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No Direct Rollovers From One to Another IRA

An IRA accountholder may move funds from one IRA to another IRA by two different methods. The IRA funds may be transferred from one IRA plan to a second IRA plan. Or, the individual may take a distribution from one IRA and then make a rollover contribution into a second (or the same) IRA. Certain rules must be met. Two basic rules are: only one rollover every 12 months and the rollover must be completed within 60 days of the distribution.

The Internal Revenue Code and the Form 1099-R instructions do not authorize an accountholder to directly rollover funds from one IRA to another IRA.

Historical Background. In 1986 the Internal Revenue Code was amended to add Code section 401(a)(31). In the early 1980's there was also a severe recession. Many individuals lost their jobs. Many withdrew their retirement funds via a lump sum distribution. At the time, the law allowed pension plan participants to waive federal income tax withholding just as is still the rule for IRA distributions. Many of these individuals had a hard time paying the income taxes they owed with respect to these pension distributions and the IRS presumably had to expend considerable resources to collect these taxes. The IRS convinced Congress that the tax laws for pension distributions needed to be changed. The law was changed: if a person was eligible to roll over his or her pension distribution, but did not do so, then the plan administrator must withhold 20% of such distribution. The individual could avoid the 20% withholding by directly rolling over his or her pension distribution to an IRA or other qualifying plan.

Code section 401(a)(31) defines a direct rollover as the direct transfer of plan funds from a qualified plan, section 403(b) plan or certain governmental 457 plans to an eligible plan. That is, the direct transfer must come from an employer plan. An IRA is not listed as being a plan from which a direct rollover distribution is made.

In order to qualify as a direct rollover, the plan administrator must issue the payment to an IRA custodian or other plan administrator. The check can't be issued to the participant.

On page 2 of the 2009 and 2010 instructions for Form 1099-R the statement is made, "The direct rollover provisions on page 3 do not apply to distributions from any IRA."

On page 3, the IRS gives guidance as to how to report on the Form 1099-R a direct rollover distribution. In general, Box 1 is completed with the gross amount of the distribution, and Box 2a (taxable amount) is completed with a 0.00. The paying plan administrator knows it sent the check to the other plan and therefore it is not taxable.

Some tax preparers believe that the direct rollover rules do apply to some IRA distributions and they try to argue that Box 2a should be completed with a 0.00. They are wrong. Again, on page 2 of the

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No Direct Rollovers,
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instructions the statement is made, "The direct rollover provisions on page 3 do not apply to distributions from any IRA."

In summary, the direct rollover rules do not apply to IRA distributions. An individual cannot directly rollover funds from one IRA to another IRA. If an IRA custodian chooses to accommodate an IRA accountholder by agreeing to issue the check to another IRA custodian, but there is no transfer form, the paying IRA custodian must report the distribution on the 1099-R Form as it would any other standard IRA distribution. The reason code would either be a "1" or a "7" depending on the age of recipient. We would suggest an IRA custodian inform its IRA accountholders that they may either do a transfer or take a distribution and then do a rollover. Do not confuse matters by stating or indicating that you will directly rollover these funds to another IRA custodian. Do not use or accept forms from other IRA custodians indicating that IRA funds are being directly rolled over to an IRA. ◆

More Than a Check is Needed for an IRA Transfer

Some IRA custodians are having to confront the following situation. A customer or client comes into your institution with a check from another financial institution naming your institution as the payee on a check. The other financial institution is an IRA custodian. For example, the check is made payable – First Bank fbo John/Jane Doe's IRA. He or she wants to deposit this check into an IRA at your institution (i.e. First Bank). Will this be a transfer contribution or a rollover contribution?

Answer: until your institution is furnished additional IRA administrative information your institution should not negotiate (i.e. deposit) the check. The additional forms will determine whether the receiving institution will handle and report the contribution transaction as a transfer or a rollover.

Most likely the intent is that this transaction be a transfer since the institution is the payee of the check. CWF believes that a transfer exists under the tax rules only if a transfer form has been completed by the two financial institutions and the individual. This transfer form creates the authority to do a transfer transaction. Both institutions certify that the individual has or will have an IRA for which it it is the IRA custodian and that both parties agree to make the transfer distribution/contribution. One institution issuing a check with the other institution endorsing the check does not create such transfer authority as clearly as we believe is necessary to comply with IRS procedures. If an institution is not reporting a transaction, it had better have good records supporting such non-preparation. The IRS instructions for Forms 1099-R and 5498 are very clear that a transfer from one IRA to another IRA is neither to be reported as a distribution nor as a contribution.

Before negotiating the check, the receiving institution will need to be furnished a transfer form or will need to contact the other institution and receive written certification that the individual had an IRA and that it will be treating the transfer distribution as a non-reportable transfer.

Unfortunately, the law is not settled that in order to have a transfer, the check must be sent directly from one IRA custodian to the other IRA custodian. The most conservative administrative approach (and the preferred approach) is that the check, even though made payable to the subsequent IRA custodian, should not be furnished to the individual, but should be sent directly to the subsequent IRA custodian. Until the IRS issues guidance on this issue, CWF believes the subsequent IRA custodian may accept a transfer where there is a valid transfer form with the check made payable to the subsequent IRA custodian, but the individual delivers the check to the subsequent IRA custodian.

In order for an individual to make a rollover contribution, he or she must be first paid funds (or deemed to have been paid such funds) from an IRA or pension plan and then he or she must make a qualifying rollover contribution. The receiving bank will need to have the individual complete a rollover certification form because the IRS model form plan agreement restricts an IRA custodian to accept a contribution for 2009 or 2010 of only $5,000 or $6,000 unless the contribution is a rollover, recharacterization, or an employer contribution to a SEP.

In conclusion, in order to have an IRA transfer, a transfer form needs to be used and completed and signed by all three parties. The issuance of a check

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alone is insufficient to meet the IRS rules for having a nonreportable IRA transfer. ◆

BE CAREFUL – The RMD Must Be Completed Before Any Roth IRA Conversion.

The Roth conversion rules are based on the rollover rules with some modifications. An IRA accountholder who is required to take a required distribution in 2010 must take his or her RMD before doing a Roth conversion. If he or she does not, the individual will create a tax mess for both the individual and the IRA custodian. This is discussed in more detail below.

The IRS sets forth a specific Q & A in the Roth IRA regulations for this question/situation. It is question and answer 6. It reads as follows.

> Q-6. Can an individual, who has attained at least age 70 1/2 by the end of the calendar year, convert an amount distributed from a traditional IRA during that year to a Roth IRA before receiving his or her required minimum distribution with respect to the traditional IRA for the year of the conversion?
>
> A-6. (a) No. In order to be eligible for a conversion, an amount first must be eligible to be rolled over. Section 408(d)(3) prohibits the rollover of a required minimum distribution. **If a minimum distribution is required for a year with respect to an IRA, the first dollars distributed during that year are treated as consisting of the required minimum distribution until an amount equal to the required minimum distribution for that year has been distributed.** (Emphasis added.)
>
> (b) As provided in A-1(c) of this section, any amount converted is treated as a distribution from a traditional IRA and a rollover contribution to a Roth IRA and not as a trustee-to-trustee transfer for purposes of section 408 and section 408A. Thus, in a year for which a minimum distribution is required (including the calendar year in which the individual attains age 70 1/2), an individual may not convert the assets of an IRA (or any portion of those assets) to a Roth IRA to the extent that the required minimum distribution for the traditional IRA for the year has not been distributed.
>
> **(c) If a required minimum distribution is contributed to a Roth IRA, it is treated as having been distributed, subject to the normal rules under section 408(d)(1) and (2), and then contributed as a regular contribution to a Roth IRA. The amount of the required minimum distribution is not a conversion contribution.** (Emphasis added.)

Paragraph (c) has been highlighted because it sets forth the tax mess created if an RMD is contributed to a Roth IRA – be it a normal contribution or a conversion contribution. The Roth IRA custodian must report the RMD contribution as a normal Roth IRA contribution in box 10 on Form 5498. It is not a conversion contribution. Conversion contributions are reported in box 3 on Form 5498. In many cases, these contributions may well be excess contributions needing to be corrected under the excess contribution rules.

The only safe administrative procedure for a Roth IRA custodian is to make sure the individual is complying with the IRS rule that requires a person to do a Roth conversion only after he or she has taken his or her RMD for the year. ◆

IRA Contribution Due Dates

It's that time of year again. Some people call it tax time. You probably call it IRA time.

If you haven't already, you likely will be getting questions as to when an IRA contribution can be made for 2009. The rules are really quite simple, they have not changed in many years.

Traditional and Roth Annual Contributions

Traditional and Roth IRA contributions for the prior tax-year, 2009, can be deposited until the due date of the IRA accountholder's personal Federal Income Tax Return, April 15, 2010. The IRA Custodian/Trustee needs written documentation from the IRA accountholder that the contribution is for the prior tax year. If written documentation is not received, it must be reported as a current year, 2010, IRA contribution by the IRA Custodian/Trustee.

Yes, an IRA accountholder can extend the date to file his or her Federal Tax Return. However, the IRA contribution must be made by the due date, without regard to any extension. There may be certain exceptions for certain individuals in the military and for certain indi-

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**Due Dates,
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viduals affected by Federal Declared Disasters. But those are special cases and must be addressed and documented separately by the IRA accountholder and the IRA Custodian/Trustee.

The due date for making regular, annual IRA contributions for 2009 is April 15, 2010.

March 1 Due Date for Commercial Farmers and Fishermen

Every year there is confusion over the special March 1 deadline for commercial farmers and fishermen. Self-employed commercial farmers and fisherman have a special date for filing federal tax returns. It really is NOT a due date, it's an early filing date. If they file their Federal tax return by March 1, and pay all taxes due by March 1, they do not have to make quarterly income tax estimates like other self-employed people. But it really is not their due date. It is only an early filing date that allows them certain other tax considerations. They can file their tax return by March 1, take credit/deduction for an IRA contribution, and wait until April 15 to actually deposit the IRA contribution.

This procedure is available to everyone. Anyone can file early, take credit/deduction for an IRA contribution, and not actually contribute it until April 15. In fact, this practice is once again becoming quite common.

Taxpayers are filing early, electronically, taking a deduction/credit for a 2009 IRA contribution, getting their refund more quickly because they filed electronically, and then use the money from the tax refund to make the IRA contribution by April 15. It's perfectly lawful.

Of course, if the tax return is filed early, and then the IRA accountholder decides to make or change an IRA contribution, the tax return would need to be amended. The due date for 2009 IRA contributions remains April 15, regardless of any extension or amendment process.

An early filing date is not the due date for anyone.

Mailed IRA Contributions

So, what about those IRA contributions that are mailed to the IRA Custodian/Trustee, that are postmarked by April 15, 2010? Even though received after April 15, are they allowed? You may be surprised at the answer.

The IRA Custodian/Trustee is allowed to accept contributions after the due date, if they are postmarked by April 15. However, you must be able to report them correctly for the prior tax year. That does not mean back-dating, process them currently. Do not show them as received on April 15 if they were not. But, they must be reported correctly on the 2009 Form 5498.

While the IRA Custodian/Trustee is allowed to accept properly postmarked contributions, they are NOT required to. If your procedures are that you must have received the IRA contribution by the close of business on April 15, that is fine. You are not required to accept them after that date.

The IRS allows the contributions to be accepted based on the proper postmark but they do not mandate it. If your financial institution does not allow them it probably is a good idea to make sure your IRA accountholders know that in advance.

If you do allow such properly postmarked IRA contributions, we recommend keeping a copy of the envelope as proof that the contribution is authorized.

Conclusion

As the IRA Custodian/Trustee, it is important to be aware that you are responsible to make sure you only accept complying contributions. And you have a responsibility to report them to the IRS. When you tell the IRS a contribution for 2009 was received, you are saying it was received timely and in compliance with the Internal Revenue Code, Regulations, and all IRS rules and procedures. ◆

Roth IRA Conversion Documentation

With the changes to Roth IRA Conversion eligibility for 2010, there will undoubtedly be more conversions being accomplished this year. The 2010 Roth Conversion rules have been discussed in previous CWF newsletters, The Pension Digest, including the July and December 2009 issues, and most recently in the January 2010 issue. If you would like a reprint of any of these articles please call our customer service department at 800-346-3961.

And based on our consulting calls already in 2010, the IRA accountholders are more confused than ever about Roth Conversions. IRA Custodians/Trustees, too. And who can blame them? Limitation changes. Taxation changes. Some reported as a Rollover yet treated and taxed as a Conversion.

Consequently, documentation of the Roth Conversion is even more important than in the past. Yes, it is the IRA Accountholder's responsibility to make sure that the conversion amount is eligible. However, that should mean the documentation obtained by the IRA Custodian/Trustee clearly states that.

Roth Conversion-Eligible amounts cannot include:

- Required Minimum Distributions;
- Any distribution based on a life expectancy of 10 years or more; and
- Corrective distributions.

In general, corrective distributions is a term used to describe the various excess contributions that may arise under a 401(k) plan.

A conversion is either done as a transfer or as a rollover. In order to authorize and accomplish the conversion and obtain supporting documentation for the IRA custodian/trustee, CWF has created a series of "conversion " forms to handle internal IRA conversions, external IRA conversions, conversions of non-Roth funds from 401(k) plans and conversions from SIMPLE-IRAs. As with normal IRA transfers, there needs to be a special transfer or rollover form completed with respect to conversion contributions.

65-R1 – Certification for the Internal Conversion of a Traditional IRA to a Roth IRA

This form is used when the Roth Conversion is being done between a traditional IRA and a Roth IRA AT THE SAME FINANCIAL INSTITUTION. It can be used whether done as an Internal Transfer or as a Distribution and 60-Day Rollover.

65-R3 – Certification for the Conversion of Non-Roth Funds Within a 401(k)/403(b)/457 Plan to a Roth IRA

This form is used when the Roth Conversion is coming from an employer sponsored retirement plan. It is a Roth Conversion even though it is reported as a rollover. It can be used whether accomplished as a Distribution and 60-Day Rollover or as a Direct Rollover.

65-R4 – Certification and Instruction for the Conversion of a Traditional IRA at One Financial Institution to a Roth IRA at a Different Financial Institution

This form is used when the Roth Conversion is being done between a traditional IRA and a Roth IRA **AT DIFFERENT FINANCIAL INSTITUTIONS**. It can be used whether accomplished as a Distribution and 60-Day Rollover or as a External Transfer.

65-R5 – Certification for the Internal Conversion of a SIMPLE-IRA to a Roth IRA

This form is only used when the Roth Conversion is being done between a SIMPLE IRA and a Roth IRA AT THE SAME FINANCIAL INSTITUTION. Remember, the SIMPLE IRA must have completed its 2-Year holding period to be eligible for Roth Conversion.

65-R6 – Certification for the External Conversion of a SIMPLE-IRA to a Roth IRA

This form is used when the Roth Conversion is being done between a SIMPLE IRA and a Roth IRA AT DIFFERENT FINANCIAL INSTITUTIONS. Remember, the SIMPLE IRA must have completed its 2-Year holding period to be eligible for Roth Conversion.

65-R2 –Certification for Rollovers and Direct Rollovers to a Roth IRA from Another Roth IRA or Roth 401(k)/403(b)

This form is NOT used for any Roth Conversion. It is only used for regular Rollovers from Roth IRAs to Roth IRAs or for Rollovers or Direct Rollovers from Roth Qualified Retirement Plans to Roth IRAs. Do not confuse its use. This form is NOT used for any type of Roth Conversion. This form is also used for the rollover to a Roth IRA of a qualified Military Death Gratuity.

All these forms are updated for the 2010 Conversion limitation changes and are available for immediate delivery. Of course they are also available electronically through CWF's Electronic FormSystem™. If you have any questions about the use of these forms, please be sure to contact our Consulting Department at 800-346-3961. ◆

Preliminary Tax Data — IRA/Pension Statistics for 2008

The IRS has recently issued preliminary tax data for tax year 2008. This tax data clearly shows that the recession was in place in 2008. The number of taxpayers who filed returns actually decreased from 143 million to 142.4 million. Taxable income also decreased. The number of tax returns reporting unemployment compensation increased from 7.7 million for 2007 to 9.6 million for 2008, a 24.1% increase. The amount of unemployment compensation increased from 29.8 billion for 2007 to 43.9 billion for 2008, a 47.6% increase. The amount of funds being withdrawn from pension plans increased (515 billion for 2008 versus 504 billion for 2007) and the amount of IRA distributions also increased (160 billion for 2008 versus 148.5 billion for 2007). The amount being contributed to pension plans and IRAs decreased as discussed below.

These statistics are preliminary statistics in the sense they were devised by an IRS economist using a sample of approximately 250,000 tax returns to make estimates with respect to 142 million tax returns.

CHART A — SEP/SIMPLE/Profit Sharing Chart

Year	Contribution Amount	Number of Contributors	Average Contribution
2001	$13.1 billion	1.29 million	$11,048
2002	$16.3 billion	1.19 million	$13,774
2003	$16.9 billion	1.19 million	$14,202
2004	$18.0 billion	1.17 million	$15,385
2005	$19.4 billion	1.20 million	$16,202
2006	$20.2 billion	1.18 million	$17,200
2007	$20.1 billion	1.14 million	$17,720
2008	$18.5 billion	.97 million	$19,072

CHART B — Traditional IRA Chart

Year	Contribution Amount	Number of Contributors	Average Contribution
2001	$7.41 billion	3.45 million	$2,148
2002	$7.41 billion	3.45 million	$2,148
2003	$10.16 billion	3.46 million	$2,936
2004	$10.20 billion	3.38 million	$3,018
2005	$12.21 billion	3.29 million	$3,707
2006	$12.77 billion	3.29 million	$3,885
2007	$13.19 billion	3.37 million	$3,914
2008	$11.91 billion	2.78 million	$4,284

Deductible Traditional IRA Contributions

The number of tax returns claiming a deduction for a traditional IRA contribution decreased by 17.4%.

The amount contributed to traditional IRAs decreased to 11.9 billion from 13.1 billion. This was a 9.7% decrease.

What was the AGI of those who made traditional IRA contributions for 2008?

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	139,929	349,224	599,185	1,042,760	531,378	121,244	2,783,721
% of Total Returns	5.03%	12.54%	21.52%	37.46%	19.09%	4.36%	100%
Contribution Amt. **(in thousands)**	$436,682	$1,118,394	$2,108,032	$4,380,906	$2,812,195	$1,049,341	$11,905,552
% of Total Contr.	3.67%	9.39%	17.71%	36.80%	23.62%	8.81%	100%
Avg. Contr. Amt.	$3,121	$3,203	$3,519	$4,201	$5,292	$8,655	$4,277

CWF Observations

1. The average IRA contribution, per return, was $4,284 for 2008.
2. 37% of all IRA contributions came from individuals with AGI between $50,000-$99,999.
3. 78.6% of all IRA contributions for 2008 came from individuals with AGI of $30,000 or More. This was down from 87% for 2007

IRA and SEP/SIMPLE/Keogh Deductible Contributions

1. The number of tax returns claiming a deduction for a self-employed person's contributions to a profit sharing, SEP or SIMPLE decreased by 15.0%.
2. The amount contributed by self-employed individuals to a profit sharing plan, SEP or SIMPLE decreased to 18.5 billion from 20.1 billion. There was a 8.2% decrease.

What was the adjusted gross income (AGI) of those who made SEP/SIMPLE/Keogh contributions?

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	18,839	32,242	58,018	176,180	298,716	381,853	965,847
% of Total Returns	1.95%	3.34%	6.00%	18.24%	30.93%	39.54%	100%
Contribution Amt. **(in thousands)**	$213,750	$173,769	$382,970	$1,585,170	$4,555,459	$11,588,384	$18,499,501
% of Total Contr.	1.16%	.94%	2.07%	8.57%	24.62%	62.64%	100%
Avg. Contr. Amt.	$11,346	$5,390	$6,601	$8,997	$15,250	$30,348	$19,072

CWF Observations on SEP/SIMPLE/Keogh Contributions for 2008

1. The average contribution per return is $19,072 for 2008 versus $17,720 for 2007.
2. 63% of contributions ($11.6 billion) come from individuals with AGI of $200,000 or more.
3. 87% of contributions (16.1 billion) come from individuals with AGI of more than $100,000.
4. The average contributions vary greatly depending on AGI.
5. Note that 965,000 self-employed individuals contributed 18.5 billion to their profit sharing, SEP and SIMPLE plans whereas 2.8 million IRA accountholders contributed 11.9 billion. There should be special marketing efforts to your customers who are self-employed.

The Retirement Savings Tax Credit

This credit has now been in existence for 7 years (2002 - 2008). This credit exists to induce individuals with low to moderate incomes to make IRA or 401(k) contributions.

What was the AGI of those who claimed this credit?

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	306,809	2,765,254	2,582,822	388,511	0	0	6,043,397
% of Total Returns	5.08%	45.76%	42.74%	6.42%	0	0	100%
Credit Amt. **(in thousands)**	$56,546	$447,640	$424,168	$65,334	0	0	$993,687
% of Total Credits	5.69%	45.05%	42.89%	6.57%	0	0	100%
Avg. Credit Amt.	$184.30	$161.88	$164.23	$168.17	0	0	$164.43

CWF Observations

1. Low- to moderate-income taxpayers were able to claim credits totaling $1 billion.
2. The average credit per tax return was $164.
3. Note that 6.0 million returns claimed this saver's credit. This is more than the number of returns which showed a traditional IRA contribution and claimed a tax deduction (2.78 million). Contributions to a traditional IRA, Roth IRA, 401(k) plan or other elective deferral plan qualify a person for this credit.

Preliminary HSA Tax Data for 2008

With respect to tax year 2008 the IRS has estimated that there were 810,279 taxpayers who made contributions to HSAs and who claimed tax deductions totalling 2.13 billion dollars. The average contribution per tax return was $2,629.

The IRS has estimated that there were 581,438 taxpayers who made contributions to HSAs and who claimed tax deductions totalling 1.448 billion dollars for 2007. This means the average contribution per tax return was $2,490.

The number of tax returns claiming a deduction for contributions to an HSA increased by 39.4% to 810,279 from 581,438.

The amount contributed to an HSA (and deducted) increased to 2.13 billion from 1.44 billion. This was an increase of 47.1%.

Since this data comes from the 1040 tax returns it does not indicate any data for contributions made by corporate employers or deductions by corporations for having made HSA contributions.

For 2008, the maximum HSA contribution was $2,900 for self-only coverage and $5,800 for family coverage. Individuals age 55 or older were eligible to make an additional catch-up contribution of $900.

What was the AGI of those who made HSA contributions?

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	33,190	63,321	119,306	255,004	206,869	132,588	810,279
% of Total Returns	4.10%	7.81%	14.73%	31.47%	25.53%	16.36%	100%
Contribution Amt. **(in thousands)**	$66,162	$95,529	$202,975	$566,280	$626,274	$571,927	$2,129,150
% of Total Contr.	3.11%	4.49%	9.53%	26.60%	29.41%	26.86%	100%
Avg. Contr. Amt.	$1,993	$1,509	$1,701	$2,221	$3,027	$4,314	$2,627

CWF Observations

1. The average 2008 return showed a contribution of $2,627 versus $2490 for 2007.
2. 82.9% of the contributions came from individuals with $50,000 or more of AGI. This was a decrease of 4.1% versus 2007.
3. The largest average contribution was from the $200,000 and over group and it was $4,314 per return. The next largest average contribution was $3,027 and it came from the $100,000 to $199,999 group.