The Pension Digest

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" The Pension Specialists "

Planning Suggestion for an IRA Beneficiary Designation - Consider the Primary Beneficiary Might Want to Disclaim

An IRA accountholder should almost always designate a primary beneficiary and also designate one or more contingent beneficiary(ies). In some older IRA files the IRA accountholder has not designated a contingent beneficiary. In such situation, almost all IRA plan agreement forms provide that the IRA funds will then be paid to the decedent's estate. Tax options are not as many or as beneficial when an estate is the inheriting IRA beneficiary.

Be nice to your IRA clients and remind them periodically they should review and update their beneficiary designations, if appropriate. Of course, your IRA accountholders should be seeking the guidance of their legal and tax advisers.

Situation. John and Mary are now in their 80's. Mary has $115,000 in her IRA. John has his own IRA with a balance approximating $75,000. Each has designated the other as their IRA beneficiary, but they did not designate any contingent beneficiaries. They have two daughters and a son. Mary died on July 8, 2016.

John has come into the bank because he wants these funds to go to the three children rather than himself. He believes this is what Mary wanted. That is, he wants three inherited IRAs set up for the three children.

The IRA custodian must not accommodate him. It would be tax fraud. It cannot be done since Mary had not designated the children as her contingent beneficiaries. If she would have designated the three children as her contingent beneficiaries and then John would have executed a valid disclaimer, then the desired result of having these IRA funds be inherited by the three children could have been realized. But this was not done.

If John executes the disclaimer now, Mary's estate will inherit her IRA and would have to comply with the RMD' rules applying to an estate beneficiary. John most likely would be making the situation worse. He will be better-off if he elects to treat Mary's IRA as his own and then withdraws only the RMD each year. He will, of course, name his three children as his IRA beneficiaries.

In summary, be nice to your IRA clients and remind them periodically they should review and update their beneficiary designations. In order to retain the flexibility of a primary beneficiary disclaiming his or her interest, one or more contingent beneficiaries need to have been designated by the deceased IRA accountholder. If so, additional planning options are then available.

SIMPLE-IRA Summary Description — IRA Custodian Must Furnish by September/October 2016 for 2017

What are a financial institution's duties if it is the custodian or trustee of SIMPLE IRA funds? After a SIMPLE IRA has been established at an institution, it is the institution's duty to provide a Summary Description each year within a reasonable period of time before the employees' 60-day election period. CWF believes that providing the Summary Description 30 days prior to the election period would be considered "reasonable." The actual IRS wording is that the Summary Description must be provided "early enough so that the employer can meet its notice obligation." You will want to furnish the Summary Description to the employer in September or the first week of October. The employer is required to furnish the summary description before the employees' 60-day election period.

IRS Notice 98-4 provides the rules and procedures for SIMPLEs. This notice is reproduced in CWF's IRA Procedures Manual. It may be found at the IRS website.

The Summary Description to be furnished by the SIMPLE IRA custodian/ trustee to the sponsoring employer depends upon what form the employer used to establish the SIMPLE IRA plan.

The employer may complete either Form 5305-SIMPLE (where all employees' SIMPLE IRAs are established at the same employer-designated financial institution) or Form 5304-SIMPLE (where the employer allows the employees to establish the SIMPLE IRA at the financial institution of his or her choice).

There will be one Summary Description if the employer has used the 5305-SIMPLE form. There will be another Summary Description if the employer has used the 5304-SIMPLE form. If you are a user of CWF forms, these forms will be Form 918-A and 918-B.

The general rule is that the SIMPLE IRA custodian/ trustee is required to furnish the summary description to the employer. This Summary Description will only be partially completed. The employer will be required to complete it and then furnish it to his employees. The employer needs to indicate for the upcoming 2017 year the rate of its matching contribution or that it will be making the non-elective contribution equal to 2% of compensation.

In the situation where the employer has completed the Form 5304-SIMPLE, the IRS understands that many times the SIMPLE IRA custodian/trustee will have a minimal relationship with the employer. It may well be that only one employee of the employer establishes a SIMPLE IRA with a financial institution. In this situation, the IRS allows the financial institution to comply with the Summary Description rules by using an alternative method.

To comply with the alternative method, the SIMPLE IRA custodian/trustee is to furnish the individual SIMPLE IRA accountholder the following:

- ✓ A current 5304-SIMPLE — this could be filled out by the employer, or it could be the blank form
- ✓ Instructions for the 5304-SIMPLE
- ✓ Information for completing Article VI (Procedures for withdrawal) (You will need to provide a memo explaining these procedures.)
- ✓ The financial institution's name and address.

Obviously, if an institution provides the employee with a blank form, he/she will need to have the employer complete it, and, the employee may well need to remind the employer that it needs to provide the form to all eligible employees.

CWF has created a form which covers the "alternative" approach of the Summary Description being provided directly to an employee.

The penalty for not furnishing the Summary Description is <u>$50 per day</u>.

Special Rule for a "transfer" SIMPLE IRA.

There is also what is termed a "transfer" SIMPLE IRA. If your institution has accepted a transfer SIMPLE IRA, and there have been no current employer contributions, then there is no duty to furnish the Summary Description.

If there is the expectation that future contributions will be made to this transfer SIMPLE IRA, then the institution will have the duty to furnish the Summary Description.

Reminder of Additional Reporting Requirements

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The custodian/trustee must provide each SIMPLE IRA accountholder with a statement by January 31, 2017, showing the account balance as of December 31, 2016 and include the contribution and distribution activity in the account during the calendar year (this is not required for a traditional IRA). There is a $50 per day fine for failure to furnish this statement (with a traditional IRA, it would be a flat $50 fee).

Is it Still Possible to Establish a SIMPLE-IRA Plan for 2016?

Yes, if the sponsoring business has never sponsored a SIMPLE-IRA Plan and if the business has not made any contributions for 2016 to another type of retirement plan (e.g. profit sharing plan or SEP).

A person or business can set up a SIMPLE-IRA plan effective on any date between January 1 and October 1 of a year, provided it did not previously maintain a SIMPLE-IRA plan. This requirement does not apply if there is a new employer that comes into existence after October 1 of the year the SIMPLE-IRA plan is set up and the new business sets up a SIMPLE-IRA plan as soon as administratively feasible after it comes into existence. If a business previously maintained a SIMPLE-IRA Plan, it can set up a SIMPLE-IRA plan effective only on January 1 of a year. A SIMPLE-IRA plan cannot have an effective date that is before the date you actually adopt the plan.

Reminder – HSA Transfers are Generally Non-Reportable

HSA funds may be transferred from a person's HSA with HSA custodian #1 to a person's HSA with HSA custodian #2.

IRS instructions should be re-written to clarify some

technical aspects of HSA transfers, but IRS guidance is clear. HSA funds may be transferred and the general HSA reporting rule is that a transfer is not to be reported. Both the distribution and the contribution are not reported.

On page 1 of the instructions for the 2016 Instructions for Form 1099-SA and 5498-SA, the IRS writes regarding the transfer-out distribution:

> **Transfers**
> Do not report a trustee-to-trustee transfer from one Archer MSA or MA MSA to another Archer MSA from an Archer MSA to an HSA, or from one HSA to another HSA. For reporting purposes, contributions and rollovers do not include transfers.

On page 2 of the instructions for the 2016 Instructions for Form 1099-SA and 5498-SA, the IRS writes regarding the transfer-in contribution.

> Transfers
> Do not report a trustee-to-trustee transfer from one Archer MSA or MA MSA to another Archer MSA or MA MSA, from an Archer MSA to an HSA, or from one HSA to another HSA. For reporting purposes, contributions and rollovers do not include these transfers. However, see box 2, later, for the reporting of a trustee-to-trustee transfer from an IRA to an HSA.

We have been informed a number of times by an HSA consulting caller that their mainframe core processor does not provide transaction codes for an HSA transfer. It really should as there is no good reason to not follow the IRS guidance. The general rule is - a transfer-in contribution is non-reportable for Form 5498-SA purposes and the transfer-out distribution is non-reportable for Form 1099-SA purposes.

We have heard that that some HSA software now has a non-reportable transaction code. It may be this code or codes are to be used when there is a transfer.

Tax Levy on an IRA by State Department of Revenue

At times an IRA custodian will be served with a state tax levy (versus an IRS levy) with respect to an individual's IRA.

If a person owes taxes (or child support) to a state many times the state tax entity is able to levy on an IRA. Individual state law must be researched and determined.

An example is the State Of California. Set forth below is CWF guidance recently furnished to an IRA custodian. The IRA custodian had received an Order to Withhold from the Franchise Tax Board of the State of California. The amount claimed owe was $ 6777.37.

CWF Response to the IRA Custodian:

I believe the Franchise Tax Board (State of California) does have the authority to levy on IRA assets if such assets are located in California. I did not see any indication IRA funds are exempt from the State of California levy. The individual is a California resident and his or her IRA was established in California. The financial institution is to remit $6777.37 even if the funds come from the individual's IRA.

When this state levy topic arises, the federal income tax withholding rules must be considered. There are two federal withholding rules when there is an IRA distribution. The IRA custodian must furnish a notice discussing the federal income tax withholding rules applying to IRA distributions and then the individual has the right to instruct what withholding amount he or she wants. This notice requirement can be met by furnishing the IRS Form W-4P or an IRA distribution form with the W-4P info.

The federal withholding rule is - 10% of the distribution amount must be withheld by the IRA custodian/trustee unless the individual instructs not to have withholding. Since the state's levy amount is $6777.37, then the amount to be withdrawn would be $7530.41 with federal withholding of $753.04. Technically, the individual has the right to instruct there is to be 100% withholding so the state tax entity would not be sent any IRA funds .

The IRA custodian should communicate with the individual indicating the bank did receive the Order to Withhold, the bank will be doing so and that the bank will be withholding 10% unless the individual instructs otherwise on the IRS Form W-4P or an IRA distribution form.

Since the funds are deemed distributed to the individual, the reason code to be used on the Form 1099-R would either be a "1" or "7" depending on his or her age.

Miscellaneous IRA Data

End-of-Year Data	Traditional IRAs	Roth IRAs	Combined IRAs
2008	$3,257	$177	$3,435
2009	$3,941	$239	$4,180
2010	$4,340	$355	$4,795
2011	$4,531	$365	$4,896
2012	$5,109	$420	$5,529
2013	$6,019	$525	$6,544
2014	$6,421	$550	$6,971

(in billions of dollars)

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Email Guidance

Automatic Distributions Must Cease

Q-1. I have received word of the death of an IRA accountholder. Her daughter was in earlier this week to let me know. The accountholder had received her RMD auto distribution 06-08-2016. She passed away 05-28-2016. What needs to be done? It was deposited into the accountholder savings account. Should this be reversed and issued in the daughter's name?

A-1. It would be best to undo the auto distribution, set up the inherited for the daughter, transfer the IRA into the daughter's inherited and then pay her the 2016 RMD by December 31, 2016.

New Inherited IRA Arising From 401(k) Plan

Q-2. I found your email on the website and if you're not the right person to ask than can you forward it on or let me know who I should call. I have a Beneficiary IRA that I'm opening with funds from a qualified retirement plan. The deceased was only 64 but I need to verify with opening the bene IRA under the son's name if he needs to take the RMD for the year as the deceased wasn't 70½.

A-2. As we discussed, since the decedent was not subject to the RMD requirement under the plan retirement as he was 64, the non-spouse beneficiary has no RMD for 2016.

The IRA custodian must set up an inherited IRA for the beneficiary with the standard titling, " Jane Doe as beneficiary of XXXX". A non-spouse beneficiary must commence RMD distributions in the year after the individual died. So, the first deadline is 12-31-2017.

The retirement plan is required to furnish her a distribution form explaining the rules applying to her situation. She is entitled to directly rollover the funds from the plan into his/her inherited IRA. A distribution cannot be taken and then rolled over.

Employers Wanting to Reclaim HSA Contributions

Q-3. I have an employer of one of our HSA customers requesting us to redeposit funds to their business account that had been deposit to the customers HSA. The deposits were made in error. He has insurance through wife's insurance. Now I am guessing, a distribution form marking mistake contributions is done? However, I do not know about giving it back to the employer. Also the account does not have enough funds in it to do a withdrawal of all the mistaken contributions totaling $200.00 since the first of the year. Do you then make a mistaken distribution for the amount to close the account and this may not be the exact amount of transactions? Below is his history for the year.

		balance
1/15/16 166 ACH CREDIT (AUTO)	50.00	67.10
1/20/16 427 DDA POS DEBIT	7.36	.74
1/25/16 427 DDA POS DEBIT	6.08	53.66
1/31/16 160 INTEREST PAID	.01	53.67
1/31/16 180 TOTAL SERVICE CHARGE	2.00	51.67
2/01/16 427 DDA POS DEBIT	19.92	31.75
2/10/16 166 ACH CREDIT (AUTO)	50.00	81.75
2/22/16 427 DDA POS DEBIT	30.00	51.75
2/29/16 180 TOTAL SERVICE CHARGE	2.00	49.75
3/09/16 166 ACH CREDIT (AUTO)	50.00	99.75
3/31/16 180 TOTAL SERVICE CHARGE	2.00	97.75
4/06/16 166 ACH CREDIT (AUTO)	50.00	147.75
5/01/16 160 INTEREST PAID	.01	147.76
6/30/16 160 INTEREST PAID	.01	147.77

A-3. This is not a mistaken contribution/mistaken distribution. A mistaken distribution/contribution occurs when a person takes money out of his or her HSA because he/she believes the HDHP will not pay the expense, but he or she is wrong. The HDHP concludes it must pay the expense. Since the service provider was already paid by the individual, the HDHP pays or reimburses the individual.

More information is needed to assist.

Was this person HSA eligible in 2014 or 2015, but he became ineligible in 2016 since he became covered by a non-HDHP via his wife's employer? He is no longer HSA eligible, but he was at some point.

Or does his wife's employer have a HDHP with family coverage? If so, he remains HSA eligible.

The fact that an employer has a HDHP and it also makes HSA contributions for its employees are two separate subjects. Some employers incorrectly conclude that they don't need to make an HSA contribution for an employee unless the employee is covered under "their" HDHP. Most likely an employer must make HSA

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contributions to all of its employees who are covered by a HDHP. The source of the HDHP generally does not matter. It could arise from a person's personal HDHP policy or it could arise from one's spouse.

The general tax rule is - a bank can return HSA contributions already in person's HSA account to an employer in only two very limited situations. Otherwise, IRS rules do not require the funds be returned to the employer. The IRS has not expressly addressed the question, is it permissible to return the funds to the employer if the employee consents? The conservative approach for the bank is - the individual in this situation can withdraw the funds as an excess contribution and return them to the employer.

Q-4. I have a H.S.A question for you today. We have a business client that opened H.S.A. accounts for all of their employees. They put $5,000 in each account and they opened them in May. Today we get a call from the business client because 3 of these employees never had medical insurance with them. So they never should have opened an H.S.A. These employees have spent a portion of these funds. What is the best way to correct this for them.

A-4. More information is needed. Your situation (bank/business client/individuals) could be very complicated. What is the business client asking be done?

The general HSA rule is - once the funds go into a person's HSA such HSA funds cannot be returned by the bank to the employer as such HSA funds now are owned by the bank on behalf of the individual(s).

A determination must be made for each employee/HSA owner if he or she was eligible to open HSA or have an HSA established on their behalf. In order to have an HSA a person must be covered by a HDHP, not be covered by a non-HDHP, not be rolled in Medicare and not be a dependent. There is no requirement that an employee must have their HDHP because it comes from or by the employer. An individual could purchase his or her own HDHP or it might arise due to a spouse.

The business client and the employees may well have some tax issues; it depends on the facts. An individual has received $5000 of income if the employer under the tax rules is unable to exclude the $5000 from an employee's income. Has the business client been given advice by an accountant or attorney?

In some situations a person might consent to having some or all of the funds returned to an employer, but the tax ramifications will want to be understood. That is, the individual can withdraw (or have a deemed withdrawal) the HSA funds and return them to the employer. IRS rules do not permit the non-reporting of the contributions or any distributions.

401(k) Rollover

Q-5. Customer wants to do a rollover of $42K. The check the customer deposited was a bank check - written off a regular business account. When we questioned this the branch told us that the CPA of the business came in and said that this business account was for profit sharing and checks were getting cut to their employees. The business account was not labeled profit sharing or anything to do with retirement saving. Can we accept these funds as rollover funds into a Traditional IRA for the customer?

A-5. Yes you may accept the rollover contribution as long as the individual signs a rollover certification form or rollover review form. The fact that the check being deposited is not a "pension check does not means a person cannot make the rollover. For example, Jane Doe receives a pension check for $20,000 and she puts it into her checking account. She can write a check to make a rollover contribution and her check is not a pension check.

It would be preferred if the business account used to make the pension distribution was clearly identified as "ABC Inc 401(k) Plan and Trust rather than ABC Inc.

The customer should know whether he or she has received a distribution from a pension plan and whether or not it is eligible to be rolled over. The employer/plan must furnish a form explaining whether a rollover may be made.

Don't Commingle Roth IRA Funds With Other Investments

Q-6. We have a client that has a Roth IRA account with us. He asked whether it is possible for the balance of his Roth IRA to be deposited to his Trust Investment Man-

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agement account with us. Is this possible? What would be the tax consequences?

A-6. He could withdraw his Roth IRA funds and add to his general investment management account, but then the funds would no longer be Roth IRA funds. The future earnings of the funds would be taxable rather than non-taxable as they are when in the Roth IRA.

Roth IRA funds cannot be commingled with non-Roth IRA funds unless there would be a qualifying common trust fund.

There are rules limiting who may make Roth IRA contributions and how much may be contributed. It may or may not be easy for him to replenish to the same or another Roth IRA the withdrawn amount.

A determination would need to be whether his current withdrawal of the Roth IRA funds would be taxable (i.e. the earnings portion in certain situations) or non-taxable since the distribution would be qualified.

How old is he, when did he establish his first Roth IRA, does he have any other Roth IRAs with another financial firm and what would be the respective balances? These are questions to be asked and understood.

If he has not used up his once per year rollover right, he could withdraw funds and then make a rollover contribution within the 60 day period and there is no tax consequence.

A Roth IRA Conversion

Q-7. I have a customer who would like to convert her Traditional IRA (value of $4,700.00) to a Roth IRA. Her birthdate is 6/19/1952, so she will be 64 years old in a few days. Considering that she is over age 59½, after opening the Roth IRA account could I simply have her take a full distribution of the Traditional IRA, withhold 10% Federal tax and 5% Iowa state tax, and make a current year contribution of the balance to the Roth IRA? I don't believe she has made any other Roth or Traditional IRA contributions for 2016, but I would verify that first to make sure she was staying under the contribution limit. Please advise me whether this method would be correct, or alternatively, how I should accomplish this.

A-7. The tax rules permit her to convert the entire $4700. That is, she can contribute as a conversion contribution the amount of $4700. Even though she makes this conversion contribution she will be eligible to make an annual contribution up to $6500 as long as she meets the applicable eligibility rules for a traditional IRA or Roth IRA. It may be she is no longer eligible to make an annual contribution (e.g. no compensation).

She will be required to include the $4700 in her 2016 income and she will owe income tax (federal and state). She is able to instruct to have no withholding which is what many individuals would do as they want to maximize the amount going into the Roth. She would use other funds to pay the tax liability. Or, she could have withholding if she is willing to convert less than the $4700.

There are 3 different ways to a conversion (distribution/rollover, internal transfer from traditional IRA Roth IRA, external transfer from Traditional IRA to Roth IRA), but whatever method is used the bank as the the traditional IRA custodian must prepare Form 1099-R showing a normal taxable distribution of $4700 and then the Roth IRA custodian will report on the 2016 Form 5498 in box 3 a conversion contribution of $4700. Check reason code 7 on the IRA distribution for. Check the Roth IRA conversion box on the Roth IRA contribution form.

One IRA or Two?

Q-8. If someone opened a SEP IRA in April for Tax Year 2015 can they open a Traditional IRA that is a Rollover for 2016?

A-8. Your customer could establish a "new" traditional IRA and it could receive a 2016 rollover contribution. Even if the individual has an existing SEP-IRA, the tax rules allow him or her to establish a new separate IRA and to keep this "rollover" IRA separate from the SEP-IRA.

The tax rules, however, would also allow this person to make a rollover contribution into the existing SEP-IRA if the individual would find maintaining just one IRA the better administrative approach. .

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The once per year rule is a rollover rule. The fact that a SEP-IRA contribution was made for a person is independent of the rollover situation.

Some SIMPLE-IRA Rollovers Are Still Prohibited

Q-9. I have a client inquiring about their client opening a SIMPLE IRA to rollover their 401(k) funds to. From what I've read in the January 2016 Pension Digest, this is only allowed if the SIMPLE Plan has been established for 2 years. Otherwise, this is a prohibited transaction. Is my understanding correct? I believe an option for them would be to roll the money into a Traditional IRA then roll the funds to the SIMPLE IRA if the individual chooses to after the 2-year rule has been met. Please confirm if I am correct and instruct with any other options available.

Also they are interested in doing this is due to the business dissolving the 401(k) plan at the end of the month.

A-9. You are correct. A person must have satisfied the 2-year SIMPLE IRA rule before funds are eligible to be rolled into a person's SIMPLE IRA. For each person the 2-year period starts on the day the first SIMPLE IRA contribution is made for a person. So, when an employer terminates its 401(k) plan and commences the SIMPLE IRA plan, as you state, the funds most likely will need to be directly rolled over by each person to a traditional IRA until the 2-year requirement has been met. The person then can decide if she or he wishes to combine one with the other.

So, the 401(k) administrator is incorrect if he or she has said the 401(k) funds can immediately go into SIMPLE IRAs.

The tax rule is - the penalty tax is 25% when a a person who is under age 59½ withdraws funds from his or her SIMPLE IRA before the 2-year requirement has been met. The law has been written to make sure a person can never owe the 25% tax with respect to rolled over funds.

If a person would add the 401(k) funds to the SIMPLE IRA before the 2-year deadline was met, there would be a non-qualifying rollover. The distribution would be taxable and contributing the funds to a SIMPLE IRA would be an excess contribution. If the excess remained too long in the SIMPLE IRA. the favorable tax treatment of the elective deferrals and the employer contributions might be lost.

Internal Transfers

Q-10. We have a customer with 1 Traditional IRA Plan and he has a 48 month IRA CD. When the CD matures this month, he wants to split the money into several different term CDs under the 1 Plan.

He's over 59½, so any withdrawals made won't be penalized by the IRS. I told him, just leave the money in the 1 CD and make the withdrawals when he needs the money. No matter how he does it, from the 1 CD, or from 3 different 6 month CDs as they each mature, it's all getting reported as income. He doesn't want to get charged the bank penalty for an early withdrawal from a CD. I said, I'll waive it. He's not comfortable, he feels like I'm doing him a favor. I am, his wife works with us.

Anyway, he's insisting on having multiple CDs under 1 Plan. I know I'll do 1 distribution from the 48 Month Certificate, but I can't process 4 or 5 rollovers now. Can I do all internal transfers?

A-10. Yes. he may do internal transfers from his one "old" CD to three (3) "new" ones. I can see a benefit if the new CDs will have different terms (e.g. 12 months. 18 months, 36 months).