

THE Pension Digest

ALSO IN THIS ISSUE –

Important Form 1099-R Rules for an IRA Custodian to Follow and Observations, *Page 4*

Guide to Distribution Codes, *Pages 5 and 6*

Emails With the IRS, *Page 7*

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



© 2010 Collin W. Fritz and Associates, Ltd. Copyright is not claimed in any material secured from official U.S. Government sources. Published by Collin W. Fritz and Associates, Ltd. Subscription: \$95 per year.

Recap for Completing the 2010 Form 1099-R

PAYER'S name, street address, city, state, and ZIP code		1 Gross distribution		OMB No. 1545-0019	
		\$		2010	
		2a Taxable amount		Form 1099-R	
		\$			
		2b Taxable amount not determined <input type="checkbox"/>		Total distribution <input type="checkbox"/>	
PAYER'S federal identification number	RECIPIENT'S identification number	3 Capital gain (included in box 2a)		4 Federal income tax withheld	
		\$		\$	
RECIPIENT'S name		5 Employee contributions / Designated Roth contributions or insurance premiums		6 Net unrealized appreciation in employer's securities	
		\$		\$	
Street address (including apt. no.)		7 Distribution code(s)	IRA/SEP/SIMPLE <input type="checkbox"/>	8 Other	%
City, state, and ZIP code		9a Your percentage of total distribution %		9b Total employee contributions \$	
1st year of design. Roth contrib.		10 State tax withheld \$		11 State/Payer's state no.	
		\$		\$	
Account number (see instructions)		13 Local tax withheld \$		14 Name of locality	
		\$		\$	
				15 Local distribution \$	

Form 1099-R Cat. No. 14439Q Department of the Treasury Internal Revenue Service

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

The approach for completing the 2010 Form 1099-R (and subsequent years) is, in general, the approach used for 2008 and earlier years. The IRS had a different approach for 2009. See the discussion set forth in the article on page 7, *Emails from the IRS*. The IRS has scrapped the 2009 approach.

On page 1 of the 2010 Instructions for Forms 1099-R and 5498 the IRS indicates what is new for 2010. With respect to Form 1099-R, the following statement is made, "Reporting IRA distributions." Unless otherwise direct through-out these instructions, report distributions from traditional, SEP and SIMPLE IRAs in boxes 1 (gross amount) and 2a (taxable amount). Check box 2b "taxable amount not determined."

There are exceptions when box 2a is not to be completed with the same amount as is reported in box 1 and the check box 2b "taxable amount not determined" should not be checked. Why? There are times when the IRA custodian is able to determine the taxable amount. The exceptions are – the reporting of the withdrawal of current year (excess) contributions, recharacterizations, direct rollovers, and IRA revocations or account closures.

In the case of the current year (excess) contribution, the earnings amount will be inserted in box 2b. In the case of a recharacterization and a direct rollover, a zero is to be inserted.

Box 1. Gross Distribution

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

Employer securities and other property. If you distribute employer securities or other property, include in box 1 the FMV of the securities or other property on the date of distribution.

Do not enter a negative amount in any box on Form 1099-R. If you are distributing worthless property only, you are not required to file Form 1099-R. However, you may file and enter 0 (zero) in boxes 1 and 2a.

Continued on page 2

Recap for Completing Form 1099-R
Continued from page 1

Box 2a. Taxable Amount

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, SEP or SIMPLE in box 2a. This will be the same amount reported in box 1. Check the "Taxable amount not determined" box in box 2b.

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

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 2b. Use Code 1 or 7 in box 7 depending on the age of the account holder.

For a distribution from an IRA that is payable to the trustee of, or is transferred to, an employer plan, or for an IRA recharacterization, enter 0 (zero) in box 2a.

Box 2b. Taxable Amount not Determined

Generally, check this box if you are reporting a traditional IRA, SEP IRA, or SIMPLE IRA distribution.

Box 2b. Total Distribution

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

Box 3. Capital Gain

Does not apply to any type of IRA.

Box 4. Federal Income Tax Withheld

Enter any **Federal income tax withheld**. This withholding under **section 3405** is subject to deposit rules, and the withholding tax return to be used is Form 945. Backup withholding does not apply. See **Pub. 15-A**, Employer's Supplemental Tax Guide, and the **Instructions for Form 945** for more withholding information.

Even though you may be using Code 1 in box 7 to designate an early distribution subject to the 10% additional tax specified in **sections 72(q), (t), or (v)**, you are not required to withhold that tax.

The 20% withholding rate does not apply to distributions from any IRA, but withholding does apply to IRAs under the rules for periodic payments and nonperiodic distributions. For withholding, assume that the entire amount of an IRA distribution is taxable (except for the distribution of contributions under **section 408(d)(4)**, in which only the earnings are taxable, and **408(d)(5)**).

An IRA recharacterization is not subject to income tax withholding since it is a non-taxable transaction.

Box 5. Employee Contributions or Insurance Premiums

Does not apply to IRAs.

Box 6. Net Unrealized Appreciation in Employer's Securities

Does not apply to IRAs.

Box 7. Distribution Code

Enter an "X" in the **IRA/SEP/SIMPLE checkbox** if the distribution is from a traditional IRA, SEP IRA, or SIMPLE IRA. Do **NOT** check the box for a distribution from a Roth IRA or for an IRA recharacterization.

You must enter the appropriate code(s) in box 7. Use the **Guide to Distribution Codes** on pages R-12 and R-13 (shown in this newsletter on pages 5 and 6) to determine the appropriate code(s) to enter in box 7 for any amounts reported on Form 1099-R. Read the codes carefully, and enter them accurately, because the IRS uses the codes to help determine whether the recipient has properly reported the distribution. If the codes you enter are incorrect, the IRS may improperly propose changes to the recipient's taxes.

When applicable, enter a numeric and an alpha code. For example, when using Code P for a traditional IRA distribution under **section 408(d)(4)**, you must also enter Code 1, if it applies. For a normal distribution from a qualified plan that qualifies for the 10-year tax option, enter Codes 7 and A. For a direct rollover to an IRA for the surviving spouse of a deceased participant, enter Codes 4 and G. Do not use Code 4 with Code H.

Enter a maximum of two alpha/numeric codes in box 7. See the Guide to Distribution Codes on pages 12 and 13 for allowable combinations.

Only three numeric combinations are permitted on one Form 1099-R: Codes 8 and 1, 8 and 2, or 8 and 4. If two or more other numeric codes are applicable, you must file more than one Form 1099-R. For example, if part of a distribution is premature (Code 1) and part is not (Code 7), file one Form 1099-R for the part to which Code 1 applies and another Form 1099-R for the part to which Code 7 applies. In addition, for the distribution of excess deferrals, excess contributions, or excess aggregate contributions, parts of the distribution may be taxable in 2 or 3 different years. File separate Forms 1099-R using Code 8, D, or P to indicate the year the amount is taxable.

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

If part of an eligible rollover distribution is paid in a direct rollover and part is not, you must file a separate Form 1099-R for

Continued on page 3

Recap for Completing Form 1099-R Continued from page 2

each part showing the appropriate code on each form. If part of a distribution is an eligible rollover distribution and part is not (e.g., a minimum distribution required by section 401(a)(9)) and the part that is an eligible rollover distribution is directly rolled over, you must file a separate Form 1099-R to report each part.

Box 8. Other

Does not apply to IRAs.

Box 9a. Your Percentage of Total Distribution

You need not complete this box for any IRA distributions or for a direct rollover.

Box 9b. Total Employee Contributions

Does not apply to IRAs.

Boxes 10–15. State and Local Information

These boxes and Copies 1 and 2 are provided for your convenience only and need not be completed for the IRS. Use the **state and local information** boxes to report distributions and taxes for up to two states or localities. Keep the information for each state or locality separated by the broken line. If state or local income tax has been withheld on this distribution, you may enter it in boxes 10 and 13, as appropriate. In box 11, enter the abbreviated name of the state and the payer's state identification number. The state number is the payer's identification number assigned by the individual state. In box 14, enter the name of the locality. In boxes 12 and 15 you may enter the amount of the state or local distribution. Copy 1 may be used to provide information to the state or local tax department. Copy 2 may be used as the recipient's copy in filing a state or local income tax return.

Roth IRAs

For a distribution from a Roth IRA, report the total distribution in box 1 and leave box 2a blank except in the case of an IRA revocation or account closure and a recharacterization. Use Code J, Q, or T as appropriate in box 7. Use Code 8 or P, if applicable, in box 7 with Code J. Do not combine Code Q or T with any other codes.

However, for the distribution of excess Roth IRA contributions, report the gross distribution in box 1 and only the earnings in box 2a. Enter Code J and Code 8 or P in box 7.

Roth IRA conversions

You must report a traditional, SEP, or SIMPLE IRA distribution that you know is converted or reconverted this year to a Roth IRA in boxes 1 and 2a (checking box 2b "taxable amount not determined" unless otherwise directed elsewhere in these instructions), even if the conversion is a trustee-to-trustee transfer or is with the same trustee. Enter Code 2 or 7 in box 7 depending on the participant's age. Even though 2010 conversions are generally taxable in 2011 and 2012, you must report the full amount converted on the 2010 Form 1099-R only. You do not have to issue Form 1099-R for any future year to report the 2010 conversion.

IRA Revocation or Account Closure

If a traditional or Roth IRA is revoked during its first 7 days (under Regulations section 1.408-6(d)(4)(ii)) or is closed at any time by the IRA trustee or custodian due to a failure of the taxpayer to satisfy the Customer Identification Program requirements described in section 326 of the USA PATRIOT Act, the distribution from the IRA must be reported. In addition, Form 5498, IRA Contribution Information, must be filed to report any regular, rollover, Roth IRA conversion, SEP IRA, or SIMPLE IRA contribution to an IRA that is subsequently revoked or closed by the trustee or custodian.

If a regular contribution is made to a traditional or Roth IRA that later is revoked or closed, and distribution is made to the taxpayer, enter the gross distribution in box 1. If no earnings are distributed, enter 0 (zero) in box 2a and Code 8 in box 7 for a traditional IRA and Code J for a Roth IRA. If earnings are distributed, enter the amount of earnings in box 2a. For a traditional IRA, enter Codes 1 and 8, if applicable, in box 7; for a Roth IRA, enter Codes J and 8, if applicable. These earnings could be subject to the 10% early distribution tax under section 72(t). If a rollover contribution is made to a traditional or Roth IRA that later is revoked or closed, and distribution is made to the taxpayer, enter in boxes 1 and 2a of Form 1099-R the gross distribution and the appropriate code in box 7 (Code J for a Roth IRA). Follow this same procedure for a transfer from a traditional or Roth IRA to another IRA of the same type that later is revoked or closed. The distribution could be subject to the 10% early distribution tax under section 72(t).

If an IRA conversion contribution or a rollover from a qualified plan is made to a Roth IRA that later is revoked or closed, and a distribution is made to the taxpayer, enter the gross distribution in box 1 of Form 1099-R. If no earnings are distributed, enter 0 (zero) in box 2a and Code J in box 7. If earnings are distributed, enter the amount of the earnings in box 2a and Code J in box 7. These earnings could be subject to the 10% early distribution tax under section 72(t).

If an employer SEP IRA or SIMPLE IRA plan contribution is made and the SEP IRA or SIMPLE IRA is revoked by the employee or is closed by the trustee or custodian, report the distribution as fully taxable.

For more information on IRAs that have been revoked, see Rev. Proc. 91-70, 1991-2 C.B. 899.

Important Form 1099-R Rules for an IRA Custodian to Follow and Observations

Set forth are the rules we think are most important for an IRA custodian to follow and some observations.

#1. An IRA includes all investments under one IRA plan agreement. File only one Form 1099-R no matter how many distributions have been made from the investments of the same IRA plan agreement during one year unless different reasons codes apply. Example, Jane Doe is paid a death distribution (reason code #4) from her former spouse's IRA (she did not treat this IRA as her own) and she is also paid a distribution from her only IRA. She is age 65 (reason code #7). One Form 1099-R must be filed for all distributions with a reason code 4 and a Form 1099-R must be filed for all distributions with a reason code 7.

#2. The Form 1099-R and the Form 5498 are per plan agreement forms. If a person, age 65, has two traditional IRA plan agreements and takes a distribution from each IRA, he or she must be furnished two 1099-R forms each having a reason code 7 in box 7. The IRA custodian could be fined \$100.00 if it only created one Form 1099-R.

The IRA custodian must file Form 1099-R using the same name and EIN/TIN used to deposit any tax withheld and to file Form 945, Annual Return of Withheld Federal income Tax).

#3. The IRS wants an IRA custodian to prepare a Form 1099-R for every distribution, even those less than \$10.00. The instructions are not very clear whether distributions (aggregated) less than \$10 for the year must be reported.

#4. If an IRA custodian is required to file a Form 1099-R, then it must furnish a statement (i.e. a copy of the 1099-R form) to the recipient.

#5. An account number must be used on a Form 1099-R when a recipient has more than one IRA plan agreement and you are required to file multiple Form 1099-R's. However, the IRS encourages an IRA custodian to designate an account number for all Form 1099-Rs which it files.

#6. Never enter a negative amount in any box on Form 1099-R.

#7. Use the name and TIN of the individual or entity which receives funds from the IRA.

Normally, this will be the IRA accountholder. However, if you make a distribution to a beneficiary (whether an

individual, trust or estate), then the 1099-R is prepared using the name and TIN of the beneficiary. You do not use the name of the decedent for payments made to beneficiaries after his or her death.

#8. An IRA custodian has a duty to correct a Form 1099-R that it knows was prepared incorrectly. The correction must be made as soon as possible.

#9. An IRA custodian will generally check box 2b, taxable amount not determined. There will be times when it is not checked - withdrawal of an excess or current year contribution before the due date, a recharacterization and rolling funds from an IRA into an accepting employer plan.

#10. The total distribution box is also found in 2b. An "X" is to be entered in this box when the amount shown in box 1 is a total distribution. The instructions for the total distribution section of box 2b are not as clear as they should be. It is doubtful if this box applies to IRA distributions; but the instructions are unclear, and an IRA custodian should complete the box pursuant to the instructions. In order for a person to use the favorable 10 year averaging or capital gain treatment he or she must receive a total distribution. Such treatment does not ever apply to any type of IRA distribution. If this box is not checked, the IRS will question any individual's attempt to use 10 year averaging.

A total distribution is one or more distributions within one tax year in which the entire balance is distributed. This means if two or more nonperiodic distributions occur in more than one year, then there is no total distribution and the box does not need to be checked. For example, a person with an IRA balance of \$30,000 withdraws \$10,000 in 2006 and the remainder in 2009 has not had a total distribution. Exception. If periodic or installment payments are made in more than one year, this box is to be marked for the year in which the final payment is made.

#11. Our guess is that the frequency of the reason code use for distributions from traditional IRAs is: 7 (normal/age 59½ or older); 1, early distribution, no known exception or exception to be claimed by account-holder; 4, death; 2, early distribution, exception applies; P, 8, 3, N, R, G and 5.

#12. If the distribution is coming from a traditional IRA, SEP IRA or SIMPLE IRA, the box in box 7 must be checked. This box is not to be checked if the distribution is from a Roth IRA.

Guide to Distribution Codes		
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 you do not know if any of the exceptions under Distribution Code 2, 3, or 4 apply. Use Code 1 even if the distribution is made for medical expenses, health insurance premiums, qualified higher education expenses, a first-time home purchase, or a qualified reservist distribution under section 72(t)(2)(B), (D), (E), (F), or (G). Code 1 must also be used even if a taxpayer is 59½ or older and he or she modifies a series of substantially equal periodic payments under section 72(q), (t), or (v) prior to the end of the 5-year period.	8, B, D, L, or P
2—Early distribution, exception applies.	Use Code 2 only if the employee/taxpayer has not reached age 59½ and you know the distribution is: <ul style="list-style-type: none"> • A Roth IRA conversion (an IRA converted to a Roth IRA). • A distribution made from a qualified retirement plan or IRA because of an IRS levy under section 6331. • A section 457(b) plan distribution that is not subject to the additional 10% tax. But see <i>Section 457(b) plan distributions</i> on page 11 for information on distributions that may be subject to the 10% additional tax. • A distribution from a qualified retirement plan after separation from service in or after the year the taxpayer has reached age 55. • A distribution from a governmental defined benefit plan to a public safety employee after separation from service in or after the year the employee has reached age 50. • A distribution that is part of a series of substantially equal periodic payments as described in section 72(q), (t), (u), or (v). • A distribution that is a permissible withdrawal under an eligible automatic contribution arrangement. • Any other distribution subject to an exception under section 72(q), (t), (u), or (v) that is not required to be reported using Code 1, 3, or 4. 	8, B, 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, B, D, G, H, L, or P
5—Prohibited transaction.	Use Code 5 if there was a prohibited transaction involving the account. Code 5 means the account is no longer an IRA.	None
6—Section 1035 exchange.	Use Code 6 to indicate the tax-free exchange of life insurance, annuity, long-term care insurance, or endowment contracts under section 1035.	W
7—Normal distribution.	Use Code 7: (a) for a normal distribution from a plan, including a traditional IRA, section 401(k), or section 403(b) plan, if the employee/taxpayer is at least age 59½, (b) for a Roth IRA conversion 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. Proc. 2008-42, available at www.irs.gov/irb/2008-29_IRB/ar19.html . Use Code 7 with Code A, if applicable. Generally, use Code 7 if no other code applies. Do not use Code 7 for a Roth IRA. Note: Code 1 must be used even if a taxpayer is 59½ or older and he or she modifies a series of substantially equal periodic payments under section 72(q), (t), or (v) prior to the end of the 5-year period.	A
8—Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2010.	Use Code 8 for an IRA distribution under section 408(d)(4), 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 <i>Corrective Distributions</i> on page 5 and <i>IRA Revocation or Account Closure</i> on page 3 for more information.	1, 2, 4, B, or J
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 8 for more information.	None
A—May be eligible for 10-year tax option.	Use Code A only for participants born before January 2, 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, <i>Tax on Lump-Sum Distributions</i>). 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
B—Designated Roth account distribution.	Use Code B for a distribution from a designated Roth account that is not a qualified distribution. But use Code E for a section 415 distribution under EPCRS.	1, 2, 4, 8, D, G, L, P, or U

Guide to Distribution Codes		
Distribution Codes	Explanations	*Used with code ...(if applicable)
D—Excess contributions plus earnings/excess deferrals taxable in 2008.	See the explanation for Code 8. Generally, do not use Code D for an IRA distribution under section 408(d)(4) or 408(d)(5).	1, 2, 4, or B
E—Distributions under Employee Plans Compliance Resolution System (EPCRS).	See <i>Distributions under Employee Plans Compliance Resolutions System (EPCRS)</i> on page 6.	None
F—Charitable gift annuity.	See <i>Charitable gift annuities</i> on page 9.	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 section 403(b) plan to an eligible retirement plan (another qualified plan, a section 403(b) plan, or an IRA). See <i>Direct Rollovers</i> on page 3. Also use Code G for IRA rollover contributions to an accepting employer plan. Note: Do not use Code G for a direct rollover from a designated Roth account to a Roth IRA. Use Code H.	4 or B
H—Direct rollover of a designated Roth account distribution to a Roth IRA.	Use Code H for a direct rollover of a distribution from a designated Roth account to a Roth IRA.	4
J—Early distribution from a Roth IRA.	Use Code J for a distribution from a Roth IRA when Code Q or Code T does not apply. But use Code 2 for an IRS levy and Code 5 for a prohibited transaction.	8 or P
L—Loans treated as deemed distributions under section 72(p).	Do not use Code L to report a loan offset. See <i>Loans Treated as Distributions</i> on page 6.	1, 4, or B
N—Recharacterized IRA contribution made for 2010.	Use Code N for a recharacterization of an IRA contribution made for 2010 and recharacterized in 2010 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 2009.	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, B, or J
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, • The participant died, or • The participant is disabled. Note: If any other code, such as 8 or P, applies, use Code J.	None
R—Recharacterized IRA contribution made for 2009.	Use Code R for a recharacterization of an IRA contribution made for 2009 and recharacterized in 2010 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 holding period has been met but: • The participant has reached age 59½, • The participant died, or • The participant is disabled. Note: If any other code, such as 8 or P, applies, use Code J.	None
U—Dividends distributed from an ESOP under section 404(k).	Use Code U for a distribution of dividends from an employee stock ownership plan (ESOP) under section 404(k). These are not eligible rollover distributions. Note: Do not report dividends paid by the corporation directly to plan participants or their beneficiaries. Continue to report those dividends on Form 1099-DIV.	B
W—Charges or payments for purchasing qualified long-term care insurance contracts under combined arrangements.	Use Code W for charges or payments, for purchasing qualified long-term care insurance contracts under combined arrangements, which are excludable under section 72(e)(11) against the cash value of an annuity contract or the cash surrender value of a life insurance contract.	6
*See the first Caution for box 7 instructions on page 11.		

Emails With the IRS

Over the last 12 months we have corresponded via email with the IRS. In some cases we have sought guidance from the IRS. In other cases, we have suggested various form changes or publication changes. Set forth is our correspondence and the IRS' response.

1. Changes to the 2009 Form 1099-R.

December 2009/January 2010 Submissions.

In February of 2009 the IRS had announced it made major changes in the instructions as to how the IRA custodian was to prepare the 2009 Form 1099-R. The IRS adopted an approach where box 2a, taxable amount, was generally to be left blank. Many IRA custodians and software providers went to a lot of work so that box 2a would be left blank on the 2009 Form 1099-R. Some IRA custodians, however, did not do so. They inquired whether or not they would be fined for preparing incorrect 2009 Form 1099-Rs if they continued to complete box 2a.

We conducted research. We observed that the IRS had an editing error in the 2009 1099-R form and the instructions which they had listed on their web site as late as November or December of 2009. In error, these forms and instructions continued the reporting procedure which had applied for 2008. The IRS removed these forms and replaced them with the forms which required the new reporting procedure for 2009 Form 1099-Rs.

We wrote the IRS and suggested we believed there should be special relief for those IRA custodians who had continued to use the 2008 reporting procedures. As stated below, the IRS chose to grant such special relief and the IRS decided to scrap the use of the 2009 reporting method and go back to the 2008 reporting method for the 2010 Form 1099-R and subsequent years.

IRS Response

Thank you for your inquiry to "TAXFORMS" regarding relief with respect to the completion of the 2009 Form 1099-R. We have received many inquiries similar to yours after we made the changes you referenced to the 2009 instructions for Forms 1099-R and 5498.

We are in the process of issuing the relief you requested via information to be listed in Important Changes: Changes to Current Tax Products found under Forms and Publications on IRS.gov. For the 2009 tax year, we are allowing processors and issuers of Forms 1099-R to report distributions from IRAs, SEP IRAs, SIMPLE IRAs and Roth conversion following either the procedures found in the 2008 instructions for Forms 1099-R and 5498, whereby the amount of the distribution was reported in boxes 1 and 2a and "Taxable amount not determined" was box 2b, or found in the 2009 reporting instructions, reporting the distribution in box 1 only and checking "Taxable amount not determined" in box 2b, as appropriate.

We apologize for any inconvenience this may cause.

Please note, as a result of your and other inquiries, the 2010 instructions for Forms 1099-R and 5498 contain a revised reporting instruction that are a return to past years for IRA distributions.

If you have any further questions or concerns, please do not hesitate to contact us.

2. IRS Confirms (sort of) That Financial Projection Schedules are Still Required to be Furnished by an IRA Custodian When an IRA is Opened. May 2010 Submission.

It would be nice if the IRS made clear whether the IRA custodian/issuer is required to furnish a financial disclosure. Page 9 and 10 of the 2009 Pub. 590 sets forth a summary of the disclosure statement rules. There is no mention of a financial disclosure which is one of the requirements set forth in regulation 1.408-6. One could read Pub. 590 as implying that an IRA custodian/issuer is no longer required to furnish a financial disclosure. Has the IRS decided that an IRA custodian is no longer required to furnish a financial disclosure?

IRS Response

Thank you for your comment on Publication 590, Individual Retirement Arrangements (IRAs). We will consider adding that a financial disclosure is required. However, Publication 590 is primarily intended for taxpayers rather than IRA custodians or administrators, so it is not meant to contain an exhaustive list of the required disclosures.

3. IRS to Add IRA Rollover Example. August 2010 Submission

In Pub. 575 on page 27 there is an express (and good) example of how the 60 day rule for a rollover works. It reads, "In the previous example, you received the distribution on June 30, 2010. To postpone including it in your income, you must complete the rollover by August 29, 2010, the 60th day following June 30. Pub. 590 discussed the rollover rules on page 23. The 60 day rule could be explained a little better than it is. Including the above example from Pub. 575 would be a good change. Thanks for considering this change.

IRS Response

We received your suggestion concerning the 60-day rollover period as described on page 23 of Publication 590. As we revise the publication for 2010 we will consider ways to clarify the information and include an example similar to the one you cite in Publication 575.

Thank You for your suggestion and for taking the time to comment on our tax products.

**Emails from the IRS,
Continued from page 7**

4. IRS to Change Instructions for Completing Box 7 of Form 1099-R for Certain Roth IRA Distributions. August 2010 Submission

I believe the IRS should change the first paragraph for box 7 of the Form 1099-R as discussed on page 10 and 11 of the 2010 instructions for Form 1099-R. Presently, the form is written to say, "It is not necessary to check the box for a distribution from a Roth IRA or of an IRA recharacterization." It should read to the effect, "you must not check this box for a distribution from a Roth IRA or for an IRA recharacterization." We are aware of IRA Custodians who checked this box even though the distribution was from a Roth IRA. The IRS is now sending out tax assessment letters because the IRS has assumed the amount is taxable. And this is true even if the reason code in box 7 was a Q. When there is a conflict, the assumption appears to be, it is taxable until proven otherwise.

IRS Response

Thank you for your email of August 13, 2010, "TAXFORMS" regarding the first paragraph of the instructions for box 7 on Form 1099-R. After discussion, we have decided to change the second sentence of the paragraph to instruct Roth IRA custodians to leave the IRA/SEP/SIMPLE checkbox blank. This should alleviate the problem of erroneous tax assessment letters being sent to persons who take distributions from their Roth IRAs.

Thank you for taking the time to write.

5. IRS to Revise Discussion of When to Use Code Q or T for Roth IRA Distributions. The Five-Year Topic. August 2010 Submission

We believe the IRS instructions could be clearer with respect to the duty of the IRA custodian to determine whether or not the Roth IRA accountholder has met the five-year. We read the IRS instructions to mean that the IRA custodian is only required to consider whether the five-year rule has been met by the time it has held the deposit and that the Roth IRA custodian is NOT permitted to look at the time the individual had a Roth IRA with a different Roth IRA custodian even if it is provided substantiating documentation by the other institution. Keep in mind, that when a "Q" is inserted in box 7 of the Form 1099-R that the recipient is not required to even report the Roth IRA distribution since the "Q" informs the IRS and the individual that the distribution is tax-free.

IRS Response

Thank you for your email of August 13, 2010, inquiring about the code to use with respect to a Roth IRA distribution when the trustee has not had the Roth IRA account for five years but the account holder is age 59 and 1/2 or older.

The custodian should use Code T (Roth distribution, exception applies) when making a distribution from a Roth IRA and it is

unknown if the 5-year holding period has been met but the participant has reached age 59 and 1/2, or deceased, or is disabled.

Thank you for taking the time to write.

6. IRS is not Ready to Provide Guidance on the Ability to Rollover After-Tax Dollars from a 401(k) Plan to a Roth IRA Without Applying the Pro-rata Taxation Rule. November 2010 Submission

We printed our correspondence in our November newsletter. See page 7 of that newsletter.

IRS Response

An IRS official called and informed me it could be another 6-8 months before the IRS is ready to issue written guidance.

We construe this response to mean that the IRS will continue to apply its current approach that the pro-rata rule must be used. Right now, the IRS does not agree that there is a method which allows a person with after-tax dollars in a 401(k) plan to move just those after-tax dollars into a Roth IRA.

I had the perception though that the IRS might conclude that the approach discussed in the November newsletter does accomplish the goal of "converting" only the after-tax dollars into a Roth IRA.

If you as a Roth IRA custodian have clients who believe they can convert only after-tax dollars into a Roth IRA, you may wish to have such clients acknowledge in writing that the IRS has not yet agreed with the approach and that there is a tax risk associated with adopting this approach before the IRS officially confirms this approach.