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"The Pension Specialists"



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Completion of Box 2b of Form 1099-R

Box 2b of the 2006 Form 1099 consists of two checkboxes: 1) Taxable amount not determined, and 2) Total Distribution. There appears confusion as to when to check the "taxable amount not determined" box. Some of the confusion could be due to the IRS instructions not being as clear as they could be. Form 1099-R is not only used to report IRA distributions; it is also used to report distributions from pension plans and insurance company annuities.

The IRS instructions state as follows:

Box 2b. Taxable Amount not Determined

Enter an "X" in this box only if you are unable to reasonably obtain the data needed to compute the taxable amount. If you check this box, leave box 2a blank, unless you are reporting a traditional IRA, SEP IRA or SIMPLE IRA 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 the final payment is made."

Box 2b, "Total Distribution" is self explanatory; this article will discuss

Excess Distributions After the Due Date and Form 1099-R Reporting

The 2006 IRS instructions for reporting the withdrawal of an excess contribution after the due date were changed versus the 2005 instructions. As you will see, withdrawing an excess contribution after the due date from a traditional IRA is the only time box 2a is ever left blank. The instructions read as follows:

2005 Instructions for Box 2a

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

2006 Instructions for Box 2a

"For a distribution of contributions without earnings after the due date of the individual's return, under Section 408(d)(5), leave box 2a blank, and check the "taxable amount not determined" checkbox in box 2b. Use Code 1 or 7 in box 7, depending on the age of the participant."

The 2005 instructions were not correct, because the IRA custodian did not really know whether or not the taxable amount was 0 (zero). The IRA custodian has no way of knowing whether or not the individual claimed a tax deduction on their 2005 tax return.

Example: Allan made a \$4,000 contribution to his IRA on October 10, 2005.

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**Excess Distributions After the Due Date,
Continued from page 1**

In April of 2006, upon completing his 2005 Form 1040, he found he was ineligible to make a 2005 IRA contribution. Allan wisely did not take a deduction for the \$4,000 on his 2005 tax return. Allan did not withdraw the \$4,000 excess contribution until November 30, 2006.

The IRA custodian should have prepared a 2006 Form 1099-R to report the withdrawal of this 2005 excess contribution withdrawn after the due date. The 2006 Form 1099-R should have been prepared by inserting the gross amount in box 1, box 2a should have been left blank, a reason code "1" or "7", as applicable, should have been inserted in box 7 and box 2b should have been checked since the taxable amount was not determined. ♦

Carrying Over a 2006 Contribution—Not So Easy

Situation. A customer contributed \$5,000 to an IRA in August of 2006. After having his 2006 taxes done by his accountant in February of 2007, it was discovered that he should not have made the contribution, because he was ineligible to claim a deduction. This individual was eligible to make the contribution, but found out that he was not able to deduct it because his income was too high and he is an active participant in a pension plan. The accountant's advice is to simply use the 2006 contribution for a 2007 contribution. Unfortunately, the tax rules are not that simple. The tax rules do allow this individual to withdraw his current-year contribution (plus earnings) and he could then make a 2007 contribution.

Because this individual is within the time guidelines, this \$5,000 contribution could be recharacterized to be a Roth IRA contribution for 2006. However, the individual did not want to do this; he wants to simply withdraw the funds and recontribute them, in 2007, to his traditional IRA.

The tax rules require the individual to withdraw not only his "excess contribution" amount, but also the related income. This income is taxable to the individual in 2006, and should have been included on his

2006 tax return. Because this individual has already filed his 2006 tax return, he and his accountant will need to decide if the income is an amount large enough to change the individual's tax liability, requiring an amended return to be filed.

Through April 17, 2007, the withdrawal of the funds will be treated as the withdrawal of a current-year contribution. The IRA custodian will want the individual to complete CWF's standard IRA distribution form, Form #57. The reason for the distribution will be Code P (for a contribution made in 2006 and withdrawn in 2007). The IRA custodian will want to use CWF Form #67-WC to calculate the earnings through the date of actual distribution, and provide the individual with CWF Form #67, which explains that the withdrawal is taxable on the individual's 2006 income tax return.

Conclusion. The accountant's advice to simply change the \$5,000 to be a 2007 contribution is not a permissible solution under IRS rules. The funds were deposited in 2006, and there is no legal authority to change the deposit to be a 2007 deposit or to simply carry it over. Leaving this contribution in the IRA would mean it would have to be treated as a nondeductible contribution. He must withdraw the \$5,000 along with the related earnings. Because the individual found out he was ineligible to make a deductible contribution before filing his taxes, he did not take an IRA deduction for the \$5,000. But he was unaware that the income on this amount is taxable income to him on his 2006 return. As explained above, he may need to file an amended return, if the addition of the earnings would place him in a higher tax bracket.

This individual will want to make certain he is eligible to make a deductible traditional IRA contribution for 2007 before recontributing these funds, or he will end up in the same situation next year. ♦

Use the Proper Forms for Recharacterizations

With tax season upon us, many individuals will be told by their accountants that, because of income limits, they are not eligible to deduct their traditional IRA contributions made for 2006. That is, they made too much money, and are not allowed to make a deductible contribution to their IRA. The easiest solution to this problem is to recharacterize the contribution to be a Roth IRA contribution instead.

A recharacterization can only be made for 2006, if it is accomplished by the tax-filing deadline of the individual plus six months. The normal tax-filing deadline for most individuals is April 15. Generally, then, an individual has until October 15, 2007, to recharacterize an IRA contribution made for 2006.

It is important to document this recharacterization, so that the custodians of both IRAs are aware of the transaction. CWF has created special forms for this situation.

One form is CWF's Form #54-TR "Notice of Recharacterization of IRA Contribution" is recommended. It collects the following information:

1. Type and amount of the contribution to the first IRA that is to be recharacterized.
2. The date on which the initial contribution was made.
3. A direction to the custodian/trustee of the first IRA to transfer the amount of the contribution, plus the allocable net income, in a trustee-to-trustee transfer to the custodian/trustee of the second IRA.
4. The name of the first and second custodian/trustee.
5. Acknowledgement by the accountholder, current and successor custodian that they understand the situation and the recharacterization will be handled and reported correctly.

An institution will also want the accountholder to understand the tax issues associated with a recharacterization, and how the individual must handle it on their tax return. CWF Form #56-TREX for 2006 provides this information.

The income earned on the amount recharacterized may also be transferred with no tax penalty. This is a valuable tax advantage. CWF has created a form to use to calculate the applicable interest on the contribution—Form #67-W.

Of course, the applicable plan agreement must also be completed, if the individual does not already have the correct type of IRA established.

Summary. Recharacterizations are becoming more popular. A financial institution will want to be certain to document these transactions correctly. The forms used must collect the needed information concerning the funds in question, the accountholder, the current IRA custodian/trustee and the successor custodian/trustee. CWF has these special forms available. ♦

Understanding the Recharacterizing of a 2006 Contribution in 2007

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 2006, 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 \$4,000/\$5,000 contribution to their Roth IRA or that they do not wish to make their contribution to the traditional IRA, as it is non-deductible. 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 made in 2006, for 2006, before he or she files a 2006 federal income tax return in 2007. Most such accountholders will normally complete the recharacterization on or before the tax-filing deadline for 2006. This is April 17, 2007. However, a person will have until October 17, 2007, to recharacterize a contribution. A person who timely files his or her 2006 income tax return without having made a recharacterization, 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 2006 income tax return. Recharacterizations are confusing to everyone involved. This is especially true for 2006 contributions which are recharacterized in 2007, because, as with excess contributions, these recharacterization transactions will be reported on the 2007 Form 1099-R and the 2007 Form 5498, which are not furnished until January of 2008 and May 2008. These forms obviously arrive well after the time the accountholder needs the information to file his or her 2006 federal income tax return. This is why the IRS requires an IRA custodian to furnish a written explanation to the accountholder. Also, be aware that the IRS has not yet issued the 2007 versions of Forms 1099-R and 5498. For this article, we have used the “2006” forms

and merely inserted the year “2007” over “2006” on these documents.

Three situations are illustrated: (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 \$4,000 contribution to a Roth IRA on 1-10-06, for 2006. The fair market value of this IRA as of 12-31-06 was \$3,100. Lisa is not married, and she is not an active participant in an employer-sponsored plan. Her MAGI for 2006 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 \$3,000 as of 3-3-07. One of the methods to correct an excess contribution is to recharacterize it. She chose to recharacterize this contribution, plus earnings, on 3-3-07. Assume the fair market value of this IRA as of 12-31-07 will be \$3,400.

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 Contribution” as set forth on page 7.

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 on page 7.

Step #3. You Will Prepare the Various Reporting Forms

1.1 You will prepare a 2006 Form 5498 to report the original contribution to the Roth IRA of \$3,000 as shown.

1.2 You will prepare a 2007 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 (\$3,180) and box 2a is to be completed with a 0.00.

Understanding the Recharacterizing of a Contribution, Continued from page 4

The reason code in box 7 is to be an "R" for recharacterization.

1.3 You will prepare a 2007 Form 5498 to report the recharacterized contribution (plus earnings) to the traditional IRA of \$3,180. It should be reported as shown below.

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0747		IRA Contribution Information	
1.1		1 IRA contributions (other than amounts in boxes 2-4 and 8-10)		2006	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		2 Rollover contributions		Form 5498	
TRUSTEE'S or ISSUER'S federal identification no.		3 Roth IRA conversion amount		4 Recharacterized contributions	
PARTICIPANT'S social security number		5 Fair market value of account		6 Life insurance cost included in box 1	
PARTICIPANT'S name		7 IRA SEP SIMPLE Roth IRA		Copy B For Participant	
Street address (including apt. no.)		8 SEP contributions		9 SIMPLE contributions	
City, state, and ZIP code		10 Roth IRA contributions		11 If checked, required minimum distribution for 2007	
Account number (see instructions)		11 If checked, required minimum distribution for 2007		This information is being furnished to the Internal Revenue Service.	
Form 5498		(keep for your records)		Department of the Treasury - Internal Revenue Service	

<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0119		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	
1.2		1 Gross distribution		2007	
PAYER'S name, street address, city, state, and ZIP code		2a Taxable amount		Form 1099-R	
PAYER'S federal identification number		2b Taxable amount not determined		3 Capital gain (included in box 2a)	
RECIPIENT'S identification number		4 Federal income tax withheld		5 Employee contributions or insurance premiums	
RECIPIENT'S name		6 Net unrealized appreciation in employer's securities		7 Distribution codes	
Street address (including apt. no.)		8 Other		9a Your percentage of total distribution	
City, state, and ZIP code		9b Total employee contributions		10 State tax withheld	
Account number (see instructions)		11 State/Payer's state no.		12 State distribution	
Form 1099-R		13 Local tax withheld		14 Name of locality	
		15 Local distribution		Department of the Treasury - Internal Revenue Service	

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0747		IRA Contribution Information	
1.3		1 IRA contributions (other than amounts in boxes 2-4 and 8-10)		2007	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		2 Rollover contributions		Form 5498	
TRUSTEE'S or ISSUER'S federal identification no.		3 Roth IRA conversion amount		4 Recharacterized contributions	
PARTICIPANT'S social security number		5 Fair market value of account		6 Life insurance cost included in box 1	
PARTICIPANT'S name		7 IRA SEP SIMPLE Roth IRA		Copy B For Participant	
Street address (including apt. no.)		8 SEP contributions		9 SIMPLE contributions	
City, state, and ZIP code		10 Roth IRA contributions		11 If checked, required minimum distribution for 2007	
Account number (see instructions)		11 If checked, required minimum distribution for 2007		This information is being furnished to the Internal Revenue Service.	
Form 5498		(keep for your records)		Department of the Treasury - Internal Revenue Service	

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 2-10-06, for 2006, rather than a Roth IRA. The fair market value of this traditional IRA was \$2,125 as of 12-31-06. 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 2-20-07. Sara has determined, on 2-20-07, she will recharacterize her traditional IRA contribution to be a Roth IRA contribution, because she is not able to claim a deduction for her \$2,000 contribution to the traditional IRA. Assume the fair market value of this IRA as of 12-31-07, 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 7, 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 shown in Step #2 of Situation #1.

Step #3. You Will Prepare the Various Reporting Forms

2.1 You will prepare a 2006 Form 5498 to report the original contribution to the traditional IRA of \$2,000. It should be reported as shown.

2.2 You will prepare a 2007 Form 1099-R to report the "deemed" distribution from the traditional IRA to the Roth IRA. It should be reported as follows. Box 1 is to be completed with the gross distribution amount (\$2,190) and box 2a is to be completed 0.00. The reason code in box 7 is to be an "R" for recharacterization.

2.3 You will prepare a 2007 Form 5498 to report the recharacterized contribution (plus earnings) to the Roth IRA of \$2,000. It should be reported as shown.

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0747		IRA Contribution Information	
2.1		1 IRA contributions (other than amounts in boxes 2-4 and 8-10)		2006	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		2 Rollover contributions		Form 5498	
TRUSTEE'S or ISSUER'S federal identification no.		3 Roth IRA conversion amount		4 Recharacterized contributions	
PARTICIPANT'S social security number		5 Fair market value of account		6 Life insurance cost included in box 1	
PARTICIPANT'S name		7 IRA SEP SIMPLE Roth IRA		Copy B For Participant	
Street address (including apt. no.)		8 SEP contributions		9 SIMPLE contributions	
City, state, and ZIP code		10 Roth IRA contributions		11 If checked, required minimum distribution for 2007	
Account number (see instructions)		11 If checked, required minimum distribution for 2007		This information is being furnished to the Internal Revenue Service.	
Form 5498		(keep for your records)		Department of the Treasury - Internal Revenue Service	

**Understanding the Recharacterizing of a Contribution,
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<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0019		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	
PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution \$ 2,190	2007	Form 1099-R	
PAYER'S Federal identification number		2a Taxable amount \$ 0.00	Total distribution <input type="checkbox"/>		
RECIPIENT'S identification number		3 Capital gain (included in box 2a)	4 Federal income tax withheld		
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) R	8 Other		
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions %		
Account number (see instructions)		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

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0747		IRA Contribution Information	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2-4 and 5-10)	2007	Form 5498	
TRUSTEE'S or ISSUER'S Federal identification no.		2 Rollover contributions	4 Rollover contributions		
PARTICIPANT'S social security number		3 Roth IRA conversion amount	5 Fair market value of account		
PARTICIPANT'S name		6 Life insurance cost included in box 1	7 IRA SEP SIMPLE Roth IRA		
Street address (including apt. no.)		8 SEP contributions	9 SIMPLE contributions		
City, state, and ZIP code		10 Roth IRA contributions	11 If checked, required minimum distribution for 2006		
Account number (see instructions)					

Form 5498 (keep for your records) Department of the Treasury - Internal Revenue Service

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 1-15-06. The fair market value of this Roth IRA was \$33,000 as of 12-31-06. She is not married. On 3-1-07, her accountant told her she was not eligible to make the Roth IRA conversion contribution for 2006, as her MAGI was \$103,000. The related income is \$3,900. The recharacterized amount is \$33,900. In order to eliminate this excess contribution, she elects to recharacterize this conversion contribution on 3-1-07. Assume the fair market value of the traditional IRA as of 12-31-07 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" set forth on page 7 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 shown in Step #2 of Situation #1.

Step #3. You Will Prepare the Various Reporting Forms

3.1 You will prepare a 2006 Form 5498 to report the original conversion contribution to the Roth IRA of \$30,000 as shown below:

3.2 You will prepare a 2007 Form 1099-R to report the "deemed" distribution from the Roth IRA to the traditional IRA. It should be reported as follows. 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.

3.3 Prepare a 2007 Form 5498 to report the recharacterized contribution (plus earnings) of \$33,900 to the traditional IRA. It should be reported as shown below.

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0747		IRA Contribution Information	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than amounts in boxes 2-4 and 5-10)	2006	Form 5498	
TRUSTEE'S or ISSUER'S Federal identification no.		2 Rollover contributions	4 Rollover contributions		
PARTICIPANT'S social security number		3 Roth IRA conversion amount	5 Fair market value of account		
PARTICIPANT'S name		6 Life insurance cost included in box 1	7 IRA SEP SIMPLE Roth IRA		
Street address (including apt. no.)		8 SEP contributions	9 SIMPLE contributions		
City, state, and ZIP code		10 Roth IRA contributions	11 If checked, required minimum distribution for 2007		
Account number (see instructions)					

Form 5498 (keep for your records) Department of the Treasury - Internal Revenue Service

<input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0019		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	
PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution \$ 33,900	2007	Form 1099-R	
PAYER'S Federal identification number		2a Taxable amount \$ 0.00	Total distribution <input type="checkbox"/>		
RECIPIENT'S identification number		3 Capital gain (included in box 2a)	4 Federal income tax withheld		
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) R	8 Other		
City, state, and ZIP code		9a Your percentage of total distribution %	9b Total employee contributions %		
Account number (see instructions)		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

Understanding the Recharacterizing of a Contribution, Continued from page 6

<input type="checkbox"/> CORRECTED (if checked)		OMB No. 1545-0747	
TRUSTEE'S or ISSUER'S name, street address, city, state, and ZIP code		1 IRA contributions (other than rollovers in boxes 2-4 and 8-10)	
3.3		2 Rollover contributions	
TRUSTEE'S or ISSUER'S federal identification no.		3 Rollover contributions	
PARTICIPANT'S social security number		4 Recharacterized contributions	
PARTICIPANT'S name		Form 5498	
Street address (including apt. no.)		5 Fair market value of account	
City, state, and ZIP code		6 Life insurance cost included in box 1	
Account number (see instructions)		7 IRA SEP SIMPLE ROTH IRA	
		8 SEP contributions	
		9 SIMPLE contributions	
		10 ROTH IRA contributions	
		11 If checked, required minimum distribution for 2006	
Form 5498		(keep for your records) Department of the Treasury - Internal Revenue Service	

Conclusion. You will certainly be receiving requests to recharacterize, in calendar year 2007, a contribution which was made in calendar year 2006. 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 explanation 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. ♦

Special Explanation to Accountholder for an IRA Recharacterization for the 2006 Tax Year

(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You recharacterized a contribution which you made for the 2006 tax year. You will need to properly report and explain your recharacterization when you file your 2006 federal income tax return. We have furnished to you a copy of the *IRA Recharacterization Form* which you executed. You will also want to review the 2006 instructions for Form 8606. The IRS' instructions require you, as the IRA accountholder, to attach an explanation to your income tax return indicating the original contribution amount, the amount which was

Special Explanation to Accountholder for an IRA Recharacterization for the 2007 Tax Year

(Name of Accountholder)

The purpose of this special explanation is to provide you with information about your recharacterization. You recharacterized a contribution which you made for the 2007 tax year. You will need to properly report and explain your recharacterization when you file your 2007 federal income tax return. We have furnished to you a copy of the *IRA Recharacterization Form* which you executed. You will also want to review the 2007 instructions for Form 8606. The IRS' instructions require you, as the IRA accountholder, to attach an explanation to your income tax return indicating the original contribution amount, the amount which was recharacterized, and the amount of earnings which was recharacterized. You may attach a copy of the *IRA Recharacterization Form* for this purpose.

In some situations you will need to do more than just attach an explanatory statement. If both the original contribution and the recharacterization occurred during 2007, then you must also include on the 2007 tax return the amount deemed distributed from the one IRA on Form 1040, line 15(a) (or similar form). This is the gross amount you recharacterized. You should also complete line 15(b), the taxable amount, with zero. If the recharacterization of the contribution for 2007 occurred in 2007 then you only need to attach the explanatory statement.

Accountholder _____ Date _____
Custodian _____ Date _____

Notice of Recharacterization of IRA Contribution

To: Current Custodian/Trustee

Date:

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

From: Depositor or Grantor

SSN

Name:
Address:
City/State/Zip:

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

The Recharacterized Contribution

Account Number:
Date of Contribution:
Amount:

Account Number:
Date of Contribution:
Amount:

Type of Original Contribution (Check only one)

Type of Recharacterized Contribution

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

- ☐ 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 designate all or my accounts and transfer the cash proceeds by sending a check to the successor custodian/trustee:

☐ I designate 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 any 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 for the current IRS instruction year. 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 recharacterized contribution on a Form 5498 (Box 4).

Signature of Current Custodian/Trustee:

Date:

Acceptance by Successor IRA Custodian/Trustee:

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

Successor Custodian/Trustee:

Phone:

Address:

City/State/Zip:

Signature of Successor Custodian/Trustee:

Date:

SALES/REG-1

White — Original (custodian/trustee) Yellow — Successor Custodian/Trustee Pink — Depositor/Grantor

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IRA-885-THX (2/07)

White — Custodian/Trustee Yellow — Accountholder

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Completion of Box 2b of Form 1099-R
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when to check and not check the "Taxable Amount not Determined" checkbox with respect to a distribution from a traditional IRA.

The general rule concerning IRA distributions from a traditional IRA is that box 1 (gross distribution) and box 2a (taxable amount) are to be completed with the same amount, and 2b, "Taxable Amount not Determined" is to be checked.

Filling in an amount on line 2a (taxable amount) and checking the box that the taxable amount has NOT been determined is confusing. These actions are inconsistent. However, the IRS has their "tax" reasons for adopting these procedures.

An IRA custodian has no duty to know and report whether an IRA accountholder has made nondeductible contributions or not, or whether the person has rolled over "basis" from a 401(k) plan. Consequently, when an IRA custodian pays IRA funds to an IRA accountholder or inheriting IRA beneficiary, it does not really know what amount is taxable and what amount is not taxable. However, IRS statistics show that the large majority of IRA accountholders have never made nondeductible contributions. The IRS doesn't want the Form 1099-R to give the wrong idea to the majority of IRA distribution recipients that the distribution is not taxable. Therefore, the IRS has the IRA custodian report the total distribution amount as taxable even though this may not be the case. The IRS also believes it is best if the IRA custodian checks box 2b (taxable amount not determined) to put the recipient on notice that the IRA custodian really does not know what amount is taxable and it will be up to the recipient to complete Form 8606 and explain why a portion of an IRA distribution is not taxable, if applicable.

The purpose of this article is to explain when the IRA custodian should NOT be checking box 2b to indicate that the taxable amount has not been determined. The two negatives mean that the IRA custodian has determined what amount is taxable and the recipient is to be informed specifically what amount is taxable. That is, the IRA custodian can determine what amount is taxable or can determine expressly that there is no taxable income because there has been a

recharacterization or a direct rollover. In these situations, the IRA custodian determines that the taxable amount is 0.00. The 0.00 needs to be inserted. Leaving the box blank does not mean 0.00.

There are three exceptions when box 1 and 2a are not to be completed with the same amount and when box 2 b is not to be checked.

- **Direct Rollover** — In the case of a direct rollover, the IRS instructions state that the gross distribution amount is to be entered in box 1, and box 2a is to be completed with "0." Do not check box 2b. The reason for this is that the IRA custodian knows that a direct rollover is not taxable.

- **Recharacterization** — For a recharacterization, complete box 1 with the gross amount of the distribution, and box 2a with "0." Again the IRA custodian knows that a recharacterization of IRA funds is not taxable. Box 2b is not checked.

- **Withdrawal of an Excess Contribution Before the Due Date** — If an excess IRA contribution is withdrawn before the due date of an individual's tax return, plus extensions (normally October 15 of the year following the year for which the excess contribution was made), and the individual did not take a tax deduction for the contribution, only the earnings on the excess contribution are taxable to the individual in the year for which the contribution was made. Therefore, the IRS instructions state that in this situation, box 1 is completed with the gross distribution amount, and box 2a is to be completed with the amount of the earnings associated with the excess contribution. Box 2b is not checked. ♦