THE Pension Digest

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ALSO IN THIS ISSUE –

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

Is One Spouse Ever Eligible to Make Their HSA Catch-Up Contribution into Their Spouse's HSA?

We at CWF believe the answer is "no". If such a contribution would be made, it would be an excess contribution.

We are going to discuss two catch-up contribution situations with respect to a married couple. Currently only the wife has her own HSA. The husband does not. The first situation is where both spouses are over age 55 and not enrolled in Medicare and both want to make $800 catch-up contributions to her HSA. The second situation is that the wife is age 45. He wants to make his catch-up contribution to her HSA even though she is ineligible to make her own catch-up contribution.

Discussion of Situation #1.

Two individuals are married and both are over age 55. The wife is an HSA account owner, but the husband is not. It is assumed she contributes the amount of $6,450. This is the sum of a contribution in the amount of $5,650 (the amount for family coverage for 2007) plus a catch-up contribution in the amount of $800. The husband, however, also wants make his $800 catch-up contribution to his wife's HSA. He does not believe he is required to have his own HSA as this is what he has been told by

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IRS Issues Revised HSA Model Forms

In late November the IRS issued revised HSA model forms. Form 5305-B and 5305-C have been updated to authorize the special transfer contributions into HSAs from IRAs, Flexible Spending Arrangements and Health Reimbursement Arrangements. The forms have also been updated to reflect the various HSA limits for 2007 and 2008.

We have set forth the revised Form 5305-C. We have highlighted the changes.

CWF is in the process of updating our HSA plan agreements and disclosure statements. Be aware that CWF had revised its HSA forms early in 2007 to cover what the IRS is covering now. We did so because the standard rule is – the HSA custodian and the HSA owner can do only what the HSA plan document authorizes. CWF is also revising our HSA amendments to include these changes.

If HSA custodians have not furnished an HSA amendment covering these changes you will want to do so. If you have already furnished an amendment in 2007, then we do not believe you would need to do so again. It may be possible that the IRS would issue written guidance stating that the new model form as included in the HSA amendment must be furnished to existing account owners. You then would be required to do so. We will keep you informed.

You will note that the IRS did not revise the HSA plan agreement to discuss

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an insurance representative. Do the federal income tax laws authorize him to contribute his $800 to his wife's HSA?

We at CWF, do not believe they do. This means if he contributes the $800 to his wife's HSA an excess contribution will have been made. Neither he nor the couple on their joint return would be eligible to deduct such amount on the tax return.

Why does CWF believe it is impermissible for the husband to make his catch-up contribution into his wife's HSA?

There needs to be a tax statute or written IRS guidance allowing him to make this contribution to her HSA. There is no such statutory authority and/or IRS written guidance. What the IRS has written indicates that each spouse's catch-up contribution amount must go into his or her respective HSA. It is certainly understandable that a married couple in this situation and other situations might like to maintain just one HSA rather than both of them having to maintain an HSA. The problem is – the law as written does not authorize this approach.

Code section 223(b)(5) allows a couple to allocate the maximum contribution amount, if there is family coverage, under the HDHP to be allocated to the HSA of just one spouse. However, the underlined language set forth below clearly states it does not apply to the catch-up contribution. See the end of this Article for the applicable provisions of Code Section 223. The underlined portion provides the rule that the catch-up contributions cannot be allocated to the other spouse's HSA.

The IRS has written two statements in the Form 5305-C (Health Savings Custodial Account) which sets forth the rule that one spouse is not authorized to make their catch-up contribution to their spouse's HSA.

Article I and II read,

Article I

1. The custodian will accept additional cash contributions for the tax year made by the account owner or on behalf of the account owner (by an employer, family member or any other person). <u>No contributions will be accepted by the custodian for any account owner that exceeds the maximum amount for family coverage plus the catch-up contribution.</u>

2. Contributions for any tax year may be made at any time before the deadline for filing the account owner's federal income tax return for that year (without extensions).

3. Rollover contributions from an HSA or an Archer Medical Savings Account (Archer MSA) (unless prohibited under this agreement) need not be in cash and are not subject to the maximum annual contribution limit set forth in Article II.

Article II

1. For calendar year 2004, the maximum annual contribution limit for an account owner with single coverage is the lesser of the amount of the deductible under the HDHP but not more than $2,600. For calendar year 2004, the maximum annual contribution limit for an account owner with family coverage is the lesser of that amount of the deductible under the HDHP but not more that $5,150. These limits are subject to cost-of-living adjustments after 2004. Eligibility and contribution limits are determined on a month-to-month basis.

2. Contributions to Archer MSAs or other HSAs count toward the maximum annual contribution limit to this HSA.

3. For calendar year 2004, an additional $500 <u>catch-up contribution may be made for an account owner</u> who is at least age 55 or older and not enrolled in Medicare. The catch-up contribution increases to $600 in 2005, $700 in 2006, $800 in 2007, $900 in 2008 and $1,000 in 2009 and later years.

4. Contributions in excess of the maximum annual contribution limit are subject to an excise tax. However, the catch-up contributions are not subject to an excise tax.

The second sentence of the first section of Article I states, "No contributions will be accepted by the custodian for any account owner that exceeds the maximum amount for family coverage plus the catch-up contribution." For 2007, the maximum contribution for someone under age 55 is $5,650 and the maximum contribution for someone age 55 or older is $6,450. The maximum contribution for 2007 is not $7,250 (i.e. $6,450 + $800 + $800).

The third section of Article II states that "an additional $500 catch-up contribution may be made for an account owner who is at least age 55 or older and not enrolled in Medicare." The catch-up contribution increases to $600 in 2005, $700 in 2006, $800 in 2007, $900 in 2008 and $1,000 in 2009 and later years. See the emphasized portion. The catch-up con-

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tribution must be made "for an account owner." The husband is not an HSA account owner.

In situation #1, the couple wants to contribute $7,250. The HSA plan agreement does not authorize such a contribution. It limits the maximum contribution for one HSA to $6,450.

These two sections make clear the IRS position that the law does not authorize one spouse to make his or her catch-up contribution to the other spouse's HSA.

Discussion of Situation #2.

In this situation the wife is younger than age 55. She will not be making a catch-up contribution for herself. Thus, she and her husband only wish to contribute $6,450 ($5,650+$800). Can the husband make his $800 catch-up contribution to his wife's HSA? Again, the answer is "no." The husband wishes to contribute $800 for his own catch-up contribution to her HSA. However, the catch-up contribution must be made for the HSA account owner. This cannot be done since the wife is not age 55 or older. He needs to contribute his $800 to his HSA.

What is the HSA custodian to do?

The most conservative administrative approach for the HSA custodian is not to allow the husband's catch-up contribution to be made in either situation to the wife's HSA. The husband should establish his own HSA and make his catch-up contribution to it. The less conservative approach is to allow the husband to contribute his catch-up contribution to her HSA. This would be allowed only if they can furnish the HSA custodian with a written tax opinion from a tax professional supporting their position. In addition, the HSA custodian would want to receive a written hold harmless agreement releasing the HSA custodian from any possible liability should the IRS impose any taxes and/or tax penalties.

The applicable provisions of Code section 223 are set forth below:

(b) LIMITATIONS

(3) ADDITIONAL CONTRIBUTIONS FOR INDIVIDUALS 55 OR OLDER-

(A) IN GENERAL – In the case of an individual who has attained age 55 before the close of the taxable year, the applicable limitation under subparagraphs (A) and (B) of paragraph (2) shall be increased by the additional contribution amount.

(B) ADDITIONAL CONTRIBUTION AMOUNT – For purposes of this section, the additional contribution amount is the amount determined in accordance with the following table:

For taxable years beginning in:	The additional contribution amount is:
2004	$500
2005	$600
2006	$700
2007	$800
2008	$900
2009 and thereafter	$1,000

(4) COORDINATION WITH OTHER CONTRIBUTIONS – The limitation which would (but for this paragraph) apply under this subsection to an individual for any taxable year shall be reduced (but not below zero) by the sum of –

(A) the aggregate amount paid for such taxable year to Archer MSAs of such individual, and

(B) the aggregate amount contributed to health savings accounts of such individual which is excludable from the taxpayer's gross income for such taxable year under section 106(d) (and such amount shall not be allowed as a deduction under subsection (a)).

Subparagraph (A) shall not apply with respect to any individual to whom paragraph (5) applies.

(5) SPECIAL RULE FOR MARRIED INDIVIDUALS – In the case of individuals who are married to each other, if either spouse has family coverage –

(A) both spouses shall be treated as having

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only such family coverage (and if such spouses each have family coverage under different plans, as having the family coverage with he lowest annual deductible), and

(B) the limitation under paragraph (1) (after the application of subparagraph (A) and without regard to any additional contribution amount under paragraph (3)) –

(i) shall be reduced by the aggregate amount paid to Archer MSAs or such spouses for the taxable year, and

(ii) after such reduction, shall be divided equally between them unless they agree on a different division.

Common Misconceptions About Spousal IRA Contributions

Misconception #1. That one spouse actually makes the contribution to their spouse's IRA.

Misconception #2. That there actually is a type of IRA called a spousal IRA.

Discussion. IRAs have been around since 1975. From the very beginning there have been special rules for married couples. However, the "spousal" laws have changed over the years.

Originally, the concept was – the spouse who had compensated was required to make the contribution on behalf of his or her spouse who had no compensation. Since the "no compensation" requirement was quite harsh, the law was changed to allow a contribution even if the one spouse has a small amount of compensation. In 1996 the law was changed much more substantially. The law was changed to eliminate the requirement that the spouse with compensation was required to make the contribution. The law no longer authorizes one spouse to make a direct contribution to their spouse's IRA. The current approach of the law is to allow one spouse (the one with lesser compensation) to make a contribution to his or her own IRA based on their "combined" incomes rather than just his or her own compensation.

It certainly would be possible for one spouse to grant a power of attorney to their spouse to make a contribution on his or her behalf as long as the eligibility rules are met.

By definition the only spouse who can receive the benefit of a spousal contribution is the one with the lesser compensation.

Set forth below is the IRS explanation as taken from Publication 590. As you will see, there is no discussion that one spouse makes the contribution to the other spouse's IRA.

Spousal IRA limit

If you file a joint return and your taxable compensation is less than that of your spouse, the most that can be contributed for the year to your IRA is the smaller of the following two amounts:

1. $4,000 ($5,000 if you are age 50 or older), or
2. The total compensation includable in the gross income of both you and your spouse for the year, reduced by the following two amounts.
   a. Your spouse's IRA contribution for the year to a traditional IRA.
   b. Any contributions for the year to a Roth IRA on behalf of your spouse.

This means that the total combined contributions that can be made for the year to your IRA and your spouse's IRA can be as much as $8,000 ($9,000 if only one of you is age 50 or older of $10,000 if both of you are age 50 or older).

Note. This traditional IRA limit is reduced by any contributions to a section 501(c)(18) plan (generally, a pension plan created before June 25, 1959, that is funded entirely by employee contributions).

Example. Kristin, a full-time student with no taxable compensation, marries Carl during the year. Neither was age 50 by the end of 2006. For the year, Carl has taxable compensation of $30,000. He plans to contribute (and deduct) $4,000 to a traditional IRA. If he and Kristin file a joint return, each can contribute $4,000 to a traditional IRA. This is because Kristin,

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Form **5305-C**
(November 2007)
Department of the Treasury
Internal Revenue Service

Health Savings Custodial Account

(Under section 223(a) of the Internal Revenue Code)

Do not file with the Internal Revenue Service

Name of account owner	Date of birth of account owner	**Identifying number** (see instructions)
Address of account owner (Street address, city, state, ZIP code)		
Name of custodian	Address or principal place of business of custodian	

The account owner named above is establishing this health savings account (HSA) exclusively for the purpose of paying or reimbursing qualified medical expenses of the account owner, his or her spouse, and dependents. The account owner represents that, unless this account is used solely to make rollover contributions, he or she is eligible to contribute to this HSA; specifically, that he or she: (1) is covered under a high deductible health plan (HDHP); (2) is not also covered by any other health plan that is not an HDHP (with certain exceptions for plans providing preventive care and limited types of permitted insurance and permitted coverage); (3) is not enrolled in Medicare; and (4) cannot be claimed as a dependent on another person's tax return.

$ .... dollars in cash is assigned to this custodial account.

The account owner and the custodian make the following agreement:

Article I

1. The custodian will accept additional cash contributions for the tax year made by the account owner or on behalf of the account owner (by an employer, family member, or any other person). No contributions will be accepted by the custodian for any account owner that exceeds the maximum amount for family coverage plus the catch-up contribution.
2. Contributions for any tax year may be made at any time before the deadline for filing the account owner's federal income tax return for that year (without extensions).
3. Rollover contributions from an HSA or an Archer Medical Savings Account (Archer MSA) (unless prohibited under this agreement) need not be in cash and are not subject to the maximum annual contribution limit set forth in Article II.
4. Qualified HSA distributions from a health flexible spending arrangement or health reimbursement arrangement must be completed in a trustee-to-trustee transfer and are not subject to the maximum annual contribution limit set forth in Article II.
5. Qualified HSA funding distributions from an individual retirement account must be completed in a trustee-to-trustee transfer and are subject to the maximum annual contribution limit set forth in Article II.

Article II

1. For calendar year 2007, the maximum annual contribution limit for an account owner with single coverage is $2,850. This amount increases to $2,900 in 2008. For calendar year 2007, the maximum annual contribution limit for an account owner with family coverage is $5,650. This amount increases to $5,800 in 2008. These limits are subject to cost-of-living adjustments after 2008.
2. Contributions to Archer MSAs or other HSAs count toward the maximum annual contribution limit to this HSA.
3. For calendar year 2007, an additional $800 catch-up contribution may be made for an account owner who is at least age 55 or older and not enrolled in Medicare. The catch-up contribution increases to $900 in 2008 and $1,000 in 2009 and later years.
4. Contributions in excess of the maximum annual contribution limit are subject to an excise tax. However, the catch-up contributions are not subject to an excise tax.

Article III

It is the responsibility of the account owner to determine whether contributions to this HSA have exceeded the maximum annual contribution limit described in Article II. If contributions to this HSA exceed the maximum annual contribution limit, the account owner shall notify the custodian that there exist excess contributions to the HSA. It is the responsibility of the account owner to request the withdrawal of the excess contribution and any net income attributable to such excess contribution.

Article IV

The account owner's interest in the balance in this custodial account is nonforfeitable.

Article V

1. No part of the custodial funds in this account may be invested in life insurance contracts or in collectibles as defined in section 408(m).
2. The assets of this account may not be commingled with other property except in a common trust fund or common investment fund.
3. Neither the account owner nor the custodian will engage in any prohibited transaction with respect to this account (such as borrowing or pledging the account or engaging in any other prohibited transaction as defined in section 4975).

Article VI

1. Distributions of funds from this HSA may be made upon the direction of the account owner.
2. Distributions from this HSA that are used exclusively to pay or reimburse qualified medical expenses of the account owner, his or her spouse, or dependents are tax-free. However, distributions that are not used for qualified medical expenses are included in the account owner's gross income and are subject to an additional 10 percent tax on that amount. The additional 10 percent tax does not apply if the distribution is made after the account owner's death, disability, or reaching age 65.
3. The custodian is not required to determine whether the distribution is for the payment or reimbursement of qualified medical expenses. Only the account owner is responsible for substantiating that the distribution is for qualified medical expenses and must maintain records sufficient to show, if required, that the distribution is tax-free.

Article VII

If the account owner dies before the entire interest in the account is distributed, the entire account will be disposed of as follows:

1. If the beneficiary is the account owner's spouse, the HSA will become the spouse's HSA as of the date of death.
2. If the beneficiary is not the account owner's spouse, the HSA will cease to be an HSA as of the date of death. If the beneficiary is the account owner's estate, the fair market value of the account as of the date of death is taxable on the account owner's final return. For other beneficiaries, the fair market value of the account is taxable to that person in the tax year that includes such date.

Article VIII

1. The account owner agrees to provide the custodian with information necessary for the custodian to prepare any report or return required by the IRS.
2. The custodian agrees to prepare and submit any report or return as prescribed by the IRS.

Article IX

Notwithstanding any other article that may be added or incorporated in this agreement, the provisions of Articles I through VIII and this sentence are controlling. Any additional article in this agreement that is inconsistent with section 223 or IRS published guidance will be void.

Article X

This agreement will be amended from time to time to comply with the provisions of the Code or IRS published guidance. Other amendments may be made with the consent of the persons whose signatures appear below.

Article XI

Article XI may be used for any additional provisions. If no other provisions will be added, draw a line through this space. If provisions are added, they must comply with the requirements of Article IX.

Account owner's signature .... Date ....

Custodian's signature .... Date ....

Witness' signature ....

(Use only if signature of account owner or custodian is required to be witnessed.)

General Instructions

Section references are to the Internal Revenue Code.

Purpose of Form

Form 5305-C is a model custodial account agreement that has been approved by the IRS. An HSA is established after the form is fully executed by both the account owner and the custodian. The form can be completed at any time during the tax year. This account must be created in the United States for the exclusive benefit of the account owner.

Do not file Form 5305-C with the IRS. Instead, keep it with your records. For more information on HSAs, see Notice 2004-2, 2004-1 C.B. 269, Notice 2004-50, 2004-2 C.B. 196, Publication 969, Health Savings Accounts and Other Tax-Favored Health Plans, and other IRS published guidance.

Definitions

Identifying Number. The account owner's social security number will serve as the identification number of this HSA. For married persons, each spouse who is eligible to open an HSA and wants to contribute to an HSA must establish his or her own account. An employer identification number (EIN) is required for an HSA for which a return is filed to report unrelated business taxable income. An EIN is also required for a common fund created for HSAs.

High Deductible Health Plan (HDHP). For calendar year 2007, an HDHP for self-only coverage has a minimum annual deductible of $1,100 and an annual out-of-pocket maximum (deductibles, co-payments and other amounts, but not premiums) of $5,500. In 2008, the $1,100 minimum annual deductible remains the same and the annual out-of-pocket maximum increases to $5,600. For calendar year 2007, an HDHP for family coverage has a minimum annual deductible of $2,200 and an annual out-of-pocket maximum of $11,000. In 2008, the $2,200 minimum annual deductible remains the same and the annual out-of-pocket maximum increases to $11,200. These limits are subject to cost-of-living adjustments after 2008.

Self-only coverage and family coverage under an HDHP. Family coverage means coverage that is not self-only coverage.

Qualified medical expenses. Qualified medical expenses are amounts paid for medical care as defined in section 213(d) for the account owner, his or her spouse, or dependents (as defined in section 152) but only to the extent that such amounts are not compensated for by insurance or otherwise. With certain exceptions, health insurance premiums are not qualified medical expenses.

Custodian. A custodian of an HSA must be a bank, an insurance company, a person previously approved by the IRS to be a custodian of an individual retirement account (IRA) or Archer MSA, or any other person approved by the IRS.

Specific Instructions

Article XI. Article XI and any that follow it may incorporate additional provisions that are agreed to by the account owner and custodian. The additional provisions may include, for example, definitions, restrictions on rollover contributions from HSAs or Archer MSAs (requiring a rollover not later than 60 days after receipt of a distribution and limited to one rollover during a one-year period), investment powers, voting rights, exculpatory provisions, amendment and termination, removal of custodian, custodian's fees, state law requirements, treatment of excess contributions, distribution procedures (including frequency or minimum dollar amount), use of debit, credit, or stored-value cards, return of mistaken distributions, and descriptions of prohibited transactions. Attach additional pages if necessary.

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who has no compensation, can add Carl's compensation, reduced by the amount of his IRA contribution ($30,000-$4,000=$26,000) to her own compensation (-0-) to figure her maximum contribution to a traditional IRA. In her case, $4,000 is her contribution limit, because $4,000 is less than $26,000 (her compensation for purposes of figuring her contribution limit.)

It is still fairly common to read in various IRA articles and forms the concept that one spouse makes the contribution on behalf of the other spouse. For example, the IRA form (10/1/2006 version) as written by Wolers Kluwer Financial Services-Banker's Systems has the following provision in its disclosure statement. This provision is incorrect in the number of ways. There is no special authority in the plan agreement portion of the document allowing a spouse to make a contribution on behalf of the IRA accountholder.

3. Contributions by your spouse. If you are married, file a joint federal income tax return, and are younger than age 70½ during the entire year, your spouse may make a contribution your behalf for the tax year if you and/or your spouse have compensation. This contribution must be made into your IRA, and it cannot exceed the contribution limits applicable to regular IRA contributions.

There are some tax rules which favor married individuals and there are other laws which impose a harsher tax result on married individuals. The "spousal" IRA contribution rule is one which favors married individuals who are allowed to make an IRA contribution based on their spouse's compensation.

Revised HSA Model Forms,
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the new rules allowing certain individuals to make a full year's contribution even though the person was covered by the HDHP for only a portion of the year. This is a tax issue and such issues are not generally covered within the plan agreement. The plan agreement normally covers the rules governing contributions and distributions. The provisions in red are the new or changed provisions.

NOTICE OF AGREEMENT

The account owner named on the application is establishing this health savings account (HSA) exclusively for the purpose of paying or reimbursing qualified medical expenses of the account owner, his or her spouse, and dependents. The account owner represents that, unless this account is used solely to make rollover contributions, he or she is eligible to contribute to this HSA; specifically, that he or she: (1) is covered under a high deductible health plan (HDHP); (2) is not also covered by any other health plan that is not an HDHP (with certain exceptions for plans providing preventive care and limited types of permitted insurance and permitted coverage); (3) is not enrolled in Medicare; and (4) cannot be claimed as a dependent on another person's tax return.

The Trustee named on the application has given you a disclosure statement. You have deposited with the Custodian the sum indicated on the application in cash, if applicable.

~~You~~ **The account owner** and the Trustee make the following agreement:

ARTICLE I

1. The Trustee will accept additional cash contributions for the tax year made by the account owner or on behalf of the account owner (by an employer, family member, or any other person). No contributions will be accepted by the Trustee for any account owner that exceeds the maximum amount for family coverage plus the catch-up contribution.
2. Contributions for any tax year may be made at any time before the deadline for filing the account owner's federal income tax return for that year (without extensions).
3. Rollover contributions from an HSA or an Archer Medical Savings Account (Archer MSA) (unless prohibited under this agreement) need not be in cash and are not subject to the maximum annual contribution limit set forth in Article II.
4. Qualified HSA distributions from a health flexible spending arrangement or health reimbursement arrangement must be completed in a trustee-to-trustee transfer and are not subject to the maximum annual contribution limit set forth in Article II.
5. Qualified HSA funding distributions from an individual retirement account must be completed in a trustee-to-trustee transfer and are subject to the maximum annual contribution limit set forth in Article II.

ARTICLE II

1. For calendar year 2007, the maximum annual contribution limit for an account owner with single coverage is $2,850. This amount increases to $2,900 in 2008. For calendar year 2007,

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the maximum annual contribution limit for an account owner with family coverage is $5,650. This amount increases to $5,800 in 2008. These limits are subject to cost-of-living increases after 2008.

2. Contributions to Archer MSAs or other HSAs count toward the maximum annual contribution limit to this HSA.
3. For calendar year 2007, an additional $800 catch-up contribution may be made for an account owner who is at least age 55 or older and not enrolled in Medicare. The catch-up contribution increases to $900 in 2008, and $1,000 in 2009 and later years.
4. Contributions in excess of the maximum annual contribution limit are subject to an excise tax. However, the catch-up contributions are not subject to an excise tax.

No Life Distribution Rule When the Estate is the Beneficiary and the Death Occurs Before the Required Beginning Date

Hypothetical Situation: Margaret Roe was born February 2, 1939. She established her IRA with your financial institution in 1979. The IRA balance is $69,000. She named her spouse, James, as her primary beneficiary. She named her estate as her contingent beneficiary. James died on July 10, 2007. Margaret died on September 10, 2007. Margaret is survived by three children – David (46), Alison (44) and Molly (40). Margaret was a resident of Minnesota. Her children are the only beneficiaries of her estate.

Discussion: The IRA custodian, at least initially, will want to establish an inherited IRA titled, "Margaret Roe's Estate as beneficiary of Margaret Roe's IRA.

There is no required distribution due for 2007 since Margaret died before her required beginning date of April 1, 2010. The life distribution rule is unavailable when the IRA accountholder dies before the required beginning date and an estate is the beneficiary. The five year (5) rule applies. The IRA (inherited IRA) must be closed by December 31, 2012. This means there will be six tax years during which distributions may be made (2007-2012).

We at CWF believe it is possible for the estate to pass through to the estate's beneficiaries the right to withdraw the IRA funds under the five year rule. That is, it is not required that the actual distributions be made to the estate. We suggest that the attorney for the estate prepare an opinion similar to the following. A six year distribution period is preferable to a 1-3 year period which would normally apply if the IRA funds were actually paid to the estate.

Sample Attorney's Opinion Letter: In my opinion, it is authorized and permissible under Minnesota law and the Internal Revenue Code, for an estate to pass through to an underlying estate beneficiary the right to receive required distributions under the required distribution rules as set forth in Internal Revenue Code section 1.401(a)(9) and 1.408-8. Consequently, First National Bank as IRA custodian, may substitute, David, Alison and Molly as the inheriting beneficiaries of Margaret Roe's IRA, rather than the estate. It will be permissible to set up 3 inherited IRAs. The accounts would be titled, David as beneficiary of Margaret Roe's IRA; Alison as beneficiary of Margaret Roe's IRA, and Molly as beneficiary of Margaret Roe's IRA.

The five year rule will apply to each of the three inherited IRAs. The entire balance of each inherited IRA will need to be distributed on or before December 31, 2012. The three children are not required to take distributions at the same time.

Note that this article has discussed the situation when the estate is the designated beneficiary and the accountholder has died before her required beginning date. Another newsletter will discuss the situation when the IRA accountholder dies after her required beginning date and the estate is the beneficiary.

Coverdell ESA Reporting Forms – 5498-ESA and 1099-Q

It's been quite a while since we have written about the CESAs. The reason is – no laws have changed in many years. The contribution amount is still $2,000 per child.

We have set forth the 2007 Form 1099-Q. This form is to be completed if CESA funds are paid out on behalf of the designated beneficiary. The deadline to furnish it is January 31, 2008. The CESA custodian is required to complete box 1. You are not required to complete boxes 2 and 3. However, the CESA custodian is then required to furnish the FMV information in the large box under boxes 5 and 6. The CESA custodian also has the discretion whether or not it will report a distribution code in the large box. It certainly is easier for the CESA custodian not to complete boxes 2 and 3.

We have set forth the 2008 Form 5498-ESA. The IRS has just recently issued the 2008 version. There have been no changes to this form other than revising deadline dates. Remember that the CESA custodian must furnish this form by the following April 30th. The deadline to furnish this form to the designated beneficiary/responsible individual form the 2007 Form 5498-ESA is April 30, 2008. The deadline for the 2008 From 5498-ESA is April 30, 2009.

☐ CORRECTED (if checked)

PAYER'S/TRUSTEE'S name, street address, city, state, ZIP code, and telephone number	1 Gross distribution $	OMB No. 1545-1760 **2007** Form **1099-Q**	**Payments From Qualified Education Programs (Under Sections 529 and 530)**
	2 Earnings $		
PAYER'S/TRUSTEE'S federal identification no. / RECIPIENT'S social security number	3 Basis $	4 Trustee-to-trustee transfer ☐	**Copy B** **For Recipient**
RECIPIENT'S name Street address (including apt. no.) City, state, and ZIP code	5 Check one: • Qualified tuition program— Private ☐ **or** State ☐ • Coverdell ESA ☐	6 If this box is checked, the recipient is not the designated beneficiary ☐	This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.
Account number (see instructions)	If an **FMV** amount is shown below, see **Pub. 970,** Tax Benefits for Education, for how to figure earnings.		

Form **1099-Q** (keep for your records) Department of the Treasury - Internal Revenue Service

Instructions for Recipient

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

Box 1. Shows the gross distribution (including in-kind distributions) paid to you this year from a qualified tuition program (section 529) or a Coverdell ESA (section 530). This amount is the total of the amounts shown in box 2 and box 3. See Pub. 970 for more information.

Caution: *For Coverdell ESA distributions (other than earnings on excess contributions) made during 2007, the payer/trustee is not required to report amounts in boxes 2 and 3. Instead, the payer/trustee may report the fair market value of the Coverdell ESA as of December 31, 2007, in the blank box below boxes 5 and 6. To figure your earnings and basis, use the* Coverdell ESA—Taxable Distributions and Basis worksheet *in Pub. 970.*

Box 2. Shows the earnings part of the gross distribution shown in box 1. Generally, amounts distributed are included in income unless they are used to pay for qualified education expenses, transferred between trustees, or rolled over to another qualified education program within 60 days. Report amounts included in income on the "Other income" line of Form 1040.

Under a qualified tuition program, the amount in box 2 is included in income if there has been (a) more than one transfer or rollover within any 12-month period with respect to the same beneficiary, or (b) a change in the designated beneficiary and the new designated beneficiary is not a family member.

Under a Coverdell ESA, the amount in box 2 is included in income if there has been a change in the designated beneficiary and the new designated beneficiary is not a family member or is over age 30 (except for beneficiaries with special needs).

Also, an additional 10% tax may apply to part or all of any amount included in income from the Coverdell ESA or qualified tuition program. See Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, and your tax return instructions for information about how to report the 10% tax.

If a final (total) distribution is made from your account and you have not recovered your contributions, you may have a deductible loss. If you itemize, claim any loss on the "Other expenses" line of Schedule A (Form 1040), Itemized Deductions.

Box 3. Shows your basis in the gross distribution reported in box 1.

Box 4. This box is checked if you transferred the amount in box 1 from one education program to another education program in a trustee-to-trustee transfer. However, this box may not be checked if the transfer was made from a Coverdell ESA.

Box 5. Shows whether the gross distribution was from a qualified tuition program (private or state) or from a Coverdell ESA.

Distribution codes. For 2007, the payer/trustee may, but is not required to, report (in the box below boxes 5 and 6) one of the following codes to identify the distribution you received: 1—Distributions (including transfers); 2—Excess contributions plus earnings taxable in 2007; 3—Excess contributions plus earnings taxable in 2006; 4—Disability; 5—Death; 6—Prohibited transaction.

Instructions for Payers/Trustees

General and specific form instructions are provided as separate products. The products you should use to complete Form 1099-Q are the 2007 General Instructions for Forms 1099, 1098, 5498, and W-2G and the 2007 Instructions for Form 1099-Q. A chart in the general instructions gives a quick guide to which form must be filed to report a particular payment. To order these instructions and additional forms, visit the IRS website at *www.irs.gov* or call 1-800-TAX-FORM (1-800-829-3676).

Caution: *Because paper forms are scanned during processing, you cannot file with the IRS Forms 1096, 1098, 1099, or 5498 that you download from the IRS website.*

Due dates. Furnish Copy B of this form to the recipient by January 31, 2008.

File Copy A of this form with the IRS by February 28, 2008. If you file electronically, the due date is March 31, 2008. To file electronically, you must have software that generates a file according to the specifications in Pub. 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically or Magnetically. IRS does not provide a fill-in form option.

Need help? If you have questions about reporting on Form 1099-Q, call the information reporting customer service site toll free at 1-866-455-7438 or 304-263-8700 (not toll free). For TTY/TDD equipment, call 304-267-3367 (not toll free). The hours of operation are Monday through Friday from 8:30 a.m. to 4:30 p.m. Eastern time. The service site can also be reached by email at *mccirp@irs.gov*.

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TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 Coverdell ESA contributions $	OMB No. 1545-1815 2008 Form 5498-ESA	Coverdell ESA Contribution Information
		2 Rollover contributions $		
TRUSTEE'S/ISSUER'S federal identification no.	BENEFICIARY'S social security number			Copy A For Internal Revenue Service Center
BENEFICIARY'S name				File with Form 1096.
Street address (including apt. no.)				For Privacy Act and Paperwork Reduction Act Notice, see the 2008 General Instructions for Forms 1099, 1098, 5498, and W-2G.
City, state, and ZIP code				
Account number (see instructions)				

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

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

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, 2009. Form 5498-ESA reports contributions and rollover contributions made for you for 2008. For more information about Coverdell ESAs, see Pub. 970, Tax Benefits for Education.

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

Box 1. Shows Coverdell ESA contributions made in 2008 and through April 15, 2009, on your behalf. Do not deduct these amounts on your income tax return.

If the total contributions made to all your Coverdell ESAs for 2008 exceeded $2,000, you must withdraw the excess, plus earnings, by June 1, 2009, 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 2008. 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 to complete Form 5498-ESA are the 2008 General Instructions for Forms 1099, 1098, 5498, and W-2G and the 2008 Instructions for Form 5498-ESA. To order these instructions and additional forms, visit the IRS website at *www.irs.gov* or call 1-800-TAX-FORM (1-800-829-3676).

Caution: *Because paper forms are scanned during processing, you cannot file Form 1096, 1098, 1099, or 5498 that you download and print from the IRS website.*

Due dates. Furnish Copy B of this form to the beneficiary (participant) by April 30, 2009.

File Copy A of this form with the IRS by June 1, 2009. To file electronically, you must have software that generates a file according to the specifications in Pub. 1220, Specifications for Filing Forms 1098, 1099, 5498, and W-2G Electronically. IRS does not provide a fill-in form option.

Need help? If you have questions about reporting on Form 5498-ESA, call the information reporting customer service site toll free at 1-866-455-7438 or 304-263-8700 (not toll free). For TTY/TDD equipment, call 304-267-3367 (not toll free). The hours of operation are Monday through Friday from 8:30 a.m. to 4:30 p.m. Eastern time.