The Pension Digest

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ALSO IN THIS ISSUE –

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

Understanding What Forms Are Needed To Establish a SEP-IRA

Jane Smith wishes to make a SEP-IRA contribution for herself. Jane is a self-employed horse rider/exerciser. She had a good year and so she wants to establish a SEP and then make a $26,000 contribution to her SEP-IRA for tax year 2015.

What forms will she need to prepare?

First, as an employer (a one person business), she must establish her Simplified Employee Pension Plan (SEP). She will do so by completing and signing the IRS model form 5035-SEP. Note that she signs the form as the "employer." The financial institution does not sign this form. Jane will either obtain this form from her accountant, attorney, financial institution or she will find it on-line at the IRS website, www.irs.gov.

Second, as the employer, she will write a business check for the amount of $26,000 and she will contribute it to her SEP-IRA. A SEP-IRA is established by a person establishing a standard traditional IRA (IRS model form 5305) and then making a SEP-IRA contribution to it. For 2015 she is permitted to make a SEP-IRA contribution equal to the lesser of 25% of her adjusted business earnings or $53,000.

We recently had a call from an IRA representative where the IRA software system her bank was using did not make this clear. The system gave the idea that the only form needed was the Form

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SEPs — The Last-Minute Retirement Plan and Tax Deduction

Definitions

SEP — SEP is the acronym for Simplified Employee Pension plan. In order to have a SEP, two requirements must be met. First, an employer must sign a SEP plan document which may be: (1) the IRS model Form 5305-SEP; (2) a SEP prototype; or (3) a SEP plan as written specifically for that employer by an attorney. The employer may be a gigantic corporation or a self employed person. Second, all eligible employees must establish (or have established for them) a SEP-IRA.

SEP-IRA — A SEP-IRA is a standard, traditional IRA established with a financial institution to which an employer has made a SEP-IRA contribution. The IRA custodian is required to report SEP-IRA contributions in box 8 on Form 5498. In all other respects, the standard, traditional IRA rules will apply to administering SEP-IRAs. Contributions to SEP-IRAs are always owned by the employee, once the funds have been contributed to the employee's SEP-IRA.

Discussion

SEP plans may be established and funded by the normal tax deadline, plus extensions. A person may come into your institution in July of 2016, and make a SEP contribution of $53,000, for tax year 2015. If an individual has the proper extension(s) a SEP contribution may be made as late as October 15 of 2016, for tax year 2015.

Establish a SEP-IRA,
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5305-SEP. The system did not make it clear that the individual either needed to have an existing IRA into which the SEP-IRA contribution would be contributed or a new SEP-IRA must be established. Both forms are needed and so hopefully the vendor will change its system once it is advised that a clarification is needed.

IRS statistics show that annual SEP-IRA contributions exceed those of annual traditional IRA contributions. A financial institution will benefit by communicating with its business customers about the benefits of SEP-IRAs.

The tax laws do not require a person who has an existing traditional IRA to set up a new SEP-IRA. Some financial institutions choose for administrative reasons to require a separate IRA, but the tax laws do not require it. If any employee would fail to have a SEP-IRA so the business did not make a SEP contribution for such employee, there would be no SEP and the expected tax benefits would not apply for the sponsoring business and other employees.

In summary, establishing a SEP is easy as long as the two steps above are completed for a one person business and the three steps are completed for a business with employees.

Form **5305-SEP**
(Rev. December 2004)
Department of the Treasury
Internal Revenue Service

Simplified Employee Pension—Individual Retirement Accounts Contribution Agreement
(Under section 408(k) of the Internal Revenue Code)

OMB No. 1545-0499
Do not file with the Internal Revenue Service

______________________ (Name of employer) makes the following agreement under section 408(k) of the Internal Revenue Code and the instructions to this form.

Article I—Eligibility Requirements (check applicable boxes—see instructions)

The employer agrees to provide discretionary contributions in each calendar year to the individual retirement account or individual retirement annuity (IRA) of all employees who are at least ________ years old (not to exceed 21 years old) and have performed services for the employer in at least ________ years (not to exceed 3 years) of the immediately preceding 5 years. This simplified employee pension (SEP) ☐ includes ☐ **does not** include employees covered under a collective bargaining agreement, ☐ includes ☐ **does not** include certain nonresident aliens, and ☐ includes ☐ **does not** include employees whose total compensation during the year is less than $450*.

Article II—SEP Requirements (see instructions)

The employer agrees that contributions made on behalf of each eligible employee will be:

A. Based only on the first $205,000* of compensation.
B. The same percentage of compensation for every employee.
C. Limited annually to the smaller of $41,000* or 25% of compensation.
D. Paid to the employee's IRA trustee, custodian, or insurance company (for an annuity contract).

______________________ Employer's signature and date ______________________ Name and title

Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

Purpose of Form

Form 5305-SEP (Model SEP) is used by an employer to make an agreement to provide benefits to all eligible employees under a simplified employee pension (SEP) described in section 408(k).

Do not file Form 5305-SEP with the IRS. Instead, keep it with your records.

For more information on SEPs and IRAs, see Pub. 560, Retirement Plans for Small Business (SEP, SIMPLE, and Qualified Plans), and Pub. 590, Individual Retirement Arrangements (IRAs).

Instructions to the Employer

Simplified employee pension. A SEP is a written arrangement (a plan) that provides you with an easy way to make contributions toward your employees' retirement income. Under a SEP, you can contribute to an employee's traditional individual retirement account or annuity (traditional IRA). You make contributions directly to an IRA set up by or for each employee with a bank, insurance company, or other qualified financial institution. When using Form 5305-SEP to establish a SEP, the IRA must be a Model traditional IRA established on an IRS form or a master or prototype traditional IRA for which the IRS has issued a favorable opinion letter. You may not make SEP contributions to a Roth IRA or a SIMPLE IRA. Making the agreement on Form 5305-SEP does not establish an employer IRA described in section 408(c).

When not to use Form 5305-SEP. Do not use this form if you:

1. Currently maintain any other qualified retirement plan. This does not prevent you from maintaining another SEP.

2. Have any eligible employees for whom IRAs have not been established.

3. Use the services of leased employees (described in section 414(n)).

4. Are a member of an affiliated service group (described in section 414(m)), a controlled group of corporations (described in section 414(b)), or trades or businesses under common control (described in sections 414(c) and 414(o)), unless all eligible employees of all the members of such groups, trades, or businesses participate in the SEP.

5. Will not pay the cost of the SEP contributions. Do not use Form 5305-SEP for a SEP that provides for elective employee contributions even if the contributions are made under a salary reduction agreement. Use Form 5305A-SEP, or a nonmodel SEP.

Note. *SEPs permitting elective deferrals cannot be established after 1996.*

Eligible employees. All eligible employees must be allowed to participate in the SEP. An eligible employee is any employee who: (1) is at least 21 years old, and (2) has performed "service" for you in at least 3 of the immediately preceding 5 years. You can establish less restrictive eligibility requirements, but not more restrictive ones.

Service is any work performed for you for any period of time, however short. If you are a member of an affiliated service group, a controlled group of corporations, or trades or businesses under common control, service includes any work performed for any period of time for any other member of such group, trades, or businesses.

Excludable employees. The following employees do not have to be covered by the SEP: (1) employees covered by a collective bargaining agreement whose retirement benefits were bargained for in good faith by you and their union, (2) nonresident alien employees who did not earn U.S. source income from you, and (3) employees who received less than $450* in compensation during the year.

Contribution limits. You may make an annual contribution of up to 25% of the employee's compensation or $41,000*, whichever is less. Compensation, for this purpose, does not include employer contributions to the SEP or the employee's compensation in excess of $205,000*. If you also maintain a salary reduction SEP, contributions to the two SEPs together may not exceed the smaller of $41,000* or 25% of compensation for any employee.

You are not required to make contributions every year, but when you do, you must contribute to the SEP-IRAs of all eligible employees who actually performed services during the year of the contribution. This includes eligible employees who die or quit working before the contribution is made.

Contributions cannot discriminate in favor of highly compensated employees. Also, you may not integrate your SEP contributions with, or offset them by, contributions made under the Federal Insurance Contributions Act (FICA).

If this SEP is intended to meet the top-heavy minimum contribution rules of section 416, but it does not cover all your employees who participate in your salary reduction SEP, then you must make minimum contributions to IRAs established on behalf of those employees.

Deducting contributions. You may deduct contributions to a SEP subject to the limits of section 404(h). This SEP is maintained on a calendar year basis and contributions to the

* *For 2005 and later years, this amount is subject to annual cost-of-living adjustments. The IRS announces the increase, if any, in a news release, in the Internal Revenue Bulletin, and on the IRS website at www.irs.gov.*

For Paperwork Reduction Act Notice, see page 2. Cat. No. 11825J Form **5305-SEP** (Rev. 12-2004)

IRA — Custodial Account Application — Form 5305-A

Revocation in accordance with the Disclosure Statement should be mailed or delivered to:

Custodian's Name ______________________
Address ______________________
City ______________ State ___ Zip ________
Attn: ______________ Phone ______________

Depositor Information

Name ______________________
Home Address ______________________
City ______________ State ___ Zip ________
County ______________ Date of Birth ______________
Phone: Home ______________ Work ______________
SSN ______________ Plan No. ______________

Adopting this plan agreement constitutes:

❍ the initial adoption of an IRA plan agreement, or
❍ the amendment and restatement (i.e. replacement) of a previous IRA plan agreement referenced as follows: ______________________

Designation of Beneficiary

Section 1.6 of Article VIII of the Individual Retirement Custodial Account (Form 5305-A) contains an important discussion of your right to name primary and contingent beneficiary(ies). Your designation will revoke all prior IRA beneficiary designations with respect to the referenced IRA account. In the event of your death you hereby direct that any balance in your IRA shall be paid to the following designated beneficiary or beneficiaries. If any primary or contingent beneficiary dies before you, then you wish to have the following result:

❍ the interest of that deceased beneficiary, his or her issue and spouse, if any, shall terminate totally and the percentage share of any surviving beneficiary(ies) shall increase on a pro rata basis; or

❍ the interest of that deceased beneficiary shall be paid to his or her issue who are alive or who have living issue, such issue will take by right of representation the share the deceased beneficiary would have taken if living, and persons of the same class shall share equally.

If you do not make the above designation, then you are deemed to have elected the "pro rata" selection.

If you designate your spouse as your sole primary beneficiary, and he or she predeceases you, then you intend the funds to be transferred to your contingent beneficiary(ies) who shall become the primary beneficiary(ies) and not pass per stirpes to the issue of your spouse.

You hereby designate the following individual(s) and/or entity(es) to be your beneficiary(ies). You must check Primary or Contingent for each beneficiary. If neither is checked, the designated beneficiary will be deemed to be a primary beneficiary.

❍ Contingent ❍ Primary Name ______________________
Address ______________________
City ______________ State ___ Zip ________
SSN ______________ Date of Birth ______________
Share % ______________ Relationship ______________

❍ Contingent ❍ Primary Name ______________________
Address ______________________
City ______________ State ___ Zip ________
SSN ______________ Date of Birth ______________
Share % ______________ Relationship ______________

❍ Contingent ❍ Primary Name ______________________
Address ______________________
City ______________ State ___ Zip ________
SSN ______________ Date of Birth ______________
Share % ______________ Relationship ______________

❍ Contingent ❍ Primary Name ______________________
Address ______________________
City ______________ State ___ Zip ________
SSN ______________ Date of Birth ______________
Share % ______________ Relationship ______________

Deposit Information

Date ______________________
Acct./Inst. No. ______________________
Deposit Amt. ______________ For Tax Yr. ________

Type of Contribution

❍ **Regular or Spousal for:** ❍ Current Year, or ❍ Prior Year
❍ **Rollover to:** ❍ Regular IRA, or ❍ SEP-IRA
❍ **SEP for:** ❍ Current Year, or ❍ Prior Year
❍ **Recharacterization**
❍ **Transfer—From Another IRA or SEP-IRA Custodian to:**
  ❍ Regular/Spousal IRA, or ❍ SEP-IRA
❍ **Transfer—Incident to Divorce**
❍ **Transfer—Surviving Spouse Elects to Treat as Own**
❍ **Special Rollover regarding Exxon Valdez litigation**
❍ **Repayment and Postponed Contributions – Complete CWF Form #54**

Your Regular or Spousal Contribution Limit

Tax Year	If Not Age 50	If Age 50 or Older
2012	$5,000	$6,000
2013-2016	$5,500*	$6,500*

*These limits may be adjusted for cost of living changes after 2016

Special Situation–Spouse's Signature/Consent

If you reside in a state with community or marital property laws and you are married and you wish to name a person(s) other than or in addition to your spouse as the beneficiary, then you need to obtain your spouse's consent. Otherwise you do not.

Spouse's Notice, Certification of Consent and Signature

I am the spouse of the IRA depositor. I understand that my spouse wishes to name an IRA beneficiary other than or in addition to myself. I hereby agree or consent to my spouse's designation of beneficiaries. I expressly understand that my signature indicates my consent and that the legal effect of this signature is to change the character of the ownership of the interest I have in such IRA funds. I understand that I may consult with my attorney before deciding to give such consent.

Spouse's Signature ______________________
Date ______________________

Signatures and Revocation Right

You have requested that the Custodian establish an Individual Retirement Account (IRA) for you. You certify that your tax identification number (social security number) and other information are correct. In the event that this is a rollover contribution, you hereby irrevocably elect to treat this contribution as a rollover contribution subject to your right to revoke this IRA as discussed below. The rules and conditions governing this IRA form are contained in this application and the IRS Model Form 5305-A plan agreement as modified. You acknowledge that you are opening a custodial IRA and that it expressly requires that your IRA funds be invested in various deposit accounts as offered by us (i.e. the Custodian). You acknowledge that the Custodian has furnished you with a copy of the application, and the Individual Retirement Plan and Disclosure Statement. In addition, you have read the disclosure statement and you qualify to make an initial contribution to this IRA. The Financial Disclosure is furnished to you using this method:

❍ 1. The financial projection information and tables as shown on the reverse side and on page 28 of the Disclosure Statement.
❍ 2. Special Attachment. For example, a customized disclosure statement or computer printout.

You have the ability to terminate this IRA which you are establishing if you comply in a timely fashion with the revocation provisions as discussed in section 2 of the Disclosure Statement. In general, you have seven (7) calendar days in which to revoke this IRA plan agreement.

Depositor's Signature ______________ Date ________

Authorized Signature of Custodian ______________ Date ________

Witness ______________________
Use only if signature of the depositor, the custodian, or the spouse is required to be witnessed

IRA #40-T (1/16) White — Custodian Yellow — Depositor (Accountholder)

Use the Proper Forms for 2015 and 2016 Recharacterizations

With tax season upon us, many individuals will be told by their accountants that, because of income limits, they are not eligible to deduct their traditional IRA contributions made for 2015 or that their 2015 conversion should be undone.

A recharacterization can only be made for 2015, if it is accomplished by the tax-filing deadline of the individual plus six months. The normal tax-filing deadline for most individuals is April 15. Generally, then, an individual has until October 15, 2016, to recharacterize an IRA contribution made for 2015.

It is important to document this recharacterization, so that the custodians of both IRAs are aware of the transaction. CWF has created special forms for this situation.

One form, CWF's Form #54-TR "Notice of Recharacterization of IRA Contribution," is recommended. It collects the following information:

1. Type and amount of the contribution to the first IRA that is to be recharacterized.

2. The date on which the initial contribution was made.

3. A direction to the custodian/trustee of the first IRA to transfer the amount of the contribution, plus the allocable net income, in a trustee-to-trustee transfer to the custodian/trustee of the second IRA.

4. The name of the first and second custodian/trustee.

5. Acknowledgement by the accountholder, and the current and successor custodian, that they understand the situation, and that the recharacterization will be handled and reported correctly.

An institution will also want the accountholder to understand the tax issues associated with a recharacterization, and how the individual must handle it on their tax return. CWF Form #56-TREX for 2015 provides this information.

The income earned on the amount recharacterized must also be transferred with no tax penalty. This is a valuable tax advantage. CWF has created a form to use to calculate the applicable interest on the contribution — Form #67-W.

Of course, the applicable plan agreement must also be completed, if the individual does not already have the correct type of IRA established.

Summary. Recharacterizations are becoming more popular. A financial institution will want to be certain to document these transactions correctly. The forms used must collect the needed information concerning the funds in question, the accountholder, the current IRA custodian/trustee and the successor custodian/trustee. CWF has these special forms available.

Calculating the Distribution Amount When There is Both Federal and State Income Tax Withholding

Set forth below is the basic formula to be used to calculate the amount to be withdrawn and the proper amounts to be withheld for federal withholding and state income tax withholding. It is assumed there is no early withdrawal interest penalty.

A	- B	- C	= D
Amount to be Withdrawn	- less federal withholding	- less state withholding	= Amount request to be furnished.

If B, C and D are known or defined then A (Amount to be withdrawn from the IRA) can be determined.

For example, if D is $1,000 and B is 10% and C is 5.3%, then A is $1,180.64 determined by dividing $1,000/.847,

If the amount to be withdrawn is x, then federal withholding is .10x and state withholding is .053x. The individual is to receive .847x.

This is 1.0 minus .10 minus .053 or .847.

$1,000 = .847x, x = $1,000/.847 and x =$1,180.64.

Federal withholding is 10% of $1,180.64 or $118.07

State withholding is 5.3% or $62.57.

The rate of federal and state withholding may vary and need not be 10% and 5.3%. Let's assume 25% for federal withholding and 5.1 % for state withholding.

1.0 - .25 - .051 = 1.0 - .301 = .699

$1,000/.699 = $1,430.62.

Federal withholding is 25% of $1,430.62 or $357.66

State Withholding is 5.1% of $1,430.62 or $72.96

$1,430.62 - $357.66 - $72.96 = $1,000.

Understanding When Reason Code G Is to Be Used and When It Is Wrong to Use Code G

There are numerous terms used to describe the movement of IRA funds and pension funds - actual distributions, deemed distributions, direct rollovers, rollovers, non-reportable transfers and reportable transfers.

Although the IRS has issued some guidance, everyone would benefit if the IRS would issue more comprehensive guidance.

This article discusses direct rollovers and the use of reason code G on the Form 1099-R. The primary use of reason code G is when an individual's 401(k) funds are directly rolled over to an IRA custodian for the benefit of an individual's traditional IRA. In a direct rollover the disbursement check issued by the 401(k) plan lists the IRA custodian as the check's payee for the benefit of a specified individual's traditional IRA. This check may look like a transfer check. but it is not since the 401(k) plan is not an IRA plan or vice versa.

Some tax accountants and some IRA personnel mistakenly believe that IRA funds are eligible to be directly rolled over to another IRA in the same way that 401(k) funds can be directly rolled over. And they believe that reason G is to be used to report this movement.

IRA funds are ineligible to be directly rolled over to another IRA so it would be improper to use reason G. By statutory definition there cannot be a direct rollover of IRA funds from one IRA to another IRA. A direct rollover requires that a pension plan (and not an IRA) makes a deemed distribution to an IRA or another pension plan. An actual distribution to an individual does not occur.

For example, Jane Doe instructs that she will have her vested 401(k) balance of $40,000 directly rolled over into her traditional IRA with IRA custodian #1. The 401(k) plan will issue her a Form 1099-R with $40,000 in box 1 (gross amount), 0.00 in box 2a (taxable amount) as there has been a rollover) box 4 (withholding will have a 0.00 or be blank) and box 7 will have a reason code G (direct rollover). The IRA custodian will prepare a Form5498 for Jane showing in box 2 that she made a rollover contribution of $40,000.

The standard pension plan distribution rule is, if a person is eligible to directly rollover his or her vested account, but elects not to, the plan must withhold 20% of the distribution amount and will pay the individual 80%. That is, for the 20% mandatory withholding rule to not apply, the participant must elect to have a direct rollover. And most do. The mandatory 20% withholding rule does not apply to a distribution of IRA funds. The IRA rule is, the IRA custodian will withhold 10% of the distribution amount unless the individual instructs to have no withholding or to have more withheld.

How does one move IRA funds from one IRA to another IRA if he or she cannot do a direct rollover?

The first answer is, one moves the funds via a nonreportable transfer.

The IRS, for a long time, has authorized that funds may be transferred from one IRA to another IRA. In a transfer, the disbursement check lists the IRA custodian as the payee. Transfers are non-reportable. In order to be considered a transfer, the movement of funds must be between the same type of plan (e.g. a QP-to-QP transfer, an IRA-to-IRA transfer, a 403(b)-to-403(b) transfer, a Roth IRA-to-Roth IRA transfer, etc.)

Concerning IRA-to-IRA transfers, the IRS' instructions state: **Transfers.** Generally, do not report transfers between trustees or issuers (unless they are direct rollovers from qualified plans) that involve no payment or distribution of funds to the participant, including a trustee-to-trustee transfer from one IRA to another (unless they are recharacterized IRA contributions or Roth IRA Conversions) or from one tax-sheltered (section 403(b)) arrangement to another.

An IRA custodian who sends a check to another IRA custodian in the format, "First Bank IRA custodian fbo Jane Doe," should do so only if a transfer form has been completed by the three parties involved.

The second answer is, the person takes an actual distribution and then makes a rollover contribution. Or, the person takes a deemed distribution (i.e. the check is made payable to IRA custodian #2 fbo of the individual's IRA) and then he or she makes a a rollover contribution. This approach assumes the individual satisfies the standard IRA rollover rules - any RMD is ineligible, 60 day rule and once per year rule.

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The IRA custodian distributing the IRA funds is required to prepare a Form 1099-R using the name and social security number of the individual. The reason code to be used will be the standard codes 1 if the individual is under age 59½ and 7 if the individual is age 59½ or older. A long time ago the IRS had a code 2 to be used if a person had indicated that he or she intended to make a rollover contribution. The IRS changed its procedures by no longer using code 2 for this purpose since the IRS learned that many individuals may initially believe they will make a rollover contribution, but they never do. Reason code G is not to be used. The individual will need to complete lines 15a and 15b of his or her tax return to show the distribution is not taxable because he or she made a rollover contribution.

The IRA custodian receiving the IRA funds is required to report the rollover contribution in box 2 of Form 5498.

Set forth below is an excerpt from the IRS chart describing the use of reason code G.

Note that a direct rollover must come from a qualified plan or other employer sponsored plan and NOT from an IRA. The deemed distributed funds may go into another qualified plan or an IRA.

Also note there is an explanation that a direct payment from an IRA (note not called a direct rollover) to an accepting employer plan may be coded as a G. Yes, it is confusing. But these IRA funds are going into an employer plan and not an IRA.

In summary, a direct rollover does not occur when funds are moved from one IRA to another IRA and using reason Code G on the Form 1099-R will subject the IRA custodian to being fined $250 for preparing an incorrect Form 1099-R.

Form 5329 - Reporting Additional IRA Taxes

A person is required to file Form 5329 to report the 6% tax for an excess contribution, the 10% tax for an early distribution and the 50% tax for a missed required distribution. Additional tax penalties most likely will be imposed if Form 5329 is not filed when required.

Who must complete and file Form 5329?

1. A person who failed to take his or her 2015 required distribution. This can be the IRA accountholder or an inheriting beneficiary.

2. A person who made an excess contribution for 2015 or there was a tax due on the 2014 Form 5329. Note that form 5329 must be completed and filed even if the individual has corrected the excess contribution situation by withdrawing the excess contributions.

3. A person who received an early distribution from a Roth IRA and withdrew some earnings which must be included in his or her income.

4. A person who received more than one early distribution from a traditional IRA.

5. A person who received a form 1099-R with a reason code 1 in box 7 indicating an early distribution from a traditional IRA, but the individual is claiming that he or she meets one of the listed exceptions to the 10% tax.

6. A person who received a form 1099-R without a reason code 1 in box 7 indicating an early distribution from a traditional IRA, but the individual is claiming that he or she meets one of the listed exceptions to the 10% tax or the exception does not apply to the entire distribution.

Normally the Form 5329 will be attached to the person's Form 1040 or Form 1040NR. Note that a person required to file Form 5329 is ineligible to use Form

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G—Direct rollover and direct payment.	Use Code G for a direct rollover from a qualified plan, a section 403(b) plan, or a governmental section 457(b) plan to an eligible retirement plan (another qualified plan, a section 403(b) plan, a governmental section 457(b) plan, or an IRA). See *Direct Rollovers*, earlier. Also use Code G for a direct payment from an IRA to an accepting employer plan, and for IRRs that are direct rollovers. **Note:** *Do not use Code G for a direct rollover from a designated Roth account to a Roth IRA. Use Code H.*	4, B, or K
H—Direct rollover of a designated Roth account distribution to a Roth IRA.	Use Code H for a direct rollover of a distribution from a designated Roth account to a Roth IRA.	4

Reminder- A Person With an Inherited Traditional IRA May Make a Qualified HSA Funding Distribution

The tax rules permit a person to move funds from his or her traditional IRA to his or her HSA and this movement is tax- free. The individual benefits since the general tax rule is that funds within the traditional IRA will one day be taxable whereas if the individual withdraws the funds from the HSA and uses them to pay qualified medical expenses the distribution is tax free.

The individual must meet the standard eligibility rules to make a qualified HSA funding distribution. The individual must be HSA eligible for the current year. The individual can never have made a prior qualified HSA funding distribution. The check or funds cannot be distributed from the IRA to the individual who then recontributes the funds into his or her HSA. The IRA funds must be withdrawn by the IRA custodian and paid to the HSA custodian for the benefit of the individual's HSA. This is a special type of transfer and IRS reporting forms must be prepared by the IRA custodian (Form 1099-R) and by the HSA custodian (Form 5498-SA).

In Notice 2008-51 the IRS issued guidance that an individual with an inherited IRA could use it to make a qualified HSA funding distribution and the IRS also stated the person could take this special distribution into account for the required distribution relating to the inherited IRA. This was a double bonus.

The IRS policy was set in 2008. Our reading of the current IRS administration is that it would not have adopted such a policy in 2008.

Set forth on the adjacent page are the IRS instructions to the individual for Form 1040 as to how he or she prepares the federal income tax return to reflect the qualified HSA funding distribution. See page 26 of the 2015 instructions for Form 1040. Most likely, the 2016 IRS forms and instructions will be very similar to the 2015 forms.

In 2016 a person under age 55 with single HDHP coverage for all of 2016 is eligible to make a qualified HSA funding distribution of $3350 and $4350 if age 55 or older as of December 31, 2016.

In 2016 a person under age 55 with family HDHP coverage for all of 2016 is eligible to make a qualified HSA funding distribution of $6750 and $7750 if age 55 or older as of December 31, 2016.

Qualified Reservist Repayments

The general IRA contribution rule is that a person may contribute the lesser of 100% of his or her compensation or $5,500/$6,500, as applicable. There is a major exception, a person may also be eligible to repay a qualified reservist distribution. This repayment is in addition to the regular IRA contribution limit as long as certain rules are met.

First, a person's repayment cannot be more than the amount the individual withdrew as qualified reservist distributions. The individual would have included such amount in his or income for the year of receipt, but would not have owed the 10% additional tax.

Second, a person has two years from the date his or her active duty ends to make his/her repayment contribution.

A repayment contribution is a non-deductible contribution. A person is to include such repayment with any other nondeductible contributions, if any, made for such year on line 1 of Form 8606.

Example, Jane Doe's contribution limit for 2015 is $5,500. She was an active participant in a pension plan for 2015. She is eligible to claim a tax deduction for $4,000, but $1,500 of her contribution is nondeductible. She is also eligible to repay a $4,500 qualified reservist distribution she received in 2012. This means she is eligible to contribute $10,000 to her traditional IRA as follows - $4,000 as deductible, $1,500 as nondeductible and $4,500 as a nondeductible repayment. She will need to file the 2015 Form 8606 and include $6,000 on line 1.

Be ready to assist with repayment IRA contributions.

Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2015** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

For the year Jan. 1–Dec. 31, 2015, or other tax year beginning , 2015, ending , 20 See separate instructions.

Your first name and initial	Last name	**Your social security number**
If a joint return, spouse's first name and initial	Last name	**Spouse's social security number**
Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	▲ Make sure the SSN(s) above and on line 6c are correct.
City, town or post office, state, and ZIP code. If you have a foreign address, also complete spaces below (see instructions).		**Presidential Election Campaign** Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse
Foreign country name	Foreign province/state/county	Foreign postal code

Filing Status

Check only one box.

1 ☐ Single
2 ☐ Married filing jointly (even if only one had income)
3 ☐ Married filing separately. Enter spouse's SSN above and full name here. ▶
4 ☐ Head of household (with qualifying person). (See instructions.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5 ☐ Qualifying widow(er) with dependent child

Exemptions

6a ☐ **Yourself.** If someone can claim you as a dependent, **do not** check box 6a
b ☐ **Spouse**

Boxes checked on 6a and 6b

c **Dependents:**

(1) First name Last name	(2) Dependent's social security number	(3) Dependent's relationship to you	(4) ✓ if child under age 17 qualifying for child tax credit (see instructions)
			☐
			☐
			☐
			☐

If more than four dependents, see instructions and check here ▶ ☐

No. of children on 6c who:
• lived with you
• did not live with you due to divorce or separation (see instructions)
Dependents on 6c not entered above

d Total number of exemptions claimed

Add numbers on lines above ▶

Income

Attach Form(s) W-2 here. Also attach Forms W-2G and 1099-R if tax was withheld.

If you did not get a W-2, see instructions.

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7
8a	**Taxable** interest. Attach Schedule B if required	8a
b	**Tax-exempt** interest. **Do not** include on line 8a — 8b	
9a	Ordinary dividends. Attach Schedule B if required	9a
b	Qualified dividends — 9b	
10	Taxable refunds, credits, or offsets of state and local income taxes	10
11	Alimony received	11
12	Business income or (loss). Attach Schedule C or C-EZ	12
13	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐	13
14	Other gains or (losses). Attach Form 4797	14
15a	IRA distributions — 15a — b Taxable amount	15b
16a	Pensions and annuities — 16a — b Taxable amount	16b
17	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	17
18	Farm income or (loss). Attach Schedule F	18
19	Unemployment compensation	19
20a	Social security benefits — 20a — b Taxable amount	20b
21	Other income. List type and amount	21
22	Combine the amounts in the far right column for lines 7 through 21. This is your **total income** ▶	22

IRS Instructions for Lines 15a and 15b of Form 1040

Exception 4. If the distribution is a health savings account (HSA) funding distribution (HFD), enter the total distribution on line 15a. If the total amount distributed is an HFD and you elect to exclude it from income, enter -0- on line 15b. If only part of the distribution is an HFD and you elect to exclude that part from income, enter the part that isn't an HFD on line 15b unless *Exception 2* applies to that part. Enter "HFD" next to line 15b.

An HFD is a distribution made directly by the trustee of your IRA (other than an ongoing SEP or SIMPLE IRA) to your HSA. If eligible, you generally can elect to exclude an HFD from your income once in your lifetime. You can't exclude more than the limit on HSA contributions or more than the amount that would otherwise be included in your income. If your IRA includes nondeductible contributions, the HFD is first considered to be paid out of otherwise taxable income. See Pub. 969 for details.

CAUTION *The amount of an HFD reduces the amount you can contribute to your HSA for the year. If you fail to maintain eligibility for an HSA for the 12 months following the month of the HFD, you may have to report the HFD as income and pay an additional tax. See Form 8889, Part III.*

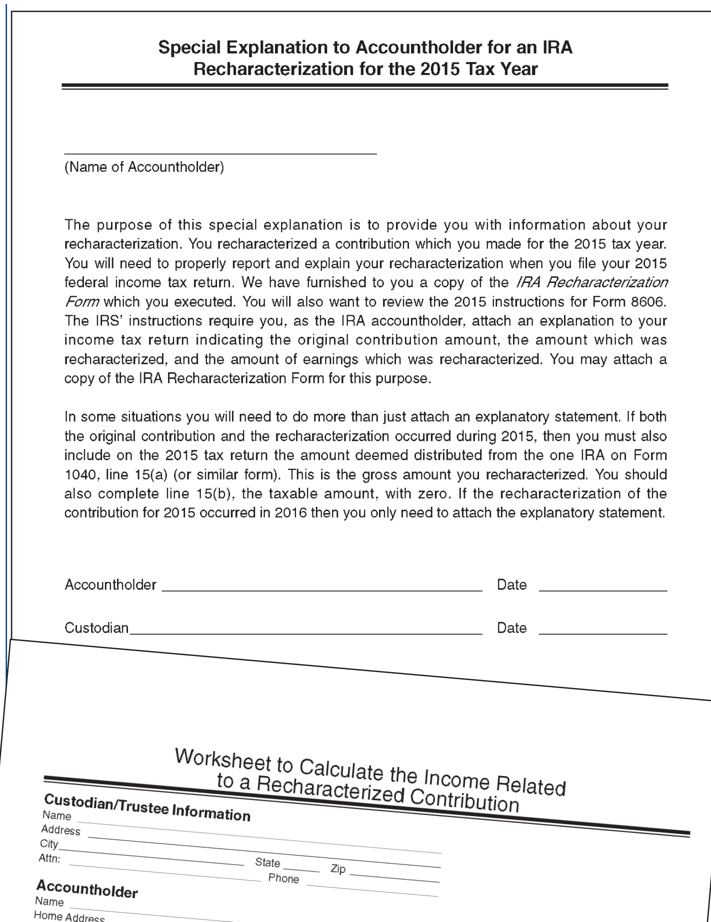
Form 5329, Continued from page 6

1040A, 1040EZ or 1040NR-EZ. In limited situations the Form 5329 may be completed and filed by itself.

In two situations a person need not file the Form 5329. First, if the person rolled over the distribution, the 10% tax is not owed and so the form need not be prepared. Second, if you only received one Form 1099-R with a reason code 1, then the person is permitted to enter the amount owing (10% times the distribution amount)on line 59 of Form 1040. The person is to put a "No" to the left of the line to indicate that he or she is not required to file Form 5329.

CWF's Recharacterization Forms

These forms are discussed in the article, "Use the Proper Forms for 2015 and 2016 Recharacterizations," page 3.



Special Explanation to Accountholder for an IRA Recharacterization for the 2015 Tax Year

____

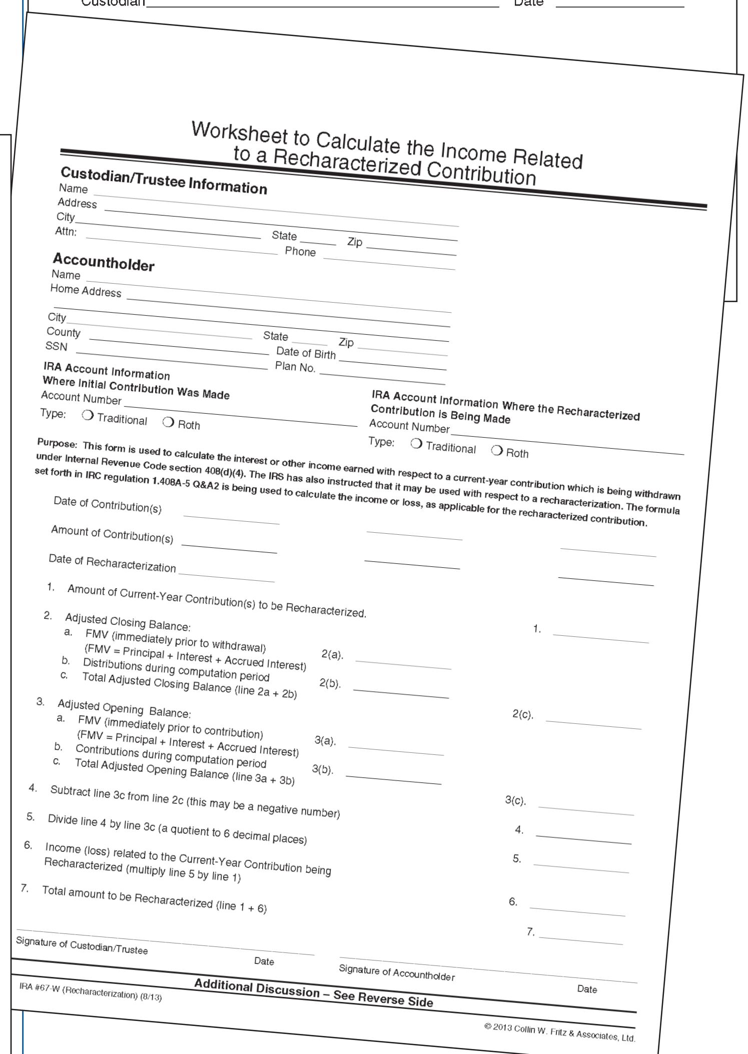
(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You recharacterized a contribution which you made for the 2015 tax year. You will need to properly report and explain your recharacterization when you file your 2015 federal income tax return. We have furnished to you a copy of the *IRA Recharacterization Form* which you executed. You will also want to review the 2015 instructions for Form 8606. The IRS' instructions require you, as the IRA accountholder, attach an explanation to your income tax return indicating the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized. You may attach a copy of the IRA Recharacterization Form for this purpose.

In some situations you will need to do more than just attach an explanatory statement. If both the original contribution and the recharacterization occurred during 2015, then you must also include on the 2015 tax return the amount deemed distributed from the one IRA on Form 1040, line 15(a) (or similar form). This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount, with zero. If the recharacterization of the contribution for 2015 occurred in 2016 then you only need to attach the explanatory statement.

Accountholder ____________________ Date __________

Custodian ____________________ Date __________



Worksheet to Calculate the Income Related to a Recharacterized Contribution

Custodian/Trustee Information
Name
Address
City
Attn: State Zip
Phone

Accountholder
Name
Home Address
City
County State Zip
SSN Date of Birth
Plan No.

IRA Account Information Where Initial Contribution Was Made
Account Number
Type: ❍ Traditional ❍ Roth

IRA Account Information Where the Recharacterized Contribution is Being Made
Account Number
Type: ❍ Traditional ❍ Roth

Purpose: This form is used to calculate the interest or other income earned with respect to a current-year contribution which is being withdrawn under Internal Revenue Code section 408(d)(4). The IRS has also instructed that it may be used with respect to a recharacterization. The formula set forth in IRC regulation 1.408A-5 Q&A2 is being used to calculate the income or loss, as applicable for the recharacterized contribution.

Date of Contribution(s)
Amount of Contribution(s)
Date of Recharacterization

1. Amount of Current-Year Contribution(s) to be Recharacterized. 1.
2. Adjusted Closing Balance:
   a. FMV (immediately prior to withdrawal) (FMV = Principal + Interest + Accrued Interest) 2(a).
   b. Distributions during computation period 2(b).
   c. Total Adjusted Closing Balance (line 2a + 2b) 2(c).
3. Adjusted Opening Balance:
   a. FMV (immediately prior to contribution) (FMV = Principal + Interest + Accrued Interest) 3(a).
   b. Contributions during computation period 3(b).
   c. Total Adjusted Opening Balance (line 3a + 3b) 3(c).
4. Subtract line 3c from line 2c (this may be a negative number) 4.
5. Divide line 4 by line 3c (a quotient to 6 decimal places) 5.
6. Income (loss) related to the Current-Year Contribution being Recharacterized (multiply line 5 by line 1) 6.
7. Total amount to be Recharacterized (line 1 + 6) 7.

Signature of Custodian/Trustee Date
Signature of Accountholder Date

Additional Discussion – See Reverse Side

IRA #67-W (Recharacterization) (8/13)

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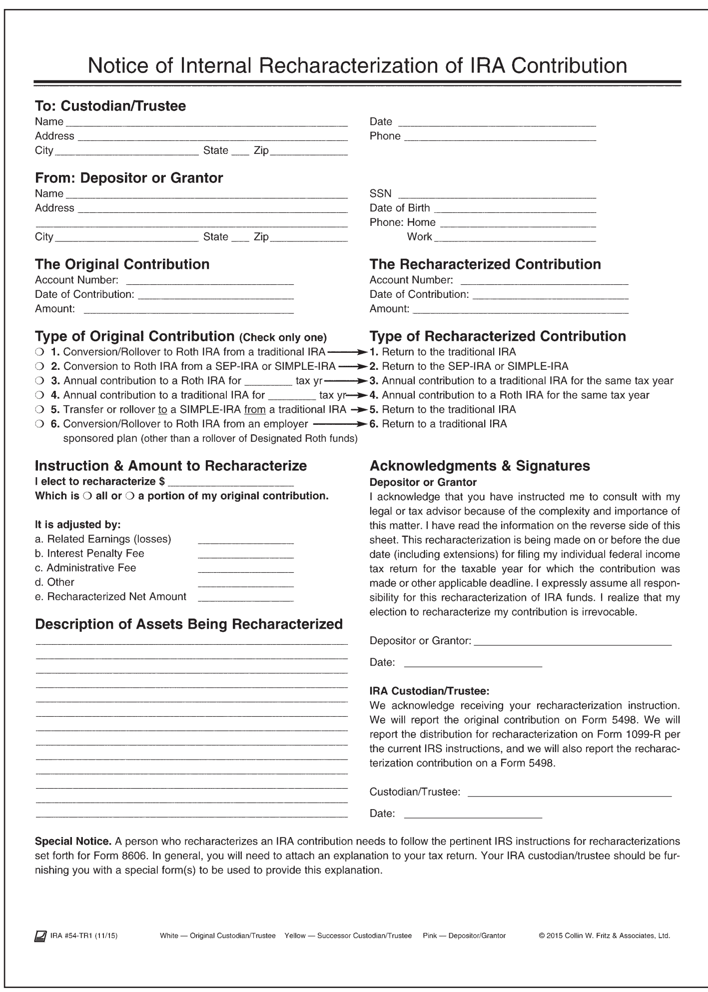

Notice of Internal Recharacterization of IRA Contribution

To: Custodian/Trustee
Name ____ Date ____
Address ____ Phone ____
City ____ State ___ Zip ____

From: Depositor or Grantor
Name ____ SSN ____
Address ____ Date of Birth ____
Phone: Home ____
City ____ State ___ Zip ____ Work ____

The Original Contribution
Account Number: ____
Date of Contribution: ____
Amount: ____

The Recharacterized Contribution
Account Number: ____
Date of Contribution: ____
Amount: ____

Type of Original Contribution (Check only one) → **Type of Recharacterized Contribution**
❍ **1.** Conversion/Rollover to Roth IRA from a traditional IRA → **1.** Return to the traditional IRA
❍ **2.** Conversion to Roth IRA from a SEP-IRA or SIMPLE-IRA → **2.** Return to the SEP-IRA or SIMPLE-IRA
❍ **3.** Annual contribution to a Roth IRA for ________ tax yr → **3.** Annual contribution to a traditional IRA for the same tax year
❍ **4.** Annual contribution to a traditional IRA for ________ tax yr → **4.** Annual contribution to a Roth IRA for the same tax year
❍ **5.** Transfer or rollover to a SIMPLE-IRA from a traditional IRA → **5.** Return to the traditional IRA
❍ **6.** Conversion/Rollover to Roth IRA from an employer sponsored plan (other than a rollover of Designated Roth funds) → **6.** Return to a traditional IRA

Instruction & Amount to Recharacterize
I elect to recharacterize $ ____
Which is ❍ all or ❍ a portion of my original contribution.

It is adjusted by:
a. Related Earnings (losses) ____
b. Interest Penalty Fee ____
c. Administrative Fee ____
d. Other ____
e. Recharacterized Net Amount ____

Description of Assets Being Recharacterized

Acknowledgments & Signatures
Depositor or Grantor
I acknowledge that you have instructed me to consult with my legal or tax advisor because of the complexity and importance of this matter. I have read the information on the reverse side of this sheet. This recharacterization is being made on or before the due date (including extensions) for filing my individual federal income tax return for the taxable year for which the contribution was made or other applicable deadline. I expressly assume all responsibility for this recharacterization of IRA funds. I realize that my election to recharacterize my contribution is irrevocable.

Depositor or Grantor: ____
Date: ____

IRA Custodian/Trustee:
We acknowledge receiving your recharacterization instruction. We will report the original contribution on Form 5498. We will report the distribution for recharacterization on Form 1099-R per the current IRS instructions, and we will also report the recharacterization contribution on a Form 5498.

Custodian/Trustee: ____
Date: ____

Special Notice. A person who recharacterizes an IRA contribution needs to follow the pertinent IRS instructions for recharacterizations set forth for Form 8606. In general, you will need to attach an explanation to your tax return. Your IRA custodian/trustee should be furnishing you with a special form(s) to be used to provide this explanation.

IRA #54-TR1 (11/15) White — Original Custodian/Trustee Yellow — Successor Custodian/Trustee Pink — Depositor/Grantor © 2015 Collin W. Fritz & Associates, Ltd.