THE Pension Digest

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FORM 5498 – WHAT'S NEW FOR 2003?

This form again has the title, "IRA Contribution Information" as the Coverdell ESA has its own reporting form. See the March 2003 newsletter.

The most important change is a new box 11. The IRA custodian/trustee will check this box to indicate that the participant is required to take a required minimum distribution for 2004. The instruction to the participant for box 11 reads as follows: "Box 11. If the box is checked, you must take a required minimum distribution (RMD) for 2004. An RMD may be required even if the box is not checked. The amount, or offer to compute the amount, and date of the RMD will be furnished to you by January 31, either on Form 5498 (in the blank box to the left of box 10) or in a separate statement. If you don't take the RMD in 2004, you are subject to a 50% excise tax on the amount not distributed. See Pub. 590 for details."

The IRS has again included a statement in box 5 discussing what reporting is to be done if the participant died during the year. The IRS never should have deleted this statement. The IRS added the following, "However, if a decedent's name is shown, the amount reported may be the FMV as of the date of death. If the FMV is zero for a decedent, the executor or administrator of the estate may request a date-of-death value from the financial institution."

The other change relates to box 7. Box 7 contains the boxes to be checked to indicate the type of IRA. In 2002 there were five boxes. In 2003 there will only be four, because of the removal of the Coverdell ESA. Be aware that checking a box in box 7 is sometimes optional and other times it is mandatory. Completing this box is optional when there is a contribution amount shown in box 1, 3, 8, 9, or 10. Completing this box is mandatory if there is an amount shown in box 2, 4, or 5 without any amount being shown in boxes 1, 3, 8, 9, or 10. In the former situation, the IRS knows the type of IRA because it knows the type of contribution. With respect to a rollover, recharacterization or fair market value, the IRS needs to be told the type of IRA.

2828 ☐ VOID ☐ CORRECTED

TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2–4 and 8–10) $	OMB No. 1545-0747 2003 Form 5498	IRA Contribution Information
		2 Rollover contributions $		
TRUSTEE'S or ISSUER'S Federal identification no.	PARTICIPANT'S social security number	3 Roth IRA conversion amount $	4 Recharacterized contributions $	Copy A For Internal Revenue Service Center
PARTICIPANT'S name		5 Fair market value of account $	6 Life insurance cost included in box 1 $	File with Form 1096.
Street address (including apt. no.)		7 IRA ☐ SEP ☐	SIMPLE ☐ Roth IRA ☐	For Privacy Act and Paperwork Reduction Act Notice, see the 2003 General Instructions for Forms 1099, 1098, 5498, and W-2G.
City, state, and ZIP code		8 SEP contributions $	9 SIMPLE contributions $	
Account number (optional)		10 Roth IRA contributions $	11 Check if RMD for 2004 ☐	

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

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ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc.,
"The Pension Specialists"

POSSIBLE LAW CHANGES

President Bush suggested various changes to IRAs and pension plans. A number of Representatives, on April 11, 2003, have introduced a bill which makes many changes to the existing laws. The House and Senate have adjourned until the first week of May, when they will take up the topic of Tax Changes/Relief.

Set forth below is a listing of the IRA changes under H.R. 1776. This bill has both Republican and Democratic sponsors. The proposed effective date of the changes is January 1, 2004, unless stated otherwise.

1. Makes all of the IRA and other pension plan changes of EGTRRA permanent. That is, the law changes due to expire in 2010 will not expire.

2. Changes the required beginning date (RBD) for required distributions to be as set forth below. In general, an RMD will be required for the year a person turns age 75 rather than age 70½. This change will be phased-in over a number of years.

Calendar Year	Applicable Age
2004 and 2005	72
2006 and 2007	73
2008 and 2009	74
2010 and thereafter	75

A person who retires in December of a calendar year shall be treated as retiring in the following calendar year. Presumably, this will apply in the same fashion to an IRA accountholder whose birthday is in December.

Observations:

A. Persons born in 1933 will have an RBD of 12-31-05, even though under existing law their RBD would have either been 4-1-04 or 4-1-05.

B. Persons born in 1934 will have an RBD of 12-31-06.

C. Persons born in 1935 will have an RBD of 12-31-07.

D. Persons born in 1936 will have an RBD of 12-31-09.

E. Persons born in 1937 will have an RBD of 12-31-10.

F. Persons born 1in 1938 will have an RBD of 12-31-12.

3. The 50% excise tax for missed RMDs will be reduced to 20%.

4. The IRA contribution limits of $5,000 (under age 50) and $6,000 (age 50 and over) would become effective 1-1-04. Under EGTRRA, the limits were to be phased in over a number of years.

5. The scheduled increases in the compensation limits for married couples filing jointly are accelerated and made larger as follows. The intent is to remove the marriage penalty aspect of the compensation limits. This change is effective as of 1-1-07.

For tax years beginning in	The applicable amount	Existing law
2003	$60,000	$60,000
2004	$70,000	$65,000
2005	$75,000	$70,000
2006	$80,000	$75,000
2007	$85,000	$80,000
2008	$90,000	$80,000
2009	$95,000	$80,000
2010 and thereafter	$100,000	$80,000

6. The Roth IRA eligibility limit for a married couple filing a joint income tax return would change from $150,000/$160,000 to $190,000/$220,000.

7. A disabled person would be eligible to make an IRA contribution even though he or she did not have any compensation. He or she would still need to meet the age 70½ requirement.

8. There is new authority to transfer IRA funds from one spouse to the other spouse. No longer will there be the limitation that this may be done only pursuant to a divorce or separation instrument. This will be a major estate and wealth transfer planning tool, if enacted.

9. Nonspouse beneficiaries of a participant in an employer plan will be authorized to establish an inherited IRA and take distributions from such inherited over their life expectancy (or, possibly the 5-year rule, if applicable).

10. A person will be able to directly roll over assets from his or her employer's retirement plan directly to a Roth IRA.

11. It appears that there will be changes in the rules used to determine the taxable and nontaxable portions of a distribution, including both before- and after-tax contributions. Further research is need.

12. A person could change from one permissible Substantially Equal Periodic Payment (SEPP) method to another permissible method as long as there is an initial reduction in the amount of payments. This change is in response to the changes in Rev. Rul. 2002-62 which did not authorize such a broad change.

A person could roll funds subject to a SEPP to another plan as long as the combined SEPP distribution was sufficient.

Any reasonable interest rate would be authorized to be used in the SEPP. Under Rev. Rul. 2002-62, today's low interest rates must be used.

These changes would apply on the date the bill becomes law.

13. The IRS is being instructed to write a new regulation covering the correction of rollover errors due to the fact the individual did not understand the rules, or the financial institution made a mistake. The procedure is to grant relief without any IRS filing. Individuals will be allowed to rescind a distribution in such a situation. And somehow, the IRS is to ensure that taxpayers do not abuse this correction procedure.

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Possible Law Changes
Continued from page 2

14. Code section 401(a)(31)(B) allows an employer to roll over certain QP funds into an IRA on behalf of a terminated participant without his or her consent. There are a number of changes to the rules. We need to research these issues as soon as possible, because it presents a business opportunity. The large 401(k) plans hate having to administer QP accounts with balances of less than $5,000.

15. It appears that certain unused health benefits in a cafeteria account plan will be able to be transferred to a pension plan or an IRA. Further research is needed.

16. SIMPLE-IRA changes.

A. Elective deferral amounts changed to $10,000, with the catch-up amount changing to $2,500 for 2004-2005 and $5,000 for 2006 and subsequent years.

B. An employer would be allowed to make nonelective contributions up to 10% of compensation for each employee eligible to participate and who $5,000 of wages or self-employment income for the current year. Under current law, the employer is not allowed to contribute any amount except the match or the 2% nonelective and is required to make a matching contribution for any employee who is expected to have $5,000 of compensation.

C. The matching contribution rules for SIMPLE-IRAs and SIMPLE 401(k) plans would be the same. Under current rules, the amount may be less in 2-5 years for SIMPLE-IRAs.

D. A new type of SIMPLE-IRA would be authorized. The plan could authorize just elective deferrals, and the employer would not be required to make any matching contribution as long as the elective deferral amount was limited to $5,000. The employer would be able to decide annually if it wished to implement this provision. Notice would need to be given.

E. It would be permissible to switch from a SIMPLE-IRA plan to another plan during the middle of a year. Under current law, a mid-year switch is not authorized. Effective for 2005.

F. The 25% pre-2-year distribution rule if under age 59½ would be repealed. The standard 10% rule would apply

G. Funds from other employer plans could be rolled over into SIMPLE-IRAs. Present law does not authorize such rollovers.

17. SEP IRA Changes.

A. A new type of SEP would be authorized. Elective deferrals would again be authorized in some situations. If the employer would make a standard SEP contribution of X%, then an elective deferral of 2 x X% could be made by an eligible employee.

B. A SEP plan could be written to authorize a level dollar contribution amount for each eligible employee. This would allow a very simple plan.

C. Compensation as defined in section 415(c)(3) would replace section 414(s) for purposes of the limit on employer contributions found in section 402(h)(2).

D. The tax on nondeductible contributions would not apply to SEP contributions.

FORM 1099-R – WHAT'S NEW FOR 2003?

There were only a small number of changes. Again, the title has changed because the Coverdell ESA has its own reporting form. See the March 2003 newsletter.

☐ CORRECTED (if checked)

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution $ 2a Taxable amount $	OMB No. 1545-0119 2003 Form 1099-R	**Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.**
		2b Taxable amount not determined ☐	Total distribution ☐	**Copy B**
PAYER'S Federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a) $	**4 Federal income tax withheld** $	**Report this income on your Federal tax return. If this form shows Federal income tax withheld in box 4, attach this copy to your return.**
RECIPIENT'S name		5 Employee contributions or insurance premiums $	6 Net unrealized appreciation in employer's securities $	
Street address (including apt. no.)		7 Distribution code(s) IRA/SEP/SIMPLE ☐	8 Other $ %	This information is being furnished to the Internal Revenue Service.
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 — Department of the Treasury - Internal Revenue Service

The most important change is a new distribution code "Q" for a qualified distribution from a Roth IRA. It applies when the recipient is age 59½ or over and the distribution was on account of the participant being age 59½ or older, the participant's death or disability. There is no mention of the first-time homebuyer requirement. Apparently, the IRS does not expect the IRA custodian/trustee to determine that the requirements for the first-time homebuyer situation have been met.

CWF has created a new Roth IRA distribution form (#57-R) and you may use the enclosed order form to order.

The general instructions inform the recipient that, generally, the IRA custodian/trustee is not required to compute the taxable amount. The recipient (or the tax preparer) is responsible to compute any taxable amount on Form 8606. And the recipient is informed that he or she will need to look to the 2003 Form 1040/1040A for instructions.

Correspondingly, the IRS did not change its instructions for a distribution from a Roth IRA for the IRA custodian/trustee. The general rule is—report the gross distribution in box 1, and generally leave box 2a blank. Box 2a is to be completed with the earnings portion when there is a withdrawal of an excess contribution (or current-year) under Code section 408(d)(4) and with a zero when there has been a recharcterization withdrawal. The instructions to the IRA custodian for Roth IRAs reads as follows: ***Roth IRAs.*** *For distributions from a Roth IRA, report the gross distribution in box 1 but generally* ***leave box 2a blank****. Check the "Taxable amount not determined" box in box 2b. Enter Code J, T, or Q as appropriate in box 7. You must enter code 5, 8, or P with Codes J and T, and 8 or P with code Q, if applicable.*

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Form 1099-R, Continued from page 3

*For the withdrawal of excess contributions, see **Box 2a** on page R-6. It is not necessary to mark the IRA/SEP/SIMPLE checkbox.*

Note that these instructions require the use of Code 5, 8, or P with Codes J and T, and 8 or P, with the new Code Q, if applicable.

The IRS made some other changes with respect to the various distribution codes for box 7. In some cases, the IRS may need to furnish additional clarification.

Code G has been retitled "Direct rollover and rollover contribution." Code H as been deleted.

Under the 2002 instructions, Code G was used to report a direct rollover from an eligible retirement plan (i.e. 401(a), 403(b) and governmental 457(b) plan) to an IRA.

Under the 2002 instructions, Code H was used to report a direct rollover from an eligible retirement plan to another eligible retirement plan or from an IRA to an eligible retirement plan.

For 2003 reporting duties, Code G is to now be used to report a direct rollover from one eligible retirement plan to an IRA or another eligible retirement plan, or from an IRA to an eligible retirement plan.

Note that there was no special code in 2002, and there will be no such code for 2003, to report a rollover from one IRA to another IRA. Set forth below are the pertinent instructions from page 25 of the 2002 Form 1040. One can expect that these instructions will be modified only slightly for 2003. These instructions read: ***Lines 15a and 15b IRA Distributions.*** *You should receive a **Form 1099-R** showing the amount of any distribution from your individual retirement arrangement (IRA). Unless otherwise noted in the line 15a and 15b instructions, an IRA includes a traditional IRA, Roth IRA, simplified employee pension (SEP) IRA, and a savings incentive match plan for employees (SIMPLE) IRA. Except as provided below, leave line 15a blank and enter the total distribution on line 15b.*

Exception 1. *Enter the total distribution on line 15a if you rolled over part or all of the distribution from one: • IRA to another IRA of the same type (for example, from one traditional IRA to another traditional IRA) or • SEP or SIMPLE IRA to a traditional IRA.*

*Also, put "Rollover" next to line 15b. If the total distribution was rolled over, enter zero on line 15b. If the total distribution was not rolled over, enter the part not rolled over on line 15b unless **Exception 2** applies to the part not rolled over.*

*If you rolled over the distribution **(a)** in 2003 or **(b)** from an IRA into a qualified plan (other than an IRA), attach a statement explaining what you did.*

These instructions make clear it is the job of the IRA accountholder (or tax preparer) to explain that the distribution was not taxable because it was rolled over.

Code J. The description has been changed when there has been an early distribution from a Roth IRA and an exception is not known. Set forth below are the descriptions for 2002 and 2003.

2002, J – Early distribution from a Roth IRA, no known exception. *Use Code J for a distribution from a Roth IRA if the taxpayer has not reached age 59½, and if none of the exceptions under section 72(q), (t), or (v) are known to apply.*

2003, J – Early distribution from a Roth IRA, no known exception. *Use Code J for a distribution from a Roth IRA where you do not know if the participant is under age 59½, and there are no known exceptions. For example, you may not know whether an exception under section 72(t) applies (such as medical expenses, first-time homebuyer, etc.) or whether the distribution is a qualified distribution because the taxpayer qualifies as a first-time homebuyer under section 408A(d)(2).*

Code T. The description has been changed. For 2002, this code was used when there was a distribution from a Roth IRA and an exception was known (age 59½ or older or another exception applied). For 2003, you are to also use Code T when you do not know if the five-year requirement has been met, even though you know one of the exceptions applies.

2002, T – Roth IRA distribution, exception applies. *Use Code T for a distribution from a Roth IRA if the taxpayer is at least age 59½, or if an exception under section 72(q), (t), or (v) applies. Also use Code T if Code 3 or 4 applies.*

2003, T – Roth IRA distribution, exception applies. *Use Code T for a distribution from a Roth IRA if you do not know if the 5-year period has been met but you know the taxpayer is at least 59½ or an exception under section 72(t) applies.*

Conclusion. Although the IRS did not make many changes to the 2003 Form 1099-R and 2003 Form 5498, some the changes are quite important. Software and forms will need to be revised to accommodate these changes.

It should also be noted that the instructions now include a reference to deemed IRAs. If an eligible employer plan permits it, a person may make his or her traditional IRA contribution to the plan. With respect to distributions, the instructions state that the administrator is to use the rules set forth for traditional or Roth IRAs as applicable. With respect to contributions, the instructions state the administrator is to file the 2003 Form 5498 with the IRS by May 31, 2004, for each person from whom, in 2003, an IRA or a deemed IRA was maintained.

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ADDITIONAL DISCUSSION OF THE NEW REASON CODE "Q"

The general rule has not changed. The Roth IRA custodian is generally not required to determine the taxable amount of a distribution from a Roth IRA. The fact that a distribution is "qualified" for reporting purposes does not mean that the Roth IRA custodian is able to determine if the distribution is taxable, because the person may well have other Roth IRAs with other financial institutions. Consequently, the Roth IRA custodian does not know if "basis" or "income" is being distributed. Basis is comprised of a person's after-tax contributions. No taxes are owing when basis is returned or distributed to a person.

A distribution from a Roth IRA is non-taxable only if income is distributed and if the distribution is a "qualified" distribution.

The IRS guide for distribution codes indicates that the "Q" is to be used if you (as the IRA custodian) know that the recipient has met the five-year holding requirement and the accountholder has reached age 59½, dies or is disabled.

The IRS does not provide much guidance to the Roth IRA custodian as to how and when it "knows" there has been a qualified distribution.

The most conservative approach for a financial institution is to use Code "Q" only if the original deposit was made with you, so that you can determine that the five-year requirement has been met and you can determine the accountholder, at the time of distribution, as either age 59½ or older, or was disabled, or you make a distribution to a beneficiary because the accountholder has died.

Obviously, Roth IRA accountholders (and their tax preparers) will want the Roth IRA custodian to use the Code "Q" rather than a Code "T." The "Q" informs the IRS that the payer believes the distribution is tax-free. The "T" informs the IRS that the payer believes the distribution may be taxable. Until the IRS states otherwise, we do not believe a financial institution should rush to use the Code "Q." You should use "Q" only when you know the above requirements have been met. If you don't "know" if such requirements have been met, then use the Code "T."

Will the IRS permit a Roth IRA custodian who has received a rollover or a transfer from another Roth IRA to insert the Code "Q" if a written certification is furnished by the original Roth IRa custodian and/or the accountholder so that a determination may be made that the five-year requirement has been met? The IRS has not yet answered this question. We hope the IRS will provide additional guidance. However, the IRS is well aware that it is generally the duty of the Roth IRA accountholder to explain the tax consequences of his or her distribution. Therefore, we do not believe the IRS will require a receiving institution to be furnished this information at the time the rollover or transfer is made.

SPECIAL EXPLANATION— REPORTING SEP CONTRIBUTIONS TO THE IRS

The purpose of this explanation is to detail how an IRA custodian is required to report contributions to an employer's SEP-IRA to the IRS on Form 5498.

When an IRA custodian receives a contribution to an employer's SEP-IRA, the custodian is to consider the contribution made by the "employer" for benefit the "employee." If a business is unincorporated, the "employer" is considered to be self-employed, and will either be an individual (i.e. sole proprietor) or a partnership. When an individual is self-employed, he/she is both the "employee" and the "employer."

The SEP-IRA custodian reports the SEP-IRA contribution in Box 8 of the Form 5498 for the year in which the contribution is received, regardless of the employer's tax year for which it was contributed. The reason for this is that the employer's deadline for making its SEP contribution is its tax-filing deadline plus extensions.

The April 15 deadline which applies to traditional and Roth IRAs does not apply to SEP-IRA contributions. The "plus extension" rule means that a business (i.e. the employer) may make its contribution for the prior year after May 31 of the current year (e.g. on August 13, 2003, an employer may contribute funds for the 2002 tax year). Note: The 2002 Form 5498 is required to be furnished to the SEP-IRA accountholder by May 31 of each year.

The IRS instructions for Box 8 of the 2002 Form 5498 read as follows:

"Shows SEP contributions made in 2002, including contributions made in 2002 for 2001, but not including contributions made in 2003 for 2002. If made by your employer, do not deduct on your income tax return. If you made the contributions as a self-employed person (or partner), they may be deductible. See Publication 560."

Tax Reporting by the Employer— The business entity is entitled to claim a tax deduction on the tax return for which the contribution was designated. The Form 5498 does not inform the IRS of the employer's tax year for which the contribution was made. It merely informs the IRS of the fact that an employer made a contribution on behalf of an employee during a specific calendar year.

IRS Guide to Distribution Codes — 2003

Distribution Codes	Explanations	*Used with code... (if applicable)
1—Early distribution, no known exception.	Use Code 1 only if the employee/taxpayer has **not** reached age 59½, and if none of the exceptions under section 72(q), (t), or (v) are known to apply when the distribution is made. For example, if a distribution is made for medical, first-time homebuyers, or qualified higher education expenses, you probably will not know if any exception under section 72(t) applies. Therefore, use Code 1. However, if an early distribution is made from a qualified retirement plan or IRA (Roth IRA) because of an IRS levy under section 6331, use Code 2.	8, D, L, or P
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 59½ 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 IRA conversion (an IRA converted to a Roth IRA) or reconversion if the participant is under age 59½ and for an early distribution made from a qualified retirement plan or IRA (Roth IRA) because of an IRS levy under section 6331.	8, D, or P
3—Disability.	For these purposes, see section 72 (m)(7).	None
4—Death.	Use Code 4 regardless of the age of the employee/taxpayer to indicate payment to a decedent's beneficiary, including an estate or trust. Also use it for death benefit payments made by an employer but not made as part of a pension, profit-sharing, or retirement plan.	8, A, D, G, L, or P
5—Prohibited transaction.	Use Code 5 if there was an improper use of the account. See sections 408 (e)(2) and 4975 (c)(1).	J or T
6—Section 1035 exchange.	Use Code 6 to indicate the tax-free exchange of life insurance, annuity, or endowment contracts under section 1035.	None
7—Normal distribution.	Use Code 7 (a) for a normal distribution from a plan, including a traditional IRA, if the employee/taxpayer is at least age 59½, (b) for a Roth IRA conversion or reconversion if the participant is at least age 59½, and (c) to report a distribution from a life insurance, annuity, or endowment contract and for reporting income from a failed life insurance contract under sections 7702(g) and (h). See Rev. Rul. 91-17, 1991-1 C.B. 190. Use Code 7 with Code A, if applicable. Generally, use Code 7 if no other code applies. **Do not** use Code 7 if Code T applies.	A
8—Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2003.	Use Code 8 for an IRA distribution under section 408(d)(4), including excess Roth IRA contributions, unless Code P applies. Also use this code for corrective distributions of excess deferrals, excess contributions, and excess aggregate contributions, unless Code D or P applies. See **Corrective distributions** on page R-3 and **IRA revocation** on page R-2 for more information.	1, 2, 4, J, Q, or T
9—Cost of current life insurance protection.	Use Code 9 to report premiums paid by a trustee or custodian for current life or other insurance protection. See **Box 2a** on page R-6 for more information.	None
A—May be eligible for 10-year tax option.	Use Code A only for participants born before 1936 or their beneficiaries to indicate the distribution may be eligible for the 10-year tax option method of computing the tax on lump-sum distributions (on **Form 4972,** Tax on Lump-Sum Distributions). To determine whether the distribution may be eligible for the tax option, you need not consider whether the recipient used this method (or capital gain treatment) in the past.	4 or 7
D—Excess contributions plus earnings/excess deferrals taxable in 2001.	See the explanation for Code 8. Generally, do not use Code D for an IRA distribution under sections 408(d)(4) or 408(d)(5).	1, 2, or 4

*See the **Caution** for the Box 7 instructions on page R-8.

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IRS Guide to Distribution Codes — 2003

Distribution Codes	Explanations	*Used with code... (if applicable)
E—Excess annual additions under section 415/certain excess amounts under section 403(b) plans.	See **Excess Annual Additions Under Section 415** on page R-4.	None
F—Charitable gift annuity.	See **Charitable gift annuities** on page R-6.	None
G—Direct rollover and rollover contribution.	Use Code G for a direct rollover from a qualified plan (including a governmental section 457(b) plan) or tax-sheltered annuity to an eligible retirement plan (another qualified plan, a tax-sheltered annuity, a governmental section 457(b) plan, or an IRA). See **Direct Rollovers** on page R-2. Also use Code G for certain distributions from conduit IRAs to an employer plan and IRA rollover contributions to an accepting employer plan. See page R-2.	4
J—Early distribution from a Roth IRA, no known exception.	Use Code J for a distribution from a Roth IRA where you do not know if the participant is under age 59½, and there are no known exceptions. For example, you may not know whether an exception under section 72(t) applies (such as medical expenses, first-time homebuyer, etc.) or whether the distribution is a qualified distribution because the taxpayer qualifies as a first-time homebuyer under section 408A(d)(2).	5, 8, or P
L—Loans treated as deemed distributions under section 72(p).	Do not use Code L to report a loan offset. See **Loans Treated as Distributions** on page R-5.	1 or 4
N—Recharacterized IRA contribution made for 2003.	Use Code N for a recharacterization of an IRA contribution made for 2003 and recharacterized in 2003 to another type of IRA by a trustee-to-trustee transfer or with the same trustee.	None
P—Excess contributions plus earnings/excess deferrals taxable in 2002.	See the explanation for Code 8. The IRS suggests that anyone using Code P for the refund of an IRA contribution under section 408(d)(4), including excess Roth IRA contributions, advise payees, at the time the distribution is made, that the earnings are taxable in the year in which the contributions were made.	1, 2, 4, J, Q, or T
Q—Qualified distribution from a Roth IRA.	Use Code Q for a distribution from a Roth IRA if you know that the participant meets the 5-year holding period and: • The participant has reached age 59½, or • The participant died, or • The participant is disabled.	8 or P
R—Recharacterized IRA contribution made for 2002.	Use Code R for a recharacterization of an IRA contribution made for 2002 and recharacterized in 2003 to another type of IRA by a trustee-to-trustee transfer or with the same trustee.	None
S—Early distribution from a SIMPLE IRA in the 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 59½, and none of the exceptions under section 72(t) are known to apply when the distribution is made. 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.	None
T—Roth IRA distribution, exception applies.	Use Code T for a distribution from a Roth IRA if you do not know if the 5-year period has been met but you know the taxpayer is at least age 59½ or an exception under section 72(t) applies.	5, 8, or P

*See the **Caution** for the Box 7 instructions on page R-8.

IRA CONVERSION AND IRA RECHARACTERIZATION— WHAT IS THE DIFFERENCE?

There seems to be much confusion concerning IRA conversions and IRA recharacterizations. It seems these terms are used interchangeably throughout the financial industry, when, in fact, they are actually very different events. In the discussion below, we hope to clarify the differences between these confusing transactions.

IRA Conversion –

An IRA conversion contribution is made when funds are distributed from a traditional IRA and put into a Roth IRA for the purpose of receiving the benefit of tax-free distributions (interest and principal) from the Roth IRA. Such Roth distributions must be "qualified" distributions in order for the interest to be distributed tax free. Another reason to make a conversion contribution to a Roth IRA is that there is no age 70½ required distribution as there is with a traditional IRA.

You must be aware that the distribution from the traditional IRA is a taxable event. An individual will receive a 1099-R and will have to pay normal income tax on this traditional IRA distribution for the year in which the funds are received. Once the funds are deposited into the Roth IRA, the earnings accumulate tax free (just as with the traditional IRA), but are never taxed if used for a "qualified" distribution.

Each conversion contribution has a separate five-year holding period which is considered to begin on the first day of the individual's tax year (normally January 1) in which the conversion contribution is made. This five-year holding period ends on the last day of the individual's fifth consecutive taxable year (normally 12/31). If funds are distributed prior to the completion of the five-year holding period, a 10% recapture tax will be assessed, unless an exception (such as attaining age 59½) applies.

IRA Recharacterization –

The law permits an individual to treat contributions made to a Roth IRA or traditional IRA as made to the other type of IRA. This is accomplished by means of a trustee-to-trustee transfer or by an internal transfer with the same trustee. There may be many reasons for recharacterizing a contribution, but it is mainly used as a correction mechanism, such as to correct a current-year excess contribution, or to move nondeductible contributions from a traditional IRA to a Roth IRA. The recharacterized contribution is treated on the individual's federal income tax return as having been originally contributed to the second IRA on the same date and for the same taxable year as the original contribution to the first IRA. All earnings are attributed to the second IRA. A recharacterized contribution is not treated as a rollover for purposes of the one-rollover-per-year limitation.

The time frame for performing a recharacterization of a current-year contribution is October 15 of the following year (the tax-filing deadline of 4/15 plus 6 months). An individual who has filed their tax return prior to completing the recharacterization will be able to file an amended return to report the recharacterization.

The net income attributable to the contribution being recharacterized must be transferred to the second IRA. The method used to calculate these earnings is the same method used to calculate the earnings associated with an excess contribution to a traditional IRA.

A recharacterization is not subject to withholding, as it is not a taxable event. However, it is a reportable transaction, and your institution will need to prepare two 5498s: one to show the original contribution and one to show the recharacterization. A 1099-R will also need to be prepared to report the "deemed" distribution.

In the case of an excess contribution, the excess amount may simply be withdrawn by the individual's tax-filing deadline, plus extensions. However, the reason to choose recharacterization over withdrawal is that under the withdrawal rules, the applicable income must also be withdrawn, normal income tax will be owing, and, if the individual is under age 59½, the 10% early withdrawal penalty will be assessed. By using recharacterization, the transaction is nontaxable, and the interest is allowed to be transferred along with the contribution.

In Summary: It is important that bank personnel be aware of the differences between conversion and recharacterization contributions. Sometimes your accountholders will incorrectly use one term when they mean the other term. In many instances the required reporting is completed incorrectly. Each transaction has very specific rules for completing the 1099-R and 5498. It is in you and your customer's best interest to complete these reporting forms correctly.