THE Pension Digest

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ALSO IN THIS ISSUE –

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

IRS Gives Guidance on 5498 Multiple Forms and Account Number Requirements

Background. CWF had originally asked the IRS if the IRS would assess the $50 per form penalty if an IRA custodian only prepared one Form 5498 when an individual actually had multiple IRA plan agreements with the IRA custodian. The IRS instructions for Form 5498 clearly state that when there are multiple IRA plan agreements the IRA custodian must prepare multiple Form 5498s. Most IRA custodians file their 5498 forms and other IRS reporting forms electronically with the IRS division in Martinsburg, West Virginia. CWF also asked this West Virginia division if an IRA custodian would be fined for submitting just one Form 5498 electronically. We were told, that no fine would be assessed. We then suggested to the IRS that the 5498 instructions be changed to conform to the guidance of the West Virginia division.

Mr. J. Healey, acting section chief of the specialty tax law section, has informed CWF via an email that the 5498 instructions will not be revised to permit aggregate account reporting of multiple IRAs for one individual by one IRA custodian.

In addition, Mr. Healey discussed the rule that an IRA custodian is required to assign an account number to each IRA and complete box on the Form 5498 if a person has more than one IRA. This requirement could not be met if the IRA custodian was allowed to prepare an aggregated Form 5498. As the instructions state, the IRS encourages an IRA custodian to assign an account number to each IRA even when a person has only one IRA.

If your institution is filing an aggregated Form 5498, you want to take steps so that you will have the capability of submitting multiple forms (i.e.. one for each IRA plan agreement). You may need to talk with your software vendor or processor.

Separate FDIC Insurance for an Inherited IRA

An FDIC representative in a recent email confirmed that inherited IRAs, if set up properly, will be insured up to $250,000 per deceased accountholder in addition to the $250,000 limit applying to an individual's personal IRAs. An individual's inherited IRAs are not required to be aggregated with his or her own personal IRAs.

Here is the FDIC response. "In response to your question as long as the IRAs inherited from your mother and father continue to be reported separately to the IRS and remain as separate deposit accountings, then the FDIC will continue to insure your mother's IRA up to $250,000, your father's IRA up to $250,000, and the combination of all of your IRAs up to $250,000."

We assume this same approach or concept will apply to spouse beneficiaries. A spouse who elects to treat the decedent's IRAs as his or her own will have only one $250,000 limit. In order to get the additional $250,000 insurance, the surviving spouse will need to maintain the inherited IRA.

Overview of Fee Disclosure Rules for Service Providers and New Deadlines

A fee to a plan or plan participant is compensation to a service provider. For some time there has been a concern that 401(k) plan participants and other pension plans may be paying unreasonably high administrative and investment fees. Higher fees means participants will have less money for retirement.

The Employee Benefits Security Administration (EBSA) of the U.S. Department of Labor has written a regulation dealing with these fee concerns. A plan fiduciary has the duty to act prudently and solely in the interest of plan participants and beneficiaries. This applies to a fiduciary selecting and monitoring entities providing administrative and investment services to the plan. An EBSA regulation requires certain service providers to provide a plan fiduciary with fee information and financial information so that the fiduciary has the information needed to determine if the fees are reasonable and whether there may be potential conflicts of interest which may affect the service provider's performance.

Originally, this regulation was to be effective as of July 16, 2010. It was later changed to be July 16, 2011. The DOL/ESBA in July of 2011 extended this deadline to be April 1, 2012.

This regulation applies to defined contribution plans and defined benefit plans. It does not apply to 403(b) plans, SEP plans, SIMPLE plans or IRAs. It also does not apply to one-person plans.

That is, a service provider performing administrative services to one-person plans, SEPs and SIMPLES is not required to furnish the fee information required by the regulation.

A service provider will be required to furnish the required information if it is expected that the service provider will receive at least $1,000 in compensation and if it provides:

1. certain fiduciary or registered investment advisory services;
2. recordkeeping or brokerage services to a participant directed individual account plan in connection with the investment options available under the plan; or
3. certain other services for which indirect compensation is received.

What Information Must be Disclosed and What Format?

1. A written description of the services to be performed and an explanation of all compensation to be received by the service provider, affiliates or subcontractors must be furnished to the plan administrator. Compensation means direct and indirect compensation. Although the writing requirement does not mean there must be a service agreement, such an agreement is generally recommended.
2. A service provider must disclose whether it is providing any services as a fiduciary.
3. Although there may be a "bundled fee", there will need to be a disclosure setting forth the fees for recordkeeping, plan investments and plan investment options.
4. A service provider has a duty of ongoing disclosures. If there is a change in any of the information initially furnished, then the service provider must disclose the changes as soon as practical, but no later than 60 days from when the service provider is informed of the change.

If a plan fiduciary or a plan administrator needs certain information in order to comply with ERISA's reporting and disclosure requirements, they now have the right to request from a service provider to be furnished information about compensation or other information about the service arrangement and be furnished such information.

Extending the deadline to April 1, 2012 will give service providers adequate time to comply with this regulation. It will not be extended again. ◆

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Overview of Fee Disclosure Rules for Plan Fiduciaries to 401(k) Plan Participants and New Deadlines

For some time there has been a concern by EBSA/DOL that 401(k) plan participants of a participant-directed plan may be paying unreasonably high administrative and investment fees and may not be furnished sufficient information to make informed decisions.

The Employee Benefits Security Administration of the U.S. Department of Labor has written a regulation dealing with these fee concerns. This regulation requires the plan administrator to furnish certain information to participants and beneficiaries.

Originally, this regulation was to be effective as of December 20, 2010. Prior to December 20, 2010, the EBSA concluded employers would be given more time to comply. The DOL/ESBA in July of 2011 adopted the following changes:

1. The initial disclosures to the 401(k) participants must be furnished no later than the later of 60 days after a first day of a plan year beginning on or after November 1, 2011 or 60 days after the effective date of the disclosure rule for service-providers. (i.e. April 1, 2012).
2. The quarterly disclosures on fees and changes must be furnished to participants and beneficiaries no later than 45 days after the end of the quarter in which the initial disclosures are furnished.

Example. This new participant-level disclosure regulation is effective as of January 1, 2012 for calendar year plans. The first set of initial disclosures must be furnished by the plan administrator no later than May 31, 2012. That is 60 days after April 1, 2012. The quarterly disclosures for fees and expenses as charged the participants and beneficiaries must be furnished no later than August 14, 2012. The initial disclosures are presumed to have been furnished on April 1, 2012 during the second quarter. 45 days after June 30 is August 14.

This regulation provides that the investment of plan assets is a fiduciary act under ERISA sections 404(a)(1)(A) and (B). A fiduciary must act prudently and solely in the interest of the plan's participant and beneficiaries. There needs to be special disclosure rules when the participants and beneficiaries will be making the investment decisions.

This regulation requires the plan administrator to furnish on a regular and periodic basis the participants and beneficiaries their rights and duties to make investment decisions. They must be provided sufficient information regarding the plan and the plan's investment options, including fee and expense information.

There are three type or categories of information which must be furnished by the plan administrator.

Category #1 - Plan Related Information

Category #2 - Investment Related Information

Category #3 - Miscellaneous Disclosures

Category #1 - Plan Related Information.

There must be an explanation of the plan provisions. Generally, the Summary Plan Description will satisfy this requirement. There will need to be discussed what plan investment's are available to the participant or beneficiary and then how he or she will give his or her investment instructions.

There must also be an explanation of general administrative expenses, which may be allocated to the individual accounts. That is, the employer does not pay these expenses, but the plan has the individuals' accounts pay these expenses. Examples include expenses for recordkeeping, accounting and legal fees.

There must also be an explanation of the specific individual expenses, which will be allocated to an individual's accounts. Examples include fees and expenses for investment transactions, plan loans and for processing qualified domestic relations orders.

The previous information must be furnished to a participant or beneficiary on or before the date he or she can first direct their investments and then annually thereafter.

In addition, the plan administrator must furnish at least quarterly a statement showing the dollar amount of the plan related fees and expenses (administrative and/or individual) actually charged to a participant's account along with a description of what fees

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were changed. These disclosures may be included in the quarterly benefit statements required under ERISA section 105.

Category #2 - Investment Related Information

The plan administrator is required to furnish the following subcategories of information to the participants and beneficiaries.

Subcategory #1 - Glossary of Investment Terms. The plan administrator must furnish a glossary of investment terms to assist a participant or beneficiary understand the plan's investment options. As an alternative, an Internet Website address may be furnished that sets forth the glossary.

Subcategory #2. Performance Data. For investment options having a fixed or stated rate of return, the annual rate of return and the term of the investment must be disclosed.

For investment options which do not have a fixed or stated rate of return such as mutual funds, there must be disclosure of the specific information about historical investment performance. This must in the form of disclosing the 1, 5 and 10 year returns.

Subcategory #3 - Benchmark Information. For investment options which do not have a fixed or stated rate of return, the name and returns of an appropriate broad-based securities market index over 1, 5 and 10 year periods (matching the Performance Data periods) must be provided.

For investment options having a fixed or stated rate of return, this disclosure requirement does not apply.

Subcategory #4 - Fee and Expense Information. For investment options which do not have a fixed or stated rate of return, the total annual operating expenses must be expressed as both a percentage of assets and as a dollar amount for each $1,000 invested, and any shareholder-type fees or restriction on the participant's ability to purchase or withdraw from the investment.

For investment options having a fixed or stated rate of return, any shareholder-type fees or restrictions on the participants ability to purchase or withdraw from the investment.

Subcategory #5 - Internet Web Site Address. The plan administrator must provide a Web site address that is sufficiently specific to provide participants and beneficiaries access to specific additional information about the investment options for workers who want more or more current information.

Subcategory #6 - Comparative Format Requirement. The investment related information must be furnished to a participant or beneficiary on or before they date he or she can can first direct their investments, and then annually thereafter.

It also must be furnished in a chart or similar format designed to allow a comparison of each investment option. The regulation sets forth a model comparative report which may be used.

Category #3. Miscellaneous Rules and Requirements.

1. The plan administrator must furnish a participant or beneficiary after his or her request with prospectuses, financial reports and statements of valuation and of assets held by an investment option.
2. The plan administrator must furnish a participant or beneficiary with any materials received by the plan relating to voting, tender or similar rights in an option after he or she has invested in a particular investment option.
3. The intent is that a plan administrator providing required information will meet the requirements of Code section 404(c) have been met.
4. The general disclosure regulation, including the electronic procedures, applies to material furnished under this regulation.
5. A plan administrator who reasonably and in good faith relies upon information provided by a service provider is not liable to the participants or beneficiaries if such information is incomplete or is inaccurate.

In summary, every plan administrator has been given additional time to comply with the participant-directed disclosure rules. This duty to furnish these disclosures only apply to 401(k) plans or similar plans. For plans having a calendar year plan year, the deadline to furnish these disclosures is now May 31, 2012. Many employers will benefit with this new deadline. There is more time to write and furnish these disclosures. ◆

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Titling of IRAs, Including Inherited IRAs

The titling of an IRA is important for a number of reasons.

An IRA is a revocable trust; it is tax preferred under U.S. federal income law. The IRA is a separate tax entity. It is a fiduciary account. A financial institution which is the IRA's trustee (or the custodian) holds assets and contributions on behalf of the person for whom the IRA has been established. That is, the financial institution owns the time deposit or other asset(s) on behalf of Jane Doe or John Doe. The individual is not the owner.

However, it is fairly common these days that some people will describe the individual as the IRA owner. They believe this is proper since the individual has the right to withdraw the funds from the IRA and then use such funds as he or she wishes.

Describing the individual as the owner can be confusing and it is misleading. The individual does not "own" the funds until he or she withdraws them from the IRA. Legally, the IRA trustee/custodian owns the IRA assets. We at CWF still prefer to use depositor or accountholder rather than owner while the funds are still within the IRA.

The title which many banks have used for an IRA is, "ABC Bank, IRA custodian, for the Jane Doe Traditional (Roth) IRA." With the existence of four types of IRAs, it is important to specify the IRA type – Traditional, Roth, SEP and SIMPLE in the title. This titling makes it very clear that this account is an IRA and that ABC Bank, as an IRA trustee/custodian owns (i.e. holds) the IRA assets on behalf of Jane Doe's IRA.

IRS Reporting. An IRA trustee/custodian must prepare the Form 5498 (contributions and fair market value) and the Form 1099-R (distributions) as the IRS instructs for both account holders and also for inheriting beneficiaries.

For the accountholder, the Form 5498 is prepared using the individual's name, address and tax identification number. For the inheriting beneficiary, the Form 5498 is prepared using the following titling, Jane Doe as beneficiary of John Doe's IRA. The individual's social security number is used. The IRS has stated in the instructions for the Form 5498 that titling showing this IRA to be an inherited IRA must be used.

For the accountholder, the Form 1099-R is prepared using the individual's name, address and tax identification number.

For the inheriting beneficiary, the Form 1099-R may also be prepared using the individual's name, address and tax identification number. However, we believe the better administrative approach is to use the same titling as is used for the Form 5498, "Jane Doe as beneficiary of John Doe's IRA." A person may inherit an IRA from more than one person. It may be important to be able to match distributions with the original IRA decedent.

FDIC Insurance.

The standard insurance amount is $250,000 per depositor, per insured bank, for each account ownership category. The FDIC has eight ownership categories: single, joint, certain "individual" retirement accounts (includes IRAs), revocable trust accounts, corporate and other business accounts, irrevocable trust accounts, employee benefit plan accounts, and government accounts.

The FDIC must be able to determine from the bank's records which category a deposit belongs to. If a deposit is an IRA, the bank's records must clearly show that it is an IRA.

As discussed in an article in this newsletter, if the IRA is an inherited IRA, it is important that the bank's records show the IRA is an inherited IRA. Inherited IRAs and regular IRAs each have their own $250,000 limit.

Bankruptcy Law.

An individual who elects to use the federal exemptions for bankruptcy law purposes, is allowed to exempt $1,000,000 of his or her traditional and Roth IRA funds and any amount attributable to SEP-IRAs and SIMPLE-IRAS. Some individuals will not wish to combine their SEP-IRA balances with their traditional IRAs.

The purpose of this article has been to discuss the titling of IRAs. In order for a person to maximize his or her IRA rights, the IRA deposits must be properly titled. Problems may arise if the proper titling is not used. ◆

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Intentional or Not?

The 2010 version of IRS Publication 590 contains no discussion of qualified HSA funding distributions. A qualified HSA funding distribution occurs when an IRA accountholder moves funds generally from their traditional IRA to an HSA. Of course, certain rules must be followed. This movement of IRA funds to an HSA is done on a tax-free basis. The 2010 version of Publication 590 does not even contain the term qualified HSA funding distribution.

There is discussion of this subject in Publication 969, *Health Savings Accounts and Other Tax-Favored Health Plans.*

Common sense says this topic should be discussed in the IRA publication since the purpose of the law was to allow a person to make a once in a lifetime transfer of his or her taxable IRA funds to an HSA on a nontaxable basis. For whatever reason, the IRS does not seem convinced that it should be added to Publication 590. The IRS, under President Obama's Administration, is lukewarm, at best, about HSAs.

Nevertheless, we submitted the following suggestion to the IRS.

Proposed Change to Publication 590. The IRS has an excellent discussion of qualified HSA funding distributions on page 6 of Publication 969, HSAs and Other Tax-Favored Health Plans.

This same discussion should be added to Publication 590, IRAs.

Both IRAs and HSAs are involved in a qualified HSA funding distribution. An explanation of a qualified HSA funding distribution needs to be in Publication 590 (IRAs) as well as Publication 969, if not more, so, since the transaction is started by making a direct rollover distribution from the IRA.

IRA accountholders should be put on notice that IRA funds may be moved once on a tax-free basis to an HSA. If one was skeptical, one might think the IRS wishes to limit these distributions since no taxes are owed on such distributions. The IRS certainly reduces these distributions by not discussing such distributions in the IRA publication. ◆

Another Reminder – Nonspouse Beneficiaries are Ineligible to Rollover Inherited IRA Funds

This question/situation keeps arising at financial institutions serving as IRA custodians or trustees. The situation – a nonspouse beneficiary is paid funds from an inherited IRA. The tax law is clear – a nonspouse beneficiary is ineligible to rollover a distribution from a decedent's IRA (i.e. an inherited IRA) to another inherited IRA or to his or her own personal IRA. Transferring an inherited is permissible as long as the proper paperwork has been done. We at CWF are unaware of any tax laws allowing this situation to be corrected. It doesn't matter if the IRA custodian makes a mistake and makes a payment the nonspouse beneficiary never wanted. It doesn't matter if the nonspouse beneficiary assumes he or she can rollover this distribution because he or she has done many rollovers in the past. It doesn't matter if the nonspouse beneficiary or the other IRA custodian doesn't understand the difference between a rollover and a transfer. Many of us think, if a person or an IRA custodian makes a mistake, one must be able to correct it without adverse tax consequences. This is not the rule applying to making a distribution to a nonspouse beneficiary. Once made it is made unless the parties wish to participate in a tax fraud. A bad tax situation can be made much worse. It may be that the tax laws should be changed to allow for a method of correcting these mistakes. Currently, the law does not authorize a correction (i.e. undoing the distribution). Set forth below is a recent memorandum discussing this topic with an IRA custodian/trustee.

Subject: Request by Former IRA Beneficiary/ Customer To Change Certain IRS Reporting Forms

An IRA custodian may revise an IRS reporting form only if there is a tax authority for doing so. In the situation discussed below, you should not revise the IRS reporting forms.

You called yesterday to discuss an inherited IRA situation. A husband and wife had each inherited IRA funds from the husband's father. Annual RMD distributions had been taken for a number of years. The husband had notified the bank that when the time deposits matured

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that he and his wife wished to move their IRA funds. When that time came, the bank issued a check to him as the payee and it issued a check to her in her name as the beneficiary of the decedent. The bank generated two Form 1099-R's to report these two distributions of approximately $50,000 for a total of $100,000. They have a tax extension for their 2010 return. A new IRA custodian (a brokerage firm) was willing to accept these inherited IRA funds. Someone has estimated this couple will need to pay approximately $28,000 in federal income taxes because of these two distributions. A representative of the new IRA custodian has suggested that that the first IRA custodian "correct" the 1099-R to show that the inherited IRA funds were transferred and not distributed/rolled over.

The IRA custodian, the two individuals, and the new IRA custodian are in an undesirable situation.

A cardinal IRA rule is that a nonspouse beneficiary is ineligible to rollover a distribution from an inherited IRA. The facts clearly show there were two distributions as the payees on the checks were the two individuals. The new IRA custodian was not the payee on the two checks as is required to have a transfer. No transfer form was completed by the new IRA custodian for the first IRA custodian.

There is no legal authority allowing an IRA custodian, the individuals, or the IRS to correct the mistake. The mistake in this situation is the actual distribution. Once an IRA distribution is made to a nonspouse beneficiary, it must be included in the income of the recipient unless it would be basis (i.e. nontaxable for some reason).

It makes no difference from a tax viewpoint if the unrequested/mistaken distribution occurs because of the individual or the IRA custodian.

An IRA custodian should understand that if its personnel makes the unrequested distribution, then it can expect the individual will ask the IRA custodian to bear some or all of the taxes which must be paid due to the unrequested distribution.

It may be that the tax laws need to be changed to allow for some corrective action to be taken by the IRA custodian. For example, the IRA custodian would pay a monetary penalty based on the size of the distribution. Presently there is no law allowing for the correction of an unwanted distribution. Once a distribution is made it must be included in the income of the recipient. The law simply does not authorize a rollover of inherited IRA funds by a nonspouse beneficiary.

It is the individual/beneficiary who is primarily responsible to comply with the laws and rules for an inherited IRA. The IRS has stated that the IRA custodian is not required to furnish a beneficiary with an an RMD notice as must done for accountholder age 70½ and older. Presumably, if the individuals had known that they were ineligible to rollover inherited IRA funds, they would not have done so.

The fact is, he expressly asked that he and his wife be sent their inherited IRA funds. Although he may try to argue that since he had used the term, "rollover", that the first IRA custodian had a duty to inform him that such rollovers were impermissible for him and his wife since they were nonspouse beneficiaries. An IRA custodian does not have this duty. Although an IRA custodian is to provide general IRA/tax information via the IRA Disclosure Statement, it is not to provide tax advice.

A bad situation can be made worse. This is true for the first IRA custodian, the two individuals and the new IRA custodian. Your institution might incur severe problems with the IRS and bank regulators by agreeing to change the two 2010 Form 1099-R's to show that the two distributions never occurred. That is, the funds were transferred rather than distributed/rolled over. It would be tax fraud to revise the 1099-R forms without a valid reason for doing so.

The new IRA custodian should have known that it was not authorized to accept the two rollover contributions of approximately $50,000. These are now excess IRA contributions. The two individuals will owe $6,000 ($50,000 x 2 x 6%) each year these excess contributions stay in the IRA. A 6% excise tax applies on an annual basis to an excess contribution. There is no statute of limitations. For example, if they left the two excess contributions in for five years, they would owe approximately $6,000 x 5 or $30,000 of excess contribution taxes. These two individuals do not want to leave these two excess contributions in the IRA. They want to withdraw them.

This additional tax of $6,000 (per year) will be avoided by the two individuals if they withdraw their funds

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2009 IRS Form 8955-SSA, Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits. Use for 2009 and 2010.

On June 18, 2011 the IRS posted the 2009 version of Form 8955- SSA. Admittedly, the IRS was late. This form is a new form and it is the successor to Schedule SSA (Form 5500) which no longer exists. It is used to satisfy the reporting requirements of Code section 6057(a) for plan years beginning after December 31,2008.

Since the 2009 form is just now being made available, there is a special filing due date for 2009 and 2010 plan year filings. The special due date is the later of: (1) January 12, 2012 or the due date that generally applies for the filing of Form 8955-SSA for the 2010 plan year. The general filing deadline is the last day of the 7th month following the last day of the plan year.

Form 8955-SSA is now a stand-alone form. It will be filed separately. It is not to be filed with Form 5500, Annual Return/Report of Employee Benefit Plan, or Form 5500-SF, Short Form Annual Return/Report of Small Employee Benefit Plan.

The 2009 version of Form 8955-SSA is to be used for 2009 reporting and/or for 2010 reporting. It is possible to combine the information for 2009 and 2010 plan years on a single 2009 Form 8955-SSA.

A plan administrator must file Form 8955-SSA if the plan is subject to the vesting rules of ERISA. In general, a participant must be reported on Form 8955-SSA if: (1) the participant separates from service, and (2) the participant is entitled to a deferred vested benefit under the plan. That is, he or she is not paid his or her total vested account balance. This form must be filed on the Form 8955-SSA for the plan year following the year he or she separated from service. It may be filed for the year of separation.

A participant need not be reported on Form 8955-SSA if he or she is paid the total vested account balance, if he or she returns to service under the plan, or forfeits all of his or her deferred vested retirement benefit.

A plan administrator must report participants who have a deferred vested benefit under the plan who:

1. separated from service covered by the plan;
2. were reported as deferred vested participants on another plan's filing if their benefits were transferred (other than in a rollover) to the plan during the covered period;
3. previously were reported under the plan but have been paid out or are no longer entitled to those deferred vested benefits; or
4. previously were reported under the plan but whose information is being corrected.

Penalties will be assessed if a required return is not timely filed or filed incorrectly.

The completed 2009 Form 8955-SSA is to be sent to:

Department of the Treasury, Internal Revenue Service Center, Ogden UT 84201-0024.

A filer may use the Filing Information Returns Electronically (FIRE) system as an optional filing alternative to filing the Form 8955-SSA on paper. A filer is unable to use the EFAST2 system to file Form 8955-SSA.

The Social Security Administration (SSA) is provided the information on the Form 8955-SSA by the IRS. The SSA provides this information to a person when he or she files for social security benefits.

Warning. The January 17, 2012 due date for 2009 and 2010 filings cannot be further extended by filing Form 5558. If an employer has a calendar year plan year, the 2011 Form 8955-SSA will be due July 31, 2012. The IRS website is www.irs.gov. ◆

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from the new IRA custodian on or before October 18, 2011 (normally the 15th) and the 6% excise tax will not be owed for 2010 or any subsequent year. The tax rules require them to withdraw the related income, if any, from the new IRAs. This income is to be reported on the tax return of the year the excess contribution was made. This is the 2010 return. The broker should help with the determination of this income or loss.

CWF puts express language on its distribution forms stating the rule that a nonspouse is ineligible to rollover a distribution he or she has received. We have never understood why the distribution forms of other IRA vendors do not state that a nonspouse beneficiary is ineligible to rollover a distribution from an inherited IRA. ◆