Tax Planning

Are You Confused by Your 1099-R?

Some IRA Distributions Require Self-Reporting

Whether you decide to tackle your tax return yourself or use a tax professional, if you took money out of your IRA last year, one of the tax forms you'll receive will be the 1099-R. Form 1099-R can be confusing because amounts reported as "taxable" don't always result in an income tax liability and items reported as being "early", which are typically subject to a 10% IRS penalty, aren't always subject to that penalty.

Common IRA Scenarios that Require Self-Reporting

Some types of IRA distributions require you to self-report your specific circumstances on your income tax return, so taxes and penalties are not applied.

A few common scenarios where this might happen are:

- Rollovers between IRAs;
- Qualified charitable distributions (QCDs);
- Distributions of non-deductible contributions; and
- Certain exceptions to the 10% early withdrawal penalty when you are younger than age 59 ½.

Rollovers Between IRAs

A distribution from an IRA that is rolled over into the same or another IRA is generally income tax-free if the rollover is completed within 60 calendar days, you have not completed any other IRA-to-IRA rollovers in the past 12 months, and you roll over the same "property" that was distributed to you.

At times, special rollover rules may apply. These special rollovers, or repayments, are tax free even if they happen outside of the 60 days or, in some cases, if they were not the only rollover you completed. Examples of distributions that provide extra time for repayment include qualifying: (i) disaster-related distributions, (ii) birth or adoption distributions, (iii) reservist distributions, (iv) first-time home purchase distributions when delayed or cancelled, and (v) terminal illness distributions.

You must meet specific criteria to qualify for repayment and an amended tax return may be required to receive a refund of prior income taxes paid if repayment occur outside of the current tax year.

The 1099-R you receive will only report the distributions that were paid from the IRA. At the time the distribution is issued, a financial institution cannot know if you will be able to meet the conditions of a tax-free rollover. Therefore, the distribution shows on the 1099-R as taxable. When you complete your income tax return, you or your tax professional will have to report the rollover. IRS instructions for completing your tax return provide details on how to do this.

The rollover deposit is reported on a separate tax form – Form 5498 – sent to you and the IRS in May. Form 5498 does not have to be attached to your tax return, but it does provide verification of the completed rollover to both you and the IRS after you have self-reported it on your income tax return.

Qualified Charitable Distributions (QCDs)

Qualified charitable distributions are tax-free gifts of up to $100,000[1] made directly from your IRA to a qualified charity when you are age 70 ½ or older. Keep in mind that you cannot both exclude the amount from income as a QCD and take a tax deduction for the same charitable gift.

QCDs are reported on Form 1099-R as a taxable amount like other IRA distributions. The financial institution does not indicate that a gift was made directly from the IRA to a qualified charity. Therefore, QCDs must be self-reported on your tax return. The charity should provide you with a receipt for the gift they received to retain with your tax records.

Distributions of Non-Deductible Contributions

Non-deductible contributions are also self-reported on your income tax return. Contributions that are not tax deductible are reported on Form 8606. It keeps track of the after-tax dollars in your IRA, so you do not pay taxes on them twice – on the way in and on the way out.

Because the financial institution that holds your IRA does not know if you claimed a tax deduction for the IRA contributions you made, when you take a distribution they cannot know if it includes after-tax dollars. Therefore, Form 1099-R will show the entire amount as taxable. However, IRAs that include non-deductible contributions are taxed on a pro-rata basis. Use Form 8606 to compute the amount of distribution that is taxable and to determine the amount of non-deductible dollars that remain in the IRA after the distribution.

Certain Exceptions to the 10% Early Withdrawal Penalty

When you receive a distribution from your IRA and you are younger than age 59 ½, the IRS may impose a 10% early withdrawal penalty tax in addition to the income taxes that are due. There are many exceptions to the 10% early withdrawal penalty including distributions paid to you if you are disabled, or to a beneficiary after your death. But there are also some that are connected to what you use the distribution for. Examples include IRA distributions used for:

- purchasing your first home
- qualified college education expenses

[1]Note: A one-time gift of up to $50,000 can also be made to a split-interest entity.

- disaster-related expenses
- qualified birth or adoption expenses
- terminal illness

These types of distributions, among others, may qualify for an exception to the 10% penalty tax if you meet certain conditions established by the IRS.

Exceptions like these also require self-reporting on your income tax return. Financial institutions will generally report your distribution as "early distribution, no known exception" on Form 1099-R because you were younger than age 59 ½ at the time of the distribution. When you complete your income tax return, include Form 5329 to document the appropriate exception that applies in your situation.

Get Help from Your Financial Advisor

Tax season can be a confusing and stressful time. Your financial advisor is here to help and can work together with you and your tax professional as you maneuver through this tax season. ■

One North Brentwood Blvd., Suite 850 | St. Louis, Missouri 63105 | 314-726-1600 | benjaminfedwards.com | Member SIPC