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Are You Ready?

IRS to Require Bank Stock Valuations for IRA Shareholders

By David S. Horvath, CPA, and Kevin F. Powers, CPA

The IRS is in the process of clarifying new information reporting requirements that could impose another layer of compliance obligations on many financial institutions. The requirements will apply to certain individual retirement account (IRA) investments with no readily available fair market value (FMV), including nonpublicly traded stock, partnership or LLC interests, real estate, and options. The change will affect issuers of Form 5498, "IRA Contribution Information," and Form 1099-R, "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc."

The New Requirements

The requirements were first published last fall in a draft of the 2014 instructions for Form 5498 and Form 1099-R. The draft proposed adding new boxes (15A and 15B) on Form 5498 that would require IRA trustees and custodians to report the FMV of certain hard-to-value assets (essentially, assets that aren't traded on an established market) and identify the type of asset by category. The instructions also proposed the use of a new distribution Code K for reporting distributions of assets without a readily available FMV on Form 1099-R.

Implications for Financial Institutions

The new reporting requirements could affect a bank in two ways. First, many nonpublic banks have shareholders who hold their shares inside of an IRA, rather than holding the stock directly, often with the goal of having dividends and/or appreciation in the value of shares occur within a tax-favored account. Bank directors who are required to invest in their banks also might do so through an IRA. Second, a public or nonpublic bank might hold hard-to-value assets for customers as IRA trustees or custodians. In either case, it's unlikely the banks have been providing annual valuations of the assets.

Moreover, it's unclear how, going forward, FMV should be determined. For example, the trustee of an employee stock ownership plan that holds stock is required to value that stock at least annually and typically retains an independent appraiser to issue a report on the stock's FMV. If banks must do the same (as opposed to simply using book value or multiples of earnings), the cost could be significant.

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Next Steps

The additional reporting for hard-to-value IRA investments will be optional for 2014. According to the IRS, this delay is intended to give financial institutions reasonable time to fully implement the new requirements.

In the meantime, banks need to ask themselves some questions. For example, banks that serve as custodians will need to determine whether it makes sense to continue to offer such services related to hard-to-value IRA assets. They might opt to cease offering custodian services to IRAs with hard-to-value assets. Privately held businesses will need to develop a policy for handling requests from IRA shareholders or their trustees to be able to provide assistance or gain access to financial information related to these valuation requirements.

Stay Tuned

Banks should stay on top of the coming obligations and take appropriate steps to prepare. Whether they serve as custodians of IRAs with hard-to-value assets or are nonpublic banks with IRA shareholders, banks can expect questions about FMV in the near future.

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