

January to February - 2011

The IRA Digest

A summary of Retirement News & Tips for the Tax Professional

Reminders for IRAs

Please note the following reminders for your clients who own IRAs and other retirement accounts:

2010 RMDs & IRS Form 5329

If you are filing a tax return for clients who were at least age 70½ last year, then check to make sure that required minimum distributions (RMD) were taken from all of their traditional IRAs, SEP IRAs and SIMPLE IRAs by December 31, 2010. If they have assets in employer plans, such as pension plans, 401(k) plans, 403(b) plans, or governmental 457(b) plans, then the clients may need to take RMDs from their accounts under these plans as well.

Exceptions to the December 31, 2010 Deadline

There are two types of clients that have exceptions to the December 31, 2010 deadline. They are:

- Clients who reached age 70½ in 2010, in which case they have until April 1, 2011 to take their 2010 RMDs, and
- Clients with assets in employer plans that allow them to defer starting RMD payments past age 70½ until retirement, providing they are still working for that employer.

Clients who miss the deadline will owe the IRS an excess accumulation penalty of 50% of the amount not taken by the deadline. However, the IRS will waive the penalty if the failure to meet the deadline is due to a reasonable cause.

If your clients missed the deadline to take their RMDs, then you will need to file IRS Form 5329. This form is filed to either pay the penalty or to notify the IRS that a waiver is being requested for the penalty.

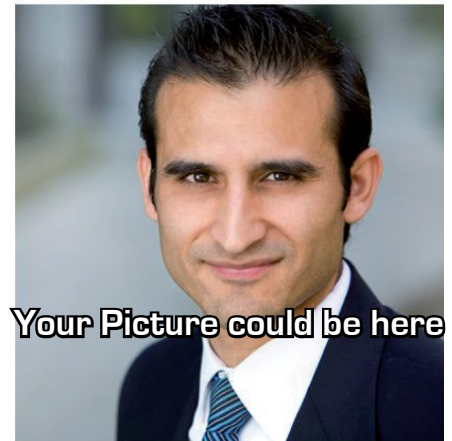
If a client took RMDs in 2010, then the IRA custodian or trustee is required to issue Form 1099-R to report the amount, by January 31, 2011. Be sure to ask your RMD-eligible clients for their copies of Form 1099-R.

Filing IRS Form 8606

In general, Form 8606 is filed to report the activity of nontaxable funds in an IRA. We find that IRS Form 8606 was not filed when required for an alarming number of clients. For example, Form 8606 is required to be filed for a client's IRA, if any of the following events occurred:

- A contribution was made to the client's traditional IRA and he didn't claim a tax deduction for all or a portion of it;
- The client had after-tax amounts in a traditional IRA from nondeductible contributions, or rollovers of after-tax amounts from a 401(k) or 403(b) plan, and he took a distribution from any of his non-Roth IRAs;
- The client converted amounts from a non-Roth IRA, unless the entire amount was recharacterized; or,
- The client received a distribution from his Roth IRA.

Failure to file Form 8606 can result in penalties being owed to the IRS, and could result in your client paying income tax and early distribution penalties on amounts that should be tax- and penalty-free.



IRA Questions? Call us!

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A SEP Means Tax Deduction for Business Clients

As the tax season approaches, business owners often look for ways to reduce their taxable income. If your client owns a business, then he or she can shelter up to \$49,000 for 2010 (compensation allowing), if the amount is contributed to a SEP IRA. SEP IRAs can be established and funded by the business owners' tax-filing deadline, including extensions.

SEP Contribution Limit

The maximum amount that can be contributed to an employee's

account is the lesser of 25% of the employee's compensation – such as W-2 wages, or \$49,000. For this purpose, compensation is capped at \$245,000. Further, the percentage is reduced to 20% of the owner's modified net profit, for those whose contribution is based on Schedule C income.

Important: Employees Must be Included

When allocating contributions, a common tendency among business owners is to make contributions only to their own SEP IRAs and exclude their employees. However, steps must be taken to ensure that contributions are made for all eligible employees. Determining eligibility can be easily accomplished by reviewing the eligibility requirements that were chosen when the SEP plan was established.

If SEP contributions are made for the business owner and none are made for other eligible employees, then retroactive contributions plus earnings may need to be made for the eligible employees. This can be quite costly for the business.

Attractive SEP Features

Small-business owners often find a SEP IRA attractive because of its features, which include the following:

- **Discretionary Contributions:** This feature allows the business owner to choose whether or not to make contributions in some years, which is a welcome option when profits are low or nonexistent.
- **Flexible Eligibility Requirements:** The business

owner can exclude employees who do not meet certain age, compensation, or years-of-service requirements.

- **Ease of Set Up:** In many cases, SEP plans can be set up easily by the employer by completing a few lines on a two-page document, and employees establishing their traditional IRAs to receive contributions.

Please contact our office if you have questions about setting up SEP IRAs for your clients.

Reporting a 2010 Roth Conversion

Clients who converted amounts from non-Roth accounts to Roth accounts in 2010 are required to indicate whether they want the taxable amount of the conversion to be either included on their 2010 tax return, or spread equally between their 2011 and 2012 tax returns.

These clients must file the 2010 version of IRS Form 8606 to indicate their preference. The election is made in Part 11 of the form.

According to the instructions, the account's owner must input the taxable amount of the conversion on line 18, and input the amount on line 19 if the amount will be included on the 2010 tax return. If the amount will be included in income for 2011 and 2012 (equally), the account's owner must input 50% on line 20a and the remaining 50% on line 20b.

Separate Forms May be Needed for Multiple Conversions

There are now three options for converting non-Roth assets to Roth

accounts. They are:

- Converting amounts from non-Roth IRAs to Roth IRAs
- Converting amounts from employer plans [such as pension, 401(k), 403(b), and governmental 457(b) Plans] to Roth IRAs. This conversion is referred to as a "rollover to a Roth IRA.", and
- Converting amounts from traditional 401(k), 403(b), or eligible 457(b) accounts to Roth accounts within the same plans. This conversion is referred to as an "in-plan conversion."

According to the instructions on Form 8606, if a client has both a rollover to a Roth IRA and an in-plan Roth rollover, then you must complete and file a separate Form 8606: Part III to report each transaction.

Spouses May make Separate Elections

If two individuals, who are married to each other, completed Roth conversions in 2010, each spouse can make separate elections for including their conversions as income. For instance, one spouse can choose to include the income from her conversion in 2010, while the other may choose to spread the income from his conversion over 2011 and 2012.

Alternatively, both can choose the same option. This flexibility is available because Form 8606 is an 'individual form', as opposed to Form 1040, which can be filed to report joint income and other tax-related activity.