THE Pension Digest

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## ALSO IN THIS ISSUE –



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



## Seek More IRA Contributions

An IRA custodian wants to see its IRA deposits grow. Here are some suggestions.

1. Seek SEP-IRA contributions. A person can establish and fund a SEP-IRA up through his or her tax filing deadline of April 17, 2018, plus tax extensions. The maximum contribution amount is $54,000 for 2017 and $55,000 for 2018.

2. Seek more periodic contributions. In this day and age of web banking an IRA custodian should make it easy for a person to establish an automatic transfer from his or her checking account into either a traditional IRA or a Roth IRA. It should also be easy to stop this transfer, either temporarily or permanently. Inform the person that any contribution is made for the tax year in which the IRA custodian receives it.

3. Seek more Roth IRA contributions. As long as a person still has compensation (and not too much), a person can make a Roth IRA contribution. There is no age 70½ limit. There is no negative consequence to participating in a 401(k) plan. A person can contribute to both a 401(k) plan or a SEP-IRA and a Roth IRA.

4. Seek more traditional IRA contributions from high income clients. Now that any person with money in a traditional IRA is eligible to make a conversion contribution to a Roth IRA, more individuals will make nondeductible IRA contribution, if it is explained to them why they should make such contributions. Making a nondeductible contribution and then converting it (assumes no other funds within a traditional IRA) has the same effect as making a Roth IRA contribution. Income limits still make many individuals ineligible to make a direct Roth IRA contribution.

## 2017 IRA Contribution Deadline is Tuesday, April 17, 2018 Due to Emancipation Day

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

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

In 2018, April 15th falls on Sunday. Under the general tax rule, the tax filing deadline would be Monday April 16. However April 16 is Emancipation Day, a recognized holiday in Washington, D.C. This means in 2018, April 16th is a holiday for federal income tax purposes. Consequently, the filing deadline for all tax forms and payments required to be filed or completed on or before April 17th (as described in Section 6072(a), including the Form 1040 returns) will be Tuesday, April 17th, 2018.

This April 17, 2018 deadline applies to traditional and Roth IRA contributions, HSA contributions and CESA contributions.

## Missed RMDs - Helping the IRA Owner Understand the IRS' Limitations On the IRA Custodian

There will be times an IRA owner (or the IRA owner's accountant) thinks the IRA custodian can do something to resolve an IRA tax problem, but it cannot be done.

See the discussion below. An IRA owner knew she had failed to withdraw her 2016 RMD of $4,900 by December 31, 2016 so in mid January of 2017 she requested two $5,000 distributions. One to be a 2016 distribution and one to be a 2017 distribution. She was furnished two $5,000 checks. It is now January of 2018 and she was sent a 2017 Form showing a distribution amount of $10,000. She believes you as her IRA custodian has made an error which needs to be corrected. Neither the IRA custodian nor the IRS has made an error.

In order to assist with your relationship with the IRA owner, it might be worthwhile to furnish basic information so the individual comes to understand that you as the IRA custodian did not make a mistake and what you can do to help is limited. The individual still should be appreciative.

Set forth below is an article. It does discuss a situation similar to your IRA client's situation.

It is January of 2018 and some IRA owners and IRA beneficiaries realize they should have taken their RMD by 12/31/17 but they failed to so. What is to be done now?

Before discussing missed RMDs for 2017, I am first going to discuss a situation where an IRA owner missed taking his 2016 RMD by December 31, 2016. His IRA custodian had informed him that his 2016 RMD was $4,900 and that his deadline was December 31, 2016. For whatever reason, he failed to take his 2016 RMD by December 31, 2016. On January 10, 2017 he visited his IRA custodian. He informed the IRA custodian he wanted to withdraw $5,000 - to satisfy his RMD for 2016 and he wanted to withdraw an additional $5,000 to satisfy his 2017 RMD. An IRA distribution form was completed with respect to these two distributions.

It is now January of 2018. Your institution as the IRA custodian has sent him his 2017 Form 1099-R showing he was distributed $10,000. He believes an error has occurred - $5,000 was to be a distribution for 2016 and $5,000 was to be the distribution for 2017.

This article is being written so that your IRA client understands your institution has prepared his 2017 Form 1099-R correctly. **Your institution as the IRA custodian is not permitted to report the one $5,000 as having been distributed in 2016 because it was not.** Even though the distribution related to 2016 (it was meant to satisfy the 2016 RMD), it was distributed in 2017. It must be reported on the 2017 Form 1099-R.

An IRA custodian must follow the federal income tax laws and procedures. So too must an IRA owner.

There is no doubt U.S. federal income tax laws are complicated and often not easy to understand. In some cases, the complexity arises because multiple rules are written to help or give options to taxpayers.

The tax rules permit a person to make a prior year IRA contribution. In January of 2017 he could have made a contribution for tax year 2016 and claimed a tax deduction on his 2016 tax return.

This carryback concept does not apply to distributions. The tax rules do not permit a person to make a prior year IRA distribution in the sense the distribution will taxed on the prior year's tax return. Apparently, this is what your IRA owner thought could be done. But it cannot be as both $5,000 distributions occurred in 2017.

A fundamental tax rule is - a person must include a distribution from an IRA or a pension plan in their income for the year it is withdrawn/received. The tax rules do not permit a person to withdraw funds in 2017 and have them taxed on their 2016 tax return. This is true even if the distribution relates to 2016. For example, John Doe attains age 70 1/2 on July 5, 2016. He must take an RMD for 2016. However, since this is the first year for which he must an RMD, the law allows to take his RMD by 12/31/16 and include it on his 2016 tax return or he can take it in 2017 by April 1st and then this amount will be included in his 2017 income along with his 2017 RMD which must be withdrawn by December 31, 2017. The tax laws do not allow him to withdraw his 2016 RMD in 2017 and have it included in his 2016 income.

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**Missed RMDs - Helping the IRA Owner Understand the IRS' Limitations On the IRA Custodian ,**
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When an IRA owner or an IRA beneficiary fails to withdraw his RMD for a given year, the tax rules impose a 50% excise tax. The IRA owner has the responsibility to complete Form 5329 and show that he owes the 50% tax. Your IRA client should have filed the 2016 Form 5329. However, the IRA owner may request the IRS waive this 50% tax by completing the Form 5329 as instructed by the IRS. Generally, if the individual has corrected the mistake soon after discovering it by withdrawing the missed RMD and has a reason (illness, sickness, family matter, etc.) for the mistake other than "I just forgot," the IRS will often waive the 50% tax.

There are special tax rules applying when a person has been impacted by a federally declared disaster. Special tax relief is available to taxpayers who reside in areas declared to be a federal disaster area.

In summary, this article is being written so that your IRA client understands your institution as an IRA custodian is not permitted to report the one $5,000 as having been distributed in 2016 because it was not. It was distributed in 2017 even though it related to 2016. It must be reported on the 2017 Form 1099-R. An IRA custodian would be guilty of tax fraud if it showed this $5,000 distribution as having taken place in 2016.

## E-mail Guidance - 3 IRA Changes for 2018

Do you know or do you have any information on the IRA changes that are to take place this year? I would greatly appreciate it.

**CWF's Guidance.**

There are 3 changes-

1. The special disaster IRA tax rules apply to all victims of federally declared disasters for 2016 and 2017 and not just to the 2017 victims of hurricanes, Harvey, Irma, and Maria.

2. There is a new rollover rule for certain 401(k) participants. Some 401(k) plans are written to allow participants to instruct to have loan made to themselves from their 401(k).

For example, Jane Doe has $40,000 in the 401(k) and she borrows $10,000. She quits her job and is to be distributed her 401(k) balance. She must repay the $10,000. Many people can't so she directly rolls over the $30,000 and under the old law was considered to have been distributed the $10,000. She had 60 days to roll it over and if she couldn't she had to include the $10,000 in her income.

The new law allows her to repay the $10,000 by her tax filing deadline rather than the standard 60 day period.

3. The new law provides that a Roth IRA conversion contribution made in 2018 is irrevocable. This is certainly the law if the funds are coming from a traditional IRA. This may also be the case if the funds are coming from a 401(k) plan. But the new law is less clear if the funds are coming from a 401(k) plan.

An IRA custodian wants to furnish IRA Amendments early in 2018, as current IRA plan agreements indicate a person is eligible to recharacterize a 2018 Roth IRA conversion. The new law eliminated this right. The tax consequences are material.

For example, Jane Doe's marginal tax rate is 35%. She converts $100,000 because she is unware of the tax law change. She thinks she has the right to recharacterize the $100,000. She no longer has the right. She has a tax liability of $35,000.

## CWF's Guide for the IRS Distribution Codes For Box 7 of the 2017 Form 1099-R

Box 7 is to be completed by the IRA custodian with one descriptive code or with two codes which will help the IRS determine if a person is paying the correct taxes with respect to his or her IRA distributions. The IRS asks the IRA custodian to help in determining if a person owes the 10% or 25% additional tax and for what year any income is taxable, if any.

In some cases only one code is to be used to describe a certain IRA distribution. The solo codes are: 1, 2, 3, 4, 5, 7, 8, G, J, K, N, P, Q, R, S and T.

In other cases it is mandatory to use two code. It is mandatory when there is an applicable numeric code and an alpha code. It is not permitted to enter more than two codes. It is also mandatory in three numeric code combination situations. They are: codes 81, 82 or 84 or 18, 28,or 48.

If two or more distribution codes are not valid combinations, then the IRA custodian must file more than one Form 1099-R. That is, a separate Form 1099-R must be filed for each distinct distribution code.

If two or more other numeric codes are applicable, an IRA custodian must file more than one Form 1099-R.

The various code combinations for IRA distributions are set forth:

1 Early distribution, no known exception or individual to indicate exception on Form 5329

18 Withdrawal of an excess contribution in same year as contributed but also an early distribution no known exception.

1P Withdrawal of an excess contribution in the year following the year contributed but also an early distribution no known exception.

1K Early distribution, no known exception of traditional, SEP, or SIMPLE IRA assets not having a readily available FMV

2 Early distribution, exception applies.

28 Withdrawal of an excess contribution in same year as contributed but an exception applies.

2P Withdrawal of an excess contribution in the year following the year contributed but an exception applies.

2K Early distribution, exception applies, but involves a traditional, SEP, or SIMPLE IRA asset not having a readily available FMV.

3 Disability

4 Distribution to a beneficiary regardless of age.

48 Distribution to a beneficiary regardless of age of an excess contribution made by the accountholder one year and withdrawn by the beneficiary the same year.

4P Distribution to a beneficiary regardless of age of an excess contribution made by the accountholder one year and withdrawn by the beneficiary the next year.

4K Distribution to a beneficiary regardless of age of an IRA asset not having a readily available FMV.

4G Distribution to a beneficiary of a 401(k) or similar plan regardless of age which is directly rolled over to an inherited traditional or Roth IRA.

5 Prohibited Transaction

7 Normal Distribution – Age 59$^1/_2$ or older

7K Normal distribution of an IRA asset which does not have a readily available FMV

8 Withdrawal of an excess contribution by a person age 59$^1/_2$ or older the same year the excess contribution was made

81 Withdrawal of an excess contribution in the same year as contributed but no known exception

82 Withdrawal of an excess contribution in same year as contributed but also an exception applies.

84 Distribution to a beneficiary regardless of age of an excess contribution made by the accountholder one year and withdrawn by the beneficiary the same year.

8J Withdrawal of a Roth IRA excess contribution in the same year as contributed but no known exception

**Continued on page 5**

8K Withdrawal of an excess contribution made one year and withdrawn the same year when the distribution involves an IRA asset not having a readily FMV

Code G is primarily used to report a direct rollover from an employer plan to an IRA. However, it is also used to report a direct payment from an IRA to an employer plan

G Used to report a direct payment from a traditional IRA to an accepting employer plan.

GK Used to report a direct payment from a traditional IRA to an accepting employer plan. when the distribution involves an IRA asset not having a readily FMV

J Used to report various distributions from a Roth IRA. It is primarily used to report nonqualified distributions. However, it is also used to report a qualified distribution on account of meeting the first time home buyer rule.

J8 Withdrawal of a Roth IRA excess contribution in the same year as contributed

JP Withdrawal of a Roth IRA excess contribution in the year following year it was contributed

K Distribution of traditional, SEP, and SIMPLE IRA assets not having a readily available FMV

K1 Early distribution, no known exception of IRA assets not having a readily available FMV

K2 Early distribution of IRA assets not having a readily available FMV, but exception known

K4 Distribution to an IRA beneficiary regardless of age of an IRA assets not having a readily available FMV.

K7 Distribution to an IRA accountholder age 59½ or older of IRA assets not having a readily available FMV

K8 Withdrawal of an excess contribution made one year and withdrawn the same year when the distribution involves an IRA asset not having a readily FMV

KG Used to report a direct payment from a traditional IRA to an accepting employer plan. when the distribution involves an IRA asset not having a readily FMV

N Deemed distribution and the recharacterized IRA contribution occur the same year

P Withdrawal of an excess contribution by a person age 59½ or older in the year following the year the excess contribution was made

P1 Withdrawal of an excess contribution in the year following the year the excess contribution was made, but no known exception

P2 Withdrawal of an excess contribution in the year following the year the excess contribution was made, but an exception known

P4 Distributions to a beneficiary regardless of age of an excess contribution made by the accountholder one year and withdrawn the next year

PJ Withdrawal of a Roth IRA excess contribution in the year following year it was contributed

Q Used to report a qualified distribution from a Roth IRA. Know 5-year holding period met and the accountholder is age 59½ or older or disable or a payment is made to a beneficiary.

R Used to report a recharacterization of an IRA contribution made for one year and recharacterized in the following year.

S Early distribution from a SIMPLE IRA by an accountholder who has not reached age 59½ in the first two years with no known exception.

T Used to report a non-qualified distribution from a Roth IRA because it is known the 5-year holding period has not been met but the accountholder is age 59½ or older or disable or a payment is made to a beneficiary.

## E-mail Guidance - Non-spouse Beneficiary Fails to Withdraw 2017 RMD by 12/31/2017

We were notified of a 70 1/2 customer who was deceased. Now beneficiaries are coming forward in 2017 so RMD was not paid. Now beneficiaries are coming forward. How do we treat the 2018 RMD?

**CWF's Guidance.**

Your situation happens. No surprise, some people procrastinate.

The bank will want to set up the inherited IRAs for the non-spouse beneficiaries as soon as possible. Review the 41TI form and the 204 form.

The tax rule is - a beneficiary includes a distribution in his/her income for the year withdrawn. That is, in 2018 each person will receive two distributions. These beneficiaries wish to withdraw their share of the missed 2017 RMD as soon as possible. They will always withdraw in 2018 their RMD for 2018. Next year in 2019 they will be furnished a 2018 Form 1099-R showing the combined amount with a reason code 4.

There is to be a standard 2018 RMD calculation for each beneficiary. The calculation is: applicable beneficiary's 12-31-2017 FMV balance divided by a divisor based on the age of the applicable beneficiary. See Single Life Table for divisors. The balance as of 12/31/17 is not adjusted to reflect the fact that the 2017 RMD was withdrawn in early 2018. For example, Sara is a beneficiary and she was born on 4-20-1988. She is age 30 in 2018 so the divisor is 53.3. For illustration purposes we assume the FMV balance is $25,000. So, her 2018 RMD would be $469.04.

A beneficiary may withdraw more than their RMD, but they will owe the 50% tax if they withdraw less.

The beneficiaries should discuss their situation with their tax advisor. Because they did not withdraw their share of the 2017 RMD by 12/31/2017, each owes the 50% tax. Each is to prepare the 2017 Form 5329 to indicate they missed taking the 2017 RMD. The Form 5329 can be completed by the beneficiary to request the IRS to waive the 50% tax. The IRS is much more likely to waive the 50% tax if the IRA owner died in November or December rather than February or March.

As a reminder, a non-spouse beneficiary has no rollovers rights. Inherited IRA funds may be transferred, but they cannot under existing law be rolled over.

## E-mail Guidance - Is It Permissible For An Employee to Waive SEP-IRA Coverage?

I have a business owner who offers a SEP plan to his employees. He came in today asking for a non-participation form as 2 of his employees do not want to participate. Can I get that off the website or can you send me the form he is requesting.

He was referred to us by his accountant.

**CWF's Guidance.**

Your business customer (and possibly the tax advisor) need to review this situation. No one with any pension/SEP knowledge has written a non-participation SEP-IRA form. The waiver concept may apply to 401(k) plans and other pension plans, but it does not apply to SEP-IRA plans. The IRS' position is - every eligible employee must participate in an employer's SEP-IRA plan and if this requirement is not met the employer's SEP-IRA plan is non-qualifying. The IRS rules do not allow a person to waive SEP-IRA plan coverage. I don't believe an inexpensive SEP-IRA plan document can be written allowing for an employee to waive coverage. Certainly, the IRS Form 5305-SEP does not allow an employee to waive coverage.

The statutory law supports the IRS position on SEP-IRA plans.

If one or more eligible employees would waive coverage and not be allocated an employer contribution, the contributions made for the other employees must be processed by the bank (if it has knowledge) as regular annual contributions and not as a SEP-IRA contribution. Most likely the non-qualifying SEP-IRA contributions will be excess IRA contributions and the 6% annual penalty would apply until corrected. The employer would not qualify to deduct these contributions as SEP contributions or be able to treat them as not being subject to FICA.

The employer must make its SEP-IRA contribution to the SEP-IRAs of all eligible employees. This means an employee is an active participant for traditional IRA deduction purposes and it may mean the employee is harmed since he or she has lost the right to deduct some or all of their traditional IRA contribution. The employer could choose to compensate this employee.

The solution is not to have an employee sign a non-participation form. It does not matter whose idea it is to use a non-participation form. It might be the employer's idea as it wants to save some money by not making the contribution or it might be the employee's idea because the amount of the SEP-IRA contribution is minimal compared to the loss of the traditional IRA deduction.

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## E-mail Guidance - Divorce and Dividing the 401(k) Account and the IRA

I have a question for a client. A husband and wife are getting divorced. The husband has agreed to split his IRA and 401(k) funds 50% to the wife. The question from the wife is can she rollover the funds into her own IRA from the IRA and 401(k) she receives from the husband?

**CWF's Guidance.**

She may instruct to have 50% of his IRA transferred into her existing IRA. There needs to be a court order instructing the transfer from his IRA to her IRA of the 50% or of a stated amount. This is to be a non-reportable and non-taxable transfer. The funds should not be distributed to her and rolled over. This would cause unwanted tax issues.

If there is a QDRO issued by a court to the administrator of his 401(k) plan indicating she has been allocated 50% of his 401(k) balance, then she is entitled to directly rollover "her/his" 401(k) balance into her existing IRA. A QDRO is a qualified domestic relations order. The order must meet certain requirements.

As with any direct rollover, the plan will prepare a Form 1099-R for her as it does for any participant and the IRA trustee will need to complete box 2 on her Form 5498 to report the rollover (direct). She will need to explain on her tax return that she owes no income tax as she did a direct rollover.

## E-mail Guidance - How Do I Determine If The Transaction is a Rollover or Transfer?

I have an existing SIMPLE IRA and this Individual wants to rollover her SIMPLE from Edward Jones to her SIMPLE here. Is it okay to add to the existing IRA Account?

What form do I need to request them to send the funds to us and any other forms needed to be completed?

**CWF's Guidance.**

It is not clear to me - are the funds being transferred from SIMPLE IRA to SIMPLE IRA or SIMPLE IRA to Traditional IRA or are the funds being withdrawn/distributed from the SIMPLE IRA at Edward Jones and then a rollover contribution will be made to SIMPLE IRA or to Traditional IRA with CVBT?

The form or forms to be completed depend upon which transaction is to occur?

A transfer will occur if the payee of the check is Cedar Valley Bank and Trust and a rollover applies if the check's payee is the individual.

Has the 2 year rule been met?

See attached for a copy of our transfer form. If not a transfer, then show on the IRA contribution form as a rollover into the applicable IRA.

## E-mail Guidance - Spousal IRA Contributions

What are the rules for a working spouse to make contributions to an IRA for a non-working spouse?

1. AGI Limits
2. Does it have to be a separate IRA, or can it be one that they started when they did work?
3. Etc.

**CWF Guidance.**

These are the spousal IRA contribution rules.

1. Two individuals must be married as of the December 31st for which the IRA contribution is being made - 12/31/17 for 2017 and 12/31/18 for 2018.
2. The couple must file a joint income tax return for the year for which the contribution is being made.
3. The spouse with the lesser compensation must have his/her own IRA.

A long time ago the rules required that one of the spouses be a non-working spouse. That is no longer the rule.

A spousal contribution can only be made into the IRA of the spouse with the lesser income.

If the spouse with no income or the lesser income had established an IRA when he/she was working, the spousal contribution may be added to that existing IRA.

At one time the concept was - the working spouse made a contribution into the non-working spouse's IRA. The current concept is - the spouse with the greater compensation may make a contribution into the spouse's IRA with the lesser income (or no income) or the spouse with the lesser compensation (or no income) can make his/her own IRA contribution.

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E-mail Guidance - Spousal IRA Contributions, Continued from page 7

4. If both are age 50 or older, the maximum contribution for both spouses is the lesser of $13,000 or 100% of their income.

5. If both are younger than age 50, the maximum contribution for both spouses is the lesser of $11,000 or 100% of their income.

6. If one is 50 or older and one is younger than age 50, the maximum contribution for both spouses is the lesser of $12,000 or 100% of their income.

There are also rules regarding the ability to deduct the contributions being made for and by both spouses.

If the working spouse is an active participant in a pension plan, his or her contribution will be 100% deductible only if his/her MAGI is less than $99,000.

By definition a non-working spouse is not an active participant in a pension plan, therefore the contribution into his or traditional IRA will be 100% deductible for 2017 as long as their joint MAGI is less than $186,000 and partially deductible if their joint MAGI is in the range of $186,000 - $195,999.

## Reminder – RMD Must Be Met Before Any Conversion or Rollover

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

This rule (first money withdrawn counts against the RMD amount) causes problems for those individuals age 70½ and older who have set up periodic RMD distributions. For example, Jane Doe, age 75 has set up a periodic distribution schedule where she has her current year's RMD transferred to her checking account from her traditional IRA. Her IRA's account balance was approximately $28,000 as of December 31, 2016. Her RMD for 2017 is $1,400. This transfer takes place on December 5th of each year. She uses these funds for Christmas presents.

However, she comes into the financial institution on July 3, 2017 and she informs you she wishes to convert $10,000 from her traditional IRA to her Roth IRA that day.

You will need to inform her of the above rules. Her RMD amount for 2017 ($1,400) must be paid to her before she is allowed to do the conversion. So, she can withdraw the RMD amount of $1,400 on July 3, 2017 and then do the conversion. Or, she could wait to do the conversion on December 5th after her RMD has been distributed to her.

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

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

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