

**IRS Guidance
Errors on Form 5498 by Custodian
May Cause Tax Trouble For Everyone**

The IRS is short of staff and so the IRS may not be as tolerable of mistakes in preparing the 2014 Form 5498 as in prior years. In general, the penalty for preparing an incorrect Form 5498 is \$50.00 for each incorrect form furnished to the accountholder and \$50.00 for each incorrect form furnished to the IRS. Mistakes may be very costly.

In recent guidance the IRS reminds IRA custodians that mistakes may be avoided by checking the information before it is sent to the IRS and furnished to the individual. The IRS cited four common mistakes.

1. Reporting the IRA contribution for the wrong year. CWF believes primary fault is with the IRS as the IRS has never adopted procedures where if the individual does not clearly designate a contribution as being for a specific year the right to do so is lost. The current IRS procedure apparently is to always allow the individual to change his or her mind as to the tax year for which a contribution is made. The IRS needs to adopt the rule, the contribution will be processed for the current year unless designated for the prior year and it is too late to change it after October 15.
2. Failing to report the contribution as a conversion from a traditional IRA to a Roth IRA. Roth IRA conversion contributions made from January 1, 2014 to December 31, 2014, are to be reported in box 3 of the 2014 Form 5498 for the Roth IRA. That is, funds within a traditional IRA, SEP-IRA or SIMPLE are moved to a Roth IRA. An individual is willing to include such amount(s) in his or her income and pay taxes now rather than in later years. Conversion reporting errors occur for a number of reasons. First, IRA personnel sometimes do not understand that there is a difference between a Roth IRA conversion contribution and a Roth IRA recharacterization contribution. They are two different transactions and there will be tax reporting problems if they are mixed up. The IRA software must have different transaction codes for these different transactions. Secondly conversion reporting errors occur because the IRA software sometimes does not make it very clear or does not allow the proper reporting of a conversion contribution. That is, it is not always the IRA custodian's personnel mistake. The number of conversion contributions has been relatively small, at least when the funds have been invested in savings and time deposits. Consequently, the IRA software vendors have not updated their IRA software to perform the conversion and recharacterization tasks more efficiently.

**Deadline for 2014 Form 5498
Is June 1, 2015**

The deadline to furnish the 2014 Form 5498 to the IRS, IRA accountholders, and inheriting IRA beneficiaries is June 1, 2015 since May 31 is a Sunday.

Conversions and recharacterizations are different transactions. Like rollovers and transfers some individuals believe they are the same. They are different. A "conversion" contribution coming from a 401 (k) is not reported as a conversion in box 3. Rather, it is reported in box 2 as a rollover contribution which it is. But it is also a conversion. The IRS decided to have this contribution reported in box 2 rather than box 3. All software providers should revisit the subject of whether their Roth IRA software could be improved by making updating changes.

3. Issuing duplicate Forms 5498. The IRS has adopted the procedure that an IRA custodian may furnish the 2014 Form 5498 in January of 2015 as long as it sends out a second Form 5498 for anyone who made a carryback contribution for 2014 during the period of January 1, 2015 to April 15, 2015. The recipient needs to be informed that the second form furnished after April 15 and before May 31 "replaces" the first one and the first should be discarded. This means the corrected box is to be checked. The IRS has done not a good job of explaining what information the IRA custodian is to be send to

those IRA accountholder who were already sent a 2014 Form 5498 and who later make a carryback contribution.

4. **Missing or incorrect RMD information.** Required distributions is an important and complex topic. Some of the mistakes being made are due to the fact that the IRS needs to furnish better guidance to individuals and the IRA custodians. The IRS should define what is meant by “missing and incorrect information.”

The tax laws impose a 50% excise tax when a person fails to withdraw a required distribution. Since 1974 there has never been sufficient support in Congress to lower the 50% to 30%, 20% or some lower percentage.

At the present time, the IRS requires the IRA custodian via Form 5498 to inform the IRS and an accountholder who is age 70½ or older that he or she must take an RMD for the upcoming year. That is, on the 2014 Form 5498 box 11 must be checked if a living accountholder has or is anticipated to reach age 70½ during 2015. Note that the IRS does not require the IRA custodian to inform the IRS of the RMD amount; either on the Form 5498 or on a different form. It is unclear and unsettled under the tax laws if the IRS has the authority to require the IRA custodian to calculate the RMD and furnish this information to the IRS. The IRS believes it has this authority, but it has been unwilling to expressly confront Congress on this issue. The IRS and the Congress spar over various tax issues and RMDs for IRAs is one of those issues.

For tax revenue collection reasons and statistical reasons the IRS wants as much information as possible about required distributions.

What the IRS cannot mandate, the IRS many times will try to obtain indirectly. For this reason, the IRS added box 12a (RMD amount) and box 12b (RMD Deadline) to the Form 5498. The IRS has authorized a IRA custodian to furnish the 2014 Form 5498 to an IRA accountholder by January 31, 2015 and it will satisfy the FMV statement requirement, the Form 5498 requirement and the RMD notice requirement. The information in boxes 12a and 12b should not be sent to the IRS unless the accountholder has expressly consented, but it may well be the software provider provides this information to the IRS and the IRS will then process and analyze this data.

The IRS has adopted what is seemingly an inconsistent approach for RMDs related to inheriting beneficiaries. The IRS has instructed that box 11 is not to be checked if the Form 5498 is being prepared for an inheriting beneficiary. Additionally, the IRS states that an IRA custodian is not required to furnish an RMD notice to an inheriting beneficiary. Consequently more and more beneficiaries fail to take their required distributions. The IRS is starting to have to deal with beneficiaries who are not happy they must pay the 50% tax. The IRS needs to adopt a better approach to inform an IRA beneficiary that he or she is primarily responsible to make sure that the required distribution is withdrawn. Presently, the IRS is not doing this. An express statement needs to be made in Publication 590 that each beneficiary must calculate his or her required distributions and that the IRA custodian is not required to make this calculation or furnish any RMD notice.

Some institutions or some software providers may wish to adopt the approach that since the IRS in the instructions for Forms 1099-R and 5498 do not require an IRA custodian to perform RMD services to a beneficiary that it is best to not perform these services. This is short-sighted as the IRA plan agreement as written by the IRS requires that RMDs be made to an inheriting beneficiary. The IRA plan agreement requires distributions to a beneficiary. The form states the life distribution rule applies unless the 5 year rule is elected. The IRS last revised their model IRA forms in 2002. It maybe the IRS will revise these forms to make it clear that it is solely up to the beneficiary to take RMDs. Until the

IRS does so, it is dangerous for any IRA custodian to ignore the IRA plan agreement which presently requires a distribution be made to the beneficiary.

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