THE Pension Digest

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ALSO IN THIS ISSUE –

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

President Obama Signs the Budget/Tax Bill on December 18, 2015.

As last year, the President signed legislation Friday afternoon before travelling to Hawaii for a two week family vacation. This year he signed the "Military Construction and Veterans Affairs and Related Agencies Appropriations Act of 2016 (Consolidated Appropriations and Tax Measures)." Included in this law is the Protecting Americans From Tax Hikes Act of 2015.

There are 4 provisions impacting IRAs.

First, the qualified charitable contribution/distribution (QCD) rules were adopted on a permanent basis. A distribution made during 2015 qualifies as a QCD if the following three rules were satisfied - the distribution occurs during 2015, it is for an amount up to $100,000 and the check is made payable to a qualifying charity.

It will be interesting to see if the IRS will change its current administrative practice for QCDs. That is, the IRA custodian prepares the Form 1099-R showing the distribution as being fully taxable and then the individual must explain on his or her tax return that the distribution is not taxable as he or she made a QCD. Because the QCD rules are no long temporary, one would think the IRS would now give serious consideration to assigning a special Form 1099-R code for the non-taxable QCD to expressly indicate the QCD is tax-fee.

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Great News – Major Exception Created to the $250 Per Incorrect Form 1099-R Penalty.

It was only 4 months ago when the Trade Preferences Extension Act of 2015 was enacted. This law authorized an increase in the per 1099 form penalty from $100 per form to $250 per form. The $250 penalty applies to the 2015 1099 forms (including form 1099-R) to be filed after December 31, 2015.

Under existing law, there is a de minimis exception, but it is very limited. A filer cannot be penalized even if it has prepared forms with errors (any error no matter how small) as long as the incorrect forms do not exceed the greater of 10, or .005 times the total number of information returns required to be filed by the filer during the calendar year.

The new law creates two "additional" exceptions - if the dollar amount of the distribution is incorrect by $100 or less then the general rule is that such incorrect form is not one for which the IRS may impose the $250 penalty. And the same is true if the amount of federal withholding differs by $25 or less from the correct amount. The IRS may issue regulations to prevent the abuse of these new exceptions.

There is, however, an exception to the exception at least with respect to the individual's form (i.e the payee statement). It appears the IRA custodian need not issue a corrected form to the IRS, but

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Secondly, modified the Internal Revenue Code rules for making a roll over contribution into a SIMPLE-IRA. Under existing law, the only distribution which was eligible to be rolled over into a SIMPLE-IRA was if the distribution had come from another SIMPLE-IRA or the same SIMPLE-IRA. That is, it was impermissible for a person to rollover a distribution from a traditional IRA into a SIMPLE-IRA or from a 401(k) plan into a SIMPLE-IRA, from a 403(b) plan into a SIMPLE-IRA or from certain other employer sponsored plans. The new rules are effective for distributions occurring on or after December 19, 2015.

Such distributions are now eligible to be rolled over into a SIMPLE-IRA as long as the individual has met the 2-year rule as set forth in Code section 72(t).

Presumably and hopefully, the IRS will be revising its two Model SIMPLE-IRA Forms (Form 5305-S and Form 5305-SA) because Article I of such forms provide, "In addition the trustee will accept transfers or rollovers from other SIMPLE-IRAs of the participant. No other contributions will be accepted by the trustee." These forms were last revised in March of 2002 and as written do not allow for rollovers for distributions from any IRAs and plans other than another SIMPLE-IRA. CWF is revising its SIMPLE-IRA forms by adding this new rollover rule. Rollover certification forms will also need to be revised.

The IRS should also be issuing a revised Rollover Chart as set forth in Publication 590A.

Thirdly, a "technical" amendment was adopted extending the deadline for rolling over certain airline payment amounts. In the FAA Modernization and Reform Act, a person had been authorized to rollover certain airline payments received with respect to certain bankruptcies. The rollover had to be accomplished by August 4, 2012. Such rollover contribution was authorized and it was not subject to the annual contribution limit. The new tax law extends the deadline to be 180 days after December 18, 2015 or June 15, 2016.

The fourth IRA provision is discussed in the adjacent article discussing a new de minimis rule which creates a major exception so that an IRA custodian will be not be assessed the $250 penalty for an incorrect Form 1099-R.

Great News,
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it will need to issue a corrected form or statement to the individual. If he or she so elects pursuant to procedures to be defined by the IRS.

Note that this new de minimis exception applies to returns required to be filed, and payee statements required to be provided, after December 31, 2016. That is, it applies to 2016 reporting forms and not to the 2015 reporting forms. This new exception is certainly good news. It is a small but reasonable change.

IRA Custodian's Duty To File Corrected Form 1099-Rs Will Change

Existing 2015 Rules

Once an IRA custodian/trustee discovers it has filed a Form 1099-R with the IRS containing an error, it must correct it as soon as possible and file a corrected form with the IRS. The IRA custodian must also furnish a copy of the corrected from to the individual. Remember that the IRS has adopted the IRA administrative approach that the individual is assumed to owe tax on the total IRA distribution amount unless he or she explains why a certain amount is not taxable. The individual's tax return may well need to be changed to reflect the new correct distribution information as shown on the corrected Form 1099-R.

In the instructions for the Form 1099-R the IRS gives the following example as clarified by CWF. If a 401(k) plan transmits a direct rollover and files Form 1099-R with the IRS reporting that none of the direct rollover is taxable by entering 0 (zero) in box 2a, and it then discovers that part of the direct rollover consists of RMDs, it must file a corrected Form 1099-R to report only the amount eligible to be rolled over in box 2a and file a new Form 1099-R for the individual reporting the RMD as a normal (and taxable) distribution.

Note that the IRS instruction do not set forth guidance that an IRA custodian is relieved of its duty to file the corrected form if the error occurred more than 3 years ago. The IRS should furnish guidance on what the IRA custodian is to do if an error more than 3 years old is discovered.

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IRA Amendments Being Required For 2015-2016

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 2016?

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 IRA forms, CWF has.

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, 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.

We at CWF have revised our IRA plan agreement forms and written the 2015-2016 IRA amendments to include the following revisions.

1. New 2016 limits impacting tax deductions and the Savers Tax Credit.
2. The three law changes made by the recent tax bill - QCD rules are now permanent; extension of special rollover period for certain airline payment; and the new SIMPLE-IRA rollover rules.

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Amendments,
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3. A reminder that an IRA distribution may disqualify a person for the premium tax credit.
4. Improved discussion of the reporting to be done by the IRA custodian to the IRA accountholder and by the IRA accountholder or beneficiary to the IRS.
5. New improved discussion of direct rollover option and rollover option for distributions from 401(k) and similar plans into a traditional IRA and/or a Roth IRA. IRS rules effective as of January 1, 2015 made it easier to move 100% basis into a Roth IRA.

In summary, answering a question whether or not an amendment is required is not simple. Each financial institution will need to make its own decision to furnish one or both amendments.

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.

February 1, 2016 Deadline

January 31, 2016 is a Sunday so the deadline for furnishing required IRA forms is February 1, 2016. An IRA custodian/trustee must furnish (i.e. mail, email, fax or personally deliver) the following to its IRA accountholders and its inheriting IRA beneficiaries. If this deadline would be missed, the IRS may assess the fines discussed at the end of the article.

2015 Form 1099-R

Any person (accountholder or beneficiary) who received a distribution(s) from an IRA totaling more than $10 for the year must be furnished a 2015 Form 1099-R.

This FMV statement must be prepared on a per plan agreement basis. That is, if a person would have two traditional IRAs and one Roth IRA, then he or she would need to be furnished three Form 1099-Rs. In addition, there must be a Form 1099-R prepared for each applicable distribution code. For example, if a person has traditional IRA and one distribution required the use of Code “1”, one the use of code “3” and one the use of Code “7”, then three Form 1099-Rs must be furnished.

When an individual receives more than one copy of the Form 1099-R, then it is mandatory for the IRA custodian/ trustee to insert a unique number in the account number box located in the lower left hand corner of the form. Even though there will be times when furnishing this account number is not required, the IRS encourages IRA custodian/s trustees to voluntarily furnish it. This account number allows the IRS to process the submissions of any corrected forms.

If the IRA custodian would fail to timely furnish a 2015 Form 1099-R or furnishes one prepared with errors due to its errors, then the IRS may assess a fine of $250 per form.

Fair Market Value (FMV) statements

An IRA custodian must furnish a FMV statement to each IRA accountholder and each inheriting beneficiary having a balance as of December 31, 2015, to each IRA accountholder who died during 2015, and to any IRA accountholder who made a reportable contribution for 2015 during 2015. The deadline to furnish the FMV statement is February 1, 2016.

This FMV statement must be prepared on a per plan agreement basis. That is, if a person would have two traditional IRAs and one Roth IRA, then he or she would need to be furnished three FMV statements these could be combined as long as there were three separate sections.

There must be a sentence on the statement informing the recipient that the FMV information (Balance as of December 31) will be furnished to the IRS when the 2015 Form 5498 will be filed with the IRS in May of 2016.

The IRA Custodian/trustee may, but is not required, to furnish contribution and earnings (including interest) information on the FMV statement for traditional IRAs, SEP-IRAs and Roth IRAs. However, a special rule applies for SIMPLE-IRAs. In the case of a SIMPLE-IRA, the IRA custodian must furnish a detailed statement listing all contributions (dates, and amounts) made by the employer on behalf of the SIMPLE-IRA accountholders.

Why is it required to furnish the FMV statement? A taxpayer who has basis within a traditional IRA, SEP-IRA or SIMPLE-IRA needs the FMV for purposes of completing the Form 8606 to determine the taxable portion of a distribution and the nontaxable portion.

The IRS may assess a penalty of $50 for each failure to furnish the FMV statement for traditional IRAs, SEP-IRAs, and Roth IRAs. The penalty is $100 PER DAY for failing to furnish the FMV statement for a SIMPLE-IRA.

RMD Notice for 2016.

An IRA custodian/trustee must furnish each traditional/SEP/SIMPLE-IRA accountholder who was born on or before June 30, 1936 and who has a balance as of December 31, 2015 with an RMD Notice. This RMD notice must be furnished to ALL such accountholders and not only to those individuals who attain age 70½ in 2016. The RMD notice is not required to be furnished to an individual who only attains age 70 in 2016 (i.e. born between July 1, 1936 and December 31, 2016).

There is no requirement and no need to furnish an RMD Notice to a Roth IRA accountholder since the RMD rules do not apply to a Roth IRA accountholder while he or she is alive.

Three items must be set forth in the required RMD Notice.

First, the deadline applying to the IRA accountholder must be set forth. This will be December 31, 2016, for an individual who is older than age 70½ in 2016 or April 1, 2017, if the individual does attain age 70½ in 2016. Second, there must a sentence informing the individual that the IRS will be told on the 2015 Form 5498 that he or she is subject to the RMD rules for 2016. Third, the individual must be informed of his or her RMD amount for 2016 or that such amount has not been calculated, but will be if the individual contacts the IRA custodian/trustee and requests that the calculation be made.

Although the RMD laws apply to an inheriting IRA beneficiary of all four types of IRAs, current IRS rules do not require the IRA custodian/trustee to furnish an RMD notice. CWF strongly suggests you do so. The model IRS IRA forms do require that there be an RMD distribution made to an inheriting beneficiary. A beneficiary who fails to take an RMD will owe the 50% tax and may well argue that the custodian/trustee should pay some of this tax for its failure to notify or payout a RMD.

The IRS may assess a fine of $50.00 for each time an IRA custodian/trustee would fail to furnish a complying RMD notice.

In summary, an IRA custodian/trustee must furnish the 2015 Form 1099-Rs, FMV statements, and 2016 RMD Notices by February 1, 2016 or it will be subject to being fined by the IRS.

Basic IRA Rollover Rule– Same Property Distributed Must Be Rolled Over

The following email question allows us to discuss a basic IRA rollover rule– if property is distributed from an IRA, then that same property must be rolled over. The property can't be sold and the proceeds rolled over. The individual can't substitute cash for the value of the property.

Question/Situation

I have a customer that holds gold coins in her SD IRA. She is questioning if she can come in and take the gold coins and give us a check in the amount of what the coins or worth. I'm not so sure that we can do that. But is it possible to do a distribution of the amount of the coins to her and then she can rollover the same amount in cash to the IRA?? This seems more plausible and I know that you can rollover a distribution to an IRA within 60days but I wasn't sure if we would be in some type of violation because we are dealing with gold coins.

CWF's Response

The prohibited transaction (Code section 4975) rules do not allow her to buy the gold from her IRA.

The rollover rules do not allow the gold to be withdrawn from her IRA and distributed to her and then she sells the gold coins and rolls over the proceeds. When there is a distribution of property from an IRA, the law requires that the specific property be rolled over. Unlike with a distribution from a 401(k) plan, the property distributed from an IRA cannot be sold and the proceeds rolled over.

If she has a SD traditional IRA, the tax rules do permit that a distribution be made to her, but she is required to include the fair market value in her income. I assume she has no non-deductible basis within her IRA.

For discussion purposes, it assumed that Jane Doe invests $42,000 of her traditional IRA in gold coins in 2009. Each coin is one ounce. The initial value of each coin was $1400 per ounce. 30 coins were purchased. At one time the value was $1,800 per ounce/coin or a total value of $54,000. Now with gold at $1,050 per ounce, the total value is $31,500. It may be a person in this type of situation should consider doing a Roth IRA conversion if she believes the Roth IRA will regain lost value. She may make partial deferrals. She is not required to covert all at once. She could a convert portion in 2015 and a portion in 2016.

Follow-up Question

Just for verification, she truly cannot do a distribution of the gold coins to herself and then rollover (in cash) what the gold coins are worth, correct? I attempted to explain this to the customer but she insists that her CPA told her she is able to do just that. I told her I would double check to make sure. Did I misunderstand you?

CWF's Response

The rollover rules applying to distributions from IRAs and from pension plans are virtually identical, but in one situation there is a difference.

When property is distributed from a pension plan the individual may sell it to a third party (but not to himself or herself) and then roll over the proceeds of the sale. See page 27.

When property is distributed from an IRA it cannot be sold and the proceeds rolled over. It does not matter if the sale is to a third or to the individual. When property is distributed from an IRA a rollover contribution can only be made if the exact same property is rolled over. See page 24.

The CPA is wrong. If the CPA is willing to write a letter explaining (and state some tax authority) why he or she is correct, I will review it. Hopefully, your client and the accountant understand that if she would contribute her cash to her IRA as a purported rollover, its does not qualify and it will be an excess contribution within the IRA. The distribution to her will be taxable as it must be included in her income and taxed at the marginal tax rate applying to her.

You may share this email with your client and the CPA. The Internal Revenue Code sections support what the IRS has written on this topic. This is not an area of the tax law where the law is murky. It is clear. She cannot substitute her cash (i.e. buy) the gold coins from her IRA.

What RMD Rules Apply to Roth IRAs?

The following email question allows us to discuss the rules applying once a Roth IRA accountholder dies.

Question/Situation

Can you please let me know if there are RMD rules for Roth Inherited IRAs? Does the Roth Inherited need to be closed at the 5-year?

Deceased was over 70.5

Beneficiary is non-spouse.

CWF's Discussion

A non-spouse Roth IRA beneficiary must comply with the RMD rules for Roth IRAs. The 50% tax is owed on any missed RMD.

These RMD rules are similar to those applying to traditional IRAs, but there is an important difference. Regardless of the Roth IRA owner's age at his or her death, the law provides that the life distribution rule applies to the non-spouse beneficiary unless he or she elects to use the 5-year rule or the 5-year rule is required to be used as there is a non-person who is the designated beneficiary.

This means there is generally an RMD for the year following the year of the Roth IRA owner's death. For example, if I have a Roth IRA and I die in 2015, my son is required to commence taking annual RMDs based on his life expectancy. His first RMD would be for 2016. If my son is age 27 in 2016, then his life expectancy is 56.2 years as set forth in the Single Life Table. In almost all cases a distribution to a non-spouse beneficiary will be tax-free. The exception is– the earnings will be taxable if the earnings are distributed prior to the 5-year rule being met.

My son as a non-spouse beneficiary would have the right to elect use the 5-year rule, but he and other non-spouse beneficiaries almost never should make this election as he/they would be giving up the right to have these funds continue to earn tax-free income for the remaining 56 years. Under the 5-year rule the Roth IRA must be closed by the year containing the 5th anniversary of the Accountholder's death. If I died in 2015, the Roth IRA must be closed by 12/31/2020 if my son would elect the 5-year rule.

A person should designate a living person(s) as the primary beneficiary and living person(s) as the contingent beneficiaries. Generally, a person should not designate his or her estate, church, favorite university or college to be a primary or a contingent beneficiary along with other beneficiaries.

If you wish to give some Roth IRA funds to your church or a favored college or university, you should set up a separate Roth IRA designating such church as the sole primary beneficiary.

If you fail to designate a beneficiary, your estate is your beneficiary and the Roth IRA must close under the 5-year rule.

No Traditional IRA Contribution for the 70$^1/_2$ Year

The following email question allows us to discuss the basic eligibility rule that a person is ineligible to make a traditional IRA contribution for the tax year during which he or she attains age 70$^1/_2$.

Question/Situation

I have an IRA customer that is turning 70$^1/_2$ on 12/26/2015 (his DOB is 6/26/1945). He has been making contributions to his IRA this year. I know that he has until April 1st of 2016 to take his RMD for this year. My question is, was he really allowed to make these contributions to his IRA in 2015 since he is turning 70$^1/_2$ in 2015? It was my understanding that a person can make contributions to their IRA until the age of 70$^1/_2$ but I just read some information that seems to be saying otherwise. And if he was not allowed to make these contributions, we will need to take the full amount plus accrued interest out as an excess, correct?

CWF's Response

A person is not permitted to make a traditional IRA contribution for the year he or she attains age 70$^1/_2$. The IRA contribution rule is different that the Coverdell ESA contribution rule. So, any traditional IRA contribution made for 2015 is an excess contribution even though he is not yet age 70$^1/_2$. You are correct, the excess contributions should be withdrawn along with the related income.

A Rollover Contribution After Age 70$^1/_2$ is Permissible

Question/Situation

Can a client do a rollover to a traditional IRA after the age of 70$^1/_2$? I know that can't make contributions but was not sure about a rollover.

CWF's Response

No annual contributions may be made for the year a person attains age 70$^1/_2$. This is a traditional IRA rule. It is not a Roth IRA, SEP-IRA or SIMPLE-IRA rule. Such rule also does not exist for a rollover contribution. However, a person is never eligible to rollover a required distribution and under the distribution rules the RMD must be satisfied before any other distribution amount is withdrawn. Thus, if Jess has $40,000 in her traditional IRA. her RMD for the year is $700 and she has not yet taken it and she withdraws $1,200 with the hope of rolling it all over, the rules permit her to roll over only $500, the amount in excess of the required distribution.

File Corrected 1099-R,
Continued from page 2

New Rules for 2016 and Subsequent Years

Due to the new exceptions being added to the de minimis penalty rules, the IRS will need to issue guidance as to how these new rules impact the duty to prepare a corrected Form 1099-R. It appears the IRA custodian may not need to file a corrected Form if the amount error is less than $100 or the withholding amount error is less than $25. It appears the individual will have the right to require an IRA custodian to correct a Form 1099-R prepared incorrectly.