1099-R Codes & Distribution Exceptions

1099-R Box 7 Codes

Generally, distributions from pensions, annuities, profit-sharing and retirement plans, IRAs, insurance contracts, etc. are reported to recipients on Form 1099-R. The codes entered in Box 7 of Form 1099-R indicate the type of distribution received and its taxability. Therefore, correct entry of these codes is really important.

Following are some key items for entering retirement account income from clients' 1099-R's:

1) **Do not forget to include tax withholding if reported on 1099-R.**
2) Indicate if 1099-R is for client or spouse.
3) Report any income shown on 1099-R even if client "rolled over" account.
4) Every code noted below is critical: **Do not** overlook them.

<u>Review pages D-39 and D-40 in Pub 4012 to see all 1099-R Box 7 codes.</u>

Disability Income Treated as Earned Income

Rule: When a taxpayer is receiving disability income (reported on a 1099-R) and the taxpayer is younger than minimum retirement age, that income is generally treated as wage income on line 7 of Form 1040. That means that it is earned income and can be used for the EITC computation, as well as additional child tax credit.
To qualify:

- The income must be received under an employer's disability retirement plan.
- The income must be taxable.
- Payments received under a disability insurance plan paid for by the taxpayer do not qualify to be treated as earned income.
- Minimum retirement age is the earliest age that the taxpayer could have received a pension if the taxpayer were not disabled.

What does this mean for tax preparation? Be on the lookout anytime you see a taxpayer with 1099-R income with distribution code 3 (disability) — particularly if the person seems too young to be retired or checks the disabled box on Form 13614-C. In these situations, the preparer needs to start asking questions to determine how the income should be reported.

Example 4*:* Marjorie, single, age 42, arrived at the tax site in a motorized wheelchair. She had $20,000 income on a Form 1099-R with distribution code 3. She had retired on disability in 2014 and was qualified to treat the 1099-R income as earned income. This meant that she got some EITC and a bigger refund.

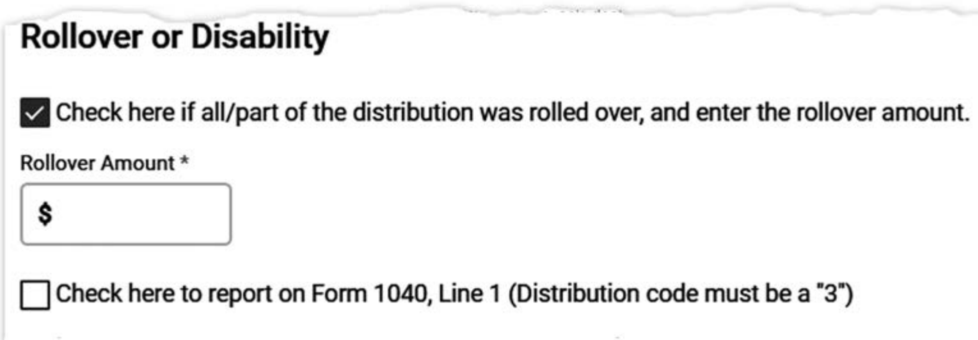
TaxSlayer Pro: When entering the Form 1099-R, check the box next to, "Check here to report on Form 1040, Line 1 (Distribution code must be a "3")." This will reclassify the disability income as wages on Form 1040. It will be considered earned income in the calculation of some credits.

Rollovers

TaxSlayer Pro: If any portion of the distribution is a rollover (deposited into an IRA or an employer plan within 60 days), check the box, "Check here if all/part of the distribution was rolled over, and enter the rollover amount." Enter the amount of the rollover amount.

Form 1099-R Rollovers and Disability Under Minimum Retirement Age

If any portion was rolled over, check to bring up screen to enter the amount. Even if Box 7 is Code G, this entry must be made.



Check if Code 3 is in box 7 and the taxpayer is disabled and under the minimum retirement age* of the employer's plan. This will reclassify the disability income as wages on Form 1040. It will be considered earned income in the calculation of some credits. Note: There is no cost recovery of employee contributions prior to minimum retirement age.

*Minimum retirement age generally is the age at which you can first receive a pension or annuity if you aren't disabled.

Internal Revenue Code 402(c). Extended rollover period for plan loan offset amounts.
Provides that the period during which a qualified plan loan offset amount may be contributed to an eligible retirement plan as a rollover contribution is extended from 60 days after the date of the offset to the due date (including extensions) for filing the Federal income tax return for the taxable year in which the plan loan offset occurs, that is, the taxable year in which the amount is treated as distributed from the plan.

Rollovers

- A taxpayer should not receive a Form 1099-R for a trustee-to-trustee transfer from one IRA to another, but should receive a Form 1099-R for a trustee-to-trustee direct rollover from an employer qualified plan to an IRA with code G.
- A rollover that involves a distribution of funds to the participant isn't taxable if the funds are deposited into an IRA (or the same IRA) or an employer plan within 60 days. Form 1099-R will have either a code 1 or code 7. Subtract the rollover amount from the gross distribution (Box 1) and enter the difference as the taxable amount in Box 2a.
- A participant is allowed only one rollover from an IRA to another (or the same) IRA in any 12-month period, regardless of the number of IRAs owned. However, you can continue to make unlimited trustee-to-trustee transfers between IRAs because it is not considered a rollover.
- Sometimes a distribution includes both a regular distribution (generally taxable) and a rollover (generally nontaxable). The Form 1099-R Rollover or Disability section is used to input the amount that won't be taxed and Box 2a needs to be adjusted.
- If taxpayer inadvertently missed the 60-day rollover deadline for one of several reasons, they can submit a certification to the trustee, and the amount can be considered a rollover on his tax return. See Revenue Procedure 2016-47 for details.

Note: The above applies to pre-tax accounts (e.g. traditional IRAs) and to post-tax accounts (e.g. Roth IRAs) within each group. If rolling or converting from pre-tax to post-tax, the amount will generally be taxable.

1099-R Distribution Code Exceptions

Most retirement plan distributions reported on Form 1099-R and paid to the client before age 59 ½ are subject to an additional tax of 10% (often referred to as an early withdrawal “penalty,” though it is not a penalty by definition). There are some exceptions to this additional 10% tax. If the payer of the funds knows the client meets an exception, then the client’s 1099-R will show “2,” “3,” or “4” in Box 7.

If the client meets an exception to the early withdrawal penalty, but code “1” (early distribution, no known exception) is shown in Box 7 of Form 1099-R, then add *Form 5329* to the tax return. Select *Other Taxes* then select *Begin* next to *Tax on Early Distribution*. In Part 1, select the client who received the distribution (if MFJ). Enter the amount that is not subject to the penalty. Select the reason for the exemption from the dropdown menu:

Code	Explanation	TaxSlayer Pro
01	Qualified retirement plan distributions (does not apply to IRA) received after separation from service in or after the year you reach 55	Separation from service after 55
02	Distributions made as part of a series of substantially equally payments	Series of equal payments
03	Distributions due to total and permanent disability	Total and permanent disability
04	**Distributions due to death**	**Death**
05	**Qualified retirement plan distributions up to the amount paid for unreimbursed medical expenses, less 10% of AGI**	**Medical expenses**
06	Qualified retirement plan distributions made to an alternate payee under a QDRO	Made to alternate payee
07	**IRA distributions made to unemployed individuals for health insurance premiums***	**Unemployed individuals for insurance**
08	**IRA distributions made for higher education expenses**	**Higher education purpose**
09	**IRA distributions made for purchase of a first home, up to $10,000**	**First home purchase**
10	Distributions due to IRS levy on the qualified retirement plan	Other
11	Qualified distributions to reservists while serving on active duty for at least 180 days	Reservists while serving on active duty
12	Other. Also, enter this code if more than one exception applies.	Other

*Medical insurance for yourself, your spouse, and your dependents (no 10% AGI reduction). All of the following conditions must apply:

- You lost your job.
- You received unemployment compensation paid under any federal or state law for 12 consecutive weeks because you lost your job.
- You receive the distributions during either the year you received the unemployment compensation or the following year.
- You receive the distributions no later than 60 days after you have been reemployed.