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IRS Releases the 2013 Version of Publication 590. It is the Last Such Version

On January 6, 2014, the IRS released the 2013 version of Publication 590 (Individual Retirement Accounts). Due to the extension of the qualified charitable distributions on January 2, 2013 it took until January 27, 2013 to release the 2012 version.

The most interesting change is the announcement that for 2014 Publication 590 is being split into two separate publications, Publication 590-A and 590-B.

Publication 590-A will discuss the laws applying to contributions to traditional IRAs and Roth IRAs, including rollover and conversion contributions. Presumably, there will also be discussion of transfer contributions. And presumably this publication will discuss the rules for establishing the traditional IRA and/or the Roth IRA.

Publication 590-B will discuss the laws applying to distributions from traditional IRAs and Roth IRAs. This publication will cover required minimum distribution rules for both living accountholders and inheriting beneficiaries.

It will be interesting to see if recharacterizations will be discussed primarily in Publication 590-A or Publication 590-B. There will need to be some discussion in both publications. Our guess is that Publication 590-A is where the primary discussion will be as a recharacterization is a special contribution type.

What about the 2013 changes and the 2014 changes?

Of course, the various IRA income limits for 2014 are discussed for deductible traditional IRA contributions, Roth IRA contribution eligibility and tax credit calculations.

In the "what's new section", there are two new paragraphs. One discusses the net investment income tax. The other mentions that there is new name for spousal IRA contributions, the "Kay Baily Hutchinson Spousal IRA."

The 2012 version had five chapters whereas the 2013 version only has four chapters. The difference, the 2012, version had chapter 4 which discussed disaster-related relief (relating to the 2008 midwestern storms). 2012 was last year to gain a tax benefit related to these storms.

There is no discussion of qualified charitable distributions at the front of the 2013 Publication. There is still a lengthy discussion in the distribution section of the Publication.

The 2012 version discussed the special rollover rules for certain airline payments in both the traditional IRA section and the Roth IRA section. In the 2013 version, the discussion of the special rules for certain airline payments is now only discussed in the Roth IRA section it was deleted from the traditional IRA section.

As in prior versions, on page 4 there is a request for comments and suggestions. A person is instructed to write to: Internal Revenue Service, Tax Forms and Publications Division, 1111 Constitution Ave.

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2013-2014 IRA Amendments

The IRS last revised the model IRA Forms 5305, 5305-A, 5305-R and 5305-RA in March of 2002. Since then there have been numerous tax laws enacted with IRA changes. The IRS has given no written explanation as to why the IRA forms have not been amended. We have asked a number of times when the IRS would be revising their IRA forms, but to no avail. It is not a good thing that the IRS has not updated their forms.

When is it necessary for an IRA custodian/trustee to furnish an IRA amendment? Is it necessary or required to furnish one in 2014?

Each institution must make its own determination because one needs to understand when was the IRA agreement last amended and how is it being amended. A primary question is, "when is the last time the financial institution furnished an amendment?" What do the current IRA plan agreements provide? Are there some IRAs set up with one certain plan agreement and others with a different plan agreement?

One may learn a tax lesson the hard way, if he or she adopts the position that an amendment is not required because the IRS has not said one is required. One must remember that the IRS has already stated in its governing IRA regulation (1.408- 6 (d) (4) (ii) (C)) when an IRA amendment is required. The regulation must be followed until the IRS revises it.

There are two types of amendments – one which amends the IRA plan agreement and one which amends the IRA disclosure statement. Regulation 1.408-6(4)(ii)(C) requires that an IRA amendment be furnished no later than the 30th day after the amendment is adopted or becomes effective.

The general rule in the governing IRA regulation is - a law change is enacted which impacts a provision found in the IRA plan agreement; the provision will be amended to implement the law change and the amendment will need to be communicated to the IRA accountholder or inheriting beneficiary.

When the IRS revises its model IRA forms, the amendment is considered to be mandatory or required. When a non-IRS change is made in the plan agreement by the financial institution (or the IRA vendor), the change may either be mandatory or not.

Mandatory changes deal with the tax code changes. For example, CWF has amended the Roth IRA plan agreement so that any person with funds in a traditional IRA is eligible to convert some or all of these funds to a traditional IRA even though he or she may have MAGI of more than $100,000.

The IRS has not yet amended its model Roth IRAs (Forms 5305-R and 5305-RA) to remove the $100,000 restriction. And the IRS has not given any guidance as to whether or not a conversion done in 2010 or later qualifies or doesn't qualify since Form 5305-R and 5305-RA state that the custodian/ trustee may not accept a conversion contribution if the person has a MAGI greater than the $100,000.

The standard IRS rule for IRAs/pensions has always been - the plan document must authorize the action. For this reason, even though the IRS has not amended the Roth forms, CWF has. And CWF has added provisions authorizing new rollovers from 401(k) plans and other employer plans. And CWF has made other changes or amendments to adopt law changes. Other vendors have taken the approach, we don't need to amend our form because the IRS has not done so. Similar changes have been made by CWF in the traditional plan agreement forms.

Non-mandatory amendments would be made by a financial institutions for its own administrative reasons. If an institution would want such a change or changes to apply to all existing IRA accountholders or some of them, the amendment would be furnished to those accountholders which the financial institution wanted the new provision to apply. An example, CWF has added special provisions covering the topics of when a power of attorney is designated by the IRA accountholder, when a non-IRS creditor may impose a claim against an IRA, or when a trust beneficiary or an estate beneficiary will have special pass-through requests.

A long time ago (1986/1987) the IRS acknowledged that there are times that even though the IRA plan agreement has not been changed, a disclosure statement amendment must still be furnished. Example,

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when the deductible/nondeductible rules were first authorized in 1986/1987, such rules did not require the IRA form to be rewritten because the IRA form discusses the maximum contribution amount limit, but does not discuss the deductible/nondeductible rules. The IRS stated there needed to be a disclosure statement amendment discussing or explaining the deductible/nondeductible rules.

In summary, answering a question whether or or not an amendment is required is not all that simple. Sometimes the caller will furnish some additional information, but many times not. Each financial institution will need to make its own decision if there is a requirement to furnish one or both amendments or if it will furnish the amendments so there is no question.

It is true that the IRS has not been very active in auditing whether or not IRA custodian/trustees are furnishing IRA amendments as required by the IRA regulation. We at CWF believe it is in the best interest of a financial institution to furnish the amendments. The governing IRA regulation provides that a $50 fine may be assessed an institution for each time it fails to furnish the IRA plan agreement and $50 each time it fails to furnish the IRA disclosure amendment.

CWF will have its 2013-2014 IRA amendments available on or after February 10, 2014. An IRA custodian may furnish them in a separate mailing or it may choose to combine the amendment with the 2013 Form 5498 or substitute 2013 Form 5498. It is good for the IRA accountholders to have a current explanation of the IRA rules.

IRS Form W-9 – Not Normally Used for IRAs and Other Tax Preferred Plans

The IRS Form W-9 is titled, Request for TIN and Certification. As with many IRS forms, this form is complicated.

A financial institution or another entity uses the IRS Form W-9 or an acceptable substitute form to gather a person's correct name and taxpayer identification number (TIN) so that such information will be reported correctly on an IRS reporting form. The main IRA reporting forms are Form 5498 and Form 1099-R. The Form W-9 is normally not used for IRAs. Why?

IRAs and other tax preferred plans are exempt from the backup withholding rules and it is easier to use a less complicated form to acquire an individual's name and social security number.

The IRS instructions for Form W-9 make it clear that a person establishing and contributing to an IRA, Coverdell ESA, HSA, Archer MSA or taking a distribution form such plans is required to furnish his or her correct TIN, to the custodian/trustee but he or she is not required to sign the certification set forth on Form W-9.

For this reason, many IRA applications, including those of CWF, are written to require the individual to furnish his or her social security number. The financial institution will use the individual's name and social security number to prepare the Form 5498 and/or Form 1099-R. There is no need to use include the certification found on Form W-9.

Federal income tax law in some situations requires a payor to backup withhold with respect to a payment it makes to a payee. In general, a payor must withhold a certain amount from any payment to an individual if such amount exceeds $600.

Certain payees are exempt from a backup withholding. An IRA and the other tax preferred plans are exempt from backup withholding. If a business or individual makes a payment to an IRA, HSA, CESA, 403(b) plan, 457(b) plan or a 401(a) qualified plan, <u>such payor will not be required to furnish a Form 1099-MISC or have such IRA or plan complete a Form W-9</u>.

Certain payments by certain payors are not subject to information reporting and also are not subject to backup withholding. An IRA or HSA custodian does not have to backup withholding with respect to a payment by an IRA to a third party because the law provides that payments from IRAs, HSAs, CESA and pension plans are also exempt front he basis backup withholding rules.

For the above reasons, many financial institutions will not use IRS Form W-9 with respect to its IRAs, HSAs, CESAs and other tax preferred accounts. There are simpler ways to obtain a person's social security number. Form W-9 is more complicated than it needs to be.

Excess HSA Contributions – the HSA Custodian Must Not Shirk its Responsibilities

An HSA custodian is required to prepare and furnish Form 1099-SA (Distributions from an HSA, Archer MSA, or Medicare Advantage MSA) to report distributions received by the HSA owner or an inheriting HSA beneficiary. The individual will use the information from the Form 1099-SA to complete their federal income tax return, including Form 8889 (Health Savings Accounts). The individual explains on this form whether all distributions were used for qualified medical reasons and so they are tax-free, whether some of the distributions are taxable since they were not used to pay a qualified medical expense, or whether some distributions are not taxable since they were the withdrawal of an excess contribution.

The IRS takes the reporting of the withdrawal of excess HSA contributions very seriously. Reason code 2 is to be inserted in box 3 of Form 1099-SA when an HSA owner withdraws an excess contribution. The amount of the earnings, if any, associated with the excess contribution is to be reported in box 2. The IRS procedures applying to the withdrawal of HSA excess contributions are very similar to the rules applying to the withdrawal of excess IRA contributions, but there are some significant differences.

Excess HSA contributions can cause tax problems for an HSA owner, but they also cause administrative problems for the HSA custodian/trustee. The purpose of this article is to discuss the tax rules applying to excess HSA contributions so that an HSA custodian will properly perform its IRS reporting duties and also help its HSA owners. The HSA custodian/trustee may well want to have the authority to charge an administrative fee for the additional work which will need to be performed on account of the excess HSA contribution(s).

Based on a number of consulting calls, some financial institutions are adopting the approach that the institution will report all HSA distributions as normal distributions and then instruct the HSA owner that it is up to him or her (and the accountant) to explain things on the Form 8889.

This approach is imprudent as it relies on wishful thinking. This approach is contrary to IRS guidance. The IRS may assess a fine of $50 for each Form 1099-SA prepared in error . If the IRS concludes that an HSA custodian has failed to provide a correct Form 1099-SA due to its intentional disregard of the requirement to furnish a correct Form 1099-SA, then the penalty is at least $250 per form with no maximum penalty. The $250 per form penalty may be assessed twice – once with respect to the copy required to be filed with the IRS and also with respect to the copy to be furnished the HSA owner.

Who is primarily responsible for correcting an excess HSA contribution?

The HSA owner is, but in some situations the HSA custodian must be proactive in making sure the excess contribution is corrected. It is the HSA owner who must pay the 6% excise tax if excess contributions have been made to his or her HSA and they have not been withdrawn by the tax filing deadline. Normally, this is April 15 of the following year. A special tax rules modifies the deadline to October 15 if the individual filed his or her tax return by April 15 and paid any taxes owing. The 6% tax applies for each year the excess remains in the HSA.

The HSA plan agreement provides that the HSA custodian is NOT authorized to accept annual contributions totaling more than $7,450 for 2013 and $7,550 for 2014. This amount is the family HDHP limit plus $1,000. This provision means the HSA custodian must be proactive in correcting excess contributions which have arisen because the individual and the employer contributed more than this limit. Both the individual and the institution have done something they should not have done. The individual made the excess contribution and the institution should not have accepted it. HSA custodians must have a procedure to monitor (and enforce) the $7,450/$7,550 limit.

In order to illustrate some of the administrative issues which may arise from an excess HSA contribution situation, two situations will be discussed.

Situation #1. Sue Taxpayer, age 39, contributed $6,450 to her HSA on April 1, 2013 for 2013. At that time she thought she had family HDHP coverage for all of 2013. However on July 1, 2013, she went to work for a new employer which covered her immediately under a non-HDHP. Thus, she was eligible to contribute only

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$3,125 to there HSA and so she needs to withdraw her excess contribution of $3,125 plus the related income, if any.

In January of 2014, Sue visits the HSA custodian and states she needs to withdraw $3,125 as an excess HSA contribution plus the related income. The HSA custodian must assist her. The withdrawal cannot be coded as the withdrawal of a normal HSA distribution. Note that even though this distribution relates to a 2013 distribution, it will be reported on a 2014 Form 1099-SA. The rule is – the income, if any, withdrawn and shown in box 2 is taxable for the year withdrawn (2014) and not 2013 which is the IRA rule.

Situation #2. John Taxpayer contributes $14,000 to his HSA in 2013 for 2013. He says he was unaware of any contribution limit. His beginning balance as of January 1, 2013 was $600. He made monthly contributions of $1,000. His HSA's ending balance as of December 31, 2013 was $200. His distributions for the year totalled $14,400. Of this $12,400, John knows that $8,800 was used to pay qualified medical expenses and the remaining $5,600 was used to pay the premiums for the HDHP. The institution does not know how John used the funds.

The HSA custodian has initially coded all of the HSA distributions as being normal HSA distributions and a code "1" would be inserted in box 3 on the 2013 Form 1099-SA.

The HSA custodian, however, knows that John made excess contributions of at least $6,950 ($14,000-$7,450). This amount is no longer in the HSA as it only has a balance of $200 at year end. Whether John knew it or not, when he took a distribution he was withdrawing an excess contribution. The HSA custodian cannot continue to report this amount as the withdrawal of a normal distribution. It must change some of withdrawals to show that he withdrew $7,950 as an excess contribution, plus the earnings, if any.

Be aware that the IRS has not furnished specific guidance on Situation #2. The IRS should do so. Note that John used the funds to pay the premiums for the HDHP. As discussed in a previous newsletter article, if he had taken a normal distribution he would have had to include the $5,600 in income and also pay the 20% penalty tax as the funds were not used to pay a qualified medical expense. But he does not have such adverse tax consequences as he withdrew an excess contribution.

An HSA custodian must adopt procedures to properly report the withdrawal of an excess HSA contribution(s). Such withdrawals must not be reported as normal distributions.

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NW IR-6526, Washington, D.C. One would think the IRS would furnish a fax number or email address, but the IRS doesn't. One wonders how receptive the IRS is to suggestions; the IRS almost never responds in writing, they want your telephone number so you can be called. The IRS is less accountable when little is put in writing. CWF will be submitting a number of suggestions to improve the new Publication 590-A and Publication 590-B so that the public may more easily understand the IRA rules.

SIMPLE-IRA Fees May be Charged Good Notices and Timing are Needed

The IRS has written two model SIMPLE-IRA forms. One (Form 5305-SIMPLE) provides for a designated financial institution and other (Form 5304-SIMPLE) does not.

An employer may choose to complete Form 5305-SIMPLE because it allows the employer to designate a particular financial institution to which all SIMPLE-IRA contributions will be made. This right greatly reduces the employer's administrative tasks. An employer which sponsors a SEP does not have such a right. Each employee can have his or her IRA set up with the financial institution of its choice. These requirements must be met in order for there to be a designated financial institution:

1. The employer and the financial institution must agree in writing the financial institution will be the designated financial institution (DFI).
2. Upon a participant's request his or her SIMPLE-IRA balance will be transferred without cost or penalty to another SIMPLE-IRA or to any IRA once 24-months have elapsed since the date of the first SIMPLE-IRA contribution.
3. Each participant must be furnished a notice explaining the procedures which must be used in order that the SIMPLE-IRA balance will be transferred without cost or penalty.

If a financial institution is not a DFI, then it is free to impose whatever frees and costs can be negotiated with respect to transferring funds from the SIMPLE-IRA to another SIMPLE-IRA or any IRA if the 2-year requirement has been met.

The general rule is – if a financial institution is a DFI, it is unable to impose any fee and/or cost for transferring funds from the SIMPLE-IRA to another SIMPLE-IRA or any IRA if the 2-year requirement has been met. Code section XXXX states this requirement. "A transfer is deemed to be made without cost or penalty if no liquidation, transaction redemption or termination fee, or any commission, load (whether front-end or back-end) or surrender charge, or similar fee or charge is imposed with respect to the balance being transferred.

Note that this rule does not prevent the imposition of fees for any non-transfer transaction. For example, if the SIMPLE-IRA accountholder wanted to take a distribution, the SIMPLE-IRA custodian could impose a distribution fee, or if the SIMPLE-IRA accountholder would close his or her SIMPLE-IRA, the financial institution could impose a closing fee. This restriction of fees applies once the employee has notified the custodian the he or she will be exercising their rights under the transfer policy.

The DFI will need to settle on its fee policies and write a notice explaining such policies and procedures. The DFI should furnish this notice to both the employer and the employees. It could be an attached summary description which the DFI furnishes the employer.

<u>In 1998 in Notice 98-4 the IRS created and announced some major exceptions to this no fee for transfers requirement.</u>

Exception #1. The financial institution may impose transfer fees as long as SIMPLE-IRA participants are given a reasonable time in which to accomplish a transfer without cost or penalty. If a participant fails to do the transfer during this period, then fees and costs may be imposed for transfers during other time periods.

An employer was required to furnish the eligible employees a summary description for 2014 during the period from November 2, 2013 to December 31, 2013. The employee then instructed the employer what his or her elective deferrals would be for 2014.

The IRS has concluded that this same 60-day period may apply for the transfer rules. That is, the employee during this period must instruct the employer and the DFI that he or she will be transferring their 2014 contributions. If such instruction is furnished, then the DFI may essentially charge no fees regarding such 2014 transfers.

IRS rules require that the time period during which transfers may be made without cost or penalty must be reasonable. The IRS has said that limiting the free transfer period to the same standard 60-day period is reasonable. For existing employees, the standard 60-day period is November 2, 2013 to December 31, 2013. For a newly hired employee in 2014, the 60-day period would start on the day he or she becomes eligible for the SIMPLE-IRA plan. Of course, the DFI could define

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the period for transfers without any cost as being longer than 60-days, but a 60-day period is compliant. One would expect that most employers will limit the period to 60-days.

Exception #2. The restriction on charing fees for a transfer of SIMPLE-IRA funds applies to the contributions to be made in 2014, but does not apply to the funds comprising the SIMPLE-IRA as of December 31, 2013. That is, the DFI may impose transfer fees to the extent existing balances would be transferred.

Exception #3. Although the DFI may not assess an employee any fee with respect to a transfer, the DFI and the employee may enter into an agreement that the employer shall pay such fee(s).

Exception #4. If the DFI charges an annual administration fee to all of its IRAs, including its SIMPLE-IRAs, the imposition of this administration fee does not violate the no fee for transfer rules.

If an employee instructs that he or she wishes to have his or her 2014 SIMPLE-IRA contributions transferred, then the SIMPLE-IRA custodian must do so on a reasonably frequent basis. The IRS has stated that "at least monthly" is deemed to be a reasonably frequent basis. Again, the SIMPLE-IRA custodian could decide to transfer the funds on a per payroll basis.

If an employee instructs that he or she wishes to have his or her 2014 SIMPLE-IRA contributions transferred, then the SIMPLE-IRA custodian is permitted to restrict how such contributions may be invested before being transferred. Such investment must have no sales charge. There only needs to be one limited investment.

In summary, many financial institutions performing SIMPLE-IRA services wrongly believe that fees cannot be charged on SIMPLE-IRAs The only time there is a legal restriction on fees for SIMPLE-IRAs is when the employer has chosen one financial institution to act as the designated financial institution. And then the restriction applies only to certain transfers. As discussed above, the IRS has created a number of exceptions allowing for fees to be charged in some transfer situations.

Be Aware of Distributions and Rollovers Around January 1st for Individuals Age 70$^{1}/_{2}$ and Older

Situation #1

Jane Doe closed her IRA at IRA custodian #1 on January 5, 2014, by taking a lump sum distribution of $38,000. Jane Doe's date of birth is September 10, 1940. She should attain age 74 in 2014. Jane goes to IRA custodian #2 and wishes to rollover the $38,000. May she do this?

No. A IRA accountholder is ineligible to roll over a required distribution. Even though Jane may prefer to wait until November or December 2014 to take her RMD the tax rules do not allow her to wait. The law is written that when a person is subject to the RMD rules any distribution he or she takes is considered to be his or her RMD until that amount has been satisfied. Jane's RMD for 2014 is $1596.64 ($38,000/23.8). She is eligible to roll over $36,403.36. If she would roll over the $38,000, there would be an excess contribution of $1,596.64.

Situation #2

Jane Doe closed her IRA at IRA custodian #1 on December 23, 2013 by taking a lump sum distribution of $38,000. Jane Doe's date of birth is September 10, 1940. She attained age 73 in 2013 and should attain age 74 in 2014. She took her 2013 RMD in early December of 2013. Jane goes to IRA custodian #2 on January 31 to rollover the $38,000. May she do this?

The IRS has not expressly addressed this situation. She could argue that she satisfied her RMD for 2013 so the entire distribution of $38,000 is entitled to be rolled over. Due to the fact that the IRS has not expressly addressed this situation, CWF would suggest the more conservative approach is, she must satisfy her RMD for 2014 before rolling over any portion of the distribution. In this case, IRA custodian #2 would calculate her RMD for 2014 since the RMD rules require an adjustment to the December 31 balance when there is an outstanding rollover. Therefore, Jane's RMD for 2014 is $1596.64 ($38,000/23.8). She is eligible to roll over $36,403.36.

2014 HSA Limits

This is a reminder article.

The Treasury Department and Internal Revenue Service issued guidance in May of 2013 on the maximum contribution levels for Health Savings Accounts (HSAs) and out-of-pocket spending and deductible limits for High Deductible Health Plans (HDHPs) that must be used in conjunction with HSAs. The HSA contribution limits for 2014 have increased by a small amount and a small percentage over the 2013 limits. The 2014 limits are set forth in Revenue Procedure 2013-25. The catch-up contribution amount of $1,000 is not subject to being adjusted by the COLA adjustment of Code section 223(g) and so it remains at $1,000 for 2014.

The maximum annual out-of-pocket expense limits for 2014 have also increased. The minimum annual deductible limits for 2014 did not change.

HSA Maximum Contribution Limits Under Age 55

	2013	2014	Change	% Change
Single HDHP	$3,250	$3,300	+ $50	1.54%
Family HDHP	$6,450	$6,550	+ $100	1.55%

HSA Catch-Up Contributions

	2013	2014	Change
Age 55 and Older	$1,000	$1,000	$0

HSA Maximum Contribution Limits Age 55 & Older

	2013	2014	Change	% Change
Single HDHP	$4,250	$4,300	+ $50	1.18%
Family HDHP	$7,450	$7,550	+ $100	1.34%

High Deductible Health Plans

	Minimum Annual Deductible			Maximum Annual Out-of-Pocket Expenses		
	2013	2014	Change	2013	2014	Change
Single Coverage	$1,250	$1,250	$0	$6,250	$6,350	+ $100
Family Coverage	$2,500	$2,500	$0	$12,500	$12,700	+ $200

The IRS announces these changes in May each year so that employers and individuals will have sufficient time to plan for HDHP insurance coverage and HSA contributions for 2014 and so that insurance companies may revise their HDHP policies.

CWF has HSA brochures and HSA Amendments available with 2014 limits. ◆