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

Warning – Determine if Your IRA Processor Has Prepared Some of Your Institution's 5498 Forms Incorrectly

An IRA custodian called CWF with the following situation/question. Jane Doe has her own personal traditional IRA and she has an inherited traditional IRA arising from her mom. The IRA processor prepared just one combined 2015 Form 5498. Is this correct or permissible?

It is incorrect. Two 5498 forms must be prepared. It is understandable why a software engineer would think that it is better and simpler if just one form 5498 record is prepared rather than multiple forms. It is not simpler. The IRS rules do not permit aggregation of the data when there are multiple IRA plan agreements.

The IRS has had the rule for a long time that contributions, distributions and fair market value statements are prepared and reported on a per plan agreement basis.

IRA tax data may be aggregated on a per IRA plan agreement basis, but it is not permissible to aggregate data from multiple IRA plan agreements. For example, Jane Doe age 53 has IRA Plan #1 and makes three $2,000 contributions for tax year 2015 on 3/10/15, 9/10/15 and 3/1/16 and she made a rollover contribution from a 401(k) plan to IRA Plan #1 of $12,000 on 6/10/15 and another rollover contribution from her 401(k) plan of $23,000 on 10/10/15. Box 1 will be completed with $6,000 and box 2 will be completed with $35,000.

As the discussion below illustrates, there is tax logic to the rule that there must be a separate IRA reporting form prepared on a per IRA plan agreement basis rather than allowing the reporting entity to aggregate the information and then furnish one form.

For example, Jane Doe has her own traditional IRA and she has has also inherited her mom's traditional IRA. There must be two also separate 5498 forms prepared for her. For income taxation purposes she does not aggregate her IRA with the inherited IRA from her mother.

Preparation of a combined Form 5498 is a violation of IRS requirements. The IRS has the authority to assess a fine of $50 for each incorrect form and $50 for each missed form. Remember, the fines are doubled in the sense that one form goes to the IRS and one copy to the individual. Most likely the processor in its contract tries to have the IRA custodian be liable for this type of mistake. It's CWF opinion that if the processor has written its software to not comply, it should be liable for any IRS fines.

What tax harm is being caused by such impermissible aggregation?

A person must do separate tax calculations for distributions from personal IRAs and inherited IRAs. This capability is lost if the data is aggregated.

If two 5498 forms both show a rollover contribution, most likely the IRS will

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More Wealthier Individuals Should Be Making Nondeductible Traditional IRA Contributions - They Just Need Some Help and You Can Provide It

Wealthier individuals should be rushing to their bank to make a nondeductible IRA contribution. This is certainly true if they are a 401(k) participant.

This author admits his bias, many individuals should be making nondeductible traditional IRA contributions and they don't do so because they (and their advisors) many times don't understand the benefits, including how the related tax rules apply.

Every person should contribute as much as possible to a Roth IRA. Why? There are very few times under US income tax laws where INCOME is not taxed. That is, no taxes are owed with respect to Roth IRA funds if the Roth owner has met a 5-year rule and is age 59½ or older or the Roth owner is a beneficiary who has inherited the Roth IRA and the 5-year rule has been met.

The federal tax laws have been expressly written to make it impossible for a person with a high income to make an annual Roth IRA contribution. Some people (i.e. many Democrats) don't want "wealthier" individuals to gain the benefit of contributing funds to a Roth IRA and earning tax-free income. They want them to pay more income taxes. A person who had tax filing status of single was ineligible to make a 2015 Roth IRA contribution if his or her MAGI (modified adjusted gross income was $132,000 or more. A person who had filing status of married filing jointly was ineligible to make a 2015 Roth IRA contribution if the couple's MAGI (modified adjusted gross income was $193,000 or more. A person who had filing status of married filing separately was ineligible to make a 2016 Roth IRA contribution if his or her MAGI (modified adjusted gross income was $10,000 or more.

For discussion and illustration purposes, we will assume that Jane Doe has the following situation. She is age 54. She is married. Her husband, Mark Doe, is a bank president. He is age 57. Their joint income is sufficiently high that neither one of them is eligible to make an annual Roth IRA contribution. Their joint income is sufficiently high that neither one of them is eligible to made a deductible traditional IRA annual contribution.

This article is going to discuss the question, "should these two each make a nondeductible traditional IRA contribution?" The primary concern is Jane's situation, but we will also discuss Mark's situation.

For the reasons discussed below, both should make a maximum nondeductible traditional IRA contribution until each is no longer eligible to make a traditional IRA contribution (i.e. the year a person attains age 70½).

On March 15, 2016, Jane contributed $6,500 to a traditional IRA she had established in 1984. She designated her contribution as being for 2015. The IRA balance at the time of contribution was $8,500. With the addition of her $6,500 contribution the IRA balance became $15,000. Since then the account has earned $40 of interest.

It is now assumed that Jane has no other IRA funds in any traditional, SEP or SIMPLE IRAs. The IRA taxation rules require in applying the taxation rules that all non-Roth IRA funds be aggregated. One cannot avoid the pro-rata taxation rule by setting up separate IRAs or having separate time deposits.

The couple's tax preparer has recently informed Jane that her contribution is nondeductible as her husband participates in a 401(k) plan and their MAGI is sufficiently high that they are not permitted to claim any tax deduction for her $6,500 contribution. What tax options are available to her? What options are unavailable to her?

1. She may not use the recharacterization rules to make her traditional IRA contribution a Roth IRA contribution as their 2015 MAGI is too high.
2. There is no IRS guidance allowing the IRA custodian to switch the year for which the IRA contribution was made from 2015 to 2016.
3. The IRS has issued rules allowing her to withdraw her 2015 IRA contribution with no adverse tax consequences as long as she does so by 10-15-16, no deduction is claimed on the 2015 tax return and the related income is withdrawn. If she withdraws her $6,500 contribution she is required to withdraw the related income and it is taxable for 2016 since the contribution was made in 2016. The relat-

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Contributions,
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ed income is a pro-rata amount of the $40 determined as follows: 6500.15000 x $40 = $17.33. Since she is younger than age 59½ she does owe the 10% additional tax on this $17.33. The bank as the IRA custodian will prepare a 2016 Form 1099-R inserting the codes (81) in box 7, box 1 would show $6,517.33 and box 2a would show $17.33.

4. In 2016 she is eligible to make a Roth IRA conversion of any amount in the range of $.01 to $15,040. If she would convert $15,040 into her Roth IRA she/they would include in income on their 2016 tax return the amount of $8,540. She as many taxpayers does not want to include the $8,540 in her/their income and pay tax on it.

Jane as many taxpayers would like to convert only her nondeductible contribution of $6,500. This would allow her to pay no taxes since she would not be converting any of the $8,540.

The tax rules require use of the standard pro-rata taxation rule when an IRA has taxable funds and nontaxable funds. If she converts $6,500, a portion would be taxable and a portion would not be. The taxable portion is: $6,500 x $8,540/$15,040 ($3,690.82) and the nontaxable portion is $6,500 x $65,00/15,040 ($2809.18) . Jane made a nondeductible IRA contribution for 2015. She is required to file Form 8606 and attach to the couple's Form 1040. If it was not filed with the original return, an amended tax return should be filed and the 2015 Form 8606 attached. She is not relieved of this duty because she withdraws the $6,500 or converts it. A $50 penalty applies to a person who fails to file Form 8606 unless she could show a reasonable cause why she did not file it. A person must pay a $100 penalty if a person overstates the amount of nondeductible contributions.

Note that Jane will also be required to file a 2016 Form 8606 regardless if she withdraws a portion or all of the $6,500.

Having to include in income the amount of $8540 and pay tax on this amount should not influence Jane or any other wealthy person to not make nondeductible contributions. But it does. Tax on $8540 should not be that material to a couple who are ineligible to make annual Roth IRA contributions.

From a practical standpoint, Jane could convert her traditional IRA over a 2-4 year time period to lessen the amount of income which would be taxed each year.

The best of all "planning" situations would be if Jane would either work for an employer that had a 401(k) plan written to accept rollovers from traditional IRAs or if she could work for the bank and become eligible under the bank's 401(k) plan. Why? If Jane was a participant of a 401(k) plan, the tax rules have been so written that if she wants to make a rollover contribution, the amount rolled over "first" is the taxable portion. The prorate rule does not apply in this situation.

If Jane only rolls over $8,540, this means that the $6,500 remaining in the IRA are nontaxable. She may then convert such amount to a Roth IRA. This is her goal, this any person's goal.

In summary, Jane wants to make as make nondeductible IRA contributions (currently $6,500 but his amount which change as it is indexed for inflation) as she can between ages 54-70½ because she should convert all such funds into a Roth IRA.

What about her husband, Mark? He too wants to make the maximum amount of nondeductible IRA contributions from ages 57-70½ and at some point convert such contributions to a Roth IRA. The sooner the conversion can be completed the better as the earnings realized after the conversion will be tax-free if the qualified distribution rules are met.

Most likely Mark participates in a 40(k) plan which will allow him to move "taxable" IRA money into his 401(k) account. If not, he probably has the ability to rewrite the plan so he would have this right.

The 401(k) plan in which he participates may allow him to make Designated Roth deferrals and he exercises that right to the maximum. This would be $24,000 for 2016 ($18,000 + $6,000). Good for him. But why not contribute an additional $6,500 to his traditional IRA as a nondeductible contribution and convert it? Contributing $6500 for 12 years would result in an additional $78,000 in a Roth IRA.

In summary, Mark too should want to make as many nondeductible traditional IRA contributions as he is eligible for until he is no longer eligible to make traditional IRA contribution.

Inheriting HSA Beneficiary – Duty to Prepare Form 8889

If the HSA owner's surviving spouse is the designated beneficiary, the surviving spouse becomes the HSA owner. Consequently, he or she completes Form 8889 for transactions occurring after the HSA owner's death.

If the HSA owner has designated a non-spouse beneficiary and dies, the HSA ceases being an HSA.

If the inheriting beneficiary is not the HSA owner's estate, the beneficiary completes Form 8889 as follows.

1. Across the top of the form write, "Death of HSA Owner."
2. At the top the beneficiary will insert his/her name and social security number. Part I (Contributions) is not to be completed. It is to be skipped as no additional HSA contributions may be made by a beneficiary.
3. On line 14a the HSA's fair market value as of the date of death is inserted.

   The beneficiary includes this amount in his or her taxable income for the year during the HSA owner died. This is true even if the beneficiary withdraws the funds in a following year. The 20% penalty for non-medical use does not apply. Any earnings realized after the death of the HSA owner are included in the beneficiary's income for the withdrawal year.

   The HSA custodian/trustee prepares the Form 1099-SA to report the distribution to the beneficiary for the year during which the withdrawal occurs.
4. The remainder of Part II (Distributions) is to be completed.
5. If the beneficiary pays within one year of the date of death medical expenses incurred by the HSA owner prior to his or her death, then such amount is to be listed on line 15. At times the beneficiary may need to file an amended tax return.

If the inheriting beneficiary is the HSA owner's estate, the final tax return and Form 8889 for the HSA owner are prepared as follows.

1. Across the top of the form write, "Death of HSA Owner."
2. Part I is to be completed, if applicable. That is, if the HSA owner made contributions prior to his death, they are reported.
3. On line 14a the HSA1s fair market value as of the date of death is inserted.

   This amount is included on the deceased HSA owner's final tax return for the year he or she died. This is true even if the personal representative withdraws the funds in a following year.
4. The remainder of Part II (Distributions) is to be completed.
5. If the estate pays within one year of the date of death medical expenses incurred by the HSA owner prior to his or her death, then such amount is to be listed on line 15. At times the final tax return for the deceased HSA owner may need to file an amended tax return.

There are two times when a person is apparently required to file a paper tax return (versus an electronic filing) and file multiple 8889 forms.

The first situation is the person has his or her own personal HSA and then inherits an HSA. The person must prepare a Form 8889 for each HSA and a summary Form 8889. "Statement" is to be written at the top of each of the non-summary 8889 forms. These statements are to be attached to the summary Form 8889. The IRS instructions use the term "controlling 8889", we prefer "summary 8889."

The IRS Form 8889 is available at
https://www.irs.gov/pub/irs-pdf/f8889.pdf

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Must an Annual IRA Statement Be Furnished by June 30, 2016?

Recently an IRA trustee sent us the following question. Set forth below is CWF's response. CWF has always followed the approach of furnishing an annual statement by January 31st of the following year which complies with the June 30th deadline discussed below.

The conservative answer to the above question is, an IRA trustee has the duty to furnish an annual IRA statement showing the information required by Regulation 1.408-5.

The CWF IRA plan agreement form indicates in section 1.3 that the IRA trustee is to furnish an IRA report showing the activity in the IRA for the preceding year as required by IRS regulations and pronouncements.

The IRS, however, has adopted rules and procedures requiring that certain IRA information be furnished using an approach different than the annual IRA statement approach. The.problem is, the IRS has never formally said that an IRA trustee no longer needs to furnish the annual IRA statement required by Regulation 1.408-5. The IRS appears to have chosen to ignore the regulation.

The IRS' current requirements for IRA statements and other IRA forms are set forth in the 2015 instructions for IRS Forms 5498 and Form 1099-R. These instructions discuss furnishing, when applicable or required, a FMV statement, the Form 5498, the Form 1099-R and an RMD notice. The contribution activity is handled by furnishing the Form 5498 and the distribution activity is handled by furnishing the Form 1099-R. In general, there is no discussion in the 5498/1099-R instructions that there is a requirement to furnish an annual IRA statement.

There is substantial discussion of the requirement to furnish a complying fair market value statement on an annual basis.

There is one exception applying to SIMPLE IRAs. On page 20 it is stated, "Trustees of SIMPLE IRAs also must provide a statement of the account activity by February 1, 2016." It is well known the IRS in many areas of tax administration has adopted the approach of issuing guidance informally in Notices, Revenue Ruling, Revenue Procedures and form instructions rather than issuing or revising formal regulations.

One should refer to Code section 408(i) and Regulation 1.408-5. The annual report required by Regulation 1.408-5 is to be furnished by June 30th of the following year.

One would think the IRS would not try and would not be able to assess fines against an IRA trustee for failing to furnish the annual IRA statement required by Regulation 1.408-5 when the IRA trustee was following the IRS guidance furnished in the instructions for Forms 5498 and 1099-R. However, the U.S. tax court judge in the Bobrow IRA rollover case made the sobering comment that a taxpayer relies at his or her own peril on informal IRS guidance.

In summary, we at CWF believe it is best to furnish an annual IRA statement showing the contribution, distribution and earnings activity. IRS1 guidance appears to indicate that it is not required to furnish an annual IRA statement. The problem is, the IRS has never changed the governing regulation. An IRA owner may well argue that he or she is entitled to an IRA statement showing the required transaction information.

Excerpt from IRS Regulation

§ 1.408-5 Annual reports by trustees or issuers.

(a) *In general.* The trustee of an individual retirement account or the issuer of an individual retirement annuity shall make annual calendar year reports concerning the status of the account or annuity. The report shall contain the information required in paragraph (b) and be furnished or filed in the manner and time specified in paragraph (c).

(b) *Information required to be included in the annual reports.* The annual calendar year report shall contain the following information for transactions occurring during the calendar year—

(1) The amount of contributions;

(2) The amount of distributions;

(3) In the case of an endowment contract, the amount of the premium paid allocable to the cost of life insurance;

(4) The name and address of the trustee or issuer; and

(5) Such other information as the Commissioner may require.

(c) *Manner and time for filing.*

(1) The annual report shall be furnished to the individual on whose behalf the account is established or in whose name the annuity is purchased (or the beneficiary of the individual or owner). The report shall be furnished on or before the 30th day of June following the calendar year for which the report is required.

Preliminary Tax Data – IRA/Pension Statistics for 2014

The IRS has recently issued preliminary tax data for tax year 2014. The number of filed returns increased from 144.7 million to 148.7 million. Taxable income increased to $6.9 trillion from $6.4 trillion. Total tax liability increased to $1.4 trillion. An increase of 10%. The amount of funds being withdrawn from pension plans increased ($652 billion for 2014 versus $652 billion for 2013) and the amount of IRA distributions decreased ($234.2 billion for 2014 versus $213.5 billion for 2013). The amount being contributed to pension plans and IRAs changed as discussed below.

These statistics are preliminary statistics in the sense they were devised by an IRS economist using a sample of tax returns to make estimates.

Note that 927,169 self-employed individuals contributed 20.8 billion to their profit sharing, SEP and SIMPLE plans, whereas 2.75 million IRA accountholders contributed 13.44 billion. There should be special marketing efforts to your customers who are self-employed.

CHART A — SEP/SIMPLE/Profit Sharing Chart

Year	Contribution Amount	Number of Contributors	Average Contribution
2003	$16.9 billion	1.19 million	$14,202
2004	$18.0 billion	1.17 million	$15,385
2005	$19.4 billion	1.20 million	$16,202
2006	$20.2 billion	1.18 million	$17,200
2007	$20.1 billion	1.14 million	$17,720
2008	$18.5 billion	.97 million	$19,072
2009	$17.5 billion	.88 million	$19,780
2010	$17.2 billion	.87 million	$19,776
2011	$17.6 billion	.87 million	$20,256
2012	$19.2 billion	.88 million	$21,843
2013	$20.2 billion	.90 million	$22,364
2014	$20.8 billion	.93 million	$22,438

CHART B — Traditional IRA Chart

Year	Contribution Amount	Number of Contributors	Average Contribution
2003	$10.16 billion	3.46 million	$2,936
2004	$10.20 billion	3.38 million	$3,018
2005	$12.21 billion	3.29 million	$3,707
2006	$12.77 billion	3.29 million	$3,885
2007	$13.19 billion	3.37 million	$3,914
2008	$11.91 billion	2.78 million	$4,284
2009	$11.49 billion	2.64 million	$4,358
2010	$11.71 billion	2.63 million	$4,449
2011	$11.26 billion	2.62 million	$4,302
2012	$12.05 billion	2.61 million	$4,608
2013	$13.30 billion	2.77 million	$4,797
2014	$13.44 billion	2.75 million	$4,896

Deductible Traditional IRA Contributions

The number of tax returns claiming a deduction for a traditional IRA contribution decreased by .1%.

The amount contributed to traditional IRAs increased to 13.44 billion from 13.30 billion. This was a 1.05% increase.

What was the AGI of those who made traditional IRA contributions for 2014?

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	121,112	284,231	518,600	982,051	685,962	153,445	2,745,400
% of Total Returns	4.41%	10.35%	18.89%	35.77%	24.99%	5.59%	100%
Contribution Amt. **(in thousands)**	$365,205	$935,466	$2,025,722	$4,835,230	$3,805,505	1,474,439	$13,471,567
% of Total Contr.	2.71%	6.94%	15.04%	35.89%	28.25%	10.94%	100%
Avg. Contr. Amt.	$3,015	$3,291	$3,906	$4,924	$5,548	$9,609	$4,907

CWF Observations

1. The average IRA contribution, per return, was $4,907 for 2014.
2. 35.77% of all IRA contributions came from individuals with AGI between $50,000-$99,999.
3. 66.35% of all IRA contributions for 2014 came from individuals with AGI of $50,000 or More.

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IRA and SEP/SIMPLE/Keogh Deductible Contributions

1. The number of tax returns claiming a deduction for a self-employed person's contributions to a profit sharing, SEP or SIMPLE basically did not change (.90 million vs. .93 million).
2. The amount contributed by self-employed individuals to a profit sharing plan, SEP or SIMPLE increased from 20.2 billion to 20.8 billion. A 3.0% increase.

What was the adjusted gross income (AGI) of those who made SEP/SIMPLE/Keogh contributions?

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	11,990	18,363	38,642	149,687	277,304	431,182	927,169
% of Total Returns	1.29%	1.98%	4.17%	16.15%	29.91%	46.50%	100%
Contribution Amt. (in thousands)	$66,074	$81,291	$318,725	$1,639,839	$4,525,857	$14,172,447	$20,804,233
% of Total Contr.	.32%	.39%	1.53%	7.88%	21.76%	68.12%	100%
Avg. Contr. Amt.	$5,511	$4,427	$8,248	$10,955	$16,321	$32,869	$22,438

CWF Observations on SEP/SIMPLE/Keogh Contributions for 2014

1. The average contribution per return is $22,438 for 2014.
2. 68.12% of contributions ($14.2 billion) come from individuals with AGI of $200,000 or more.
3. 89.88% of contributions (18.7 billion) come from individuals with AGI of more than $100,000.
4. Note that 927,169 self-employed individuals contributed 20.8 billion to their profit sharing, SEP and SIMPLE plans whereas 2.75 million IRA accountholders contributed 13.4 billion. There should be special marketing efforts to your customers who are self-employed.

Taxable IRA Distributions for 2014

(Based on AGI)

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	1,771,876	1,920,321	1,915,704	4,309,682	2,799,,600	1,033,991	13,751,681
% of Total Returns	12.88%	13.96%	13.93%	31.34%	20.36%	7.52%	100%
Distribution Amt. (in thousands)	$9,239,343	$14,980,321	$19,765,146	$65,012,770	$73,391,319	$51,808,936	$234,164,835
% of Total Distrib.	3.95%	6.40%	8.44%	27.76%	31.34%	22.11%	100%
Avg. Distrib. Amt.	$5,214	$7,801	$10,317	$15,085	$26,215	$50,106	$17,028

CWF Observations

1. 13.75 million returns reported a taxable IRA distribution.
2. There were taxable IRA distributions of 234.2 billion.
3. The average distribution was $17,028.
4. As one would expect, the average distribution was larger for those with higher incomes.
5. 81.21% of the taxable distributions ($190 billion) arose from those returns showing AGI of $50,000 or more.

Pension Distributions for 2014
(Based on AGI)

	Under $15,000	$15,001 to $29,999	$30,000 to $49,999	$50,000 to $99,999	$100,000 to $199,999	$200,000 Or more	Total
Number of Returns	3,974,599	4,543,858	4,678,367	8,685,856	5,177,992	1,485,027	28,545,699
% of Total Returns	13.92%	15.92%	16.39%	30.43%	18.14%	5.20%	100%
Distribution Amt. **(in thousands)**	$26,805,147	$56,353,523	$81,730,014	$224,415,710	$206,006,831	$80,222,132	$675,553,358
% of Total Distrib.	3.97%	8.34%	12.10%	33.22%	30.49%	11.88%	100%
Avg. Distrib. Amt.	$6,744	$12,402	$17,470	$25,837	$39,785	$54,021	$23,666

Observations

1. 28.5 million returns reported a taxable pension distribution.
2. There were taxable pension distributions of 675.5 billion.
3. The average distribution was $23,666.
4. As one would expect, the average distribution was larger for those with higher incomes.
5. 75.59% of the taxable distributions ($510 billion) arose from those returns showing AGI of $50,000 or more.

Multiple Form 5498s Required,
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determine that only one of them qualifies to be a rollover contribution because of the once per year rule and the other would be a taxable distribution. This audit capability is lost if there is just one combined Form 5498 prepared. The IRS prepares many statistical studies based on the info set forth on the 5498 forms. Many analytic capabilities are lost if there is not one Form 5498 prepared for each plan agreement.

IRA & HSA Webinars Suspended Until July

We are suspending our IRA and HSA Webinars for June as we are busy with IRA compliance reviews (audits).

We will resume our Webinars in July. IRA custodians should especially consider attending the webinar covering transfers, direct rollovers and rollovers as still too many IRA staff process a direct rollover as a transfer. The Update Webinar is also a good one to attend as it covers the impact of the DOL's new definition of fiduciary.