IRA was a traditional IRA. The institution has the right to rely upon the transfer form from the former institution; therefore the institution is not at fault for placing the funds in a traditional IRA.

It now must be determined that the individual was eligible to make a contribution to a traditional IRA in 2001 and subsequent years. If they were not, the amount contributed would be an excess contribution, and the 6% excise tax would be owing for 2001 and later years, unless the rules of Code section 219(f)(6) would apply.

Because the income was removed from a Roth IRA and not rolled over or transferred to another Roth IRA, the tax result is that there was a distribution from the Roth IRA, and, to the extent the distribution was comprised of income, the income will be taxable and subject to the 10% additional tax, if applicable.

Continued on page 3

The Pension Digest

Correctable or Not? Funds Placed in Wrong IRA, Continued from page 2

Is it possible to now move the funds from the traditional IRA to the Roth IRA? Unfortunately, the answer is, "No." It is possible to recharacterize an annual contribution to a traditional IRA to be an annual contribution to a Roth IRA, as long as this transaction is accomplished by October 15 of the following year, but that deadline is long past, in this case. There is no authority allowing a failed transfer from a Roth IRA to a traditional IRA to be recharacterized.

If it is determined that the contribution is an excess contribution, your institution will want to help the customer by notifying them that they will wish to withdraw the amount as soon as possible, to avoid any additional 6% penalty tax. It is not acceptable, once an institution is aware of an excess contribution, to simply ignore that fact under the guise that it is the customer's problem — you will need to be proactive and help the customer eliminate the excess.

An institution could have much liability if a Roth IRA is not established properly. The customer is entitled to tax-free income only if the Roth IRA was validly established, and certain distribution requirements are satisfied.

Example: An individual, age 25, contributes $4,000 per year for 5 consecutive years, into what she believes is a Roth IRA; the reporting is done as a Roth IRA. However, she mistakenly signed a traditional IRA plan agreement. The $20,000 of contributions will grow to be approximately $325,000 (assuming 6% interest, compounded annually) if left in the account until the individual attains age 70 (45 years). The earnings of $305,000 would never be taxed when distributed from a Roth IRA. When such funds are withdrawn from a traditional IRA, they will be taxable. The tax could amount to anywhere from $45,000 - $100,000, depending on the individual's tax bracket at the time of withdrawal.

As you can see, the institution could face substantial damages for placing the funds into the wrong IRA, should the individual decide to take legal action.

It is possible for an individual (or a financial institution) to seek a private letter ruling from the IRS asking that the transfer be considered to have been made to a Roth IRA. However, the current fee for this service is apparently $9,000. The IRS does have the authority to grant relief with respect to rollovers, if the 60-day rule is violated. There is no statutory authority for the IRS to grant relief for other types of errors (e.g. violating the once-per-twelve-month rule).

Summary. An IRA custodian needs to be aware that there is little IRS authority allowing an IRA custodian or the IRA accountholder to correct for the error of setting up the wrong type of IRA. The most conservative approach is for the individual to bear the adverse tax consequences incurred so far, and then, in the case described herein, set up a new Roth IRA going forward.

An IRA account should be so titled that there is no question as to what type of IRA it is. As an example, a traditional IRA would be entitled, "ABC Bank as Traditional IRA Custodian for Benefit of Jane Doe's Traditional IRA." A Roth IRA would be entitled, "ABC Bank as Roth IRA Custodian for Benefit of Jane Doe's Roth IRA." By mentioning the type of IRA in the account title, the chance of mistakenly placing funds in the wrong type of IRA should be eliminated. ◆

Coins and Bullion as an IRA Investment and as a Business Opportunity for the Financial Institution

A financial institution is allowed to offer "limited" self-directed IRAs. A financial institution is not required to offer its customers every investment opportunity. You can choose to limit the investments which are made available to the "self-directed" accounts. Some financial institutions have chosen to act as the IRA custodian for those IRA accountholders wanting to invest their IRA funds in certain coins and bullion.

Why would a financial institution consider doing so?

The primary reason is the special fees such customers are willing to pay.

Service Fees Associated With Coins and Bullion

The IRA custodian will often assess an annual administrative fee in the range of $150.00 - $200.00 per year and then also impose a per-transaction fee ($25.00-$50.00) per purchase or sale.

Continued on page 4

The Pension Digest

Coins and Bullion as an IRA Investment,
Continued from page 3

General Rules

Code section 408(m) sets forth the general rule that the acquisition of a collectible by an IRA or a self-directed 401(k) plan or a similar plan, is to be treated as a distribution in an amount equal to the cost of the collectible.

In general, coins and other tangible personal property are defined to be collectibles. Therefore, the purchase of a coin for the amount of $800 will generally be considered to be a distribution from the IRA in the amount of $800.

A Special Rule

Code section 408(m)(3) creates an exception for certain coins and bullion. No distribution will be considered to have taken place if the following coins or bullion are purchased.

1. **Any coin described in paragraphs (7), (8), (9), or (10) of section 5112(a) of title 31 of the United States Code.**
   a. Paragraph 7 provides — A fifty-dollar gold coin that is 32.7 millimeters in diameter, weighs 33.931 grams, and contains one troy ounce of fine gold;
   b. Paragraph 8 provides — A twenty-five dollar gold coin that is 2.0 millimeters in diameter, weighs 16.966 grams, and contains one-half troy ounce of fine gold;
   c. Paragraph 9 provides — A ten-dollar gold coin that is 22.0 millimeters in diameter, weighs 8.483 grams, and contains one-fourth troy ounce of fine gold; and
   d. Paragraph 10 provides — A five-dollar gold coin that is 16.5 millimeters in diameter, weighs 3.393 grams, and contains one-tenth troy ounce of fine gold.

   In general, the above coins are called, "Gold American Eagle" coins. These coins must also meet the following requirements.
   a. The Secretary of the Treasury will have the discretion to decide the design of the five-dollar, ten-dollar and twenty-five dollar coins.
   b. The fifty-dollar gold coin shall have the following design elements:
      (1) Symbolic of Liberty on the obverse (front) side;
      (2) A family of eagles on the reverse side with the male carrying an olive branch and flying above a nest containing a female eagle and hatchlings;
      (3) Have inscriptions of the denomination, the weight of the fine gold content, the year of minting or issuance, and the words "Liberty," "In God We Trust," "United States of America," and "E Pluribus Unum," and;
      (4) Have reeded edges.
2. **A silver coin described in section 5112(e) — such coin must meet the following requirements:**
   a. Be 40.6 millimeters in diameter and weigh 31.103 grams;
   b. Contain .9990 fine silver;
   c. Have a design (1) symbolic of Liberty on the obverse (front) side; and (2) of an eagle on the reverse side;
   d. Have inscriptions of the the year of minting or issuance, and the words "Liberty," "In God We Trust," "United States of America," "1 Oz. Fine Silver," "E Pluribus Unum," and "One Dollar; and
   e. Have reeded edges.

   This coin is called the American Silver Eagle. Note that this coin is limited to the one-dollar coin (i.e. the silver dollar).
3. **A platinum coin described in section 5112(k)**
   This subsection provides that the Secretary may mint and issue platinum coins and proof platinum coins in accordance with specifications, designs, varieties, quantities, denominations and inscriptions as the Secretary, in the Secretary's discretion, may prescribe from time to time. It appears that the Secretary has authorized the coining of American Platinum Eagle coins.
4. **A coin issued under the laws of any state, or**
5. **Any gold, silver, platinum, or palladium bullion—**
   Of a fineness equal to or exceeding the minimum fineness that a contract market (as described in section 7 of the Exchange Act, 7.U.S.C.) requires for metals which may be delivered in satisfaction of a regulated futures contract, if such bullion is in the physical possession of an IRA custodian or trustee.

   In general, the gold bullion must be .9950 pure, the silver bullion must be .9990 pure, the platinum bullion must be .9995 pure, and the palladium bullion must be .9995 pure.

   It appears that certain coins may be considered to be bullion. A number of foreign governments mint coins of silver, gold, platinum or palladium, with the fineness to meet the above standards of purity. However, the IRS has not yet given specific written guidance saying that such coins qualify as bullion.

CWF Observations

1. Bullion must be in the possession of the IRA custodian or trustee. The American Eagle coins or the coins issued under the laws of a state should also be in the custody of the IRA custodian or trustee.

2. No pureness standards apply to any coins as issued by a state.

3. Old U.S. gold coins are generally 90% pure. They do not meet the purity standards set forth above. The purchase of such a coin by an IRA will need to be treated as a distribution.

4. U.S. silver coins (pre-1965) are also 90% pure and do not meet the purity standards set forth above. The purchase of such a coin by an IRA will need to be treated as a distribution. Silver-clad coins, obviously, do not meet the purity standards.

5. The following foreign coins do meet the purity standards for bullion:

   a. Gold Maple Leafs
   b. Kangaroo Nuggets
   c. Philharmonikers
   d. Perth Mint's Lunar Series

6. Copper coins as issued by the U.S. Treasury, no matter how valuable, are considered to be a collectible, and, if such coin is purchased by an IRA, a distribution is deemed to have occurred.

Continued on page 5

Coins and Bullion as an IRA Investment, Continued from page 4

7. Paper currency, no matter how valuable, is considered to be a collectible, and, if such currency is purchased by an IRA, a distribution is deemed to have occurred.

8. An institution will need to decide if the special fees associated with coins and bullion make offering these special investments worthwhile. An institution offering such services will want to adopt special procedures. CWF is available to assist you with establishing the special procedures. ◆

Combined Reporting — When Permissible and When Not?

Assume an IRA custodian has the following situation. An IRA accountholder's husband died sometime in 2005. He had both a Roth and a traditional IRA, listing his wife as his beneficiary. The wife is not yet age 59½, and, therefore, she is maintaining the traditional IRA as an inherited IRA (i.e. she did not treat it as her own). With respect to his Roth IRA, she did elect to treat it as her own.

Can reporting for these two IRAs be combined on the January statement? The IRS does have rules allowing a number of reporting forms to be combined onto one form. For example, if a person has two different traditional IRAs, there could be one statement setting forth the required information for each traditional IRA. Or, in this case, where a customer has her own Roth IRA and an inherited traditional IRA from her husband, there must be two sections on the form setting forth the required information for each plan agreement. These different types of IRAs must be reported separately; the interest, contributions, ending balances, etc. cannot be listed as a combined total. It must be made clear that the IRS will be furnished the fair market value for both IRAs.

Because each IRA would have been established using a separate plan agreement, it is necessary to title the accounts separately and to prepare separate Forms 5498. The traditional IRA should be titled, "Jane Doe, Beneficiary of John Doe's IRA." Because this individual is treating the Roth as her own IRA, you will not call it an inherited IRA; it is simply Jane Doe's Roth IRA.

Summary. Although it is permissible to combine the reporting of more than one IRA on the January statement, the transactions relating to each IRA must be clearly identifiable, and cannot be combined into one total amount. A Form 5498 must be prepared for each IRA. ◆

What's With Boxes 2 & 3 of the 2005 Form 5498-SA?

There seems to be some confusion among HSA custodians as to how to correctly complete boxes 2 and 3 of HSA Form 5498-SA (see page 6). The same information is being reported twice, and many people are wondering why.

The 2005 Form 5498-SA— In box 2, enter the total amount of contributions made from 1/1/05 - 12/31/05 (i.e. made in 2005 — this will include all contributions made in 2005 for 2005, and all contributions made in 2005 for 2004). In Box 3, enter the total amount of contributions made in 2006, for 2005.

The 2006 Form 5498-SA— In box 2, enter the total amount of contributions made from 1/1/06 - 12/31/06 (i.e. made in 2006 — this will include all contributions made in 2006 for 2006, and all contributions made in 2006 for 2005). Note that this last category was set forth in Box 3 of the 2005 Form 5498-SA. In Box 3, enter the total amount of contributions made in 2007, for 2006.

Discussion: We are not exactly sure why the IRS has adopted this "two-box" approach for reporting HSA contributions. It is different from the standard IRA approach, where all contributions for a give tax year are reported in one box. Our guess is that the information is being sought by the two-box method because the additional box will aid the IRS in preparing their statistical reports. By using this approach, the IRS is able to determine the contributions made during the calendar year for a given tax year, and also the contributions made during the carryback period (January 1 to April 15 of the following year), for such tax year.

The IRS might be considering changing the IRA Form 5498 to adopt the same approach. ◆

IRS Issues the 2006 HSA Forms

The IRS has recently issued its 2006 1099-SA forms. CWF has compared the 2006 and 2005 forms; there are no differences except the updating of the year. The 2006 Form 5498-SA and the instructions to the participant are set forth below. ◆

Instructions to Participant

This information is submitted to the Internal Revenue Service by the trustee of your health savings account (HSA), Archer MSA, or Medicare Advantage MSA (MA MSA).

Generally, contributions you make to your HSA or Archer MSA are deductible. However, employer contributions to your HSA are not deductible. If your employer makes a contribution to one of your Archer MSAs, you cannot contribute to any Archer MSA for that year. If you made a contribution to your Archer MSA when your employer has contributed, you cannot deduct your contribution, and you will have an excess contribution. If your spouse's employer makes a contribution to your spouse's Archer MSA, you cannot make a contribution to your Archer MSA if your spouse is covered under a high deductible health plan that also covers you.

Contributions that the Social Security Administration makes to your MA MSA are not includible in your gross income nor are they deductible. Neither you nor your employer can make contributions to your MA MSA.

See Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, and its instructions or Form 8889, Health Savings Accounts (HSAs) and its instructions. Any employer contributions made to an Archer MSA are shown on your Form W-2 in Box 12 (code R); employer contributions made to HSAs are shown in Box 12 (code W).

For more information, see Pub. 969, Health Savings Accounts and Other Tax-Favored Health Plans.

Account number. May show an account or other unique number the trustee assigned to distinguish your account.

Box 1. Shows employee or self-employed person's Archer MSA contributions made to your Archer MSA in 2006 and through April 16, 2007, for 2006. You may be able to deduct this amount on your 2006 Form 1040. See the Form 1040 instructions.

Note. The information in boxes 2 and 3 is provided by the trustee for IRS use only.

Box 2. Shows the total employer and employee/self-employed contributions made in 2006 to your HSA or Archer MSA. The trustee of your MA MSA is not required to, but may, show contributions to your MA MSA.

Box 3. Shows the total HSA or Archer MSA contributions made in 2007 for 2006.

Box 4. Shows any rollover contribution you made to this Archer MSA in 2006 after a distribution from another Archer MSA or shows any rollover to this HSA from another HSA or Archer MSA. See Form 8853 or Form 8889 and their instructions for information about how to report distributions and rollovers. This amount is not included in box 1, 2, or 3.

Box 5. Shows the fair market value of your HSA, Archer MSA, or MA MSA at the end of 2006.

Box 6. Shows the type of account that is reported on this Form 5498-SA.

Other information. The trustee of your HSA, Archer MSA, or MA MSA may provide other information about your account on this form.

Note. Do not attach Form 5498-SA to your income tax return. Instead, keep it for your records.

2727 ☐ VOID ☐ CORRECTED

TRUSTEE'S name, street address, city, state, and ZIP code		1 Employee or self-employed person's Archer MSA contributions made in 2006 and 2007 for 2006 $ 2 Total contributions made in 2006 $	OMB No. 1545-1518 **2006** Form **5498-SA**	**HSA, Archer MSA, or Medicare Advantage MSA Information**
TRUSTEE'S federal identification number	PARTICIPANT'S social security number	3 Total HSA or Archer MSA contributions made in 2007 for 2006 $		**Copy A For Internal Revenue Service Center** **File with Form 1096.** For Privacy Act and Paperwork Reduction Act Notice, see the **2006 General Instructions for Forms 1099, 1098, 5498, and W-2G.**
PARTICIPANT'S name		4 Rollover contributions $	5 Fair market value of HSA, Archer MSA, or MA MSA $	
Street address (including apt. no.)		6 HSA ☐ Archer MSA ☐ MA MSA ☐		
City, state, and ZIP code				
Account number (see instructions)				

Form **5498-SA** Cat. No. 38467V Department of the Treasury - Internal Revenue Service

The Pension Digest

Additional Discussion of the Early Withdrawal Interest Penalty Subject

(Correction to Withdrawal Penalty Article Published in May 2005)

Many banks still charge an early withdrawal interest penalty of one or three months simple interest, if the depositor withdraws funds prior to the maturity date.

Many other banks today impose an early withdrawal interest penalty of 12 months or more with respect to an early withdrawal of a time deposit prior to maturity.

The purpose of this article is to discuss the rules and policy considerations in assessing an early withdrawal penalty with respect to IRA deposits. With interest rates increasing, this is a subject more and more financial institutions will be re-evaluating. what should your penalty be, and in what situations will you impose the penalty? Will you assess the penalty when a person is over age 59½? Will you assess the penalty when the person is over age 70½ if his or her distribution exceeds the required distribution amount? Will you allow a person over age 59½ to upgrade their time deposit once a year, or not at all?

Historical Background

At one time, banking laws mandated a penalty of one month simple interest if a time deposit with an original maturity of 32 days to one year was paid prior to maturity, and a penalty of three months simple interest if a time deposit of more than one year was withdrawn prior to maturity. These mandated penalty amounts were repealed in the mid 1980s. We mentioned these penalty amounts in our May 2005 newsletter, in error. We apologize for this error.

What are the rules pertaining to assessing an early withdrawal interest penalty for an early withdrawal from an IRA time deposit or savings account?

No penalty for Savings Accounts—

By definition, a savings account does not have a term or a maturity date. Consequently, there is no early withdrawal penalty related to withdrawing funds from a savings account.

A 7-Day Penalty for Time Deposits—

The law now requires a very minimal penalty for early withdrawals from all time deposits, not just from IRA time deposits. The banking rules in section 204, (Reserve Required for Depository Institutions), known as "Regulation D," state that a penalty of 7 days of simple interest applies for the early withdrawal of a time deposit within the first 6 days. The same minimum penalty applies to the early withdrawal of any portion of a time deposit. In general, the penalty is mandated to be 7 days of simple interest, in some situations. If the financial institution can get the depositor to agree to a larger penalty amount, then the financial institution is free to charge that larger penalty amount (12 months, 18 months, 24 months, etc). It appears that any penalty amount greater than 7 days of simple interest is permissible, as long as the bank and the depositor have agreed to it, and it has been properly disclosed. The financial institution must define very clearly in its disclosures, when it will and will not impose the penalty. The applicable Federal Reserve Regulations are reproduced here:

Time deposit means:

(1) A deposit that the depositor does not have a right and is not permitted to make withdrawals from within six days after the date of deposit unless the deposit is subject to an early withdrawal penalty of at least seven days' simple interest on the amount withdrawn within the first six days after deposit. A time deposit from which partial early withdrawals are permitted must impose additional early withdrawal penalties of at least seven days' simple interest on amounts withdrawn within six days after each partial withdrawal. If such additional early withdrawal penalties are not imposed, the account ceases to be a time deposit. The account may become a savings deposit if it meets the requirements for a savings deposit.

(2) Notwithstanding the provisions of paragraph (d)(1), where a time deposit, or any portion thereof, maintained in an Individual retirement Account established in accordance with 26 U.S.C. 408 is paid before maturity within seven days after the establishment of the Individual Retirement Account pursuant to the provisions of 26 CFR 1.408(1)(d)(4), or where a time

Continued on Page 8

Early Withdrawal Interest Penalty Subject,
Continued from Page 7

deposit, or any portion thereof, maintained in a Keogh (H.R. 10) Plan account established in accordance with 26 U.S.C. 401 is paid before maturity within seven days after the establishment of the Keogh (H.R.10) Plan, a depositor shall forfeit an amount at least equal to the interest earned on the amount withdrawn at the nominal (simple interest) rate being paid on the deposit.

CWF Observation. This paragraph says that the penalty amount must be less than 7 days of simple interest when an IRA is revoked. The penalty amount must be limited to the amount of interest earned before the IRA was revoked. Remember that an IRA depositor is entitled to have returned to him or her 100% of their initial contribution if he or she revokes a newly-established IRA within the 7-day revocation period. That is, in a revocation situation, the penalty cannot be 7 days of simple interest. The penalty can only be the amount of interest earned by the account prior to revocation.

(8) A time deposit, or a portion thereof, may be paid before maturity without a forfeiture of interest as prescribed by this paragraph in the following circumstances:

(i) Where a member bank pays all or a portion of a time deposit representing funds contributed to an Individual Retirement Account or a Keogh (H.R. 10) Plan established pursuant to 26 W.S.C. (IRC 1954) 408, 401 when the individual for whose benefit the account is maintained attains age 59½ or is disabled (as defined in 26 U.S.C. (IRC 1954) 72(m)(7)) or thereafter; or

(ii) Where a member bank pays that portion of a time deposit on which Federal deposit insurance has been lost as the result of the merger of two or more Federally insured banks in which the depositor previously maintained separate time deposits, for a period of one year from the date of the merger.

CWF Observation. Subsection (8) provides authority to the financial institution to not charge the penalty, if it so chooses. Many institutions still waive the interest penalty if the customer is age 59½. Some institutions will waive the penalty once every twelve months. Other institutions no longer waive the penalty unless the IRA accountholder is age 70½.

(9) A time deposit, or the portion thereof requested, must be paid before maturity without a forfeiture of interest as prescribed by this paragraph in the following circumstances:

(i) Where requested, upon the death of any owner of the time deposit funds; or

(ii) Where requested, when the owner of the time deposit is determined to be legally incompetent by a court or other administrative body of competent jurisdiction.

CWF Observation. Subsection (9) requires the financial institution to not charge the penalty, if the depositor has died or is determined to be legally incompetent.

Summary. A financial institution will want to clearly define all rules and procedures for calculating and imposing a penalty for an early withdrawal from a time deposit. For those institutions imposing a penalty of more than 6 months of simple interest, the institution most likely will need to have an addendum for their IRA projection schedules.

CWF will be sending a correction to our Procedures Manual clients concerning the early withdrawal issue in the near future. We apologize for any confusion. ◆

President Signs IRA Bill,
Continued from Page 1

If the contribution causes a lower tax bill for a particular year, the individual can file for a refund. It would appear they would have the longer of one year from the date of the retroactive contribution, or three years from the date of filing their original tax return, to file an amended return to request such refund.

We would assume that IRA custodian/trustee reporting of these prior-year IRA contributions will be handled in the same manner as combat zone contributions are now. CWF will keep you informed as the IRS formally addresses this situation. ◆