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ALSO IN THIS ISSUE –

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

Seeking IRA Contributions by April 15, 2013

U.S.taxpayers are not taking advantage of IRAs as one would expect and hope. Many younger individuals have not grown up with IRAs being common. Many individuals do not understand that a person is able to contribute to both a traditional IRA and the 401(k) plan at work.

The IRS has recently released their preliminary tax data for tax year 2011. April 15th and the end of the 2012 tax year is close at hand. This is the deadline for contributions to a traditional IRA and a Roth IRA. The deadline for SEP-IRAs and SIMPLE-IRAs may be extended if a tax extension is in effect.

Here is some basic 2011 tax, IRA and pension information. This article does not discuss Roth IRA contributions since an individual does not inform the IRS on the Form 1040 or Form 1040A whether or not he or she made a Roth IRA contribution. Contributions to traditional IRAs, SEP-IRAs and SIMPLE-IRAs are covered. Other IRS statistics indicate that individuals are contributing larger amounts to Roth IRAs and SEP-IRAs versus traditional IRAs.

1. There were 145.6 million federal income tax returns filed for 2011 with the filing statuses being: 65.5 million filing single, 55.3 million for married filing joint, 21.9 million filing as head-of-household, and 2.9 million for married filing separately.
2. 2.62 million returns show a tax deduction was claimed for a traditional IRA contribution. This is less than 2% of all returns. The average contribution amount was $4,298.
3. .87 million returns show a tax deduction was claimed for a SEP/SIMPLE/ Keogh contribution. This is less 6/10ths of 1%. The average contribution amount was $20,230. There should be special marketing efforts to customers who are self-employed or own small corporations.
4. 13.09 million returns show "taxable " IRA distributions in 2011 in the amount of 216.3 billion dollars. The average IRA distribution was $16,511. Taxable IRA distributions in 2010 192.6 billion.
5. 27.00 million returns show "taxable " pension distributions in 2011 in the amount of 590.38 billion dollars. The average pension distribution was $21,865. Taxable pension distributions in 2010 were 567.8 billion.

During the next 30-60 days a financial institution should be seeking IRA/SEP/ SIMPLE-IRA contributions. One would expect the 2013 contribution amounts will be slightly larger than for 2011 and 2012 as the maximum contribution amount has increased to $5,500/$6,500 from $5,000/ $6,0000 for traditional and Roth IRAs. The maximum SEP contribution for 2012 is $50,000 and $51,000 for 2013.

Deadlines for 2012 5498 Forms

Type of Account	Type of Form	Due to Owner	Due to IRS
Traditional	5498	5/31/13	5/31/13
Roth	5498	5/31/13	5/31/13
HSA	5498-SA	5/31/13	5/31/13
CESA	5498-ESA	4/30/13	5/31/13

Roth IRA Conversions in 2012

As the economy improves and as more individuals come to believe that federal income tax rates will be increased, more individuals will decide to make Roth IRA conversions. Roth IRA conversions are generally taxable in the year the conversion occurs. A person doing a conversion in 2012 will include the converted amount in their 2012 income and pay tax on it at his or her then applicable marginal tax rate. A person who did a Roth IRA conversion during 2012 must report this transaction by completing Part I1 of the 2012 Form 8606. ◆

Reminder of 2010 Roth IRA Conversions

Individuals were given the special right to report half of their 2010 conversion on their 2011 tax return and the remaining half on their 2012 tax return. The IRS has issued an announcement reminding these individuals to not forget to report the second half of their 2010 conversions on their 2012 return.

If an individual is filing Form 1040, he or she is to report such amount on line 15b. If an individual is filing Form 1040A, then this amount is to be reported on Line 12b.

If an individual did a conversion from a 401(k) plan to a Roth IRA and file Form 1040, then the taxable amount is reported on line 16b. This is also what is to be done if the conversion was done within the 401(k) plan.

If an individual did a conversion from a 401(k) plan to a Roth IRA and file Form 1040A, then the taxable amount is reported on line 12b. This is also what is to be done if the conversion was done within the 401(k) plan.

Financial institutions can expect the number of conversions to increase. It is only a matter of time before more individuals realize it is in their best interest to do so. Income limits restricting eligibility to make a conversion contribution were repealed effective for 2010 and subsequent years. ◆

Rollover
Tax Lesson Learned the Hard Way

For the reasons discuss below, a person must decide if he or she is making a rollover contribution. The tax rules do not allow a person to change his or her mind.

Background. John Doe has come into his financial institution with a request, He made an annual contribution of $3,200 on September 20, 2012. His tax advisor has told him to see if the IRA custodian will change the contribution type to be a rollover contribution rather than an annual contribution. Roberta, the IRA representative, has told him that the financial institution will not be changing its IRS reporting for the reasons discussed below. Roberta seeks confirmation from CWF that her approach was the correct approach.

Additional Factual Background. John Doe separated from service with ABC Employer on September 20, 2012. His vested account balance within his 401(k) account was $4,000. Because he did not instruct to directly rollover this $4,000 to his traditional IRA, the 401(k) plan administrator withheld 20% ($800) and gave him a check for the remaining $3,200. On September 28, 2012, he came into the IRA custodian and wanted to deposit this check into a traditional IRA. The

Form 8606 (2012) Page **2**

Part II **2012 Conversions From Traditional, SEP, or SIMPLE IRAs to Roth IRAs**

Complete this part if you converted part or all of your traditional, SEP, and SIMPLE IRAs to a Roth IRA in 2012 (excluding any portion you recharacterized).

16	If you completed Part I, enter the amount from line 8. Otherwise, enter the net amount you converted from traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2012. **Do not** include amounts you later recharacterized back to traditional, SEP, or SIMPLE IRAs in 2012 or 2013 (see instructions)	16	
17	If you completed Part I, enter the amount from line 11. Otherwise, enter your basis in the amount on line 16 (see instructions)	17	
18	**Taxable amount.** Subtract line 17 from line 16. Also include this amount on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b	18	

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Tax Lesson,
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customer service representative asked him if his deposit of $3,200 was to be an annual contribution or a rollover question. He responded (and completed the contribution form to show that the $3,200 contribution was to be an annual contribution.

CWF Analysis.

The law is clear that in order to make a rollover contribution, an individual who has received a pension distribution must elect at the time the contribution is made, to treat the contribution as a rollover contribution. He did <u>not</u> do this. He instructed to have it treated as a regular, non-rollover contribution.

The regulation is also clear that once the decision is made to make a rollover contribution, that such rollover contribution is irrevocable and cannot later be undone by changing it to be regular contribution.

See question and answer 13 of Regulation 1.402(c)(2).

One must remember the general IRA/pension rule– there must be authority supporting an action to be taken either by the individual or the IRA custodian. The tax law expressly allows a person to recharacterize certain type of IRB contributions. There is no express law allowing a person to change a regular contribution into a rollover contribution after the fact.

Unless his accountant would furnish clear written authority for this change, the bank should not change its reporting for this transaction.

Question and Answer 13 from Regulation 1.402(c)(2)

Q–13: Must an employee's (or spousal distributee's) election to treat a contribution of an eligible rollover distribution to an individual retirement plan as a rollover contribution be irrevocable?

A–13: (a) In general. Yes. In order for a contribution of an eligible rollover distribution to an individual retirement plan to constitute a rollover and, thus, to qualify for current exclusion from gross income, <u>a distributee must elect, at the time the contribution is made, to treat the contribution as a rollover contribution.</u> An election is made by designating to the trustee, issuer, or custodian of the eligible retirement plan that the contribution is a rollover contribution. <u>This election is irrevocable.</u> Once any portion of an eligible rollover distribution has been contributed to an individual retirement plan and designated as a rollover distribution, taxation of the withdrawal of the contribution from the individual retirement plan is determined under section 408(d) rather than under section 402 or 403. Therefore, the eligible rollover distribution is not eligible for capital gains treatment, five-year or ten-year averaging, or the exclusion from gross income for net unrealized appreciation on employer stock.

(b) Direct rollover. If an eligible rollover distribution is paid to an individual retirement plan in a direct rollover at the election of the distributee, the distributee is deemed to have irrevocably designated that the direct rollover is a rollover contribution. ◆

May a rollover contribution be made to a Coverdell ESA?

Yes. A distribution from a Coverdell ESA is not taxed if it is rolled over to the same or another Coverdell ESA as long as it is for the same designated beneficiary or a member of his or her family who is under age 30.

Note – neither the age restriction or the family member restriction applies if the new designated beneficiary is a special needs individual.

The rollover must be completed within 60 days after the date of the distribution. Day one of the 60 day period is the day after the date of the distribution.

IRS instructions indicate that the designated beneficiary is NOT to report the rollover on his or her federal income tax return (Form 1040 or Form 1040NR) since such a rollover is not a taxable distribution. This IRS guidance is different than that given when one makes an IRA rollover contribution. ◆

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Rollovers and Transfers Involving SIMPLE-IRAs

The tax law imposes a 25% penalty on a person who is under age 59½ and takes a distribution from his or her SIMPLE-IRA before a special 2-year time period has expired. This 2-year period commences on the date the employer first made a contribution into the SIMPLE-IRA. For example, ABC Employer contributes $3,000 into Jane's SIMPLE-IRA on February 20, 2013. Jane is age 31. Jane will owe the 25% penalty tax if she takes a distribution before February 20, 2015 and she does not roll over this distribution. Jane will owe a 10% penalty tax if she takes a distribution on or after January 20, 2015.

Rolling Over a Distribution from a SIMPLE-IRA

If the 2-year requirement has NOT been met, then the only rollover contribution which can be made of a SIMPLE-IRA distribution is into the same or another SIMPLE-IRA. It is impermissible for the funds to be rolled over into a traditional IRA. The three standard rollover rules must also be satisfied: the once per year rule, the 60 day rule and the no rolling over an RMD rule.

If the 2-year requirement has been met, then a rollover contribution may be made into the same SIMPLE-IRA, a different SIMPLE-IRA, a traditional IRA, or an employer sponsored plan such as a 401(k), 403(b) or a 457 plan.

Trying to Rollover a Distribution From a Traditional IRA To A SIMPLE-IRA.

The law does not allows a person to withdraw funds from their traditional IRA and make a rollover contribution to a SIMPLE-IRA. It does not matter if the 2-year requirement has been satisfied or not. It would seem that a person should be able to rollover traditional funds into a SIMPLE-IRA if the 2-year requirement has been met, but the law has not been so written.

If somehow this impermissible rollover occurred, there would be an excess contribution. The IRS does allow this erroneous contribution to be recharacterized back into the traditional IRA from the SIMPLE-IRA.

Trying to Rollover a Distribution From a QP/401(k)/403(b)/457 Plan to a SIMPLE-IRA.

The law does not allow a person to withdraw funds from their traditional IRA and make a rollover contribution to a SIMPLE-IRA. It does not matter if the 2-year requirement has been satisfied or not. The impermissible contribution would be an excess contribution. To correct, the individual would need to use the withdrawal of an excess contribution rules. Unless some special relief would be furnished by the IRS, there are no standard rules permitting the funds to recharacterized and returned to the employer plan.

SIMPLE-IRA transferred to SIMPLE-IRA.

This is always be permissible, even when the 2-year requirement has NOT been met.

SIMPLE-IRA Transferred to a Traditional IRA.

If the 2-year requirement has been met, then such a transfer is permissible.

If the 2-year requirement has NOT been met, then such a transfer is impermissible. If it occurs, there is a deemed distribution and a form 1099-R will need to be prepared and the contribution to the traditional will be a regular annual contribution. If the person is ineligible to make such contribution, then he or she would need to withdraw it using the excess contribution withdrawal procedures. The recharacterization rules cannot be used to correct for this type of error.

Trying to Transfer Traditional IRA Funds To a SIMPLE-IRA.

The tax law as written does not authorize this transaction. If it was done, there would be an excess contribution. The IRS does allow this erroneous contribution to be recharacterized back into the traditional IRA from the SIMPLE-IRA.

Conclusion.

There are some unique rules applying to transfers and rollovers involving a SIMPLE-IRA. If not followed, the individual will incur unwanted adverse tax consequences. In some cases, the recharacterization rules may be used to correct for an erroneous rollover or transfer. ◆

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Military Death Gratuities and Servicemembers' Group Life Insurance (SGLI) Payments and Coverdell ESAs

A special type of rollover contribution is authorized. If a person receives a military death gratuity or a payment from Servicemembers' Group Life Insurance (SGLI), this person may roll over all or part of the amount received to a Coverdell ESA for the benefit of the decedent's family members. Such payments are made to an eligible survivor upon the death of a member of the armed forces.

If you are the person and you are a member of the decedent's family, then you may make a rollover contribution to your Coverdell ESA or any other family member of the decedent. The maximum amount eligible to be rolled over is the total of the survivor benefits less any amounts already rolled over on your behalf of another family member's behalf to a Roth IRA or other Coverdell ESAs. The amount of survivor benefits contributed to the Coverdell ESA will be basis and will not be taxed when withdrawn.

This special rollover must be completed within one year after the date the beneficiary received the death benefit gratuity or the SGLI payment. The once per year rollover limit applying during a 12-month period does not apply to rolling over a military death gratuity or a SGLI payment.

This special rollover is not subject to the annual contribution limits applying to Coverdell ESA contributions. ◆

Military Death Gratuities and Servicemembers' Group Life Insurance (SGLI) Payments and Roth IRAs

A special type of rollover contribution is authorized. If a person receives a military death gratuity or a payment from Servicemembers' Group Life Insurance (SGLI), this person may roll over all or part of the amount received to his or her Roth IRA. Such payments are made to an eligible survivor upon the death of a member of the armed forces.

If you are the person and you are a member of the decedent's family, then you may make a rollover contribution to your Roth IRA. The maximum amount eligible to be rolled over is the total of the survivor benefits less any amounts already rolled over on your behalf of another family member's behalf to a Roth IRA or other Coverdell ESAs. The amount of survivor benefits contributed to the Roth IRA will be basis and will not be taxed when withdrawn.

This special rollover must be completed within one year after the date the individual received the death benefit gratuity or the SGLI payment. The once per year rollover limit applying during a 12-month period does not apply to rolling over a military death gratuity or a SGLI payment.

This special rollover is not subject to the annual contribution limits applying to Roth IRA contributions. ◆

The Education Exception to the 10% Early IRA Distribution Tax

The tax law permits a person to take a distribution from his or her IRA before attaining age $59^{1}/_{2}$ and not owe the 10% additional tax if, for the year of the distribution, he or she pays the qualified higher education expenses for himself/herself, a spouse and/or his/her child, the child of his or her spouse, any foster child, adopted child or a descendent of any of them.

The individual will need to complete Part I of Form 5329 and indicate he or she is claiming the education exception. This would be done by inserting "08" on the blank line under 2. See below the excerpt of Part I of Form 5329 and the codes the IRS has assigned for the various exceptions. Note that some exceptions apply only to a distribution from a pension pal, some only to a distribution from an IRA and some to distributions from an IRA and/or pension plan. The IRA custodian will prepare the Form 1099-R with a reason code "1", no known exception or on account of certain exceptions."

If the amount withdrawn from a person's IRA exceeds the amount of the "adjusted qualified education expenses," then the person will not owe the 10% on any of his or her IRA withdrawal. He or she will still need to include the amount withdrawn in his or her income. This assumes there is no basis within the IRA.

What expenses are higher education expenses?

These are expenses for tuition, fees books, supplies, and equipment required for enrollment or attendance at an eligible educational institution. Room and board are such expenses if the student is at least a half-time

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Number	Exception
01	Qualified retirement plan distributions (does not apply to IRAs) you receive after separation from service in or after the year you reach age 55 (age 50 for qualified public safety employees).
02	Distributions made as part of a series of substantially equal periodic payments (made at least annually) for your life (or life expectancy) or the joint lives (or joint life expectancies) of you and your designated beneficiary (if from an employer plan, payments must begin after separation from service).
03	Distributions due to total and permanent disability.
04	Distributions due to death (does not apply to modified endowment contracts).
05	Qualified retirement plan distributions up to (1) the amount you paid for unreimbursed medical expenses during the year minus (2) 7.5% of your adjusted gross income for the year.
06	Qualified retirement plan distributions made to an alternate payee under a qualified domestic relations order (does not apply to IRAs).
07	IRA distributions made to unemployed individuals for health insurance premiums.
08	IRA distributions made for higher education expenses.
09	IRA distributions made for purchase of a first home, up to $10,000.
10	Distributions due to an IRS levy on the qualified retirement plan.
11	Qualified distributions to reservists while serving on active duty for at least 180 days.
12	Other (see Other below). Also, enter this code if more than one exception applies.

Form 5329 Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts

If you **only** owe the additional 10% tax on early distributions, you may be able to report this tax directly on Form 1040, line 58, or Form 1040NR, line 56, without filing Form 5329. See the instructions for Form 1040, line 58, or for Form 1040NR, line 56.

Part I Additional Tax on Early Distributions

Complete this part if you took a taxable distribution before you reached age 59½ from a qualified retirement plan (including an IRA) or modified endowment contract (unless you are reporting this tax directly on Form 1040 or Form 1040NR—see above). You may also have to complete this part to indicate that you qualify for an exception to the additional tax on early distributions or for certain Roth IRA distributions (see instructions).

1	Early distributions included in income. For Roth IRA distributions, see instructions	1	
2	Early distributions included on line 1 that are not subject to the additional tax (see instructions). * Enter the appropriate exception number from the instructions: ________	2	
3	Amount subject to additional tax. Subtract line 2 from line 1	3	
4	**Additional tax.** Enter 10% (.10) of line 3. Include this amount on Form 1040, line 58, or Form 1040NR, line 56	4	

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Can a Grandparent be the Responsible Individual of a CESA?

Yes, but the IRS model CESA forms must be revised. Such a revision is permissible.

The IRS has written in Article V of its Model Coverdell ESA (CESA) plan agreement form (5305-E and 5305-EA) to require that the individual must be a parent or guardian beneficiary and that there shall only be one responsible individual at any time.

Collin W. Fritz and Associates, Ltd. has chosen to write its current version of the Coverdell ESA plan agreement forms to allow a grandparent or a great grandparent to be the responsible individual. Many grandparents today make contributions to CESAs for their grandchildren. However, many grandparents are frustrated because they would prefer to control the funds by being the depositor and the responsible individual, but they lose this control to their son, daughter-in-law, daughter or son-in-law if the standard IRS Coverdell ESA form is used. Many financial institutions don't understand that there are CESA forms available allowing a grandparent or a great grandparent to serve as the custodian.

The authority for Coverdell Education Savings Accounts is section 530. Nowhere in this tax code section is the term, "responsible individual," mentioned let alone defined. The IRS settled on the approach that an adult needed to act on behalf of the child (i.e. the designated beneficiary) and so wrote the model Coverdell ESA forms to require that a parent or guardian be the responsible individual. He or she is to act on the behalf of the designated child and in some cases on behalf of other family members of the designated beneficiary. Articles V and VI on set forth on the following page.

Article VIII sets forth the procedure that other articles may be added or incorporated into the Coverdell ESA. However, if the additional article would conflict with any of the provision in Article I-III, then the provisions of Articles I through III will control. This means Article V may be revised. Authorizing a grandparent or a great grandparent will not cause problems with the IRS. Nowhere has the IRS ever stated that a grandparent may not serve as the responsible individual. In Chapter 7 of Publication 970, in numerous places the IRS states that a parent or guardian is "generally" the responsible individual. The CESA plan document must authorize a grandparent or a great grandparent to be eligible to be a responsible individual – either in the original document or by adopting an amendment. ◆

Education Exception,
Continued from page 6

student. And such expenses include expenses for special needs services incurred by or for special needs students in connection with their enrollment or attendance. The IRS has been nice by including the expenses for special needs individual because the statutory law does not expressly authorize this special treatment. It does for Coverdell ESA accounts, but not for IRA distributions used for higher education purposes.

What expenses are adjusted qualified higher education expenses?

These are a person's total education expenses as reduced by any tax-free education assistance such as:

1. Expenses used to determine the tax-free portion of a CESA distribution?
2. The tax-free part of scholarships and fellowships;
3. Pell grants;
4. Veterans' educational assistance;
5. employer-provided education assistance; and
6. any other nontaxable (tax-free) payments received as educational assistance, but this would not be loans or gifts.

Although an IRA is meant to be a retirement account, the law permits a person under age 59½ to use his or her IRA funds for education purposes, obviously not for retirement purposes. The person being educated need not be the IRA accountholder, but may be various family members. The IRA accountholder receives the special tax treatment - he or she will include the distribution amount in income, but will not owe the 10% penalty tax. ◆

Articles V-X from IRS Form 5305-EA

Article V

The "responsible individual" named by the depositor shall be a parent or guardian of the designated beneficiary. The custodial account shall have only one responsible individual at any time. If the responsible individual becomes incapacitated or dies while the designated beneficiary is a minor under state law, the successor responsible individual shall be the person named to succeed in that capacity by the preceding responsible individual in a witnessed writing or, if no successor is so named, the successor responsible individual shall be the designated beneficiary's other parent or successor guardian. Unless otherwise directed by checking the option below, at the time that the designated beneficiary attains the age of majority under state law, the designated beneficiary becomes the responsible individual. If a family member under the age of majority under state law becomes the designated beneficiary by reason of being a named death beneficiary, the responsible individual shall be such designated beneficiary's parent or guardian.

☐ **Option** *(This provision is effective only if checked):* The responsible individual shall continue to serve as the responsible individual for the custodial account after the designated beneficiary attains the age of majority under state law and until such time as all assets have been distributed from the custodial account and the custodial account terminates. If the responsible individual becomes incapacitated or dies after the designated beneficiary reaches the age of majority under state law, the responsible individual shall be the designated beneficiary.

Article VI

The responsible individual ☐ may or ☐ **may not** change the beneficiary designated under this agreement to another member of the designated beneficiary's family described in section 529(e)(2) in accordance with the custodian's procedures.

Article VII

1. The depositor agrees to provide the custodian with all information necessary to prepare any reports required by section 530(h).
2. The custodian agrees to submit to the Internal Revenue Service (IRS) and responsible individual the reports prescribed by the IRS.

Article VIII

Notwithstanding any other articles which may be added or incorporated, the provisions of Articles I through III will be controlling. Any additional articles inconsistent with section 530 and the related regulations will be invalid.

Article IX

This agreement will be amended as necessary to comply with the provisions of the Code and the related regulations. Other amendments may be made with the consent of the depositor and the custodian whose signatures appear below.

Article X

Article X 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 applicable requirements of state law and the Internal Revenue Code.

Preliminary HSA Tax Data for 2011

With respect to tax year 2011 the IRS has estimated that there were 981,452 (up from 968,282) returns which showed contributions to HSAs and claimed tax deductions totalling 2.94 billion dollars. The average claimed deduction per tax return was $2,986.

The number of tax returns claiming a deduction for contributions to an HSA increased by only 1.01%. Last year the percentage increase was 4.6%.

The amount contributed to an HSA (and deducted) increased to 2.94 billion from 2.77 billion. This was an increase of 6.1%.

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 2011, the maximum HSA contribution was $3,050 for self-only coverage and $6,150 for family coverage. Individuals age 55 or older were eligible to make an additional catch-up contribution of $1,000.