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The Pension Digest

ALSO IN THIS ISSUE –

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

An IRA Distribution May Disqualify a Person For the Premium Tax Credit.

The premium tax credit (PTC) is a refundable tax credit authorized under the Affordable Care Act. It assists individuals and families with low or moderate income to afford health insurance purchased through a health insurance marketplace. A person is ineligible for this credit if the health insurance coverage is purchased outside the marketplace. A person who is eligible to enroll in certain employer-sponsored coverage or government programs such as Medicare, Medicaid or TRICARE is ineligible. To be eligible and to obtain this credit a person must meet certain requirements and must file a federal income tax return. One of the requirements is that a person's household income must fall within a certain range.

If a person is receiving this credit, before taking any IRA distribution he or she will want to determine that such an IRA distribution will not make him or her ineligible to receive this credit. A person becomes ineligible for this credit if his or her household income exceeds more than 400% of the Federal poverty line for his or her family size. A person will be required to repay any advance payment he or she receives for which he or she later becomes ineligible. For 2015, the limit is $45,960 for an individual, $62,040 for a family of two and $94,200 for a family of four. A person will want to review Publication 974 and other IRS guidance.

2015 IRA Contribution Deadline is Monday, April 18, 2016 Due to Emancipation Day

The federal rule is that when April 15th falls on Saturday, Sunday or a legal holiday, then a tax return is considered timely if filed on the next succeeding day which is NOT a Saturday, Sunday or holiday.

Emancipation Day is April 16th and it is a legal holiday in Washington, D.C. In some years this holiday will impact the deadline for filing federal income tax returns.

In 2016, April 15th falls on Friday. However, Washington D.C. observes Emancipation Day on Friday since it falls on a Saturday. This means in 2016, April 15th is a holiday for federal income tax purposes. Consequently, the filing deadline for all tax forms and payments required to be filed or completed on or before April 15th (as described in Section 6072(a), including the Form 1040 returns) will be Monday April 18th, 2016.

This April 18, 2016 deadline applies to traditional and Roth IRA contributions, HSA contributions and CESA contributions.

THE Pension Digest

Is an IRA Custodian to Complete Boxes 10 and 11 on the Form 1099-R?

Never. Set forth below is a recent email inquiry and our response.

Question/Situation

In the IRS instructions for 1099-R, Box 11 is to reflect the "first year of designated Roth contributions." The instructions go on to say "Enter the first year of the 5-taxable-year period. This is the year in which the designated Roth account was first established by the recipient."

Did the IRS mean to use the word *account*? Shouldn't it be the year in which the designated Roth plan was first established?

My core processor is taking the literal meaning of the word account and reporting the year of the first contribution in the account and I'm trying to determine if they are wrong in doing this.

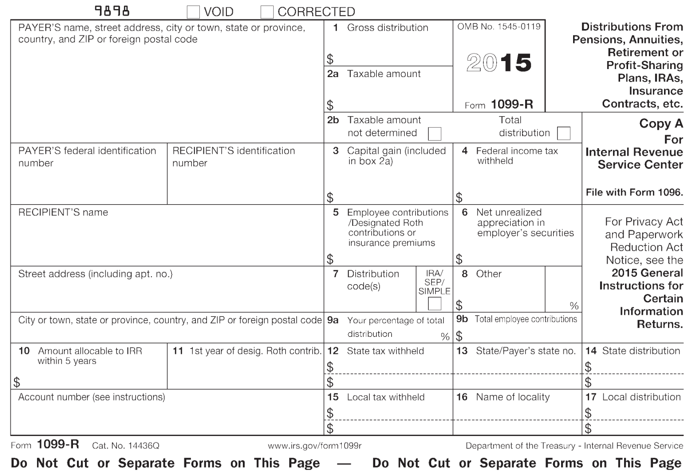
CWF's Response

Box 11 is never to be completed for a Roth IRA. It is to be completed when an employer sponsors a 401(k) plan which permits Designated Roth contributions and the person's distribution is comprised (partially or totally) of a Roth designation contribution plus earnings.

The IRS instructions should be improved by the IRS to make it clear that this box is NOT to be completed with respect to a Roth IRA distribution.

Box 10 also is not completed with respect to any IRA distribution. A 401(k) plan will complete box 10 if a person has standard funds in a 401(k) plan, makes the decision to convert them into the designated Roth account and then withdraws them within the 5-year period beginning within the first day of the year in which the special rollover was made. Box 10 is not to be completed if an exception under Code Section 72(t) applies. The 5-year period relates to this special type of conversion within a 401(k) plan and has nothing to do with a Roth IRA. IRR is the acronym for an in-plan Roth rollover.

You may furnish this email to your software vendor in that it helps convince them not to complete boxes 11 and 12 for a Roth IRA distribution.



9898 VOID CORRECTED

PAYER'S name, street address, city or town, state or province, country, and ZIP or foreign postal code		1 Gross distribution $ / 2a Taxable amount $	OMB No. 1545-0119 2015 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 2015 General Instructions for Certain Information Returns.
Street address (including apt. no.)		7 Distribution code(s) IRA/ SEP/ SIMPLE	8 Other $ %	
City or town, state or province, country, and ZIP or foreign postal 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

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

When are SEP-IRA Funds No Longer SEP-IRA Funds?

A recent email allowed us to discuss the topic of when SEP- IRA funds cease to be SEP-IRA funds and become ordinary traditional IRA funds. Fairly often, a person with funds in a SEP-IRA at IRA custodian #1 wishes to move the funds to IRA custodian #2, but custodian #2 states it does not service SEP- IRAs .

The simple answer is, as long as the SEP-IRA accountholder consents to have such funds transferred to an ordinary traditional IRA such funds may be so transferred.

In general, the standard IRA distribution rule requires a person to aggregate his or her balances in traditional IRAs, SEP-IRAs and SIMPLE-IRAs when applying the distribution taxation rules. So, as discussed below, as a practical tax matter it makes little difference whether a distribution comes from a SEP-IRA or a traditional IRA.

However, there is at least one time when it can be very important that funds are within a SEP-IRA versus a traditional IRA. If a person with a SEP-IRA participates in a SEP-IRA with other participants, then the SEP-IRA is covered by ERISA. Therefore, creditors cannot reach such assets until they would be distributed from the SEP-IRA plan. Admittedly, the law is unsettled on this issue, a person has a very strong argument that such assets may not be reach by a creditor (other than the IRS).

Continued on page 3

The Pension Digest

SEPs,
Continued from page 2

Question/Situation #1

I have a customer who has had a SEP-IRA with us for many years. He is the employer and no longer makes SEP contributions (age 67). He wants to move the plan to a bank that does not offer or support SEP plans. I told him I didn't see a problem with it, as the IRS considers SEPs only to be SEPs at the time of contribution and as a Traditional IRA at all other times. Do you agree? Can you reference any IRS literature that he could provide to the other bank to ease their concerns? The movement of funds would be as a bank to bank transfer.

CWF's Answer #1

The IRS has done a poor job of discussing when SEP funds are no longer SEP funds.

I believe SEP funds are no longer SEP fund when the individual no longer wants them classified as SEP funds. The individual does this by agreeing to transfer the SEP-IRA funds into a traditional IRA. See the attached form and see the special transfer options at the top of the form.

For application of the IRA distribution rules, the law requires a person to aggregate all of his/her traditional IRAs, SEP-IRAs and SIMPLE-IRAs.

See the CWF transfer form wherein the individual can indicate he no longer wishes the funds to remain SEP-IRA funds.

It appears the other institution has some unwarranted concerns. To get the matter resolved, the SEP-IRA funds at ABC Bank could be transferred into a traditional IRA at ABC Bank and then the funds could be transferred to the other IRA custodian.

At times it could be important that funds be in a SEP-IRA versus a traditional IRA. Although some courts have ignored the statutory law, the stronger legal position is - a person in a SEP-IRA plan with more than one participant can argue that the SEP-IRA plan is an ERISA plan and thus under federal law has protection from creditors which funds in a traditional IRA do not have.

Question/Situation #2

If we transfer the SEP at ABC Bank into a Traditional IRA at ABC Bank, that's a non-reportable transaction, right? So could I just change the current SEP plan into a Traditional, by doing maintenance on our core system, or do I really need to reflect 2 separate and distinct plans being established?

CWF's Answer #2

You can just change the current account to be a traditional IRA from the SEP-IRA. You can do this as long as the customer consents. He can consent by signing the transfer form, but you don't need to set up a new account.

Does the IRA Custodian Report "1" or "2" if Distribution Due to Education?

Set forth is a recent email inquiry and our response.

Question/Situation

We have a client who is 37 years old, She is doing a distribution from her IRA and her tax accountant said she can take it without penalty because it's for Education expenses. If this is true do I need to code this in any special way? On our distribution form we have "early distribution, exception applies" is this what I would use?

CWF's Answer

No, do not use #2 (i.e. an exception applies). You want to use #1, the no exception known or account of one of the following exceptions - education is one of the listed ones.

The accountant should be furnishing a more comprehensive explanation. A person may withdraw funds from her traditional and not owe the 10% pre-age 59½ tax as long as certain requirements are met. The main requirements, the expense must be a post-secondary expense for the individual or a family member and the IRA funds withdrawn must be used to pay that year's education expense.

The Form 1099-R is prepared with a reason code (1) which means the IRS believes she will owe the 10% tax or it means she must furnish an explanation as to why she does not owe the 10% tax. It is the latter. She must furnish an explanation on her tax return.

Continued on page 4

Distribution,
Continued from page 3

Reason code (1) is used because the IRS does not expect the bank to determine if she has met all of the requirements so the the 10% tax tax is not owed. She (or her accountant) must complete and file Form 5329 (Part I) to claim the 10% exception.

Rolling Over 401(k) Funds Into a Traditional IRA and/or Roth IRA

The following email allows us to discuss the rolling over (or directly rolling over) of 401(k) funds into a traditional IRA, Roth IRA or into both types of IRAs.

Question/Situation

We have a client that has a 401(k) at his former employer and also Roth IRAs with them. The client is wondering if he can move it all over with us into one Roth IRA. Is this possible? If so how?

CWF's Answer

The client should be furnished by his/her former employer a distribution instruction form explaining his/her options and the tax consequences of such options.

In general, does the individual have "taxable" 401(k) funds and then also Designated Roth funds?

The Designated Roth funds are very similar to Roth IRA funds but they are different when in the 401(k) plan. The only place Designated Roth funds can be directly rolled over into is a Roth IRA. If the individual has met the 5-year rule and is age 59½ or older, such funds are nontaxable and will go into the Roth IRA as basis.

An individual with taxable 401(k) funds has the option of directly rolling over a portion into a traditional IRA (no tax as taxation deferred until a later distribution from the traditional IRA) and the option of directly rolling over to a Roth IRA. The amount going into the Roth must be included in income and income tax paid for the year of distribution.

Example. Option #1. John Doe has $90,000 of taxable funds in his 401(k). He may directly roll it over to a traditional IRA and no tax will be owing at time.

Option #2. John Doe has $90,000 of taxable funds in his 401(k). He may directly roll it over to a Roth IRA. He will include the $90,000 in his income.

Follow-up

The client decided to open 2 IRAs with us. A traditional to do a Direct Rollover and a Roth for a direct rollover from a designated Roth account. Do you feel this is correct and ok to do?

CWF Response

I do think what he has done is correct. That is, he has done what most people would do.

SOI Tax Stats at a Glance

Summary of Collections Before Refunds by Type of Return, FY 2014 [1]

Type of return	Number of returns	Gross collections (millions of $)
Individual income tax	147,444,789	1,614,213
Corporation income tax	2,220,921[2]	353,141
Employment taxes	30,065,749	976,223
Excise taxes	987,238	71,158
Gift tax	334,641	2,583
Estate tax	34,132	17,572

Selected Information from Returns Filed

Corporation Returns (TY 2012) [3]	
Number filed with assets of $250 million (M) or more	15,501
Percent of total corporation net income for firms with assets of $250M or more	73.3%
S Corporation Returns (TY 2012) [3]	
Number of returns	4,205,452
Partnership Returns (TY 2013) [3]	
Number of returns	3,460,699
Individual Returns	
Top 1-percent adjusted gross income (AGI) break (TY 2013) [3]	$428,713
Top 10-percent AGI break (TY 2013) [3]	$127,695
Median AGI (TY 2013) [3]	$36,841
Percent that claim standard deductions (TY 2013) [3]	68.5%
Percent that claim itemized deductions (TY 2013) [3]	30.1%
Percent e-filed (TY 2014) through 4/30/2015 [4]	92.2%
Percent using paid preparers (TY 2013) [3]	55.5%
Number of returns with AGI of $1M or more (TY 2013) [4]	347,070
State with the highest number-California (TY 2013)	53,990
State with the lowest number-Vermont (TY 2013)	400
Number of individual refunds (TY 2013) (millions) [3]	112.7
Individual refund amount (TY 2013) (billions of $) [3]	$320.6
Average individual refund amount (TY 2013)	$2,843
Earned income tax credit (TY 2013) [3]	
Number of returns with credit (millions)	28.8
Amount claimed (billions of $)	$68.1
Nonprofit Organizations (TY 2011) [3,5]	
Number of returns (Forms 990 and 990-PF filers)	367,277
Assets controlled by nonprofits (trillions of $)	$3.6
Taxpayer Assistance (FY 2014) [1]	
Number of call and walk-in contacts	69,385,822

Notes:
FY—Fiscal Year TY—Tax Year
1. Source—2014 *IRS Data Book*
2. Excludes S corporations
3. Source—SOI data
4. Source—IRS Master File System
5. Organizations tax exempt under Internal Revenue Code section 501(c)(3)

IRS Statistics of Income 2015

THE Pension Digest

IRA Conversion and IRA Recharacterization — What is the Difference?

Sometimes there is confusion concerning IRA conversions and IRA recharacterizations. It seems these terms are used interchangeably throughout the financial industry, when, in fact, they are actually very different events. In the discussion below, we hope to clarify the differences.

IRA Conversion

An IRA conversion contribution is made when funds are distributed from a traditional IRA and put into a Roth IRA for the purpose of receiving the benefit of tax-free distributions (interest and principal) from the Roth IRA. Such Roth distributions must be "qualified" distributions in order for the interest to be distributed tax free. Another reason to make a conversion contribution to a Roth IRA is that there is no age 70½ required distribution as there is with a traditional IRA.

One must be aware that the conversion distribution from the traditional IRA is a taxable event. An individual will receive a 1099-R and will have to pay normal income tax on this traditional IRA distribution for the year in which the funds are received. However, a special rule did apply for 2010 conversions. Once the funds are deposited into the Roth IRA, the earnings accumulate tax free (just as with the traditional IRA), but are never taxed if used for a "qualified" distribution.

Each conversion contribution has a separate five-year holding period for purposes of the 10% pre-59½ tax which is considered to begin on the first day of the individual's tax year (normally January 1) in which the conversion contribution is made. This five-year holding period ends on the last day of the individual's fifth consecutive taxable year (normally 12/31). If funds are distributed prior to the completion of the five-year holding period, a 10% recapture tax will be assessed, unless an exception (such as attaining age 59½) applies.

IRA Recharacterization —

The law permits an individual to treat contributions made to a Roth IRA or traditional IRA as made to the other type of IRA. This is accomplished by means of a trustee-to-trustee transfer or by an internal transfer with the same trustee. <u>There may be many reasons for recharacterizing a contribution, but it is mainly used as a correction mechanism, such as to correct a current year excess contribution, or to move a current year nondeductible contribution from a traditional IRA to a Roth IRA or to un-do a Roth conversion.</u> The recharacterized contribution is treated on the individual's federal income tax return as having been originally contributed to the second IRA on the same date and for the same taxable year as the original contribution to the first IRA. All earnings are attributed to the second IRA. A recharacterized contribution is not treated as a rollover for purposes of the one-rollover-per-year limitation.

The time frame for performing a recharacterization of a current-year contribution is generally October 15 of the following year (the tax-filing deadline of 4/15 plus 6 months). An individual who filed their tax return in a timely manner will be able to file an amended return to report the recharacterization.

The net income attributable to the contribution being recharacterized must be transferred to the second IRA. The method used to calculate these earnings is basically the same method used to calculate the earnings associated with an excess contribution to a traditional IRA. There are some minor differences.

A recharacterization is not subject to withholding, as it is not a taxable event. However, it is a reportable transaction, and your institution will need to prepare two 5498s: one to show the original contribution and one to show the recharacterization. A 1099-R will also need to be prepared to report the "deemed" distribution

In the case of an excess contribution, the excess amount may simply be withdrawn by the individual's tax-filing deadline, plus extensions. However, the reason to choose recharacterization over withdrawal is that under the withdrawal rules, the applicable income must also be withdrawn, normal income tax will be owing, and, if the individual is under age 59½, the 10% early withdrawal penalty will be assessed. By using recharacterization, the transaction is nontaxable, and the interest is allowed to be transferred along with the contribution.

Continued on page 6

Conversion and Recharacterization,
Continued from page 5

In Summary: It is important that an IRA custodian's personnel be aware of the differences between conversion and recharacterization contributions. Sometimes your accountholders will incorrectly use one term when they mean the other term. In many instances the required IRS reporting is then completed incorrectly. Each transaction has very specific rules for completing the 1099-R and 5498. It is in you and your customer's best interest to complete these reporting forms correctly.

Roth Account in Your Retirement Plan

If you participate in a 401(k), 403(b) or governmental 457(b) retirement plan that has a designated Roth account, you should consider your Roth options. With a designated Roth account, you can:

- make designated Roth contributions to the account; and
- if the plan permits, roll over certain amounts in your other plan accounts to the Roth account.

Designated Roth contributions

Unlike pre-tax salary deferrals, which are not taxed when you contribute them to the plan, you have to pay taxes on your designated Roth contributions. That is, they are not excluded from your income. This means your gross income for the year you make designated Roth contributions will be higher than if you had made only pre-tax salary deferrals.

However, any pre-tax salary deferrals and related earnings are taxable when you withdraw them from the plan. Roth contributions, on the other hand, are not taxed when you withdraw them from the plan. Earnings on Roth contributions are also not taxed when they are withdrawn from the plan if your withdrawal is a qualified distribution. A "qualified distribution" is a distribution that is made:

- at least 5 years after the first contribution to your Roth account; and
- after you're age 59½ or on account of your being disabled, or to your beneficiary after your death.

In-plan Roth rollovers

Your plan may allow you to transfer amounts to your Roth account in the plan if the amounts are:

- eligible rollover distributions from your other plan accounts; or
- any amounts, including those not otherwise eligible for a distribution, from your other plan accounts.

You must include in gross income in the year of transfer any previously untaxed amount you roll over to your designated Roth account.

You don't include in gross income any withdrawal of the amount you rolled over to the Roth account. However, you may have to pay:

- a special recapture tax; and
- tax on the earnings on the rolled over amounts that are withdrawn, unless the withdrawal is a qualified distribution.

Check with your employer to find out if your plan has a Designated Roth account and whether it allows in-plan Roth rollovers.

This article written by the IRS can be found at https://www.irs.gov/Retirement-Plans/Roth-Acct-in-Your-Retirement-Plan

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TOP TEN DIFFERENCES BETWEEN A ROTH IRA AND A DESIGNATED ROTH ACCOUNT

IRS

	Roth IRA	Designated Roth Account
Number of Investment Choices	Many as long as not prohibited	As offered by the plan
Participation	Anyone with earned income	Participant in a 401(k), 403(b) or 457 governmental plan that allows designated Roth contributions
Contribution limits	$5,500 (for 2015 and 2016*) $6,500* (if age 50 or older)	$18,000 (in 2015 and 2016*) $24,000* (if age 50 or older)
Recharacterization of rolled-over amounts	Allowed	Not allowed
Required minimum distributions	Only after the original IRA owner's death	Yes
Tax on nonqualified distributions	Nonqualified distributions are distributed in this order: 1. Nontaxable contributions 2. Taxable earnings	Nonqualified distributions are pro-rated between Roth contributions (nontaxable) and earnings (taxable) **
Withdrawals	Anytime. May be subject to tax if not a qualified distribution	Only when allowed by the terms of the plan. Subject to tax if not a qualified distribution
Loans	No	Yes, if plan allows
5-year holding period for qualified distributions	Begins January 1 of the year a contribution is made to any Roth IRA	Separate for each Roth account and begins on January 1 of the year contributions made to that account. If one Roth account is rolled into another, the earlier start date applies. *
Beneficiary	Anyone	Anyone but, if married, spouse must consent to nonspouse beneficiary

*See Cost-of-Living Adjustments for other years' limits.

Reminder – RMD Comes Before Any Conversion or Rollover

The rule is – a person is ineligible to rollover his or her RMD from a traditional IRA. A conversion is a special type of rollover as the funds move from a traditional IRA to a Roth IRA. The governing IRA regulation provides that the first money withdrawn from an IRA is allocated to satisfy the RMD. This happens by law whether the person wants to use it to satisfy his or her RMD.

This rule (first money withdrawn counts against the RMD amount) causes problems for those individuals age 70½ and older who have set up periodic RMD distributions. For example, Jane Doe, age 75 has set up a periodic distribution schedule where she has her current year's RMD transferred to her checking account from her traditional IRA. Her IRA's account balance was approximately $28,000 as of December 31, 2014. Her RMD for 2015 is $1,400. This transfer takes place on December 5th of each year. She uses these funds for Christmas presents.

However, she comes into the financial institution on November 3, 2015 and she informs you she wishes to convert $10,000 from her traditional IRA to her Roth IRA that day.

You will need to inform her of the above rules. Her RMD amount for 2015 ($1,400) must be paid to her before she is allowed to do the conversion. So, she can withdraw the RMD amount of $1,400 on November 3, 2015 and then do the conversion. Or, she could wait to do the conversion on December 5th after her RMD has been distributed to her.

What would be the consequence if a financial institution allows Jane Doe to do the conversion as of November 3rd and then she was paid her RMD amount as of December 5th?

A tax mess occurs. Presumably, the IRA custodian will report a conversion amount of $10,000. However, only $8,600 was eligible to be converted. This means there is an excess contribution of $1,400 within the Roth IRA. The 6% excise tax will apply until corrected. If the Form 5498 is prepared to show a conversion of $10,000, the IRS may fine your institution $50 for preparing the 5498 form incorrectly. If Jane would prepare her tax return showing a conversion of $10,000, she would need to amend her return to show a conversion of $8,600 and not $10,000. The $1,400 withdrawn on December 5th would not be converted unless she would so instruct. She has 60 days to roll it over or convert it or it will be an ordinary IRA distribution and in most eases the 60-day rule will not be met.

The above illustration discusses RMDs and a conversion. Virtually identical rules will apply when a person wants to rollover funds in the same year he or she must take an RMD. The rule is – no rollover is possible until the RMD has been withdrawn for such year. Remember, that a person is allowed to transfer some or all of their IRA without having to take their RMD.