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The Pension Digest

ALSO IN THIS ISSUE –

No Tax Legislation Yet to Extend QCDs for 2012

The federal income tax laws presently do not authorize a person to make a qualified charitable distribution (QCD) for 2012. The authority to make a QCD ended December 31, 2011.

Only time will tell whether or not there will be a tax bill enacted into law allowing a person to make a QCD for 2012 and later years.

The extension of this special tax law is not guaranteed. The charitable industry has a powerful lobby in Washington, D.C., and they will be arguing the QCD rules should be extended or made permanent.

However, the QCD rules result in less tax revenues being paid to the U.S. Treasury. Individuals have been allowed to give $100,000 of taxable funds to certain charities on a tax-free basis. Additional discussion is set forth on page 8. ◆

Holiday Hours

CWF's office will close at 11:30 a.m. on Monday, December 24, 2012 and will be closed Tuesday, December 25 for Christmas.

On New Year's Day (Tuesday, January 1) we will also be closed.

We wish everyone a wonderful holiday season.

DOL Seeking More Power Over IRAs

The Department of Labor (DOL) exercises great regulatory power over 401(k) plans and other private employer pension plans. It is no secret that the DOL wants more power over the administration of IRAs. Why? There is a lot of money in IRAs as there is a lot of money in pension plans. 2.6 trillion of assets is held by 48,000 private employer defined benefit pension plans. 3.9 trillion of assets is held by 670,000 private-employer 401(k) plans and other defined contribution plans. And 4.7-5.0 trillion of assets is held by IRAs. Much of the balances in IRAs is due to rollovers from 401(k) plans and other pension plans.

The DOL expresses the concern that the people advising IRA owners about investments are not as professional as the people who in the past have invested the plan assets of the defined benefit plans. The DOL does not believe that the majority of individuals are better-off when they invest their own account balances. And the DOL believes that IRA investment advisers need to be held to higher standards than the current law requires.

How does the DOL/EBSA plan to gain more authority over IRAs? Phyllis Borzi, Assistant Secretary for the Employee Benefits Security Administration at the DOL has stated that the EBSA will be proposing within the next 3-6 months a revised definition of who is a fiduciary for pension and IRA purposes. The DOL wants to impose more formal accountability standards on IRA investment advisers. ◆

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

9898 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution $ 2a Taxable amount $	OMB No. 1545-0119 2012 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2b Taxable amount not determined ☐	Total distribution ☐	Copy A For Internal Revenue Service Center File with Form 1096.
PAYER'S federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	
RECIPIENT'S name		5 Employee contributions /Designated Roth contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	For Privacy Act and Paperwork Reduction Act Notice, see the 2012 General Instructions for Certain Information Returns.
Street address (including apt. no.)		7 Distribution code(s) IRA/ SEP/ SIMPLE ☐	8 Other $ %	
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions $	
10 Amount allocable to IRR within 5 years $	11 1st year of desig. Roth contrib.	12 State tax withheld $ $	13 State/Payer's state no.	14 State distribution $ $
Account number (see instructions)		15 Local tax withheld $ $	16 Name of locality	17 Local distribution $ $

Form 1099-R Cat. No. 14436Q www.irs.gov/form1099r Department of the Treasury - Internal Revenue Service

Important Form 1099-R Rules for an IRA Custodian to Follow and Observations

Set forth are the rules we think are most important for an IRA custodian to follow in preparing the 2012 Form 1099-R.

#1. An IRA includes all investments under one IRA plan agreement. File only one Form 1099-R no matter how many distributions have been made from the investments of the same IRA plan agreement during one year unless different reasons codes apply. Example, Jane Doe is paid a death distribution (reason code #4) from her former spouse's IRA (she did not treat this IRA as her own) and she is also paid a distribution from her only IRA. She is age 65 (reason code #7). One Form 1099-R must be filed for all distributions with a reason code 4 and a Form 1099-R must be filed for all distributions with a reason code 7.

#2. The Form 1099-R and the Form 5498 are per plan agreement forms. If a person, age 65, has two traditional IRA plan agreements and takes a distribution from each IRA, he or she must be furnished two 1099- R forms each having a reason code 7 in box 7. The IRA custodian could be fined $100.00 if it only created one Form-1099-R. The IRA custodian must file Form 1099-R using the same name and EIN/TIN used to deposit any tax withheld and to file Form 945, Annual Return of Withheld Federal income Tax).

#3. The IRS wants an IRA custodian to prepare a Form 1099-R for every distribution, even those less than $10.00. The instructions are not very clear whether distributions (aggregated) less than $10 for the year must be reported.

#4. If an IRA custodian is required to file a Form 1099-R, then it must furnish a statement (i.e. a copy of the 1099-R form) to the recipient.

#5. An account number must be used on a Form 1099-R when a recipient has more than one IRA plan agreement and you are required to file multiple Form 1099-R's. However, the IRS encourages an IRA custodian to designate an account number for all Form 1099-Rs which it files.

#6.Never enter a negative amount in any box on Form 1099-R.

Continued on page 3

The Pension Digest

Form 1099-R Rules,
Continued from page 2

#7. Use the name and TIN of the individual or entity which receives-funds from the IRA. Normally, this will be the IRA accountholder. However, if you make a distribution to a beneficiary (whether an individual, trust or estate), then the 1099-R is prepared using the name and TIN of the beneficiary. You do not use the name of the decedent for payments made to beneficiaries after his or her death.

#8. An IRA custodian has a duty to correct a Form 1099-R that it knows was prepared incorrectly. The correction must be made as soon as possible.

#9. For a distribution from a traditional IRA boxes 1 and 2a are to be completed with the same amount unless an exception applies.

#10. For a distribution from a Roth IRA, box 2a is to be left blank unless an exception applies.

#11. An IRA custodian will generally check box 2b, taxable amount not determined. There will be times when it is not checked - withdrawal of an excess or current year contribution before the due date, a recharacterization and rolling funds from an IRA into an accepting employer plan.

#12. The total distribution box is also found in 2b. An "X" is to be entered in this box when the amount shown in box 1 is a total distribution. The instructions for the total distribution section of box 2b are not as clear as they should be. It is doubtful if this box applies to IRA distributions; but the instructions are unclear, and an IRA custodian should complete the box pursuant to the instructions. In order for a person to use the favorable 10 year averaging or capital gain treatment he or she must receive a total distribution. Such treatment does not ever apply to any type of IRA distribution. If this box is not checked, the IRS will question any individual's attempt to use 10 year averaging. A total distribution is one or more distributions within one tax year in which the entire balance is distributed. This means if two or more nonperiodic distributions occur in more than one year, then there is no total distribution and the box does not need to be checked. For example, a person with an IRA balance of $30,000 withdraws $10,000 in 2008 and the remainder in 2012 has not had a total distribution. Exception. If periodic or installment payments are made in more than one year, this box is to be marked for the year in which the final payment is made.

#13 For a distribution of contributions plus earnings rom an IRA under **section 408(d)(4)**, report the gross distribution in box 1, only the earnings in box 2a, and enter Code 8 or P, whichever is applicable, in box 7. Enter Code 1, 2, 4 or 7, if applicable.

#14. For a distribution of contributions without earnings <u>after</u> the due date of the individual return, under section **408(d)(5)**, leave box 2a blank, and check the "Taxable amount not determined" checkbox in 2b. Use Code 1 or 7 in box 7 depending on the age of the accountholder.

#15. For a distribution from an IRA that is payable to the trustee of, or is transferred to, an employer plan, or for an IRA recharacterization, enter 0 (zero) in box 2a.

#16. In box 7 indicate the distribution code and enter an "X" in the **IRA/SEP/SIMPLE checkbox** if the distribution is from a traditional IRA, SEP IRA, or SIMPLE IRA. Do <u>NOT</u> check the box for a distributing from a Roth IRA or for an IRA recharacterization.

#17. **Roth IRAs.** For a distribution from a Roth IRA, report the total distribution in box 1 and leave box 2a blank except in the case of an IRA revocation or account closure and a recharacterization. Use Code J, Q, or T as appropriate in box 7. Use Code 8 or P, if applicable, in box 7 with Code J. Do not combine Code Q or T with any other codes.

However, for the distribution of excess Roth IRA contributions, report the gross distribution in box 1 and only the earnings in box 2a. Enter Code J and Code 8 or P in box 7. ◆

Use of Single Life Table to Calculate RMD of IRA Accountholders is Wrong and Causes Severe Problems

The IRS rewrote the RMD regulation in 2001 and 2002. It was adopted by the IRS in May of 2002. The regulation requires separate RMD calculations for IRA accountholders versus inheriting IRA beneficiaries.

Prior to 2002, an IRA accountholders RMD, in some situations, had to be determined by using his or her single life expectancy. This was the case if the individual had designated his or her estate as the designated beneficiary. And prior to 2002, many times there was not a clear distinction between calculating the RMD and calculating the amount a person would withdraw each year.

A person has always been able to take a distribution larger than his or her RMD for the year. Calculating the RMD amount and calculating a person's annual distribution are two different calculations when the person is going to withdraw more than the minimum required amount.

Under the final RMD regulation now in effect, an IRA custodian/trustee has the duty to prepare an RMD notice for an individual each year, including calculating the RMD amount, if the individual attains age 70$^1/_2$ or older that year. The formula or equation used to calculate a living person's RMD under the Final regulation has always required the divisor to come from either the Uniform Lifetime Table or the Joint Life Expectancy Table; it never comes from the Single Life Table. The Single Life Table is the only table used to determine the divisor for the RMD for an inheriting beneficiary.

It appears that some IRA RMD software, at least as furnished by a major main frame core vendor, has been written so if the RMD calculation being made prior to 2002 was calculated using the single life expectancy divisor that using this single life expectancy divisor for 2002 and subsequent years as reduced by one each year is permissible.

It is WRONG to calculate the RMD for a living accountholder using the single life expectancy factor. Using the Single Life Table, means the individual is being told that he or she must take a much larger RMD than is actually the case. See the two RMD distribution charts on the adjacent page. Using the Single Life Table means the IRA accountholder will be told he or she needs to take out, in general, twice as much as he or she is required. Consequently, the individual pays more federal income taxes than required and the individual sees his or her IRA have a much smaller balance than would have been required.

Illustration. John Doe was born on November 6, 1930. He attained age 70$^1/_2$ on May 6, 2001 and age 71 on November 6, 2001. His estate was his beneficiary. Under the "old" RMD rules, the Single Life Expectancy Table was used and his divisor for 2001 was 15.3. Then the reduce by one method was used to calculate the divisor for subsequent years. The adjacent charts show the severity of the error(s) if an IRA custodian's software has continued to use this "old" single formula for 2002-2012.

If John was told that his required distribution for 2002 was $4,755 when it was only $2,566, his required distribution for 2003 was $4,960 when it was only $2,662, etc. serious errors have occurred. By the end of 2012 John will have withdrawn $31,300 more than required.

The IRS could assess a fine of $50 for each RMD notice prepared in error. Some individuals may be sufficiently perturbed that they may try to seek monetary damages from the IRA custodian/trustee.

In summary, a financial institution wants to make sure it is not currently using the Single Life Table in its RMD calculation for any of its IRA accountholders age 70$^1/_2$ and older. Be sure to look at your RMD calculations for your IRA accountholders age 80 or older. A financial institution wants to stop using the Single Life Table immediately if it is being used to calculate the RMD for an IRA accountholder. The Single Life Table is to be used only if an RMD is being calculated for an inheriting beneficiary. ◆

The Pension Digest

RMD Calculation Is Incorrect if Single Life Table Used

	Beginning Balance	Divisor	RMD*	Interest Earned	Ending Balance
2001	--	15.3	--	--	--
2002	$68,000	14.3	$4,755	$2,720	$65,965
2003	$65,965	13.3	$4,960	$2,638	$63,643
2004	$63,643	12.3	$5,174	$2,545	$61,014
2005	$61,014	11.3	$5,399	$2,440	$58,055
2006	$58,055	10.3	$5,636	$2,322	$54,741
2007	$54,741	9.3	$5,886	$2,190	$51,045
2008	$51,045	8.3	$6,150	$2,041	$46,936
2009	$46,936	7.3	$6,430	$1,877	$42,383
2010	$42,383	6.3	$6,728	$ 635	$36,290
2011	$36,290	5.3	$6,847	$ 544	$29,987
2012	$29,987	4.3	$6,974	$ 449	$23,462

Total of Incorrect RMD Distributions $64,939

RMD Distributions RMD Calculation Is Correct If Uniform Lifetime Table Used

	Beginning Balance	Divisor	RMD*	Interest Earned	Ending Balance
2001	--	27.4	--	--	--
2002	$68,000	26.5	$2,566	$2,720	$68,154
2003	$68,154	25.6	$2,662	$2,726	$68,218
2004	$68,212	24.7	$2,762	$2,729	$68,185
2005	$68,185	23.8	$2,865	$2,727	$68,047
2006	$68,047	22.9	$2,971	$2,722	$67,798
2007	$67,798	22.0	$3,082	$2,712	$67,428
2008	$67,428	21.2	$3,180	$2,697	$66,945
2009	$66,945	20.3	$3,298	$2,678	$66,325
2010	$66,325	19.5	$3,401	$ 996	$63,919
2011	$63,919	18.7	$3,418	$ 959	$61,460
2012	$61,460	17.9	$3,434	$ 922	$58,948

Total of Correct RMDs $33,639

Excess of Incorrect RMD Distributions $31,300

A Parent's HSA Can't be Transferred to Become a Child's HSA

As with an IRA, there will be times when a married individual who is going through a divorce is ordered by a state court to transfer his or her HSA to the HSA of the former spouse. And sometimes a state court may try to do something different, such as transfer the HSA from a parent to an HSA for a child.

CWF recently furnished the letter set forth below. A bank serving as a HSA custodian had been furnished a copy of a court order where the judge had ordered that funds be transferred from the husband's HSA to a new HSA to be set up for two children.

Set forth below is a letter we furnished an HSA custodian. The intent was, this letter could be furnished to the HSA owner, the two attorneys, and the court, if necessary.

Dear XXX:

You called earlier this week to discuss a court order transferring funds from a parent's HSA to a child's HSA. Today, you sent me the HSA portion of the court order.

A state court does not have the authority to change federal income tax law.

I have reviewed the court order. Until the Court or the attorneys furnish tax authority supporting the position that moving a parent's HSA funds to a child's HSA is a non-taxable event and non-reportable event, the IRS reporting rules require the Bank to report the distribution on Form 1099-SA.

One of the duties imposed by the IRS on the Bank and every other HSA custodian is that it must report on the Form 1099-SA the funds which are withdrawn from an HSA. Moving funds from a parent's HSA to a child's HSA is a reportable distribution. There is federal tax law authorizing HSA funds be transferred on a tax-free basis from a spouse to the other spouse pursuant to a divorce decree, but there is no federal tax law authorizing such a transfer on behalf of a child. There is also no law authorizing a rollover of a distribution from a parent's HSA into a child's HSA, even if the child was eligible for his or her own HSA. In fact, federal tax expressly provides that a "minor" child is ineligible to establish an HSA. See the summary from IRS Publication 969. Most children are dependents and are ineligible to be an HSA owner,

Consequently, the Bank is required by current IRS rules to report such a transfer as a reportable distribution on a 2012 Form 1099-SA. The parties should keep in mind that the ultimately the parent will have the responsibility to complete Form 8889 and explain whether or not a distribution is taxable or not. A distribution used for qualified medical reasons is tax-free whereas one not used to pay a qualified medical expense is taxable (includible in income) and also subject to the 20% penalty tax.

The court in its order is trying to allocate certain funds to make sure they are used to pay the medical expenses of the children. This is understandable. However, federal tax law does not permit this for two reasons. First, the HSA plan agreement must provide (because the law requires it) that the HSA owner is entitled to use these funds for any purpose he or she wishes. Secondly, the prohibited transaction rules of Internal Revenue Code section 4975 must also be considered. The imposing of any type of restriction on the use of the HSA funds most likely results in a prohibited transaction. In such case, the HSA ceases to exist as of the first day of the year and the HSA balance must be included in the individual's income and is also subject to the 20% penalty tax.

Neither the bank, an employer, a family member who has made contributions, nor a judge may change federal income tax law and impose a restriction on the HSA owner's use of the HSA funds. The definition of what is a qualified medical expense does not include moving funds into a child's HSA. The IRS in Publication 502 explains what expenses are qualified medical expenses.

In addition, such a contribution to a child's HSA will be an excess contribution subject to the 6% excise tax applying to excess HSA contributions. The only way to correct an excess HSA contribution is to withdraw the excess.

The Court and the attorneys should consider and adopt a different approach so the IRS cannot argue that the HSA funds are taxable and subject to the 20% penalty tax. Until an attorney and/or the Court provides

Continued on page 7

The Pension Digest

A Parent's HSA,
Continued from page 6

legal authority under the federal income tax laws that HSA funds may be transferred tax-free from a parent's HSA to their child's HSA, the Bank should not participate in setting up the two HSAs for the children nor the transfer distribution(s).

The attorneys and/or the Court may wish to contact the IRS to see if the IRS position is as I have stated. I think it is. You may furnish this letter to the individual(s) who can discuss it with their attorney. I am available for a conference call if the parties would wish.

In summary, there may be times when a state family law judge will try to take an action with respect to an HSA or an IRA, which if actually put into effect, will cause tax adverse federal tax consequences which the attorneys and the judge may not have been aware. ◆

Email Q & A

Q-1. I have a customer retiring early 2013 from a local Hospital and was wondering if she can roll over her Tax Sheltered Annuity, I think she said 403b to a Roth IRA.

If so, can she roll over to her existing Roth or does it need to have a new one set up?

A-1. The tax laws now allow a person with "taxable" (NonRoth) funds in a 403(b)plan or a 401(k) plan to directly roll over such funds into either a traditional IRA or a Roth IRA or a combination of both.

If she moves such funds into a Roth IRA she will need to include this amount in her income for 2013.

The law permits her to add these rollover funds to an existing Roth IRA. Most of the time an individual would decide to only maintain one Roth IRA, but there may be situations where a person would want to maintain two separate Roth IRAs. There is no one right answer.

Q-2. We have a customer that passed away, she was over 70$^1/_2$ and had taken her distribution for the year. Her surviving spouse was the primary beneficiary of her IRA. We transferred the funds from her IRA to a beneficiary IRA for her husband. He is coming in and wanting to take the whole amount in the beneficiary IRA. Do we need to transfer the funds to his own IRA (treat as his own) then do the distribution or can we process the distribution from his inherited IRA? Would it need to be coded as a normal distribution or a death distribution?

A-2. If the funds are presently in an inherited IRA, he may withdraw the funds from that inherited IRA. The reason code which applies is the reason code 4 (death). There is no need that it be transferred into his own IRA and then distributed to him.

Q-3. Can you please tell me if it is Ok for reporting purposes to do a Roth Rollover (regular Roth funds, not meant for conversion) into a Roth Conversion Plan? Or do we need to open a complete separate plan or change the Conversion Plan to a Roth? No additional conversion reporting needs to be done for 2012 tax reporting.

A-3. You have asked a Roth IRA rollover question. My answer, "yes", a person may withdraw funds from a "regular" Roth IRA and then use such funds to make a rollover contribution into a Roth conversion IRA. From a tax viewpoint, it generally is not necessary to set up separate Roth IRAs or traditional IRAs to accept different types of contributions. There may be times from a planning standpoint where it will help someone if the person has two Roth IRAs rather than just one. This can be true if a person converts such assets as stocks, bond, real estate, etc. because if one recharacterizes his or her conversion it can be easier to do so if the conversion amount has not been combined into a Roth IRA holding other types of contributions. If many years have passed since the conversion, there is no reason to not make a rollover into this Roth IRA.

A traditional IRA may accept annual contributions, rollover contributions, recharacterizations, transfer and SEP contributions.

A Roth IRA may accept annual contributions, rollover contributions, recharacterizations and conversion contributions.

Sometimes an IRA is given the name describing the type of contribution which was made to open the IRA. This is certainly permissible, but it is also unnecessary as an IRA is written to be able to accept many types of contribution the same year.

Continued on page 8

Email Q&A,
Continued from page 7

IRS Reporting Purposes. IRS form 5498 is the form which reports IRA contribution and fair market value information. Since 2003, Box 7 has listed four types of IRAs - traditional IRA. SEP IRA, SIMPLE IRA and Roth IRA. In 1998 the IRS designed the 1998 Form 5498 to list six types of IRAs. the same four as in 2003, but also an Education IRA and a Roth conversion IRA. However, starting with the 1999 Form 5498 the IRS no longer listed a Roth Conversion as a separate type of IRA.

The IRS had a good reason for no longer listing a Roth conversion IRA separately from a Roth IRA. Remember that 1998 was the first year a person could make a Roth IRA contribution- whether an annual contribution or a conversion contribution. The law in 1998 provided that a conversion contribution had to meet its own 5-year period requirement separate from the 5-year requirement for an annual contribution. For this reason, the IRS strongly recommended that a person should set up a separate conversion Roth IRA. In 1999 the law was changed so that a person only had to meet one 5-year requirement regardless of the type of contribution. Once this change was made, there was less reason to not make annual and conversion contributions into the same Roth IRA. The Roth IRA software written to perform 1998 Form 5498 reporting tasks had to have a Roth conversion IRA as a separate Roth IRA type from a regular Roth IRA. Therefore, many conversion Roth IRAs were established on computer systems in 1998. Once titled as a conversion Roth they are probably still titled this way. It is permissible to no longer call them a conversion Roth IRA, but it also it not really necessary to change the titling.

In summary, funds may be withdrawn from a Roth IRA originally created because annual contributions were made and then these funds may comprise a rollover contribution to a Roth IRA originally established as a Roth conversion IRA. ◆

What to Do – A Person Wants to Make a Charitable IRA Distribution in 2012

Right now a distribution cannot qualify as a charitable IRA distribution. IRA accountholders should be informed of this fact. Up until the laws authorizing a charitable IRA distribution expired on 12/31/11, a person age $70^1/_2$ or older was able to direct his or her IRA custodian to withdraw an amount of up to $100,000 from his or her IRA and have such proceeds sent directly to a qualifying charitable organization. The distribution was tax free if certain rules were met.

What made this so attractive?

The majority of tax filers over age $70^1/_2$ use the standard deduction when filing their taxes, making them unable to claim a deduction for their charitable contributions. Individuals were allowed to withdraw funds from their IRA and contribute them to the eligible charity of their choice. <u>These contributions were then excluded from their income.</u> This exclusion, in effect, was the equivalent of claiming a tax deduction. Needless to say, this provision was also a great benefit for many charities. Since the maximum contribution/ deduction amount was $100,000, this benefit was substantial. <u>These contributions were also considered part of the taxpayer's required minimum distribution for the year — another benefit.</u>

What's the outlook for 2012?

It is very uncertain that there will be new legislation authorizing charitable IRA distributions for 2012. Tax revenues are needed and this provision reduces revenues. The most conservative approach is for a person to wait until a new tax law is enacted authorizing such distributions again. For those individuals over age $70^1/_2$ and who are willing to assume the risk of a new law being enacted, they could instruct their IRA custodian to send their distribution amount directly to a qualifying charitable organization. The payee of the check must be the charitable organization. If the law would be enacted on a retroactive basis (i.e. for tax year 2012), then it would qualify as a qualified charitable IRA distribution. These individuals must act on the advice of their tax advisers. ◆