July 2015
Published Since 1984

The Pension Digest

ALSO IN THIS ISSUE –

Traditional IRA Beneficiary Chart, *Page 2*

Roth IRA Beneficiary Chart, *Page 3*

Basics of Administering Coverdell ESAs or CESAs, *Page 4*

CESAs – Moving Funds Between Family Members, *Page 5*

May a rollover contribution be made to a Coverdell ESA?, *Page 6*

IRS Issues Guidance on ABLE Accounts for People with Disabilities, *Page 7*

Beneficiary/Inherited IRAs and CWF IRA Test #801, *Page 8*

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

Roth IRA Conversions, Is It Worthwhile For a Person To Change His/Her State of Residence Before Converting?

For most individuals it will not be worth the effort or the inconvenience to change their state of residence prior to doing a Roth IRA conversion contribution. For others, not having to pay state income tax on the conversion will make it worthwhile.

When one converts the funds within his traditional IRA to a Roth IRA, he will include the taxable amount in his income for federal income tax purposes.

What about state income tax? Individuals residing in states with incomes taxes will also need to pay state income tax on the amount converted if they reside in a state which assesses an income tax. For some, this may be substantial as the highest tax rate is the following in: (California- 13.3%, Hawaii- 11.01%, Oregon- 9.9%, Minnesota- 9.85%, Iowa - 8.98%, New Jersey- 8.97%, New York- 8.82%, etc.).

For example, an individual residing in California, New York, Michigan, Minnesota, Iowa or any other state with an state income tax may wish to move to a state with no income tax (Texas, Florida, Tennessee, Nevada, Wyoming, Washington, and South Dakota.) for the period required under the various state laws to avoid paying the state income tax with respect to his Roth IRA conversion.

For most individuals it will not be worth the effort or the inconvenience, but for others the tax savings will make it worthwhile to move to a state without an income tax for a certain time period so that the individual may convert his or her Roth IRA and avoid paying state income tax. Under current laws, a person could return to his "home" state later after doing the conversion while residing in another state. Time will tell if these states will enact laws giving them the right to try to tax such funds even though the conversion had occurred when a person was a non-resident.

The Questions to be Asked to Administer a Nonspouse Inherited Traditional IRA

Many traditional IRAs are now being inherited by nonspouse beneficiaries. Asking and answering the following questions will simplify the administration of these inherited IRAs.

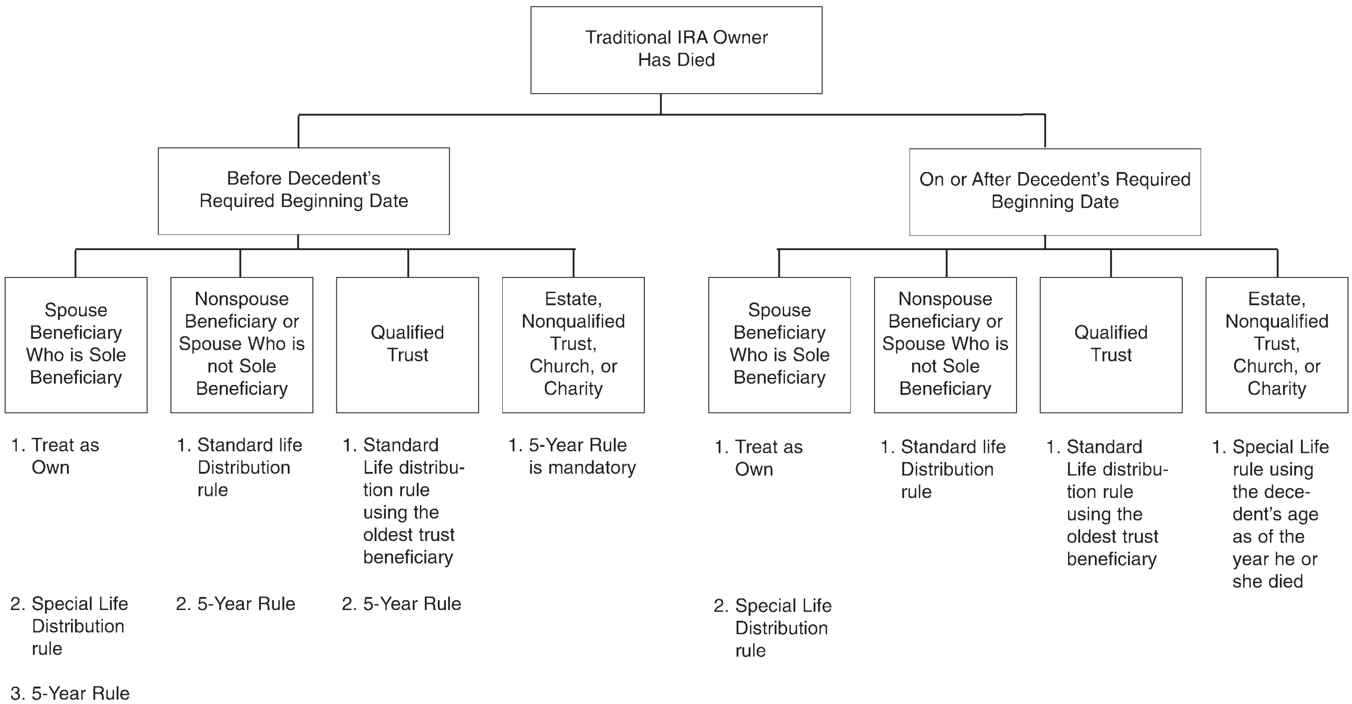
1. When was the deceased IRA accountholder born?

2. When did the deceased IRA accountholder die?

From the answers to these two questions, one can determine if the decedent died before on or after his or her required beginning date.

3. If the decedent died on or after his or her required beginning dated, had the decedent been paid his or her RMD for the year of death or is there a portion of his or her RMD which needs to be distributed to the beneficiary(ies)?

Continued on page 2



Discussion

1. Any surviving spouse may take a distribution regardless if the life distribution rule or the 5-year rule applies and roll it over as long as the standard rollover rules are met.

2. Distribution, if any, due for year of death.
   A. If the decedent died before his or her 70½ year, then there is no required distribution for the beneficiary to take for the year of death.
   B. If the decedent died during the year he or she attained or would have attained age 70½ or the following year, but before his or her required beginning date and the beneficiary is a nonspouse beneficiary, then the RMD for such year "disappears" and the beneficiary is not required to take a distribution for the year the decedent died.
   C. If the decedent died during the year he or she attained or would have been attained age 70½ or the following year, but before his or her required beginning date and the beneficiary is a spouse beneficiary, then the RMD for such year must be distributed to the surviving spouse beneficiary to the extent not distributed to the decedent prior to his or her death.
   D. If the decedent died on or after his or her required beginning date,then his or her RMD for such year must be distributed to the beneficiary to the extent not distributed to the decedent prior to his or her death.

Nonspouse Inherited IRA,
Continued from page 1

If the entire RMD had been paid, then there is no remaining RMD for the year of death needing to be distributed.

If the entire RMD had NOT been paid to the decedent prior to his or her death, then a beneficiary must be paid his or her share of the remaining RMD by December 31 of that year.

For the years after the year of the decedent's death, RMDs for each nonspouse beneficiary must be determined using the following rules. It is assumed the beneficiary will qualify to use the separate accounting rules applying to inherited IRAs.

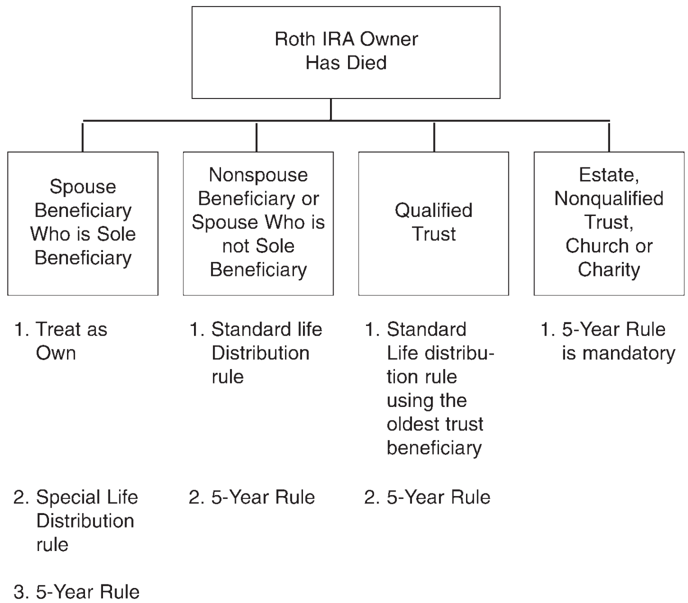
If the decedent died on or after his or her required beginning date, the beneficiary will need to take at least the RMD amount for each year following the year of the death. The beneficiary may certainly take more than the RMD, including a lump sum. The five year rule never applies when the decedent dies on or after the required beginning date.

The standard RMD formula is used to calculate each year's RMD, except the single life table is to used to calculate the initial divisor based on the age of the beneficiary rather than the uniform lifetime table.

4. What is the date of birth of each beneficiary? This will allow the determination of each beneficiary's lie expectancy in the year after the year the accountholder died?

To determine the divisor for subsequent years, one is subtracted from the initial factor for each subsequent year.

If the decedent died before the required beginning date, the beneficiary will need to take at least the RMD amount over his or her life expectancy as calculated as described above, unless the beneficiary elects the five year rule.



Discussion

1. Unlike with the traditional IRA, the beneficiary is never required to take an RMD for the year the Roth IRA owner died since the Roth IRA owner is not required to take an RMD while alive.

2. A surviving spouse who is the sole beneficiary almost always will wish to elect to treated the deceased spouse's Roth IRA as his or her own in the year the deceased Roth IRA died. By treating as own, the surviving spouse is not required to take an RMD while alive.

3. A surviving spouse who is NOT the sole beneficiary almost always will wish to take a distribution and then make a rollover contribution into his or her own Roth IRA. The standard once per year and 60 day rollover will apply. If the distribution occurs after the year of death, the surviving spouse will be able to rollover such funds into his or her own Roth IRA, but any RMD for such year is ineligible to be rolled over.

4. If there are multiple beneficiaries, the separate accounting rules must be met by all beneficiaries by December 31 of the year following the death of the deceased Roth owner, or application of the 5-year rule will be mandatory. That is, the Roth IRA must be closed by December 31st of the year containing the fifth anniversary of the death of the Roth IRA owner.

5. Most nonspouse beneficiaries will take only the required amount as this will maximize the tax-free income to be earned.

Basics of Administering Coverdell ESAs or CESAs?

It is now 2015 and CESAs have been around since 1998. More and more distributions are being taken. More and more changes in the designated beneficiary are being made.

The purpose of this article is to summarize the basics of administering CESAs. The CESA was originally called the Education IRA. The Taxpayer Relief Act of 1997 sets forth the governing law. The first year for contributions was tax year 1998. It was soon realized that "Education IRA" did not fit the account as it was not an IRA. The name change was authorized by a 2001 law change.

The CESA is a tax preferred account similar to other tax preferred accounts such as a Roth IRA, traditional IRA, or HSA. The tax benefits are limited as no tax deduction or tax credit applies. The CESA's income is tax-free if used to pay qualifying education expenses. The concept is certainly good.

The child for whom the CESA was established is called the designated beneficiary. Since the designated beneficiary is generally a child who has limited or restricted contractual rights, the IRS adopted the concept that a parent (i.e. the responsible individual) would control the account and act on behalf of the child.

The primary administrative duties of a CESA custodian are as follows. For this discussion it is assumed that the designated beneficiary is not an individual with special needs.

The procedures to establish a CESA are very similar to those for establishing an IRA but there are some differences. The account is owned to benefit a child. This child is called the designated beneficiary. The person acting on behalf of the child is called the responsible individual. Should the child die before the account is closed, a designated death beneficiary is designated by either the initial depositor or the responsible individual.

It is the responsible individual who is authorized to take a distribution on behalf of the child.

Personnel of the HSA custodian must understand how the HSA plan agreement was completed. It provides the child becomes the responsible individual upon attaining age 18 (the age of majority) unless a box is checked indicating the parent or adult who was designated as the responsible individual retains such authority even when the child attains age 18.

A CESA contribution for a child must be made on or before his or her 18th birthday. A CESA custodian may wish to furnish a reminder notice to its accountholders.

The CESA custodian must also remember the two rules set forth in Article III of the IRS model Forms 5305-E and EA.

Rule #1 is, "Any balance to the credit of the designated beneficiary on the date he or she attains age 30 shall be distributed to him or her within 30 days of such date." An institution wishes to have procedures in place to make this required distribution. Most institutions will try to contact the designated beneficiary or the responsible individual prior to this deadline.

Rule #2 is, "Any balance to the credit of the designated beneficiary shall be distributed within 30 days of his or her death unless the designated death beneficiary is a family member of the designated beneficiary and is under the age of 30 on the date of death. In such case, that family member shall become the designated beneficiary as of the date of death."

If your customers wish to change the designated beneficiary, you should review the discussion on pages 5-6 discussing the moving CESA funds between family members.

The CESA custodian is required to prepare Form 5498-ESA and Form 1099-Q. Completion of these forms have been discussed in prior newsletters.

CESA transactions are not generally complicated. However, they may be infrequent. It is up to your customers to explain the tax consequences of their contributions and distributions on their tax return. In many cases, if the distribution was used solely to pay a qualified educational expense and so is not taxable, the designated beneficiary is not required to mention the distribution on his or her income tax return.

As a reminder, it can be prudent to establish a CESA for an individual with special needs. The annual $2,000 contribution limit still applies, but contributions are permissible after age 18 and there is no required distribution at age 30.

THE Pension Digest

CESAs – Moving Funds Between Family Members

Some individuals are returning to college this Fall and some are not. There are times when a CESA has been established for a son or daughter or grandchild and that individual has decided that he or she does not wish to continue his or her higher education. A Coverdell ESA (CESA) is an individual account just as an IRA is an individual. The CESA benefits one person.

In order for a distribution from a CESA to be non-taxable, it must be used to pay for a qualified education expense of the designated beneficiary at an eligible educational institution. Note the funds cannot be withdrawn by the designated beneficiary on a tax-free basis from his or her CESA and then he or she uses the funds to pay for an education expense of a brother or sister, spouse, child, etc.

If a designated beneficiary withdraws funds from his or her CESA and does not use the proceeds to pay for qualifying education expenses, the general tax rule is - he or she is required to include any "earnings" in his or her income and would also owe a 10% additional tax on the earnings.

However, the funds in one person's CESA may be moved via transfer or rollover into a second person's CESA as long as the second person is a member of the first person's family. And the subsequent use of these funds by the new CESA designated beneficiary to pay his or her education expenses will be non-taxable.

What approaches or procedures may be used to move the CESA funds from the first individual to another family member?

Approach #1. The responsible individual may change the designated beneficiary of the CESA from one person to another family member.

Approach #2. The responsible individual may transfer the funds from individual's CESA to another family member's CESA.

Approach #3. The responsible individual may take a distribution from an individual's CESA and make a rollover contribution to another family member's CESA.

The CESA's responsible individual may or may not have the authority to change the designated beneficiary. This will need to be determined. The responsible individual is generally a parent of the designated beneficiary, but it may be a grandparent in some situations. And the designated beneficiary many times becomes the responsible individual at attaining the age of majority.

Article V of Form 5305-EA (Coverdell Education Savings Custodial Account) and Form 5305-E (Coverdell Education Savings Trust Account) provides that at the time the designated beneficiary attains the age of majority under state law that he or she becomes the responsible individual of his or her CESA unless the form has been completed authorizing that the responsible individual is to remain as the responsible individual.

Article VI provides that the responsible individual may be given the authority by checking a box allowing the responsible individual to change the designated beneficiary to another family member.

Set forth is a typical situation where the family may wish to move funds from one person's CESA to another family member's CESA. A parent established three Coverdell ESA accounts for her three children, two daughters and a son. She retained the right to remain as

Continued on page 6

7272 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city or town, state or province, country, and ZIP or foreign postal code	1 Coverdell ESA contributions $ / 2 Rollover contributions $	OMB No. 1545-1815 / 2015 / Form 5498-ESA	Coverdell ESA Contribution Information
TRUSTEE'S/ISSUER'S federal identification no. / BENEFICIARY'S social security number			Copy A For Internal Revenue Service Center
BENEFICIARY'S name			File with Form 1096.
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the 2015 General Instructions for Certain Information Returns.
City or town, state or province, country, and ZIP or foreign postal code			
Account number (see instructions)			

Form 5498-ESA Cat. No. 34011J www.irs.gov/form5498esa Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

3131 ☐ VOID ☐ CORRECTED

PAYER'S/TRUSTEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	1 Gross distribution $ / 2 Earnings $	OMB No. 1545-1760 / 2015 / Form 1099-Q	Payments From Qualified Education Programs (Under Sections 529 and 530)
PAYER'S/TRUSTEE'S federal identification no. / RECIPIENT'S social security number	3 Basis $	4 Trustee-to-trustee transfer ☐	Copy A For Internal Revenue Service Center
RECIPIENT'S name	5 Check one: • Qualified tuition program — Private ☐ or State ☐ • Coverdell ESA ☐	6 Check if the recipient is not the designated beneficiary ☐	File with Form 1096.
Street address (including apt. no.)			For Privacy Act and Paperwork Reduction Act Notice, see the 2015 General Instructions for Certain Information Returns.
City or town, state or province, country, and ZIP or foreign postal code			
Account number (see instructions)			

Form 1099-Q Cat. No. 32223J www.irs.gov/form1099q Department of the Treasury - Internal Revenue Service

Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page

Moving Funds,
Continued from page 5

the responsible individual even when a child attained the age of majority. One of her children with $9,500 in her CESA has decided to not attend college until 2018. Her other sister could use the $9500 to pay towards her Fall 2015 college expenses.

Moving the funds from one person's CESA to a different family member's CESA can be achieved in a number of ways.

It is possible to change the CESA's designated beneficiary to one of the other siblings. CWF has a form to accomplish this task. It appears the IRS allows the changing of the designated beneficiary by allowing the responsible to instruct the CESA custodian to change the account's name. The IRS instructions to the CESA custodian indicate that the custodian is not to file Form 1099-Q for a change in the name of the designated beneficiary as long as the new beneficiary is a member of his or her family and be under age 30, but this age condition does not apply if the new beneficiary has special needs.

CESA funds may also be moved by rollover or transfer.

A rollover means the funds are distributed to the responsible individual. He or she may redeposit such funds into the designated beneficiary's CESA at another financial institution. Or, the responsible individual may make a rollover contribution into a CESA established for a family member of the designated beneficiary.

Moving the funds from one person's CESA to another family member's CESA can also be done as a transfer.

Unlike with IRA transfers, CESA transfers are reportable under IRS reporting rules. The fact that a CESA transfer is reportable does not mean it is taxable. It is not.

The CESA custodian making the distribution/transfer is to complete box 4 of Form 1099-Q by checking the box if there was a distribution directly from one CESA to another CESA or to a QTP.

The CESA custodian accepting the rollover/transfer is to complete box 2 (Rollover Contributions) of Form 5498-ESA by entering the rollover or transfer amount in box 2. Any amount distributed from a CESA may be rolled over (or transferred) to another CESA and it is not taxable if it is for the benefit of the same designated beneficiary or a member of the beneficiary's family.

The following are family members of the designated beneficiary:

1. His or her spouse;
2. His or her children, stepchildren, foster children and their decedents;
3. His or her siblings and their children;
4. His or her parents, their siblings and ancestors;
5. His or her step-parent;
6. His or her in-laws;
7. The spouse of any person in 2-6; and
8. His or her first cousin.

In summary, the law defines quite broadly those individuals who qualify as a family member of the designated beneficiary. This allows the CESA funds to be transferred tax-free between family members.

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. ◆

IRS Issues Guidance on ABLE Accounts for People with Disabilities

In December 2014, President Obama signed into law the Tax Increase Prevention Act of 2014. He had threatened to veto this legislation, but he did not. The primary purpose of this legislation was to extend many expiring tax provisions for 2014, including the qualified charitable distribution rules. However, there were a number of new provisions. One of the new provisions was the creation of The Achieving a Better Life Experience (ABLE) account provisions.

This is a new tax favored account intended to provide various tax and financial benefits to disable individuals and their families. In general, funds within an ABLE account are not be counted in determining a person's eligibility for any means-testes programs. However, special rules apply for purposes of determining eligibility for Supplemental Social Security purposes.

The new tax authorizes states to offer tax-favored ABLE accounts to individuals with disabilities as long as they became disabled before age 26.

In general, banks and other financial institutions will not be able to sponsor such ABLE accounts since the law only grants this authority to a state. The intent is that the ABLE rules will be similar to the rules for Internal Revenue Code section 529 educational programs. The ABLE rules are found in Code section 529A.

On June 19, 2015, the IRS issued its proposed regulations to govern ABLE accounts. The sponsors of the ABLE program and taxpayers are able to rely on these proposed regulations until final regulations are issued.

It is now easier for individuals who have disabilities and also for their families to save for and to pay for disability related expenses. Annual contributions can be made to an ABLE account. The earnings on such contributions will be tax fee if used to pay qualified disability expenses. The annual contribution limit equals the annual gift tax exclusion amount. Currently this is $14,000.

The definition of what is a qualifying disability expense has been defined very broadly. Included are expenses that help a person maintain or improve their health, independence and quality of life. For example, they include expenses for housing, education, transportation, health, prevention and wellness, employment training and support, assistive technology, personal support and other expenses.

The IRS has recently developed two new IRS reporting forms for ABLE accounts. Form 5498-QA will reports contributions to an ABLE account and Form 1099-QA will report distributions. At this stage, the forms are only "draft" forms.

Test Answers, Continued from page 8

Answers to IRA Test

1. b, False
2. a, Yes
3. b, Different
4. b, False
5. b, No
6. d, The year the RMD divisor is 1.0 or less
7. b, No
8. b, No
9. a, Yes
10. b, False
11. d, 50%
12. b, No
13. b, False
14. c, T

Beneficiary/Inherited IRAs and CWF IRA Test #801

A person who inherits a traditional IRA or a Roth IRA must withdraw a required distribution. Generally, this must be done each year commencing the year after the death of the IRA owner. There is a special rule called the five year If it applies, the rule requiring an annual distribution does not apply. A 50% excess accumulation tax is imposed inheriting beneficiary who fails to take his or her total required distribution.

Once a financial institution knows of the death of an owner, it should inform an inheriting beneficiary of the basic rules, the need to take a required distribution and that there are no rollover rights.

The main duty of the IRA custodian is to report these distributions to the IRS and the beneficiary by preparing Form 1099-R correctly.

CWF has written an IRA test covering the rules applying to administering the inherited IRA of a nonspouse beneficiary. The test has 124 questions. Set forth are 14 questions from this test. See page 7 for the answers.

1. A non-spouse has 90 days rather then 60 days in which to complete a roll over of a distribution of inherited traditional IRA funds

❍ a)True ❍ b)False

2. A non-spouse IRA beneficiary no longer has the right to treat the decedent's IRA as his or her own. At one time in the 1970's did a non-spouse beneficiary have this right?

❍ a)Yes ❍ b)No

3. Are the rules applying to a non-spouse beneficiary of a traditional IRA always the same or sometimes different from the rules applying to a non-spouse beneficiary of a Roth IRA?

❍ a)Same ❍ b)Different

4. For tax calculation purposes, a person must aggregate all of his or her traditional IRAs, including inherited traditional IRAs and keep separate from any other type of IRA ?

❍ a)True ❍ b)False

5. When a traditional IRA owner dies, are there rules requiring that his or her IRA be closed by December 31 of the following year?

❍ a)Yes ❍ b)No

6. The general rule is that when a traditional IRA owner dies, the beneficiary must close the inherited IRA by December 31st of what year?

❍ a) The year containing the 4th anniversary of the death
❍ b) The year containing the 5th anniversary
❍ c) The year containing the 6th anniversary
❍ d) The year the RMD divisor is 1.0 or less

7. Does the IRS require an IRA custodian of an inherited traditional IRA or Roth IRA to calculate the RMD for a beneficiary?

❍ a)Yes ❍ b)No

8. Is it permissible for a person who is a non-spouse beneficiary to combine his personal traditional IRA with an inherited traditional IRA?

❍ a)Yes ❍ b)No

9. Are there times it will be impermissible to combine inherited traditional IRA from your mother at IRA custodian #1 with an inherited traditional IRA from your mother at IRA Custodian #2?

❍ a)Yes ❍ b)No

10. A non-spouse beneficiary has rollover rights with respect to an inherited Roth IRA?

❍ a)True ❍ b)False

11. A non-spouse beneficiary who fails to take his or her required distribution will owe what tax rate on the under-paid amount (excess accumulation)?

❍ a)10%
❍ b)20%
❍ c)25%
❍ d)50%

12. Is the RMD box (Box 11) of the Form 5498 to be checked for a beneficiary?

❍ a)Yes ❍ b)No

13. The IRS now has the legal authority to waive the rule stating a non-spouse beneficiary is always ineligible to roll over a distribution from an inherited IRA?

❍ a)True ❍ b)False

14. Which code is used to report a Roth IRA distribution to Mary, age 28, beneficiary of her Dad's Roth IRA. She withdrew $700 in 2014. Her dad had opened his Roth IRA in 2012. He died in 2014 at age 56.

❍ a)S ❍ b)J ❍ c)T ❍ c)Q