The Pension Digest

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ALSO IN THIS ISSUE –

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IRS Gives Guidance on Qualified Charitable IRA Distributions for 2012 and 2013

During the first week of January we sent subscribers an email explaining that the American Taxpayer Relief Act of 2012 (ATRA) as signed into law by President Obama on January 2, 2013, extended the QCD (qualified charitable distributions) provisions for 2012 and 2013. These provisions will not apply for 2014 and subsequent years unless there would be another tax extension.

The IRS has recently issued guidance to IRA accountholders and also IRA custodians regarding QCDs for 2012 and 2013. A qualified charitable distribution (QCD) is an otherwise taxable distribution from a traditional IRA, Roth IRA, or a SEP IRA or SIMPLE-IRA to which a current year contribution has not been made, to an IRA accountholder or an inheriting IRA beneficiary who is age 70½ or older that is paid directly to a qualified charity. A QCD for a year can be used to satisfy the RMD for such year. A qualifying individual who makes a QCD may exclude from his or her gross income up to $100,000 for a year.

ATRA included two special transition rules to handle the situation that until ARTA was adopted retroactively an IRA accountholder was unable to make a QCD for 2012. Consequently, ATRA was written to include two special transition rules which allow an IRA accountholder

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ATRA Makes Permanent the Coverdell ESA Law Changes Made in 2001

Unlike with the QCD which has had another 2 year short term extension, the Coverdell ESA changes of 2001 have been adopted on a permanent basis. The main changes are: the maximum contribution limits remains at $2,000 and is not reduced to $500, qualifying education expenses are all school related education expenses and not just post-secondary expenses and the special rules applying to an individual who has special needs.

The IRS should be revising its model Coverdell ESA forms (Form 5305-E and 5305-EA) to incorporate the special laws applying to individuals with special needs and the law authorizing military death gratuities be rolled over into a Coverdell ESA. Certain family members of soldiers who receive military death death benefits may make a rollover contribution, subject to certain limits, up to 100% of such benefits into a Coverdell ESA.

CESAs For Special Needs Individuals

2013 Tax/Financial Planning Rule. There should be a Coverdell ESA established for every special needs individual. How many CESAs does your institution service for special needs individuals?

ARTA was enacted into law on January 2, 2013. The CESA law changes in effect from 2002-2011 were made permanent. The special rules for individuals with special needs are now permanent. A $2,000

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or an inheriting beneficiary to make a QCD for 2012 in January of 2013.

Transition rule #1. An IRA accountholder who had taken a distribution which did not qualify as a QCD in December of 2012 could in January give cash to the charity of all or a portion of such IRA distribution and have it now qualify to be a QCD for 2012 provided that such contribution would have been a 2012 QCD if it had been paid directly to the charity from the IRA. Note that distributions made directly to the IRA accountholder from January 1, 2012 to November 30, 2012 will not qualify as a QCD for 2012. As discussed in prior newsletters, if the distribution had been made directly to the charity under the QCD rules, the distribution will qualify as a QCD if all of the other requirements had also been met.

Transition rule #2. By January 31, 2013, the IRA custodian pursuant to the instruction from the IRA accountholder that he or she still wants to make a QCD for 2012 pays the charity directly a 2013 distribution. It will qualify to be a QCD for 2012 provided that such contribution would have been a 2012 QCD if it had been paid in 2012.

A QCD made in January of 2013 that is treated as a 2012 QCD will satisfy an individual's RMD for 2012, This is true even if the individual would have otherwise owed the 50% tax for failing to take his or her RMD by December 31, 2012. The IRS has stated that a QCD made in January of 2013 must be for 2012 and cannot be designated 2013. This is true even if the individual had already satisfied his RMD for 2012.

2012 and 2013 Reporting Duties of the Individual

The individual is to report the total 2012 QCDs made in January 2013 on their 2012 Form 1040 by including the full amount of the 2012 QCDs (even if in excess of $100,000) on line 15a and not including any amount on line 15b (i.e. leave it blank), but "QCD" must be written next to line 15b. For years 2006-2011, line 15b had been completed with 0 if the QCD was the same as the total distributions.

The individual will also report on the 2013 Form 1040 the amount of 2012 QCDs made in January 2013. The specifics as to how such reporting is to be made on the 2013 Form 1040 as will be discussed in the instructions for the 2013 Form 1040.

An IRA accountholder or an inherited IRA beneficiary who makes a QCD for 2012 in January of 2013 must keep the appropriate tax records to substantiate the timing of the distribution from the IRA and the contribution to the charity.

If a 2012 Form 8606 must be filed, the instructions to the form will describe how to report any 2012 QCD made in January of 2013. An IRA accountholder must file a 2012 Form 8606, nondeductible IRAs, with his or her 2012 Form 1040 if: the 2012 QCD was from a traditional IRA and there was basis and there had been a distribution in 2012 other than the 2012 QCD or the 2012 QCD was from a Roth IRA.

2012 and 2013 Reporting Duties of the IRA Custodian and RMD Calculation for 2013.

ATRA states that the QCD made in January of 2013 for 2012 is treated as if if had been made on December 31. <u>Because of this, the IRS has stated that in determining the RMD for 2013, the 2012 QCD made in 2013 must be subtracted from the fair market value as of December 31, 2012.</u> Where appropriate an IRA custodian will need to send a revised RMD notice.

The IRA custodian will report any distribution occurring in 2012 on the 2012 Form 1099-R. As for years 2006-2011, these distributions are reported as taxable even if they were QCDs.

Distributions made in 2013, including any 2012 QCDs made in January of 2013 are reported on the 2013 Form 1099-R in the same manner. Boxes 1 and 2a will be completed with the same amount and the individual must complete line 15b to show as non-taxable.

2013 QCD Rules and Procedures

The standard rules and procedures will apply in 2013 for 2013 QCDs made after January 31. The check from the IRA custodian or trustee will need to be issued to the charity and the check must have a date of December 31, 2013, or earlier.

Any bets if it will be extended for 2014 and 2015? ◆

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IRA Amendments Being Required

The IRS last revised the model IRA Forms 5305, 5305-A, 5305-R and 5305-RA in March of 2002. Since then there have been numerous tax laws enacted with IRA changes. The IRS has given no written explanation as to why the IRA forms have not been amended. We have asked a number of times when the IRS would be revising their IRA forms, but to no avail. It is not a good thing that the IRS has not updated their forms.

When is it necessary for an IRA custodian/trustee to furnish an IRA amendment? Is it necessary or required to furnish one in 2013?

Each institution must make its own determination because one needs to understand when was the IRA agreement last amended and how is it being amended. A primary question is, "when is the last time the financial institution furnished an amendment?" What do the current IRA plan agreements provide? Are there some IRAs set up with one certain plan agreement and others with a different plan agreement?

One may learn a tax lesson the hard way, if he or she adopts the position that an amendment is not required because the IRS has not said one is required. One must remember that the IRS has already stated in its governing IRA regulation (1.408- 6 (d) (4) (ii) (C)) when an IRA amendment is required. The regulation must be followed until the IRS revises it.

There are two types of amendments – one which amends the IRA plan agreement and one which amends the IRA disclosure statement. Regulation 1.408-6(4)(ii)(C) requires that an IRA amendment be furnished no later than the 30th day after the amendment is adopted or becomes effective.

The general rule in the governing IRA regulation is - a law change is enacted which impacts a provision found in the IRA plan agreement; the provision will be amended to implement the law change and the amendment will need to be communicated to the IRA accountholder or inheriting beneficiary.

When the IRS revises its model IRA forms, the amendment is considered to be mandatory or required. When a non-IRS change is made in the plan agreement by the financial institution (or the IRA vendor), the change may either be mandatory or not.

Mandatory changes deal with the tax code changes. For example, CWF has amended the Roth IRA plan agreement so that any person with funds in a traditional IRA is eligible to convert some or all of these funds to a traditional IRA even though he or she may have MAGI of more than $100,000.

The IRS has not yet amended its model Roth IRAs (Forms 5305-R and 5305-RA) to remove the $100,000 restriction. And the IRS has not given any guidance as to whether or not a conversion done in 2010 or later qualifies or doesn't qualify since Form 5305-R and 5305-RA state that the custodian/ trustee may not accept a conversion contribution if the person has a MAGI greater than the $100,000.

The standard IRS rule for IRAs/pensions has always been - the plan document must authorize the action. For this reason, even though the IRS has not amended the Roth forms, CWF has. And CWF has added provisions authorizing new rollovers from 401(k) plans and other employer plans. And CWF has made other changes or amendments to adopt law changes. Other vendors have taken the approach, we don't need to amend our form because the IRS has not done so. Similar changes have been made by CWF in the traditional plan agreement forms.

Non-mandatory amendments would be made by a financial institutions for its own administrative reasons. If an institution would want such a change or changes to apply to all existing IRA accountholders or some of them, the amendment would be furnished to those accountholders which the financial institution wanted the new provision to apply. An example, in 2011/2012 CWF added special provisions covering the topics of when a power of attorney is designated by the IRA accountholder, when a non-IRS creditor may impose a claim against an IRA, or when a trust beneficiary or an estate beneficiary will have special pass-through requests.

A long time ago (1986/1987) the IRS acknowledged that there are times that even though the IRA plan agreement has not been changed, a disclosure statement amendment must still be furnished. Example, when the deductible/nondeductible rules were first authorized in 1986/1987, such rules did not require the IRA form to be rewritten because the IRA form discuss-

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es the maximum contribution amount limit, but does not discuss the deductible/nondeductible rules. The IRS stated there needed to be a disclosure statement amendment discussing or explaining the deductible/nondeductible rules.

In summary, answering a question whether or or not an amendment is required is not all that simple. Sometimes the caller will furnish some additional information, but many times not. Each financial institution will need to make its own decision if there is a requirement to furnish one or both amendments or if it will furnish the amendments so there is no question.

It is true that the IRS has not been very active in auditing whether or not IRA custodian/trustees are furnishing IRA amendments as required by the IRA regulation. We at CWF believe it is in the best interest of a financial institution to furnish the amendments. The governing IRA regulation provides that a $50 fine may be assessed an institution for each time it fails to furnish the IRA plan agreement and $50 each time it fails to furnish the IRA disclosure amendment. ◆

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annual contribution may be made for an individual with special needs regardless of his or her age. That is, even if he person with special needs is age 39, an annual $2,000 contribution may be made to his or her CESA. As long as the earnings of the CESA are used for the special needs individual's educational needs, such income will not be taxable.

One would expect that many parents, grandparents, sisters, and brothers will choose to establish a Coverdell ESA for an individual with special needs. This assumes they understand the availability of the Coverdell ESA. For whatever reason, the IRS has not yet revised its model CESA forms to authorize and emphasize the special rules for individuals with special needs. Even though the IRS is busy implementing other taxes, the IRS hopefully will make this revision. We at CWF will be revising Coverdell ESA forms to discuss the special rules applying to individuals with special needs.

In many cases the fact that the only tax benefit is relatively nominal (no taxation of the earnings); in some cases, this no taxation of earnings will be a substantial tax benefit. Considering how easy it is to establish a Coverdell ESA, more people should be doing so. ◆

Divorce and IRAs – Don't Let an Attorney or Accountant Confuse or Complicate

The law is simple - funds transferred from one spouse's IRA to the ex-spouse's IRA is a nontaxable event if done pursuant to the divorce decree judgment or a property settlement.

An attorney or an accountant may try to make the situation more complicated by modifying the approach. Illustration.

An attorney sends the following letter to the IRA custodian. Note that the attorney's client involved in the divorce proceeding is the wife, Jane Doe. $8,000 is to be transferred from her IRA to her ex-spouse's IRA.

January 21, 2013

ABC Bank
123 Main Street
Liberty, MI

RE: Jane Doe's IRA, Customer Number 12345

Dear Sir/Madam:

Enclosed please find a General Judgment of Dissolution of Marriage regarding Jane Doe.

Pursuant to paragraph 4 of the judgment, please do a distribution directly to John Doe from Jane Doe's IRA, so it will not be taxed against Jane Doe. Paragraph #4 is attached and reads as follows, "Award of Wife's ABC Bank IRA. Husband is awarded an interest in Wife's IRA ABC Bank IRA equal to the sum of $8,000. Wife is awarded the entire remaining interest in her ABC Bank IRA. Wife shall assign to Husband the sum of $8,000 from this account to equalize the division of the retirement accounts. The appropriate language and document for a tax free transfer shall be prepared by the two IRA custodian's."

If you need a form signed by Ms. Jane Doe, you may forward it to my office or directly to her.

Sincerely,
Mark Attorney
Attorney

Apparently the attorney does not understand the importance that the $8,000 be transferred from her IRA and it must go into his IRA. Otherwise, the transaction will be a taxable transaction rather than a non-taxable transaction. He requests that the IRA custodian issue the check to the ex- spouse and not to the IRA custodian of such spouse's IRA.

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In prior guidance, the IRS has made clear that if the IRA custodian issues the check to the ex-spouse husband, then his client as the IRA accountholder will need to include the distribution amount in her income.

How should the IRA custodian respond to the attorney? A letter should be sent to the attorney as follows.

January 31, 2013

Mr. Mark Attorney
Attorney at Law
555 Main Street
Liberty, MI. Te1efax:l-xxx-yyy-zzzz

Subject: Your Letter of January 24, 2013

Dear Mr. Attorney:

A copy of your letter of January 24, 2013, is enclosed.

We are unwilling to follow your request to do a distribution directly to John Doe. Paragraph 4 of the judgment requires that $8,000 be transferred from Jane Doe's IRA to an IRA for John Doe. The judgment does not instruct that a distribution be made to John Doe. The judgment has been written as it was because there is a tax provision providing that funds transferred from one spouse's IRA to the ex-spouse's IRA is a nontaxable event. There is no tax provision authorizing an ex-spouse to rollover a distribution which is paid out of the other ex-spouse's IRA to his own IRA.

By an act of law (divorce judgement and federal tax law), he is considered to have an IRA to the extent of $8,000. However, he has not complied with any of the banking rules needed to establish a new deposit account. He must do so or she must instruct to have the IRA funds transferred to another financial institution with which he has established a traditional IRA.

In addition, if we issued a check to Mr. John Doe from Jane Doe's IRA, we, as the IRA custodian, are required to issue a 2013 Form 1099-R to Jane Doe since she is the person from whose IRA the funds are withdrawn. She would need to include this amount in her income and if she is under age 59½ she would also owe the 10% additional tax. Just because the check is made payable to John does not mean he is the one who must pay tax on the amount withdrawn. This situation is an exception to the general rule that a recipient must pay tax on the withdrawal.

We have sent you a partially completed IRA transfer form. Mr. John Doe and his IRA custodian will need to complete the remainder of the transfer form and sign the form and return it to us. We will then transfer the $8,000 from Jane Doe's IRA to John Doe's IRA. We would also like Ms. Doe to sign an IRA distribution form showing she consents to the transfer of the $8,000 from her IRA. ◆

How to administer an Inherited IRA When the Beneficiary is a Trust?

When a trust is the inheriting beneficiary, an IRA custodian will use the following titling for Form 5498 purposes - The Jane Doe trust as beneficiary of Jane Doe's IRA." Distribution checks will be furnished to the trustee of the trust. Each year the trustee will need to be paid the RMD amount for such greater amount. If not, the 50% tax will be owed. The Form 1099-R will list the trust (and its EIN) as the recipient.

The general RMD rule is that the life distribution rule can be used only if the beneficiary is a living person. This means that if the IRA accountholder died before his or her required beginning date (April 1 after the 70½ year) and he or she had designated a non-person beneficiary, then the 5-year rule will apply for satisfying the RMD rules. And if the IRA owner died after his or her required beginning date, then the life distribution rule as based on the age of the decedent in the year of death must be used to calculate the RMD for all years after the year of death.

A qualifying trust is an exception to the general rule. Rather than using the RMD rules discussed, the payout period for RMD purposes will be based on the age of the oldest beneficiary of the "qualifying" trust. For example, the Jane Doe trust has three beneficiaries: Mark (age 46), Helen (age 43) and Mary (age 41) in 2013 with the Jane Doe dying in 2012. The 2013 RMD calculation will use the age of Mark. The divisor will be 37.9 for 2013, it will be 36.9 for 2014, 35.9 for 2015, etc. The trustee should complete CWF forms #57 and #204 as any other beneficiary would. And possibly a new inherited IRA plan agreement.

The IRA custodian or trustee has the duty to determine that the trust meets the requirements set forth below and that the oldest trust beneficiary trust may be used to determine the distribution period for RMD calculation purposes. The IRA custodian or trustee may ask the attorney of the trust to furnish a legal opinion stating that the trust is a qualified trust for RMD purposes.

A qualifying trust is one which meets the following requirements:

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1. The trust is a valid trust under state law, or would be but for the fact that there is no corpus.
2. The trust is irrevocable or will, by its terms, become irrevocable upon the death of the IRA accountholder. Since the accountholder is deceased, the trust must be irrevocable for this exception to apply to the beneficiary.
3. The beneficiaries of the trust who are beneficiaries with respect to the IRA are identifiable from the trust instrument.
4. The required documentation has been provided to the IRA custodian or trustee. The documentation to be provided depends upon whether the required distributions are occurring before the IRA accountholder has died or after the accountholder has died.

There are also two ways to meet the documentation requirements when an RMD must be paid to a trust beneficiary after the accountholder has died. This requirement must be met by October 31 of the year after the year the accountholder has died.

1. The trustee of the trust provides the IRA custodian/trustee with a copy of the trust instrument for the trust that is the designated IRA beneficiary as of the IRA accountholder's date of birth.
2. The trustee of the trust provides the IRA custodian/trustee with the following:
   a. A final list of all the beneficiaries of the trust as of September 30 of the year following the year of the accountholder's death. This list must include all contingent and remainder main beneficiaries with a description of the conditions of their entitlement.
   b. A certification that the list is correct and complete and that the first three trust requirements discussed above have been met:
   c. An acknowledgment that he or she will provide a copy of the trust instrument when requested by the IRA custodian/trustee ◆

Email Guidance

The following 10 email questions and the answers represent every day IRA, pension and HSA situations. We hope our answers will help you when your clients have similar questions and situations. Send us your email questions.

Q-1. Roth IRA Distribution

I have a customer who opened a Roth IRA on 01/16/2009 - his age at that time was 66. He has made small monthly Roth IRA contributions (he had earned income) since the account opened.

He made a Roth IRA Conversion contribution on 04/14/2010. He began withdrawing funds from this Roth IRA in 2010 and has withdrawn almost all of both his regular Roth IRA contributions and the Roth IRA conversion contribution.

Question: Will there be a distribution penalty assessed since the Roth conversion contribution was not in the account for 5 years? If I'm reading correctly there will not be a 10% penalty because he's 59½ but is there a penalty on interest earnings?

A-1. Was the contribution made on January 16, 2009 for 2009 or 2008?

If for 2008, any distribution taking place in 2013 will be qualified.

If for 2009, any income withdrawn from his Roth IRAs will be tax-fee only if withdrawn after December 31, 2013.

Any distribution prior to 2013 would have been nonqualified for bank reporting purposes. He might have made a Roth IRA contribution to another institution so it is unknown for his tax purposes whether your distributions are actually nonqualified.

The 5-year rule applying for conversion purposes no longer applies once the individual is age 59½. Since he did the conversion in 2010 when he was in his 60s, this 5-year rule does not apply to him. Again, any income withdrawn from his Roth IRAs will be tax-fee only if withdrawn after December 31, 2013 if 2009 was the first year for which a Roth contribution was made.

Q-1A. What you're saying is that because he was 59½ when he made his Roth conversion contribution, the five year rule for conversion contributions does not apply at all.

But, the Roth IRA rules for regular contributions do

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apply which means that the income will be tax-free only if withdrawn after Dec. 31, 2013 - right?

A-1A. Yes.

Q-2. IRA Coding for a Rollover Out to Employer Plan

I have a customer who is taking a distribution from their Traditional IRA and rolling it into a 403b. What type of code do I need for this? I'm certain it's not a transfer but would I code it as a normal distribution, as the customer is over $59\frac{1}{2}$, and let the receiving custodian code it as a rollover?

A-2. If the bank issues the check to the customer, the bank will prepare the Form 1099-R as a normal distribution. Either code 1 (under $59\frac{1}{2}$) or 7 (over $59\frac{1}{2}$) will be used in box 7 and boxes 1, 2a and 2b will be prepared in the standard fashion. If the bank issues the check to the 403(b) plan, then the bank will prepare the Form 1099-R in a special way. Box 1 is to be completed with the gross amount; box 2a is to be completed with 0.00 and and box 7 is to be completed with a "G".

Note that the 403(b) plan or any other employer plan does not prepare a Form 5498 or other form to report that a specific person made a rollover contribution. The individual will want to attach a note or something showing a rollover contribution was made into the plan.

Q-3. Spousal IRA Beneficiary

We have an IRA owner (Les) that died earlier this year. He is over $70\frac{1}{2}$ and has not taken his RMD for 2013.

His wife (Linda) plans on treating the funds as her own and adding them to her existing IRA account. Do we need to process a RMD from Les's existing IRA before transferring the funds?? If 'no' - do we re-calculate Linda's RMD based on her schedule by taking the sum of 12/31 balances of both IRAs?

A-3. The RMD for Les for 2013 needs to be distributed to Linda (surviving spouse) by December 31, 2013. No recalculation of his 2013 RMD or hers is done even if his IRA is transferred into her IRA. She has until year end to take out this amount. His RMD does not need to be paid to her before it is transferred into her IRA. It would have a reason code "7." If she has her own RMD, she will need to take that amount also.

Q-4. $70\frac{1}{2}$ Contribution

Can you tell me if a customer is turning $70\frac{1}{2}$ in 2013 can they still make a contribution for 2012 even though they will be required to start taking their RMD by 4-1-2014? This is a traditional IRA.

A-4. Yes, a person who will attain age $70\frac{1}{2}$ in 2013 is allowed to make an annual contribution for 2012.

This contribution will not impact the 2013 RMD calculation since that calculation uses the FMV balance as of 12-31-2012.

Q-5. FDIC Coverage for HSAs

Would HSAs fall under the individual FDIC coverage or would it be IRAs?

A-5. An HSA is insured under the FDIC's revocable trust category if the revocable trust rules are met. If not, then the HSA is insured as an "individual" account. An HSA is not insured under the IRA category.

Q-6. RMD Notice for Roth IRAs

We will be having 2 Roth IRA customers that turn $70\frac{1}{2}$ this year. Do I need to do an RMD notice for them?

A-6. No. A living Roth accountholder never has to take an RMD so no need to send him or her an RMD notice.

Q-7. Conduit IRA

We have a customer rolling over a balance to a conduit IRA from a qualified retirement plan as an in-service withdrawal. If the customer takes a distribution from the IRA, does it no longer qualify as a conduit IRA?

Also, could the conduit IRA be rolled back into the qualified plan it originated from at a later date if the customer is still employed?

A-7. A distribution from a conduit IRA does not mean that the IRA no longer qualifies as a conduit IRA. A con-

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duit exists if funds have been distributed for a pension plan and rolled into an IRA and then no additional funds have been added. It used to be that the only IRA funds which could be rolled into a pension plan were conduit IRA funds. That is no longer the rule. Any "taxable" IRA fund may be rolled into a pension plan. So, funds within a conduit IRA from which distributions have been taken may be rolled at a later time into the pension plan.

Q-8. Nonspouse IRA Beneficiary

We have a customer who is the sole beneficiary of his mother's IRA. She was 89 years old and in distribution.

He has not yet taken his Death Distribution for 2012 but is contemplating taking a 'one lump sum' distribution and perhaps rolling a portion of it into his Roth IRA. I understand that if he takes the one lump sum it is a taxable event, but is he then able to contribute a portion of those funds to a Roth, assuming that his tax preparer has determined his eligibility?!?

A-8. A non-spouse beneficiary (son) has no roll over rights. If he withdraws the entire account, he will need to include it in his income for tax purposes. I presume he does not want this tax result.

He is unable to move it (i.e convert it) into his own Roth IRA. He is ineligible to move inherited traditional IRA funds into an inherited Roth IRA.

He should take at least the 2012 RMD not yet taken by his mother prior to her death by December 31, 2012. If he does not, he owes the 50% tax unless the IRS would waive it.

If he is eligible to make a regular Roth IRA contribution (i.e. he has compensation and his MAGI is not too high) he could use the withdrawn funds from the traditional IRA as the source of the case to make his Roth IRA contribution.

Q-9. Roth IRA Distribution

I have a customer who wants to cash in her ROTH IRA and take a lump sum. She is under 59½ and the Roth has not been invested for 5 years, therefore, there will be income tax and a 10% penalty on the earnings, correct? The reason code will be J?

A-9. The reason code is a J. Whether or not there will be tax on the earnings at your bank depends on whether she has other Roth IRA(s) at another Roth IRA custodian(s). If she would have another Roth IRA, then because of the aggregation of all Roth IRAs and the distribution ordering rules, she might only be withdrawing her own contributions, and these are not taxable.

Q-10. Form 1099-R

We have been having a discussion here regarding 1099-Rs and I just need clarification from you. Regarding Box 2(b) - does the "taxable amount not determined" need to be checked on ALL Traditional/SEP/SIMPLE-IRA distributions? And, if it is not checked, what is the penalty to the bank for not checking it?

It does not look like our software is checking that box, and it will need to be done manually, which is why I am asking the question.

A-10. The general rule is that for an IRA distribution box 2b is to be checked. There are three situations when box 2b is not to be checked: (1) withdrawal of an excess contribution or current year contribution before the due date, (2) a recharacterization distribution, and (3) IRA funds being sent to directly to an employer plan.

Technically, the IRS would have the authority to assess the maximum $100 per form penalty (lesser penalty if corrected within certain time periods) if box 2(b) is to be checked, but is not. From a practical standpoint, I am not sure if the IRS would assess the $100 penalty or not as the individual (or tax preparer) has the duty under the law to understand that his or her IRA distribution is fully taxable unless he or she can explain why it is not fully taxable.

Possibilities: nondeductible contributions have been made, QCD, qualified HSA funding distribution, and rollovers.

The instructions in Publication 1220 (electronic submissions) make it clear that the box (taxable amount not determined) is to be checked (insert a 1) for any IRA distribution.

I think your idea of manually checking box 2(b) is excellent. That is what I would do if faced with the same situation.