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The Pension Digest

ALSO IN THIS ISSUE –

Is a Roth IRA Permissible for a Child?

A child (i.e. a minor) is certainly able to establish a Roth IRA. The Roth IRA laws do not have a minimum age requirement. The IRS, in Publication 590, starts its discussion of Roth IRAs with the following sentence, "Regardless of your age, you may be able to establish and make nondeductible contributions to an individual retirement plan called a Roth IRA."

A person (including a minor) is eligible to contribute to a Roth IRA (and/or a traditional IRA) if he or she has taxable compensation and his or her modified adjusted gross income is less than $110,000. For purposes of this article, it is assumed the child is not married and it is also assumed that the child has less than $110,000 of modified adjusted gross income.

Why would a child, or a parent on behalf of a child, want him or her to have a Roth IRA? The tax benefits associated with a Roth IRA are so great that most parents will want their child to have one. As long as the child has compensation, there is nothing in the law which says that the child must contribute that compensation to his or her Roth IRA. In fact, he or she may spend that amount on clothes and CD's, and then use a parent's gift to fund the Roth IRA.

The governing IRA statutes and the IRS regulations do not provide as comprehensive a definition of compensation as one would expect to find. The definition which the IRS sets forth in Publication 590 is essentially a combination of the IRA section 219(f)(1) and the related regulation, and is as follows: "Compensation includes wages, salaries, tips, professional fees, bonuses, and OTHER AMOUNTS received for providing personal services. It also includes commissions, self-employment income, and taxable alimony and separate maintenance payments. The IRS treats as compensation any amount properly shown in box 1 (Wages, tips, other compensation) of Form W-2, Wage and Tax Statement, provided that amount is reduced by any amount properly shown in box 11 (Nonqualified plans). In addition, compensation does not include any of the following items: earnings and profits from property, such as rental income, interest income and dividend income; pension or annuity income; deferred compensation received (compensation payments postponed from a past year); income from a partnership for which you do not provide services that are a material, income-producing factor; any amounts you exclude from income, such as foreign earned income and housing costs.

Should a child have a Roth IRA? The answer is a definite "yes." The Roth IRA provides any taxpayer, including a child, an excellent way to accumulate wealth. Under the Internal Revenue Code, there are only a very limited number of ways that income can be earned yet not be taxed. In addition, the Roth IRA is an excellent way to accumulate the funds needed to buy that first home.

Examples:

#1. A child is age 8. She mows lawns for ten years and earns $1,000 per year for the first five years and $2,000 per year for the next five years. she contributes this $1,000/$2,000 to a Roth IRA on January 2 of each year for ten years, and never makes another contribution. If an earnings rate of 7% will be realized, the Roth IRA will have the following balances at the indicated times:

Year 1/Age 8	$1,070
Year 2/Age9	$2,215
Year 3/Age 10	$3,440
Year 4/Age 11	$4,751
Year 5/Age 12	$6,152
Year 6/Age 13	$8,724
Year 7/Age 14	$11,475
Year 8/Age 15	$14,418

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Roth IRA
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Year 9/Age 16	$17,567	
Year 10/Age 17	$20,937	Contributions Stop
Year 15/Age 22	$29,365	
Year 20/Age 27	$41,186	
Year 25/Age 32	$57,766	
Year 30/Age 37	$81,020	
Year 35/Age 42	$113,634	
Year 40/Age 47	$159,378	
Year 45/Age 52	$223,536	
Year 50/Age 57	$313,520	
Year 55/Age 62	$439,728	
Year 60/Age 67	$616,741	
Year 65/Age 72	$865,011	
Year 70/Age 77	$1,213,223	
Year 75/Age 82	$1,701,609	
Year 80/Age 87	$2,386,594	

#2. A child is age 4. She is a child model/actor and she has, on average, earnings of $18,000 per year. She makes a contribution to a Roth IRA of $2,000 from ages 4 to age 18. The earnings rate is set forth at 7%.

Year 1/Age 4	$2,140	
Year 2/Age 5	$4,430	
Year 3/Age 6	$6,880	
Year 4/Age 7	$9,501	
Year 5/Age 8	$12,307	
Year 6/Age 9	$15,308	
Year 7/Age 10	$18,520	
Year 8/Age 11	$21,956	
Year 9/Age 12	$25,633	
Year 10/Age 13	$29,567	
Year 11/Age 14	$33,777	
Year 12/Age 15	$38,281	
Year 13/Age 16	$43,100	
Year 14/Age 17	$48,258	
Year 15/Age 18	$53,776	Contributions Stop
Year 20/Age 23	$75,424	
Year 25/Age 28	$105,785	
Year 30/Age 33	$148,370	
Year 35/Age 38	$208,096	
Year 40/Age 43	$291,866	
Year 45/Age 48	$409,356	
Year 50/Age 53	$574,144	
Year 55/Age 58	$805,266	
Year 60/Age 63	$1,129,428	
Year 65/Age 68	$1,584,080	
Year 70/Age 73	$2,221,754	
Year 75/Age 78	$3,116,125	
Year 80/Age 83	$4,370,527	

Requirements to file a Tax Return and to Substantiate Compensation.

It is very possible for a person to have sufficient compensation to be eligible to make a contribution to a Roth IRA and yet not be required to file a tax return because the person is under the threshold amount. This can happen to a taxpayer of any age, but it primarily will happen to young taxpayers and older taxpayers.

Examples:

#1. Richard Yates is age 74. He is single. He works part-time at a local nursery. He has taxable earnings of $4,000. He receives social security benefits of $13,000. He receives $4,000 of taxable dividends and interest. He has no other income.

He is not required to file a federal income tax return for 2000 as his adjusted gross income is $8,000 and this is less than the $8,700 which is required to file a federal income tax return for 2000.

#2. Marianna Yates is age 13. She works part-time as a babysitter. Thus, she has self-employment income of $375. She has other unearned income of $650.

She is not required to file a federal income tax return because she is under all of the applicable requirements:

1. her self-employment income is less than $400;
2. her unearned income is less than $700;
3. her earned income is less than $4,400; and
4. her gross income was less than the larger of $700 or her earned income (up to $150) plus $250.

The IRS does not discuss, in Publication 590, or the regulation, the issue of what one needs to do to substantiate that he or she had compensation as a minor. Therefore, people frequently ask the following types of questions:

• Does lawn-mowing money constitute compensation so a child may make a traditional or Roth IRA contribution?

• Does baby-sitting money constitute compensation so a child may make a traditional or Roth IRA contribution?

• Does money earned by doing chores around the house constitute compensation so a child may make a traditional or Roth IRA contribution?

The answer to any and all of the above questions is "yes," as long as the personal services were in fact rendered and the compensation paid was appropriate.

Why would a child, or a parent on behalf of a child, want to have a Roth IRA? The tax benefits associated with a Roth IRA are so great that most parents will want their child to have one.◆

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Reporting and Record Retention Requirements for a Roth IRA

The Internal Revenue Code requires that an individual retain his or her tax records for that period of time as needed for the proper administration of the federal income tax laws. Because there really is no time limit which applies to a Roth IRA, all transactions (contributions and distributions) should be retained by the taxpayer. Thus, income tax records with respect to the Roth IRA will need to be retained for a very long time.

IRS Publication 552 states that all taxpayers should keep Forms 5498, 1099-R and 8606 until all IRA funds are completely distributed. Except for that, the IRS has given little, if any guidance on this subject. We suggest the following will be required. It may be that the IRS will adopt some rules which would lessen these requirements.

Records to Substantiate Contributions

A taxpayer is not required to file any tax form to inform the IRS that he or she has made an annual contribution to a Roth IRA.

The IRS has included a worksheet in the instructions for Form 8606 to enable a taxpayer to record his contributions and to annually determine his basis. Completing this worksheet is a recommendation; it is not mandatory. A taxpayer may need to know his basis to determine the portion, if any, of any distribution which is nontaxable and which portion is taxable. The taxpayer will want to retain the records to prove that each contribution which he or she made was permissible.

With respect to each annual contribution, the taxpayer will want to be able to prove that he or she had the necessary compensation (i.e. the contribution limit is the lesser of 100% of compensation or $2,000) to justify the contribution. If an employer has prepared a Form W-2, the individual certainly wishes to retain that form. If the taxpayer is self-employed and was required to file the schedule C form, then the taxpayer will certainly want to retain a copy of such forms. If the taxpayer does not have a W-2 form or did not need to prepare the schedule C, or failed to do so, then he or she should maintain some type of small business journal wherein he or she records the job performed and the amount which was paid. This is true even if the payers are the taxpayer's parents.

In addition, the taxpayer will wish to retain his tax form for that year to demonstrate that he satisfied the modified adjusted gross income limit.

Records to Substantiate Distributions

This will be relatively easy, as the Roth IRA custodian is required to report on Form 1099-R any distribution for $10 or more.

A taxpayer is required to report distributions from his or her Roth IRA regardless of the dollar amount. Such amounts are reported on that year's Form 8606.◆

Technical Corrections for IRAs

President Clinton signed into law on December 27, 2000, the Consolidated Appropriations Act (Public Law 706-554). This act included three technical corrections for IRAs.

Change #1. Prior to the law change, distributions from Roth IRAs were subject to the standard withholding rules. The existing law had come from the Taxpayer Relief Act of 1997 (TRA 1997). Under the technical correction, withholding no longer applies to distributions from Roth IRAs. This change is retroactively effective as of January 1, 1998 (the effective date of TRA 1997).

Change #2. Prior to the law change, the IRS thought there was a gap in the law regarding the contribution limit which applied to spousal contributions. After technical correction, Code section 219(c)(1) reads as follows:

(c) Special Rules For Certain Married Individuals

(1) In General. In the case of an individual to whom this paragraph applies for the taxable year, the limitation of paragraph (1) of subsection (b) shall be equal to the lesser of

(A) the dollar amount in effect under subsection (b)(1)(A) for the taxable year, or

(B) the sum of

(i) the compensation includible in such individual's gross income of the taxable year,

(ii) the amount of any designated nondeductible contribution (as defined in section 408(o)) on behalf of such spouse for such taxable year, and

(iii) the compensation includible in the gross income of such individual's spouse for the taxable year reduced by the amount allowed as deduction under subsection (a) to such spouse for such taxable year.

Code section 219(c)(1)(B) was amended by adding provision (ii).

The purpose of the change was to make sure that a married couple using the spousal contribution rules could not contribute more than their combined amount of qualifying compensation.

The existing law had come from the Small Business Job Protection Act of 1996. Note that this change is retroactively effective as of January 1, 1996.

Change #3. This is a mere clerical change. After being amended, the title for Code section 408(d)(5) now reads as follows: "DISTRIBUTIONS OF EXCESS CONTRIBUTIONS AFTER THE DUE DATE FOR TAXABLE YEAR AND CERTAIN EXCESS ROLLOVER CONTRIBUTIONS."

Prior to the law change, it read as follows. "CERTAIN DISTRIBUTIONS OF EXCESS CONTRIBUTIONS AFTER THE DUE DATE FOR TAXABLE YEAR.

The purpose of the change is to clarify that this section will apply to certain erroneous rollovers.◆

Recap – Completing the 2000 Form 1099-R

9898 ☐ VOID ☐ CORRECTED

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution $ 2a Taxable amount $	OMB No. 1545-0119 2000 Form 1099-R	Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2b Taxable amount not determined ☐	Total distribution ☐	Copy A For Internal Revenue Service Center
PAYER'S Federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	4 Federal income tax withheld $	File with Form 1096.
RECIPIENT'S name		5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	For Privacy Act and Paperwork Reduction Act Notice, see the 2000 General Instructions for Forms 1099, 1098, 5498, and W-2G.
Street address (including apt. no.)		7 Distribution code — IRA/ SEP/ SIMPLE ☐	8 Other $ %	
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions $	
Account number (optional)		10 State tax withheld $ $	11 State/Payer's state no.	12 State distribution $ $
		13 Local tax withheld $ $	14 Name of locality	15 Local distribution $ $

Form 1099-R Cat. No. 14436Q Department of the Treasury - Internal Revenue Service

Do NOT Cut or Separate Forms on This Page — Do NOT Cut or Separate Forms on This Page

This article summarizes completing the 2000 Form 1099-R for each IRA type

Traditional IRAs

General Instructions

1. **IRA distributions.** Distributions from any individual retirement arrangement (IRA), must be reported in boxes 1 and 2a regardless of the amount. You may mark the "Taxable amount not determined" box in box 2b.

   An IRA includes all investments under one IRA plan or account. File only one Form 1099-R for distributions from all investments under one plan that are paid in one year to one recipient, unless you must enter different codes in box 7. You do not have to file a separate Form 1099-R for each distribution under the plan.

2. **Roth conversion.** Report the total amount converted or reconverted from an IRA, SEP, or SIMPLE to a Roth IRA in boxes 1 and 2a. A conversion or reconversion is considered a distribution and must be reported, even if it is with the same transfers. For a Roth conversion, use Code 2 in box 7 if the participant is under age 59 1/2, or Code 7 if the participant is at least age 59 1/2. Do not use Code J. Also, mark the "IRA/SEP/SIMPLE" box in box 7.

   Even though 1998 conversions are taxable over 4 years (unless the participant elects otherwise), you only had to report the full amount converted on the 1998 Form 1099-R. You do not have to issue Form 1099-R for any future year to report the 1998 conversion.

3. **IRA revocation.** If a traditional IRA is revoked during its first 7 days (under Regulations section 1.408-6(d)(4)(ii)), the distribution from the IRA must be reported.

   If a regular contribution is made to a traditional IRA that later is revoked, and distribution is made to the taxpayer, enter the gross distribution in box 1 of Form 1099-R. If no earnings are distributed, enter 0 (zero) in box 2a and Code 8 in box 7. If earnings are distributed, enter the amount of earnings in box 2a. Such earnings could be subject to the early distribution tax under section 72(t). If they are subject to that tax, enter Code 1 in box 7; if the earnings are not subject to that tax, enter Code 8.

   If you know that the taxpayer deducted the contribution, report the total amount distributed in box 2a and use the appropriate code in box 7.

   If a **rollover** contribution is made to an IRA that later is revoked, and distribution is made to the taxpayer, enter the gross distribution in boxes 1 and 2a of Form 1099-R, and the appropriate Code in box 7. Follow this same procedure for a transfer from one IRA to another IRA that later is revoked. The distribution could be subject to the early distribution tax under section 72(t).

   If an employer SEP (simplified employee pension) or SIMPLE (savings incentive match plan for employees) contribution is made, and the SEP or SIMPLE is revoked by the employee, report the distribution as fully taxable.

4. **Conduit IRAs.** If you know the distribution is from a conduit IRA, follow these rules. If a distribution from a conduit IRA is paid to the participant, report the full amount in boxes 1 and 2a, and use Code 1 or 7 depending on the participant's age. If a distribution from a conduit IRA is paid to the trustee of, or is transferred to, an employer plan, report the distribution in box 1, 0 (zero) in box 2a, and use Code H in box 7.

5. **Reporting a direct rollover.** Report a direct rollover in box 1 and 0 (zero) in box 2a. You do not have to report capital gain in box 3 or net unrealized appreciation in box 6. Enter the applicable Code G or H in box 7. Prepare the form using the name and social security number of the person for whose benefit the funds were rolled over (generally the participant), not those of the trustee of the IRA or other plan to which the funds were rolled.

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6. **IRA recharacterizations.** You must report each recharacterization of an IRA contribution. If a participant makes a contribution to an IRA (first IRA) for a year, the participant may choose to recharacterize the contribution by transferring, in a trustee-to-trustee transfer, any part of the contribution (plus earnings) to another IRA (second IRA). The contribution is treated as made to another IRA (recharacterization). A recharacterization may be made with the same trustee or with another trustee. The trustee of the first IRA must report the recharacterization as a distribution on Form 1099-R (and the contribution to the first IRA and its character on Form 5498).

   Enter the fair market value (FMV) of the amount recharacterized in box 1, 0 (zero) in box 2a, and Code R in box 7. It is not necessary to mark the IRA/SEP/SIMPLE checkbox. For more information, see Notice 98-49, 1998-2 C.B. 365.

   *For IRA recharacterizations and Roth reconversions in 2000 with the **same** trustee, you may report the results of the recharacterizations and reconversions on Forms 1099-R and 5498 using a reasonable alternative method. however, if you use an alternative method to report, in addition to Forms 1099-R and 5498, you must provide instructions to the IRA owner, in conjunction with account statements or other information, about how to use the information shown on the forms to properly report the recharacterizations and reconversions on Form 1040. The instructions must include how to use the information to properly complete **Form 8606**, Nondeductible IRAs, and **Form 5329**, Additional Taxes Attributable to IRAs, Other Qualified Retirement Plans, Annuities, Modified Endowment Contracts, and MSAs. If trustees use different employer identification numbers to file Forms 1099-R and 5498, they are not the same trustee. See Announcement 99-5, 1999-3 I.R.B. 16, for more information.*

7. **Transfers.** Generally, do not report transfers between trustees or issuers (unless they are direct rollovers from qualified plans) including a trustee-to-trustee transfer from one IRA to another (unless they are recharacterized IRA contributions or Roth conversions) or from one tax-sheltered (section 403(b)) arrangement to another.

   Transfer of IRA to spouse. If you transfer in an IRA from one spouse to another spouse under a divorce or separation instrument, the transfer is tax free. Do not report such a transfer on Form 1099-R.

8. **SIMPLE IRAs.** Do not report a trustee-to-trustee transfer from one SIMPLE to another SIMPLE. However, you must report as a taxable distribution, in boxes 1 and 2a, a trustee-to-trustee transfer from a SIMPLE IRA to an IRA that is not a SIMPLE IRA during the 2-year period beginning on the day contributions are first deposited in the individual's SIMPLE by the employer. Use Code S in box 7, if appropriate.

9. **Corrected Form 1099-R.** If you filed a Form 1099-R with the IRS and later discover that there is an error on it, you must correct it as soon as possible. For example, if you transmit a direct rollover and file a Form 1099-R with the IRS reporting that none of the direct rollover is taxable by entering 0 (zero) in box 2a, and you then discover that part of the direct rollover consists of required minimum distributions under section 401(a)(9), you must file a corrected Form 1099-R.

10. **Filer.** The payer, trustee, or plan administrator must file Forms 1099-R using the same name and employer identification number used to deposit any tax withheld and to file Form 945, Annual Return of Withheld Federal Income Tax.

11. **Beneficiaries.** If you make a distribution to a beneficiary or estate, prepare Form 1099-R using the name and taxpayer identification number (TIN) of the beneficiary or estate, not those of the descendent. If there are multiple beneficiaries, report on each Form 1099-R only the amount paid to the beneficiary whose name appears on the Form 1099-R, and enter the percentage in box 9a, if applicable.

12. ***Do not enter a negative amount in any box on Form 1099-R***

Specific Instructions to Complete Boxes 1-15.

Box 1. Enter the **total amount of the distribution** before income tax or other deductions were withheld. Include direct rollovers, and the gross amount of any IRA distribution, including a recharacterization and a Roth conversion. However, in the case of a distribution by a trust representing CDs redeemed early, report the net amount distributed.

Employer securities and other property. If you distribute employer securities or other property, include in box 1 the FMV of the securities or other property on the date of distribution. If there is a loss, see Losses on page R-6 of the 1099-R instructions.

If you are distributing worthless property only, you are not required to file Form 1099-R. However, you may file and enter 0 (zero) in boxes 1 and 2a and any after-tax employee contributions in box 5.

Box 2a. Generally, you must enter the taxable amount in box 2a. However, if you are unable to reasonably obtain the data needed to compute the taxable amount, leave this box blank. Do not include excludable or tax-deferred amounts reportable in boxes 5, 6, and 8.

IRA or SEP. Generally, you are not required to compute the taxable amount of traditional IRA or SEP, nor designate whether

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any part of a distribution is a return of basis attributable to

nondeductible contribution. Therefore, report the total amount distributed from a traditional IRA or SEP in box 2a. This will be the same amount reported in box 1. You may mark the "Taxable amount not determined" box in box 2b.

However, for a distribution by a trust representing CDs redeemed early, report the net amount distributed. Do not include any amount paid for IRA insurance protection in this box.

For a distribution of contributions plus earnings from an IRA under **section 408(d)(4)**, report the gross distribution in box 1, only the earnings in box 2a, and enter Code 8 or P, whichever is applicable, in box 7. You may also enter Code 1, 2, or 4, if applicable.

For a distribution of contributions without earnings after the due date of the individual's return, under section 408(d)(5), enter 0 (zero). You might use Code 1 or 7 in box 7 depending on the age of the participant.

For a distribution from a conduit IRA or for an IRA recharacterization, enter 0 (zero) in box 2a.

SIMPLE. Enter the total amount distributed from a SIMPLE in box 2a.

Box 2b – Taxable Amount not Determined. If you mark this box, leave box 2a blank unless you are reporting a traditional IRA, SEP, or SIMPLE distribution. Except for IRAs, make every effort to compute the taxable amount.

Box 2b – Total Distribution. Enter an "X" in this box only if the payment shown in box 1 is a total distribution. A total distribution is one or more distributions within 1 tax year in which the entire balance of the account is distributed. If periodic or installment payments are made, mark this box in the year final payment is made.

Box 3. This box will never be completed for any IRA distribution.

Box 4. This box is used to report the amount of federal income tax withheld. It is mandatory if applicable.

Box 5. This box will never be completed for an IRA distribution.

Box 6. This box will never be completed for an IRA distribution.

Box 7. Enter an "X" in the **IRA/SEP/SIMPLE checkbox** if the distribution is from a traditional IRA, SEP or SIMPLE, or is a Roth conversion.

You must enter the appropriate code(s) in box 7. Read the codes carefully and enter them accurately, because the IRS uses the codes to help determine whether the recipient has properly reported the distribution. If the codes you enter are incorrect, the IRS may improperly propose changes to the recipient's taxes.

When applicable, you may enter a numeric and an alpha code. For example, when using Code P for an IRA distribution under section 408(d)(4), you may also enter Code 1, if it applies.

Only three numeric combinations are permitted on one Form 1099-R: Codes 8 and 1, 8 and 2, or 8 and 4. If two or more other numeric codes are applicable, you must file more than one Form 1099-R. For example, if part of a distribution is premature (Code 1) and part is not, file one Form 1099-R for the part to which Code 1 applies, and another Form 1099-R for the part that is a normal distribution, Code 7. Thus, file separate Forms 1099-R using Code 8, D, or P to indicate the year the amount is taxable.

Use the codes below for any amounts reported on Form 1099-R – distributions from qualified plans, any IRAs, Keoghs, commercial annuities, insurance contracts, charitable gift annuities, etc.

Codes

1 – Early distribution, no known exception. Use Code 1 only if the employee/taxpayer has not reached age 59 1/2, and if none of the exceptions under section 72(q), (t), or (v) are known to apply. For example, if a distribution is made for medical or qualified higher education expenses, you probably will not know if any medical or qualified higher education expense exception under section 72(t) apples. Therefore, use Code 1. However, if an early distribution is made from a qualified retirement plan because of an IRS levy under section 6331, use Code 2.

Even if the employee/taxpayer is 59 1/2 or over, use Code 1 if a series of substantially equal period payments was modified within 5 years of the date of the first payment (within the meaning of section 72(q)(3) or (t)(4)). For example, Mr. B began receiving payments that qualified for the exception for part of a series of substantially equal periodic payments under section 72(t)(2)(A)(iv) when he was 57. When he was 61, Mr. B substantially modified the payments. Because the payments were modified within 5 years, use Code 1 in the year the payments were modified, even though Mr. B is over 59 1/2.

2 – Early distribution, exception applies (as defined in section 72(q), (t), or (v)). Use Code 2 if the employee/taxpayer has not reached age 59 1/2, to indicate that an exception under section 72(q), (t), or v) applies. However, instead of Code 2, use Code 3 or 4, whichever applies, for an early distribution due to disability or death. Also use Code 2 for a Roth conversion (an IRA converted to a Roth IRA) or reconversion if the participant

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is under 59 1/2, and for an early distribution made from a qualified retirement plan because of an IRS levy under section 6331.

3 – Disability. Please be aware, the definition of "disabled" for IRA purposes may be different than that for workman's compensation or the disability payment. Per IRC section 72(m)(7) and IRS Regulation 1.72-17(f), disability for this distribution code means the IRA accountholder is "unable to engage in ANY substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration."

4 – Death. Code 4 is always used regardless of the age of the accountholder, to indicate payment to a beneficiary from any inherited IRA. Do not use Code 4 if the surviving spouse has elected the deceased spouse's IRA as his or her own.

5 – Prohibited Transaction. Code 5 is used if the IRA trustee or custodian or accountholder incurs a prohibited transaction.

6 – Not used for IRA and pension purposes.

7 – Normal distribution. Use Code 7 for a normal distribution from a plan, including a traditional IRA, if the employee/taxpayer is at least age 59 1/2. Use Code 7 for a Roth conversion or reconversion if the participant is at least age 59 1/2.

8 – Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2000. Use Code 8 for an IRA distribution under section 408(d)(4).

9 – Codes not used for IRAs

- A – Not used for traditional IRAs.
- B – Not used for traditional IRAs.
- C – Not used for traditional IRAs.
- D – Not used for traditional IRAs.
- E – Not used for traditional IRAs.
- F – Not used for traditional IRAs.
- G – Not used for traditional IRAs.
- H – Used to report a direct rollover from a conduit IRA to a Qualified plan.
- J – Not used for traditional IRAs.
- L – Not used for traditional IRAs.
- M – Not used for traditional IRAs.
- P – Excess contributions/deferrals refunded plus earnings taxable in the previous calendar year.
- R – **Recharacterized IRA contribution.** Use Code R for a recharacterization of an IRA contribution to another type of IRA by a trustee-to-trustee transfer or with the same trustee.
- S – Early distribution from a SIMPLE IRA in first 2 years, no known exception. Use Code S only if the distribution is from a SIMPLE IRA in the first 2 years, the employee/taxpayer has not reached age 59 1/2, and none of the exceptions under section 72(t) are known to apply. The 2-year period begins on the day contributions are first deposited in the individual's SIMPLE IRA. Do not use Code S if Code 3 or 4 applies.

Box 8. Other. This box is used to give the accountholder information on distributions not covered by the above.

Box 9a. If this is a total distribution and it is made to more than one person, enter the percentage received by the person whose name appears on Form 1099-R. You need not complete this box for any IRA distributions or for a direct rollover.

Box 9. This box is used if a total distribution is split among a number of recipients (i.e. more than one beneficiary). This box is used to enter the percentage this recipient was paid.

Boxes 10 to 15. These boxes do not need to be completed for IRS purposes, but may need to be completed for state and local tax reasons.

Roth IRAs

Set forth are the instructions which specifically apply to Roth IRAs.

For distributions from a Roth IRA or an Ed IRA, report the gross distribution in box 1, but generally **leave box 2a blank**. Mark the "Taxable amount not determined" box in box 2b. Enter Code J in box 7. You may also enter Code 1,2, 3, 4, 5, 8, or P with Code J. It is not necessary to mark the IRA/SEP/SIMPLE checkbox.

However, for the distribution of excess Roth contributions under section 4089(d)(4), report the gross distribution in box 1, and only the earnings in box 2a. Enter Code J and 8 or P in box 7.

Education IRAs

Set forth are the instructions which specifically apply to Education IRAs.

For distributions from an Ed IRA, report the gross distribution in box 1, but generally **leave box 2a blank**. Mark the "Taxable amount not determined" box in box 2b. Enter Code M in box 7. You may also enter Code 3, 4, 8, or P with Code M. It is not necessary to mark the IRA/SEP/SIMPLE checkbox. For the withdrawal of excess contribution, see the standard rules.

Additional Discussion Ordering of Multiple Codes

CWF recently received a consulting question asking us to discuss whether there were any ordering requirements for Box 7

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of the Form 1099-R when multiple (two) codes will be reported. For example, if a person withdraws an excess contribution from a Roth IRA, does it matter if the order of the distributions code is 8J or J8. The answer is – the order is mandated if the form is furnished to the IRS via magnetic media or electronically. The reasons are discussed below.

The order of the multiple code is generally not mandated for the paper copy (Copy B – for the recipient).

Discussion:

As is well known, the IRS has instructions for the PAPER version (Copy A – for the IRS) of the reporting Form 1099-R as it does for many reporting forms. What may not be so well known is that the IRS has a second set of instructions for the magnetic/electronic version of such reporting forms. One might believe that the instructions would be identical, but at times they are not.

We will discuss the rules for completing the Form 1099-R (either paper version or electronic version) when two codes are used.

We understand the "paper" instructions as follows:

1. In most situations, the instructions do not appear to mandate any particular order for the codes.

2. Note that three examples are given. Two show starting with the numeric code followed by the alpha code (7A or 4G) and one leads with the alpha code followed by the numeric code (P1).

3. It is clear that only three numeric combinations are permitted on one Form 1099-R (81, 82, 84).

It is not clear if it is mandated that "8" is the first multiple code, but one knows there is compliance if you do start with the "8."

We understand the "magnetic/electronic" instructions as follows:

1. These instructions are called the Rules of Record Layout for Form 1099-R, Field Position 545 and 546 for the distribution code.

2. Must enter at least one distribution code from the table.

3. A blank in position 545 is not acceptable.

4. A blank in position 546 is acceptable.

5. If only one distribution code is required or applies, then it must be entered in position 545.

6. Position 545 must contain a numeric code EXCEPT when using Code D, E, F, G, H, J, L, M, P, R, or S.

CWF's Comment: This appears to be a confusing way of saying that position 545 must be an alpha code and then position 546 must be a numeric code. Exception – if the alpha code to be used is an "A" it must go in position 546, and the numeric code would go in position 545.

7. It is very clear that only three numeric combinations are permitted on one Form 1099-R (81, 82, 84). CWF suggests you follow the indicated order of 8, then 1, 2 or 4.

8. Distribution Codes E, F, and H cannot be used with any other codes.

9. Distribution Code G can be used with a numeric code only if it is code 4.◆

MSAs Deadline Changed to December 31, 2002

An unexpected provision of the Consolidated Appropriations Act (Public Law 106-554) as signed into law on December 21, 2000, was the extension of the final cut-off date for MSAs from December 31, 2000, until December 31, 2002.

This means that certain small employers are still entitled to establish MSAs for their employees. Set forth below is a summary of the new limits which apply for MSAs for 2001.◆

2001 COLAs for MSAs

The IRS has recently released various cost-of-living adjustments for 2001, in Rev. Proc. 2001-13. One of these adjustments applies to medical savings accounts.

In order to be able to claim a deduction for contributions to a medical savings account, there must be a qualifying "high deductible health plan."

If a taxpayer has self-only coverage, a high-deductible health plan means a health plan which: (1) has an annual deductible that is not less than $1600 (was $1550 for 2000); (2) has an annual deductible that is not more than $2400 (was $2350 for 2000); and (3) under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits does not exceed $3200 (was $3100 for 2000).

If a taxpayer has family coverage, a high-deductible health plan means a health plan which: (1) has an annual deductible that is not less than $3200 (was $3100 for 2000); (2) has an annual deductible that is not more than $4800 (was $4650 for 2000); and (3) under which the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits, does not exceed $5850 (was $5700 for 2000).◆