

THE Pension Digest

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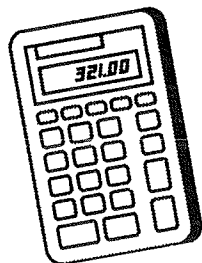
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RECHARACTERIZING A 2000 CONTRIBUTION IN 2001

This time of year is the season for recharacterizations. People are visiting their tax accountants. The accountants will be telling some of your accountholders they were ineligible to convert their traditional IRA to a Roth IRA in 2000, or, if eligible to perform the conversion transaction, that it was not in their best interest to have done so. Or, they may tell the accountholder that they were ineligible to make a \$2,000 contribution to their Roth IRA or vice versa. The point is—you, as an IRA custodian or trustee, can expect to see some of your IRA accountholders instruct you that they want to recharacterize a contribution he or she has made in 2000, for 2000, before he or she files a 2000 federal income tax return in 2001. Most such accountholders will normally complete the recharacterization on or before the tax-filing deadline for 2000. This is April 16, 2001, since April 15 falls on a Sunday. However, a person will have until October 16, 2001, to recharacterize a contribution. A person who timely files his or her 2000 income tax return without having made a recharac-

terization may file an amended return and still make the recharacterization within six months of the due date of his or her return, excluding extensions.

This explanation focuses on how you can assist your customer(s) to understand how he or she will need to handle the recharacterization on his or her 2000 income tax return. Recharacterizations are confusing to everyone involved. This is especially true for 2000 contributions which are recharacterized in 2001, because, as with excess contributions, these recharacterization transactions will be reported on the 2001 Form 1099-R and the 2001 Form 5498, which are not furnished until January of 2002 or May 2002, which is obviously well after the time the accountholder needs the information to file his or her 2000 federal income tax return. This is why the IRS requires an IRA custodian to furnish a written explanation to the accountholder.

Three situations are covered: (1) recharacterizing a Roth IRA contribution to be a contribution to a traditional IRA;

(2) recharacterizing a contribution to a traditional IRA to be a contribution to a Roth IRA and (3) recharacterizing a conversion contribution.

Situation #1. Annual Roth IRA Contribution Recharacterized to a Traditional IRA Contribution

Lisa Water made a \$2,000 contribution to a Roth IRA on 1-10-00, for 2000. The fair market value of this IRA as of 12-31-00 was \$2,100. Lisa is not married and she is not an active participant in an employer-sponsored plan. Her MAGI for 2000 was \$123,000. Therefore, she has determined that she is not eligible to make a contribution to a Roth IRA. There were earnings of \$180 related to the contribution of \$2,000 as of 3-3-01. One of the methods to correct an excess contribution is to recharacterize it. She chose to recharacterize this contribution plus earnings on 3-3-01. The fair market value of this IRA as of 12-31-01 will be \$2,400.

Continued on page 2

Recharacterizing, Continued from page 1

Step #1. Accountholder Must Instruct to Recharacterize

The individual must instruct you (the IRA custodian) to recharacterize. The individual is required to furnish you with very specific information. You can make his/her task easier by making available to your

accountholder a form such as CWF's Notice of Recharacterization of IRA Contributions as set forth on page 5.

Step #2. You (the IRA Custodian) Must Furnish an Explanation to the Accountholder

You should furnish an explanation to your accountholder similar to the one below.

Situation 1, Step #2

Special Explanation to Accountholder for an IRA Recharacterization for the 2000 Tax Year	
Lisa Water (Name of Accountholder)	
<p>The purpose of this special explanation is to provide you with information about your recharacterization. You will need to properly report and explain your recharacterization when you file your 2000 federal income tax return. We have furnished to you a copy of the IRA Recharacterization Form which you executed. The IRS' instructions require you, as the IRA accountholder, to do two things if you have recharacterized an IRA contribution.</p> <ul style="list-style-type: none"> First, you will need to complete the 2000 Form 8606 and file it with your 2000 Form 1040 (or similar form). Second, you need to attach an explanation about the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized. <p>You have recharacterized your IRA contribution. Specifically, you instructed us on 3-3-01 to recharacterize a <input type="checkbox"/> traditional <input checked="" type="checkbox"/> Roth (check one) IRA contribution of \$2,000.00 which you had made on 1-10-00 for tax year 2000. Your contribution will now be treated for federal income tax purposes as if it had been contributed originally to a <input checked="" type="checkbox"/> traditional <input type="checkbox"/> Roth (check one—must be the opposite of type checked above) IRA. The amount of \$2,180.00 has been recharacterized; \$2,000.00 was the contribution amount and \$180.00 is the related earnings.</p> <p>You should complete line 15(a) of your 2000 Form 1040 (or similar form) with \$2,180.00. This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount with 0.00. Thus, you will not be required to include any amount in income for 2000 or 2001 because of your recharacterization.</p> <p>You will want to review the instructions for the Form 8606 before you complete the Form 8606. You will either need to complete line 14(b) and/or line 18(c) to indicate the amount recharacterized.</p>	

IRA R990 (1/00) © 2000 Cohn W. Frits & Associates, Ltd.

Step #3. You Will Prepare the Form 1099-R and Form 5498

1. You will prepare a 2000 Form 5498 to report the original contribution to the Roth IRA of \$2,000 as shown below.

2. You will prepare a 2001 Form 1099-R to report the "deemed" distribution from the Roth IRA to the traditional IRA. It should be reported as follows. Box 2 is to be completed

with the gross distribution amount (\$2,180) and box 2a is to be completed with a 0.00. The reason code in box 7 is to be an "R" for recharacterization.

3. You will prepare a 2001 Form 5498 to report the recharacterized contribution (plus earnings) to the traditional IRA of \$2,000. It should be reported as shown below.

Situation 1, Step #3(1)

2626 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0047	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than rollovers in boxes 2, 3, and 7-10)	
Roth IRA Custodian		2000	
2 Rollover contributions		Form 5498	
3 Roth conversion amount		4 Fair market value of account	
5 Life insurance cost included in box 1		6 IRA SEP SIMPLE Roth IRA Rollover Ed IRA	
7 SEP contributions		8 SIMPLE contributions	
9 Roth IRA contributions		10 Ed IRA contributions	
11 State/Payer's state no.		12 State distribution	
13 Local tax withheld		14 Name of locality	
15 Local distribution		16 Other	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

Situation 1, Step #3(2)

9898 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0119	
PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution	
Roth IRA Custodian		2001	
2a Taxable amount		2b Taxable amount not determined	
3 Capital gain included in box 2a		4 Federal income tax withheld	
5 Employee contributions or insurance premiums		6 Net unrealized appreciation in employer's securities	
7 Distribution code		8 Other	
9a Your percentage of total distribution		9b Total employee contributions	
10 State tax withheld		11 State/Payer's state no.	
13 Local tax withheld		14 Name of locality	
15 Local distribution		16 Other	

Form 1099-R Cat. No. 144384 Department of the Treasury - Internal Revenue Service

Situation 1, Step #3(3)

2626 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0047	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than rollovers in boxes 2, 3, and 7-10)	
IRA Custodian		2001	
2 Rollover contributions		Form 5498	
3 Roth conversion amount		4 Fair market value of account	
5 Life insurance cost included in box 1		6 IRA SEP SIMPLE Roth IRA Rollover Ed IRA	
7 SEP contributions		8 SIMPLE contributions	
9 Roth IRA contributions		10 Ed IRA contributions	
11 State/Payer's state no.		12 State distribution	
13 Local tax withheld		14 Name of locality	
15 Local distribution		16 Other	

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

Recharacterizing, Continued from page 2

Situation #2. Annual Traditional IRA Contribution Recharacterized to be a Roth IRA Contribution

Sara Roe made a \$2,000 contribution to a traditional IRA on 2-10-00, for 2000 rather than a Roth IRA. The fair market value of this traditional IRA was \$2,125 as of 12-31-00. Sara is not married. She is an active participant in an employer-sponsored plan. Her MAGI was \$92,000. There were earnings of \$190 related to the contribution of \$2,000 as of 2-20-01. Sara has determined on 2-20-01 she will recharacterize her traditional IRA contribution to be a Roth IRA contribution because she is not able to claim a deduc-

tion for her \$2,000 contribution to the traditional IRA. The fair market value of this IRA as of 12-31-01 will be \$2,300.

Step #1. Accountholder Must Instruct to Recharacterize

The individual must instruct you (the IRA custodian) to recharacterize. The individual is required to furnish you with very specific information. You can make his or her task easier by making available to your accountholder a form such as CWF's Notice of Recharacterization of IRA Contribution as set forth on page 5, or a similar form.

Step #2. You (IRA Custodian) Must Furnish an Explanation to the Accountholder

You should furnish your accountholder an explanation similar to the one below.

Situation 2, Step #2

Special Explanation to Accountholder for an IRA Recharacterization for the 2000 Tax Year

Sara Roe

(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You will need to properly report and explain your recharacterization when you file your 2000 federal income tax return. We have furnished to you a copy of the IRA Recharacterization Form which you executed. The IRS' instructions require you, as the IRA accountholder, to do two things if you have recharacterized an IRA contribution.

- First, you will need to complete the 2000 Form 8606 and file it with your 2000 Form 1040 (or similar form).
- Second, you need to attach an explanation about the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized.

You have recharacterized your IRA contribution. Specifically, you instructed us on **2-20-01** to recharacterize a ☒ traditional ☐ Roth (check one) IRA contribution of **\$2,000.00** which you had made on **2-10-00** for tax year 2000. Your contribution will now be treated for federal income tax purposes as if it had been contributed originally to a ☐ traditional ☒ Roth (check one)—must be the opposite of type checked above) IRA. The amount of **\$2,190.00** has been recharacterized; **\$2,000.00** was the contribution amount and **\$190.00** is the related earnings.

You should complete line 15(a) of your 2000 Form 1040 (or similar form) with **\$2,190.00**. This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount with **0.00**. Thus, you will not be required to include any amount in income for 2000 or 2001 because of your recharacterization.

You will want to review the instructions for the Form 8606 before you complete the Form 8606. You will either need to complete line 14(b) and/or line 18(c) to indicate the amount recharacterized.

Step #3. You Will Prepare Form 1099-R and Form 5498

1. You will prepare a 2000 Form 5498 to report the original contribution to the traditional IRA of \$2,000. It should be reported as shown below:

2. You will prepare a 2001 Form 1099-R to report the "deemed" distribution from the traditional IRA to the Roth IRA. It should be reported as fol-

lows. Box 1 is to be completed with the gross distribution amount (\$2,180) and box 2a is to be completed 0.00. The reason code in box 7 is to be an "R" for recharacterization.

3. You will prepare a 2001 Form 5498 to report the recharacterized contribution (plus earnings) to the Roth IRA of \$2,000. It should be reported as shown below.

Situation 2, Step #3(1)

2828 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0047	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code IRA Custodian 42-1234567		1 IRA contributions (other than amounts in boxes 2, 3, and 7-10) \$ 2,000.00	2 rollover contributions \$
3 Roth conversion amount \$		2000 Form 5498	
TRUSTEE'S or ISSUER'S federal identification number 42-1234567		PARTICIPANT'S social security number 999-88-6666	
PARTICIPANT'S name Sara Roe		4 Fair market value of account \$ 2,125.00	5 Life insurance cost included in box 1 \$
Street address (including apt. no.) 		6 IRA SEP SIMPLE Roth IRA Rechar Ed IRA <input checked="" type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/>	8 SIMPLE contributions \$
City, state, and ZIP code 		7 SEP contributions \$	10 Ed IRA contributions \$
Account number (optional) 		9 Roth IRA contributions \$	10 Ed IRA contributions \$

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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Situation 2, Step #3(2)

9898 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0119	
PAYER'S name, street address, city, state, and ZIP code IRA Custodian 42-1234567		1 Gross distribution \$ 2,190.00	2a Taxable amount \$ 0.00
3 Capital gain (included in box 2a) \$		4 Federal income tax withheld \$ 0.00	
PAYER'S federal identification number 42-1234567		RECIPIENT'S identification number 999-88-6666	
RECIPIENT'S name Sara Roe		5 Employee contributions or insurance premiums \$	6 Net unrealized appreciation in employer's securities \$
Street address (including apt. no.) 		7 Distribution code R	8 Other \$
City, state, and ZIP code 		9a Your percentage of total distribution %	9b For employee contributions \$
Account number (optional) 		10 State tax withheld \$	11 State/Payer's state no. \$
		13 Local tax withheld \$	14 Name of locality \$
		15 Local distribution \$	15 Local distribution \$

Form 1099-R Cat. No. 144360 Department of the Treasury - Internal Revenue Service

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Situation 2, Step #3(3)

2828 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0047	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code Roth IRA Custodian 42-1234567		1 IRA contributions (other than amounts in boxes 2, 3, and 7-10) \$ 2,190.00	2 rollover contributions \$
3 Roth conversion amount \$		2001 Form 5498	
TRUSTEE'S or ISSUER'S federal identification number 42-1234567		PARTICIPANT'S social security number 999-88-6666	
PARTICIPANT'S name Sara Roe		4 Fair market value of account \$ 2,300.00	5 Life insurance cost included in box 1 \$
Street address (including apt. no.) 		6 IRA SEP SIMPLE Roth IRA Rechar Ed IRA <input type="checkbox"/> <input type="checkbox"/> <input type="checkbox"/> <input checked="" type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>	8 SIMPLE contributions \$
City, state, and ZIP code 		7 SEP contributions \$	10 Ed IRA contributions \$
Account number (optional) 		9 Roth IRA contributions \$	10 Ed IRA contributions \$

Form 5498 Cat. No. 50010C Department of the Treasury - Internal Revenue Service

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Recharacterizing, Continued from page 3

Situation #3. Recharacterizing a Conversion Contribution from a Traditional IRA to a Roth IRA

Francoise Bell converted \$30,000 from her traditional IRA to a Roth IRA on 1-15-00. The fair market value of this Roth IRA was \$33,000 as of 12-31-00. She is not married. Her accountant has told her she was not eligible to make the Roth IRA contribution for 2000, as her MAGI was \$103,000. There was income of \$3,900 related to her conversion contribution. In order to eliminate this excess contribution, she elects to recharacterize this conversion contribution on 3-1-01. The fair

market value of this IRA as of 12-31-01 will be \$37,000.

Step #1. Accountholder Must Instruct to Recharacterize

The individual must instruct you (the IRA custodian) to recharacterize. The individual is required to furnish you with very specific information. You can make his or her task easier by making available to your accountholder a form such as CWF's Notice of Recharacterization of IRA Contribution asset set forth on page 5 or a similar form.

Step #2. You (IRA Custodian) Must Furnish an Explanation to the Accountholder

You should furnish an explanation to your accountholder similar to the one below:

Situation 3, Step #2

Special Explanation to Accountholder for an IRA Recharacterization for the 2000 Tax Year	
Francoise Bell (Name of Accountholder)	
<p>The purpose of this special explanation is to provide you with information about your recharacterization. You will need to properly report and explain your recharacterization when you file your 2000 federal income tax return. We have furnished to you a copy of the IRA Recharacterization Form which you executed. The IRS' instructions require you, as the IRA accountholder, to do two things if you have recharacterized an IRA contribution.</p> <ul style="list-style-type: none"> First, you will need to complete the 2000 Form 8606 and file it with your 2000 Form 1040 (or similar form). Second, you need to attach an explanation about the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized. <p>You have recharacterized your IRA contribution. Specifically, you instructed us on 3-1-01 to recharacterize a <input type="checkbox"/> traditional <input checked="" type="checkbox"/> Roth (check one) IRA contribution of \$30,000.00 which you had made on 1-15-00 for tax year 2000. Your contribution will now be treated for federal income tax purposes as if it had been contributed originally to a <input checked="" type="checkbox"/> traditional <input type="checkbox"/> Roth (check one—must be the opposite of type checked above) IRA. The amount of \$33,900.00 has been recharacterized; \$30,000.00 was the contribution amount and \$3,900.00 is the related earnings.</p> <p>You should complete line 15(a) of your 2000 Form 1040 (or similar form) with \$33,900.00. This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount with 0.00. Thus, you will not be required to include any amount in income for 2000 or 2001 because of your recharacterization.</p> <p>You will want to review the instructions for the Form 8606 before you complete the Form 8606. You will either need to complete line 14(b) and/or line 18(c) to indicate the amount recharacterized.</p>	

Step #3. You Will Prepare Form 1099-R and Form 5498

1. You will prepare a 2000 Form 5498 to report the original conversion contribution to the Roth IRA of \$30,000 as shown below:

2. You will prepare a 2001 Form 1099-R to report the "deemed" distribution from the Roth IRA to the traditional IRA. It should be reported as fol-

lows. Box 1 is to be completed with the gross distribution amount (\$33,900) and box 2a is to be completed 0.00. The reason code in box 7 is to be an "R" for recharacterization.

3. Prepare a 2001 Form 5498 to report the recharacterized contribution (plus earnings) of \$33,900 to the traditional IRA. It should be reported as shown below:

Situation 3, Step #3(1)

2628 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0747	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2, 3, and 7-10)	
Roth IRA Custodian		\$ 30000.00	
2 Rollover contributions		\$	
3 Roth conversion amount		\$ 30000.00	
4 Fair market value of account		\$ 33000.00	
5 Life insurance cost included in box 1		\$	
6 IRA SEP SIMPLE Roth IRA Rollover Ed IRA		7 SEP contributions	
8 SIMPLE contributions		9 Roth IRA contributions	
10 Ed IRA contributions		11 IRA contributions (other than amounts in boxes 2, 3, and 7-10)	
12 Rollover contributions		13 Rollover contributions	
14 Rollover contributions		15 Rollover contributions	
16 Rollover contributions		17 Rollover contributions	
18 Rollover contributions		19 Rollover contributions	
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**Recharacterizing,
Continued from page 4**

Conclusion. You will certainly be receiving requests to recharacterize in calendar year 2001 a contribution which was made in calendar year 2000. Taxpayers and their accountants are beginning to understand the concept of recharacterizing a contribution as a correction tool. The taxpayer (or accountant) will need to complete the Form 8606 to report the recharacterization. The instructions for the Form 8606 state the taxpayer is to attach a statement explaining the recharacterization. This expla-

nation should indicate the total amount recharacterized; the original contribution, the earnings or loss and the amount that is now deductible, if applicable. The instructions also indicate that an IRA custodian has the duty to furnish this same information to the accountholder. Set forth on pages 7 and 8 is the Form 8606. A conversion contribution which is totally or partially recharacterized is reported on line 14b of Part II of the form. ♦

CWF Form 54-TR

Notice of Recharacterization of IRA Contribution

To: Current Custodian/Trustee

Name: _____
Address: _____
City/State/Zip: _____
Phone: (____) _____

Date: _____

From: Depositor or Grantor

Name: _____
Address: _____
City/State/Zip: _____

SSN: _____
Date of Birth: _____
Phone: - Home: _____
Work: _____

I hereby instruct you that I wish to irrevocably recharacterize my previous contribution. The successor IRA will be with the ☐ current custodian/trustee or ☐ a successor custodian/trustee as indicated below. If I have indicated a successor custodian/trustee, then you are to issue a check for the amount indicated below to the successor custodian or trustee. I understand I must provide the following information to have my previous contribution recharacterized:

The Original Contribution

Account Number: _____
Date of Contribution: _____
Amount: _____

The Recharacterized Contribution

Account Number: _____
Date of Contribution: _____
Amount: _____

Type of Original Contribution (Check only one)

- ☐ 1. Conversion/Rollover to Roth IRA _____
☐ 2. Annual Contribution to a Roth IRA for _____ tax year _____
☐ 3. Annual contribution to a traditional IRA for _____ tax year _____

Type of Recharacterized Contribution

1. Rollover to a traditional IRA
2. Annual contribution to a traditional IRA for the same tax year
3. Annual Contribution to a Roth IRA for the same tax year

Instruction and Amount to Recharacterize

I elect to recharacterize \$ _____
Which is ☐ all or ☐ a portion of my original contribution.
It is adjusted by:

- a. Related Earnings (losses) _____
b. Interest Penalty Fee _____
c. Administrative Fee _____
d. Other _____
e. Recharacterized Net Amount _____

I instruct you to transfer the recharacterized net amount to the successor custodian/trustee. I want this recharacterized net amount to come from the following assets held within my referenced IRA and paid in the instructed manner. I understand that there may be various fees associated with liquidating and/or transferring such assets in kind. These fees are set forth above. I authorize you to deduct such fees from the IRA.

- ☐ Liquidate all of my accounts and transfer the cash proceeds by sending a check to the successor custodian/trustee;
☐ Liquidate the accounts I specify below and transfer the cash proceeds by sending a check to the successor custodian/trustee: _____
☐ Transfer all such assets "in kind" to the successor custodian/trustee;
☐ Transfer "in kind" the assets I specify below to the successor custodian/trustee: _____

I acknowledge that you have instructed me to consult with my legal or tax advisor because of the complexity and importance of this matter. This recharacterization is being made on or before the due date (including extensions) for filing my individual Federal income tax return for the taxable year for which the contribution was made. I expressly assume all responsibility for this recharacterization of IRA funds. I realize that my election to recharacterize my contribution is irrevocable.

Signature of Depositor or Grantor: _____ Date: _____

Acknowledgment of Current IRA Custodian/Trustee:

We acknowledge receiving your recharacterization instruction. We will report the original contribution on Form 5498, showing the character of the contribution (annual, conversion, etc.) and will report the distribution for recharacterization on Form 1099-R per the current IRS instructions. If your recharacterized contribution has been made into an IRA that you maintain with us, then we will also report the aforementioned contribution as a rollover on a Form 5498.

Signature of Current Custodian/Trustee: _____ Date: _____

Acceptance by Successor IRA Custodian/Trustee:

We, the successor custodian/trustee, agree to report this recharacterized contribution as identified above as a rollover contribution on Form 5498 and agree to accept this contribution as if it had originally been made to us rather than the previous trustee/custodian.

Successor Custodian/Trustee: _____ Phone: _____

Address: _____

City/State/Zip: _____

Signature of Successor Custodian/Trustee: _____ Date: _____

IRA #54-TR (10/99)

White — Original Custodian/Trustee Yellow — Successor Custodian/Trustee Pink — Depositor/Grantor

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Form 8606 As It Relates to Form 1099-R

Because box 1 and box 2a of the Form 1099-R are required to be completed with the same amount when a distribution from an IRA is involved, the question arises, "How does the IRS know what portion of the listed amount is taxable, if any?" On Form 8606, the individual lists the portion of the distributions which are attributable to nondeductible contributions. As you are aware, nondeductible contributions are contributions which an individual is not able to deduct from his income on the Form 1040. The individual attaches the Form 8606 to his or her Form 1040. In this way, the IRS is informed of the amount of nondeductible contributions which are included in boxes 1 and 2a of the 1099-R. Because nondeductible contributions have already been taxed, the individual is not again required to pay tax upon the distribution of these funds.

If an individual neglects to complete Form 8606 for a year in which he or she has received a nondeductible distribution, he or she will have no proof that the amount is indeed non-taxable, and the IRS will consider it a taxable amount. As the IRS perceives this situation, the entire amount distributed from an IRA is believed to be taxable, unless the individual can prove otherwise. The way to do this is to complete Form 8606 and file it with the Form 1040.

Reducing the Employer Match for SIMPLE IRA Plans

Is it possible to reduce the employer matching contribution for a SIMPLE IRA plan below the 3% limit? It is possible if the conditions as set forth in Article III(2)(a)(ii) of the IRS Model Form 5304-SIMPLE are met. This article reads as follows: *"The employer may reduce the 3% limit for the calendar year which it previously communicated to its employees only if: (1) the limit is not reduced below 1%; (2) the limit is not reduced for more than 2 calendar years during the 5-year period ending with the calendar year the reduction is effective; and (3) each employee is notified of the reduced limit within a reasonable period of time before an employee's 60-day election period for the calendar year."* This 60-day period is described in Article II, item 2a.

Once the 60-day election period has expired, an employer has no authority to change or amend the percentage of the matching contribution. It also appears that an employer could not terminate the SIMPLE IRA plan, thus eliminating its obligation to make the matching contribution. Termination would be a type of reduction which is not authorized.

In summary, the SIMPLE IRA employer match may not be reduced below 1%, and the match may only be reduced to less than 3% for a maximum period of two years out of the five-year period as described above. Also, such

reduction (including plan termination) must be communicated to the employees within a reasonable period prior to the employees 60-day election period.

Correct Rollover Reporting — Form 1099-R

We have received many consulting calls concerning the following situation with respect to the correct Form 1099-R reporting of a rollover. Let's assume that an individual has taken \$12,000 in distributions from his IRA in 2000. One distribution, in the amount of \$3,000 was rolled back into the IRA within the required 60-day period. The individual's bank prepared the 1099-R showing \$12,000 in both box 1 (gross distribution amount) and box 2a (taxable amount). The individual's accountant believes \$12,000 should be reported in box 1 and \$9,000 should be reported in box 2a. Who is correct?

The bank is correct in reporting the same amount (in this case \$12,000) in both box 1 and box 2a. A distribution from an IRA must be reported in boxes 1 and 2a of the 1099-R, regardless of the amount. There are specific times when box 2a is not completed with the same amount as box 1, but a rollover is not one of those times. This IRS rule is the same whether the funds were rolled over to the same bank from which the funds came, or whether the funds were rolled over into a new bank's IRA.

On the individual's 1040 form on which he reports his annual income, he should complete line 15a with the

total amount of the distribution (\$12,000), and line 15b with \$9,000 (the \$12,000 minus the \$3,000 rollover). How does the IRS know that only \$9,000 is taxable when the 1099-R has \$12,000 in the "taxable amount box?" The bank will prepare a Form 5498 for this individual indicating the rollover amount of \$3,000 in box 2.

Many years ago the IRS had a distribution code on the 1099-R which indicated when an accountholder intended to perform a rollover. However, the IRS concluded that nothing was really meant by "intended." Either the rollover was made and was not taxable, or the rollover was not made, in which case a taxable event would have occurred. Previously, if the amounts on line 15a and 15b were different, and the taxpayer did not attach a Form 8606, then the IRS would look to see if a Form 5498 was prepared for the individual, showing a rollover in box 2.

In summary, the Form 1099-R instructions state: *"IRA or SEP. Generally, you are not required to compute the taxable amount of a traditional IRA or SEP nor designate whether any part of a distribution is a return of basis attributable to nondeductible contributions. 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."* The word "may" is permissive, not mandatory.

IRS Form 8606

Form **8606**

Nondeductible IRAs

OMB No. 1545-1007

2000

Attachment
Sequence No. **48**

Department of the Treasury
Internal Revenue Service (99)

▶ See separate instructions.

▶ Attach to Form 1040, Form 1040A, or Form 1040NR.

Name. If married, file a separate form for each spouse required to file Form 8606. See page 3 of the instructions.

Your social security number

**Fill in Your Address Only
if You Are Filing This
Form by Itself and Not
With Your Tax Return**

Home address (number and street, or P.O. box if mail is not delivered to your home)

Apt. no.

City, town or post office, state, and ZIP code

Part I Traditional and SIMPLE IRAs

Complete Part I if:

- You made nondeductible contributions to a traditional IRA for 2000,
- You received distributions from a traditional or SIMPLE IRA in 2000 and you made nondeductible contributions to a traditional IRA in 2000 or an earlier year, or
- You converted part, but not all, of your traditional or SIMPLE IRAs to Roth IRAs in 2000 and you made nondeductible contributions to a traditional IRA in 2000 or an earlier year. See the instructions for lines 8, 11, and 15 for special computations.

- 1 Enter your nondeductible contributions to traditional IRAs for 2000, including those made for 2000 from January 1, 2001, through April 16, 2001. See page 3 of the instructions
- 2 Enter your total basis in traditional IRAs for 1999 and earlier years. See page 3 of the instructions ..
- 3 Add lines 1 and 2

Did you receive any
distributions from
traditional or SIMPLE
IRAs or make a Roth IRA
conversion in 2000?

No

Enter the amount from
line 3 on line 12. Do not
complete the rest of Part I.

Yes

Go to line 4.

- 4 Enter only those contributions included on line 1 that were made from January 1, 2001, through April 16, 2001. See page 3 of the instructions
- 5 Subtract line 4 from line 3
- 6 Enter the value of all your traditional and SIMPLE IRAs as of December 31, 2000, plus any outstanding rollovers. See page 4 of the instructions
- 7 Enter your total distributions from traditional and SIMPLE IRAs in 2000. Do not include rollovers or Roth IRA conversions. See page 4 of the instructions
- 8 Add lines 6 and 7. (But if you converted any amount from traditional or SIMPLE IRAs to Roth IRAs in 2000, see page 4 of the instructions for the amount to enter.) . . .
- 9 Divide line 5 by line 8 and enter the result as a decimal (rounded to at least 3 places). Do not enter more than "1.000"
- 10 Multiply line 7 by line 9. This is the amount of your nontaxable distributions for 2000
- 11 Subtract line 10 from line 5. (But if you converted any amount from traditional or SIMPLE IRAs to Roth IRAs in 2000, see page 4 of the instructions for the amount to enter.) This is your basis in traditional IRAs as of December 31, 2000.
- 12 Add lines 4 and 11. This is your total basis in traditional IRAs for 2000 and earlier years
- 13 Taxable distributions from traditional and SIMPLE IRAs. Subtract line 10 from line 7. Also include this amount on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b

Part II 2000 Conversions From Traditional or SIMPLE IRAs to Roth IRAs

Caution: If your modified adjusted gross income is over \$100,000 or you are married filing separately and you lived with your spouse at any time in 2000, you **cannot** convert any amount from traditional or SIMPLE IRAs to Roth IRAs for 2000. If you erroneously made a conversion, you must recharacterize (correct) the conversion. See page 4 of the instructions for details.

- 14a Enter the total amount you converted from traditional and SIMPLE IRAs to Roth IRAs in 2000 . . .
- * b Enter the portion of the amount on line 14a that you recharacterized back to a traditional or SIMPLE IRA. Do not include earnings or reduce the amount recharacterized by any loss that occurred in the Roth IRA. See page 5 of the instructions
- c Subtract line 14b from line 14a. This is the net amount you converted to Roth IRAs in 2000 . . .
- 15 Enter your basis in the amount on line 14c from traditional IRAs. See page 6 of the instructions . .
- 16 Taxable amount of conversions. Subtract line 15 from line 14c. Also include this amount on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b

IRS Form 8606

Form 8606 (2000)

Page **2**

Part III Distributions From Roth IRAs

Complete Part III **only** if you received a Roth IRA distribution in 2000 or you recharacterized 2000 contributions to or from a Roth IRA.



Be sure to keep copies of all Forms 1099-R, 5498, and 8606 for all years. You will need amounts from these forms if you take a nonqualified distribution (see page 2 of the instructions) from a Roth IRA in future years.

17	Enter your total distributions from Roth IRAs in 2000. Do not include rollovers	17	
18a	Enter your basis in Roth IRA contributions for 1998 and 1999 . See page 6 of the instructions	18a	
b	Enter your contributions to Roth IRAs for 2000, including those made for 2000 from January 1, 2001, through April 16, 2001. Do not include rollovers or amounts converted from traditional or SIMPLE IRAs	18b	
* c	Recharacterizations of 2000 contributions to or from Roth IRAs. See page 6 of the instructions	18c	
d	Combine lines 18a through 18c	18d	
19	Subtract line 18d from line 17. If zero or less, enter -0- and do not complete the rest of Part III	19	
Note: If you converted amounts from traditional IRAs to Roth IRAs in 1998 and elected to report the taxable portion over 4 years, go to line 20a; otherwise, skip to line 21.			
20a	Enter the amount from your 1998 Form 8606, line 16	20a	
b	Enter the amount from line 5 of the worksheet on page 6 of the instructions	20b	
c	Enter the amount from line 8 of the worksheet on page 6 of the instructions	20c	
d	Add lines 20b and 20c	20d	
e	Subtract line 20d from line 20a. If zero or less, enter -0-	20e	
21	Enter the smaller of line 19 or line 20e. If line 20e is blank, enter -0-	21	
22	Subtract line 21 from line 19. If zero, skip lines 23 through 26 and go to line 27	22	
23	Enter your basis in Roth IRA conversions for 1998 and 1999 . See page 7 of the instructions	23	
24	Enter the amount, if any, from line 14c of this form	24	
25	Add lines 23 and 24	25	
26	Subtract line 25 from line 19. If zero or less, enter -0-	26	
27	Taxable distributions from Roth IRAs. Add lines 20c, 21, and 26. Also include this amount in the total on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b	27	
Note: You may be subject to an additional 10% tax. See page 7 of the instructions for details.			

Part IV Distributions From Education (Ed) IRAs

Caution: For 2000, you can receive up to \$500 of contributions to Ed IRAs. See page 7 of the instructions if the contributions to your Ed IRAs were over \$500.

28	Enter the total distributions from your Ed IRAs in 2000. Do not include rollovers	28	
29	Do you elect to waive the exclusion from income for Ed IRA distributions? If you check "No" and exclude from income any portion of an Ed IRA distribution, no Hope or lifetime learning credit can be claimed for your 2000 qualified higher education expenses.	29	
	<input type="checkbox"/> Yes. Enter -0-.		
	<input type="checkbox"/> No. Enter your qualified higher education expenses for 2000.		
30	Taxable amount. Is line 28 equal to or less than line 29?	30	
	<input type="checkbox"/> Yes. Enter -0-; none of your Ed IRA distributions are taxable for 2000. Be sure to keep a copy of this form for your records so you can figure your basis in your Ed IRAs. You may need to know your basis in future years. See page 7 of the instructions.		
	<input type="checkbox"/> No. See the worksheet on page 7 of the instructions for the amount to enter. Also include this amount in the total on Form 1040, line 15b; Form 1040A, line 11b; or Form 1040NR, line 16b. See page 8 of the instructions to find out if you owe an additional 10% tax.		

Sign Here Only if You Are Filing This Form by Itself and Not With Your Tax Return

Under penalties of perjury, I declare that I have examined this form, including accompanying attachments, and to the best of my knowledge and belief, it is true, correct, and complete.

Your signature

Date