

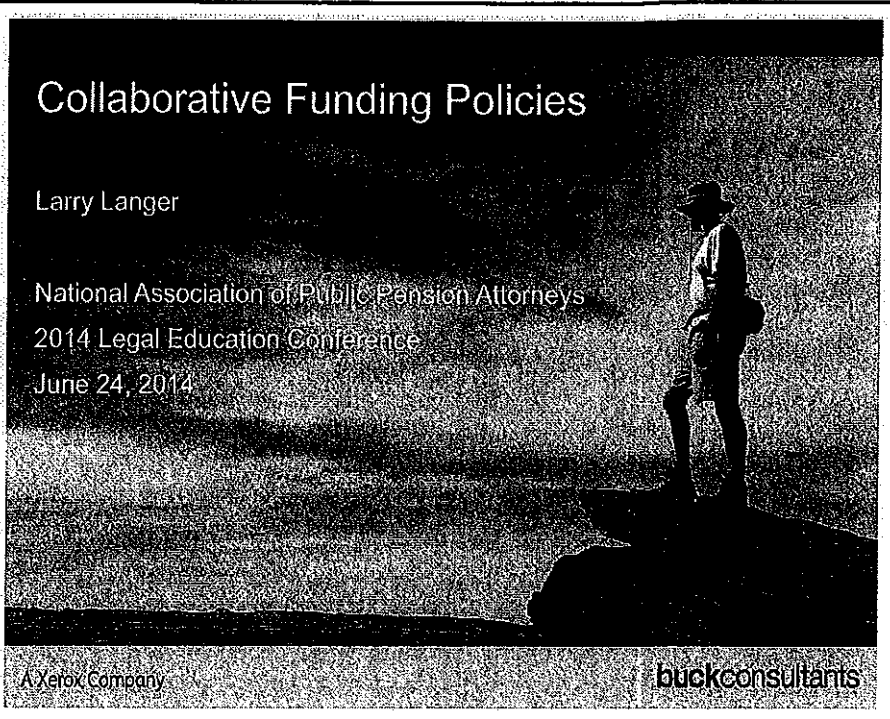
# Collaborative Funding Policies

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National Association of Public Pension Attorneys

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## Introduction

The views and opinions expressed in this presentation are the speaker's and do not necessarily reflect the official policy or position of his employers (either current or prior), professional organizations to which he belongs (the Society of Actuaries, the Conference of Consulting Actuaries, the American Academy of Actuaries, or the Joint Board for the Enrollment of Actuaries) or any Retirement System Boards for which he has previously or currently served as actuary. Friends and relatives also very likely disagree with the speaker's viewpoints or opinions, actuarial or otherwise.

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## Background

- The City of Milwaukee's Employees' Retirement System (ERS) manages a variety of benefits for over 25,000 active, deferred, survivor and retired members
- ERS is Governed by the Annuity and Pension Board
- Annuity and Pension Board sets the assumptions based on input from the actuary. Beginning in 2010 the Board was granted a veto over changes made to the City Charter regarding Board-approved codified funding policy. The funding policy is now the joint responsibility of the board and the Plan sponsor (City Council and Administration).
- The January 1, 2008 Actuarial Valuation Report reported \$5.2 Billion in assets and \$3.8 Billion in Liabilities, with no employer contributions
- The January 1, 2009 Actuarial Valuation Report reported \$3.4 Billion in assets and \$3.9 Billion in Liabilities, and an employer contribution of about half the tax levy

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## Background

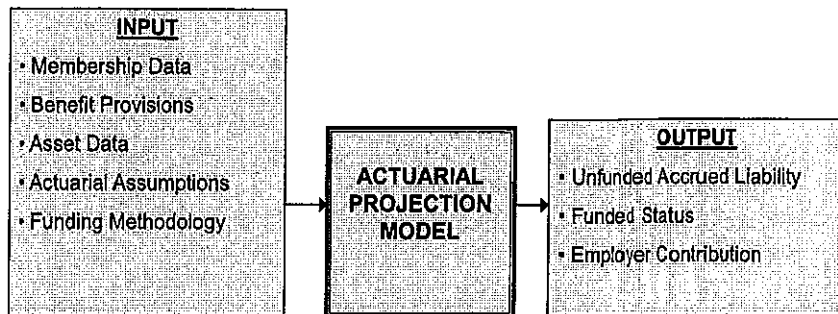
- The actuary serves at the pleasure of the Annuity and Pension Board
- Policy allows for the actuary to work with employer and member stakeholders with permission.
- The actuary's focus is to make sure that the funding policy secures the benefit promise for the members
- The City Finance Director requested to work with the actuary to formulate a new funding policy to address the marked increase in contributions

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## Background

- The immediate response was to change the assumptions; but the Board had just reviewed and approved them
- The real need was to review the Funding Methodology



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## Funding Policy Considerations

- There are three broad considerations when establishing a funding policy for a pension plan
  - Sufficiency - The funding target should be the value of benefits accrued to date
  - Intergenerational equity – taxpayers should pay for workers' pensions while those workers are providing their services – fund for benefits over the worker's career.
  - Stability of contributions – while stable contributions are easy to budget for, stability should not be achieved at the expense of the first two
- There are some nice papers on this topic, which have been issued in the past year given the passage of GASB 67 and 68 standards as the de facto funding policy of public plans
- Of course these did not exist in 2009...

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issue, what happens when overpayments!  
 ment fd, consider hardship waiver  
 but case law says you can't waive or collect,  
 will jeopardize qualification; viable effect  
 ad hoc amendments

may be  
 crim. misdemeanor  
 if don't collect  
 overpayments

fiduc. duty requires  
 less effort, but cost  
 of equit. estoppel?

diff to convince state  
 of re applicability  
 of IRS stan

### Funding Policy Considerations

- Funding methodology (aka Actuarial Methods) describes the funding policy for the Retirement System in actuarial terms. Actuarial Methods generally are comprised of the three components below:
  - Actuarial Cost Methods - allocate costs to the past, current and future to allow for systematic payment of the costs over a members career
  - Amortization Payment for UAAL Methods determine the payment schedule for unfunded actuarial accrued liability
  - Asset Valuation Methods smooth or average the market value returns over time to alleviate contribution volatility that results from market returns that differ from the investment return assumption used in the actuarial valuation
- Actuarial methods allow for a considerable amount of flexibility in paying of the costs of a Retirement System.
- We provided City finance staff with a model to analyze the impact of potential changes.

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how to deal  
 w/ bad posts?

is there a "press  
 policy"  
 limit bad member  
 comments, in favor  
 of ED  
 discuss

best to have policy  
 in place before  
 need arises, re  
 who speaks on  
 behalf of bid

### City of Milwaukee Pension Funding Policy Model

Based on Valuation Results as of January 1, 2008 and Assets as of January 1, 2009

Input Section

Corridor	20%	View Instructions and Workbook Information	Smoothing Period (Years)	5
Payment Type	Level % of pay		Amortization Period Type	Closed
Apply Full Funding Limit?	Yes		Payment Period (Years)	25

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re computer portal  
 if retirees have account, online?  
 how verify identity?  
 if able to make changes, consider PIN  
 consider fraud can be done on paper, not just electronically

## Policy Adoption

- The policy changes that best suited the City (and the actuary):
  - Extended the amortization period to 25 years level percent of pay, but provided for it to reduce over time to the previous policy
  - Increased the smoothing period for assets from 3 years to 5 years and also the corridor from 10% to 20%
  - Didn't fix the full funding limit, but the Plan Sponsor contributed to a contribution reserve fund instead
- Impact of the changes was to decrease the employer contributions from half of the levy to a quarter of the levy
- Board adopted the policy
  - Not a simple decision
  - Concern over effect on members' benefit security of lowering near-term contribution
- All was well...for about 6 months

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## Funding Policy Deja Vu

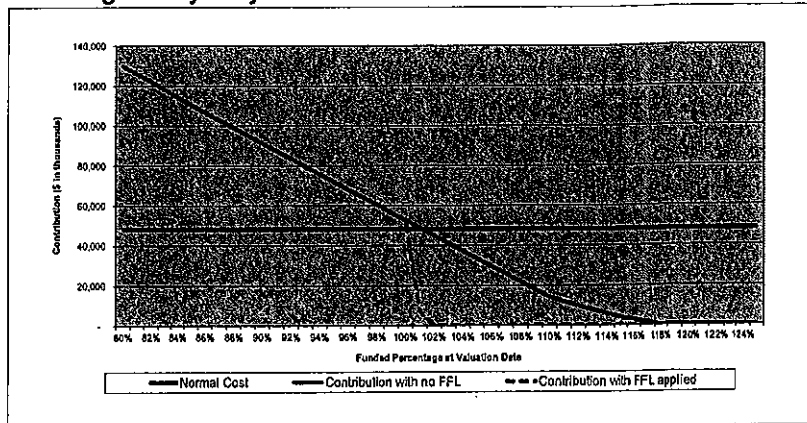
- Markets rebounded in 2009
  - Employer contributions reduced to zero
  - Contribution was made to a reserve fund
  - Components of Funding Policy placed in the Charter -- Board and Sponsor share joint control of Funding Policy
  - Markets rebounded more in 2010
  - No employer contribution again
  - Larger contribution made to reserve fund
- Markets returned less than assumed rate in 2011
  - Employer contribution of one-third of levy
- Contribution volatility discussion begins in earnest with Retirement System and City Finance staff

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*funding policy:*

## Funding Policy Deja Vu



Investment returns are the biggest driver of funded status volatility, which drives contribution volatility under traditional actuarial methods. Better funded plans ironically suffer more from this volatility because they are holding more assets compared to poorly funded plans.

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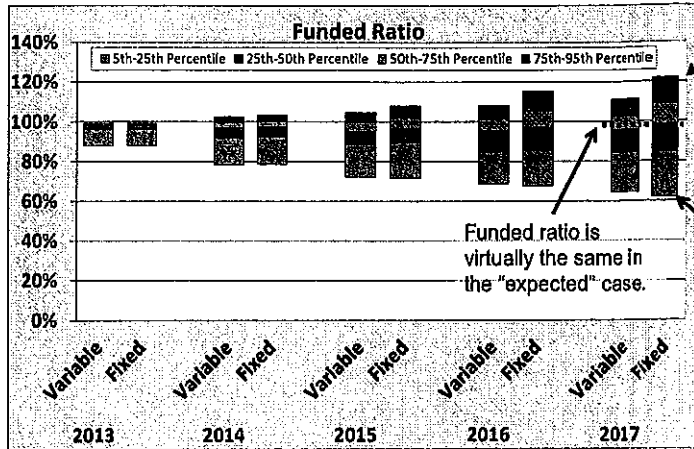
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## Funding Policy Deja Vu

- Given volatility of current contribution policy, staff requested that Buck review a contribution policy with the following objectives:
  - Budget annually for the normal cost (funds could go to Reserve if funded status allows)
  - Make progress on reducing unfunded liability
  - Maintain asset coverage = or > retired lives' liabilities
  - Achieve stable and predictable contribution levels over 5-year periods
  - Review adequacy of contributions as part of a 5-year cycle
  - No change to member contributions
- To review this policy, we need to make use of Asset Liability Modeling (ALM) techniques

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## Funding Policy Deja Vu



Fixed contribution has higher funded ratio in stronger markets

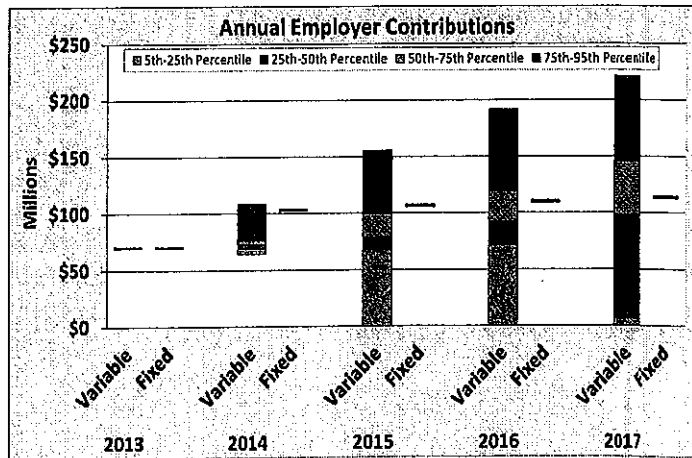
Funded ratio is virtually the same in the "expected" case.

Monitor tracking error to avoid / manage negative surprises

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## Funding Policy Deja Vu



In this case, fixed contribution is slightly above median of variable contribution

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## Funding Policy Deja Vu

- Policy presented to City Stakeholders and go ahead given
- Policy presented in public City Council Finance Committee meeting where it met with approval
  - Many Retirement System Board members present
- Policy presented to Retirement System Board members
  - Retirement System Board sought opinion of independent actuary
  - Opinion was favorable
- Policy passed by Common Council and implemented in charter
  - Amendment includes statement that the actuary is to "speak up" if the funding policy is not sufficient

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## Funding Policy Deja Vu

- We continue to monitor the stable contributions policy and the previous policy
  - Previous policy is still the basis upon future rates will be based
  - Retirement Board desires to monitor the difference
    - In first year, stable contribution policy contribution was less than previous policy
    - In the second year, we expect the stable contribution policy contributions will be much more than the previous policy
- We have found some unexpected benefits
  - Employers don't have to wait for the actuary to determine their contribution amount, so they are contributing months earlier
  - Moody's reacted somewhat favorably to the contribution stability

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## Finally

- Achieving a sound funding policy requires a lot of collaboration among various stakeholders
  - Pension Board
  - Finance
  - The actuaries
  - The attorneys

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Questions?

Thank you

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## NAPPA SEC Actions Working Group

### I. Proxy Advisor.

In 2010 the SEC issued a "Concept Release on the U.S. Proxy System", accessible at: <http://www.sec.gov/rules/concept/2010/34-62495fr.pdf> (Concept Release). That document examined the history of proxy voting and how proxy advisory firms have evolved to assist institutional investors with the proxy voting process. It identified several potential problems inherent in proxy advisory services, including conflicts of interest and concerns regarding accuracy of information and transparency. The Concept Release provided several potential solutions for those problems and invited public comment on the issue. Some of those solutions include increased regulation of proxy advisory firms.

More recently, on December 5, 2013, the SEC hosted a proxy advisory firm roundtable. Information on the roundtable, including the agenda and participants, can be found here: <http://www.sec.gov/spotlight/proxy-advisory-services.shtml>. The purpose of the roundtable was to engage stakeholders in a conversation on proxy advisory services and the issues identified in the Concept Release. Nothing was decided during the roundtable, of course. And although this is a relatively recent topic for the SEC's attention, it is certainly an issue to keep an eye on going forward.

### II. SEC Enforcement Actions in Public Pension Space.

In January 2010, the United States Securities and Exchange Commission ("SEC") formed five specialized enforcement units to focus on high priority issues in areas where enforcement of the securities laws is particularly complex and "highly specialized." One of the five units is called the Municipal Securities and Public Pensions Unit (the "Public Pensions Unit") within the Enforcement Division. In announcing the formation of the Public Pensions Unit, the SEC stated that it would focus on "misconduct in the large municipal securities market and in connection with public pension funds including: offering and disclosure fraud; tax or arbitrage-driven fraud; pay-to-play and public corruption violations; public pension accounting and disclosure violations; and valuation and pricing fraud."<sup>1</sup>

The current head of the Public Pensions Unit is LeeAnn Gaunt, who was appointed to the post in November 2013. She has been with the unit since its formation in 2010.

However, actions by the SEC in areas that intersect with public pension funds have been building since at least 2008. This memorandum summarizes those earlier actions, highlights some of the changes in the area prompted by the formation of the Public Pensions Unit, and concludes with a discussion of some of the general enforcement initiatives since Mary Jo White took over as Chair of the SEC.

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<sup>1</sup> *SEC Names New Specialized Unit Chiefs and Head of New Office of Market Intelligence*, Release No. 2010-5 (Jan. 13, 2010), available at <http://www.sec.gov/news/press/2010/2010-5.htm>.

A. SEC Enforcement Actions Prior to the Formation of the Public Pensions Unit.

1. Insider Trading Enforcement.

One recent trend in SEC enforcement activity more generally has been an increase in high-profile insider trading prosecutions, such as those against Dallas Mavericks owner Mark Cuban, the SAC Capital insider trading prosecutions, and the Galleon Hedge Fund-related insider trading prosecutions.

But public pension funds, or personnel that work at pension funds, also can be exposed to insider trading liability according to a formal report and warning issued by the SEC in March 2008.

The SEC issued its report<sup>2</sup> following an investigation of a public pension fund that purchased shares of Liberty Corporation while in possession of material, non-public information related to a potential acquisition by Liberty of another company. The head of the pension fund and its chief investment officer were aware of the potential acquisition because the fund was providing financing for it. Liberty's stock rose significantly following an announcement of the proposed acquisition, and the pension fund gained about \$700,000 on its trade.

In announcing the release of the report, the SEC's then-chairman stated that "While public pension funds are exempt from most of the federal securities laws governing other money managers, they are not exempt from important anti-fraud provisions that prohibit insider trading and other manipulative and dishonest behavior that threatens the integrity of our markets. It is vitally important, therefore, that they have appropriate policies and procedures."<sup>3</sup>

The SEC report concluded that the pension fund had engaged in insider trading, in violation of the anti-fraud provisions of the securities laws. The report specifically noted the concern that, despite managing over \$30 billion in assets, the pension fund "did not have any program, policy, practice, or training to ensure that its investment staff understood and complied with the federal securities laws in general, or insider trading laws in particular."

Despite the violation and the concerns about the lack of a compliance program, the SEC did not bring formal charges against the pension fund or its management because:

- The fund took remedial action that the Commission might have sought in an enforcement proceeding, including adoption of a compliance program and compensation to the sellers of the Liberty stock that it purchased.
- The fund cooperated in the investigation.

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<sup>2</sup> *Report of Investigation Pursuant to Section 21(a) of the Securities Exchange Act of 1934: The Retirement Systems of Alabama*, Exchange Act Release No. 34-57446 (Mar. 6, 2008), available at <http://www.sec.gov/litigation/investreport/34-57446.htm#1>.

<sup>3</sup> *SEC Warns Public Pension Funds About Inadequate Compliance Procedures*, Rel. No. 2008-35 (Mar. 6, 2008), available at <http://www.sec.gov/news/press/2008/2008-35.htm>.

- The fund's trading was directed by its CEO, who cooperated in the investigation and authorized the fund's remedial action.
- No individual personally profited from the fund's trading.

Given today's general enforcement climate and the establishment of the Public Pensions Unit, one wonders whether the SEC would take the same course of action today.

## 2. Pay-to-Play Enforcement Actions.

The SEC really began stepping up its enforcement activity in relation to public pension funds after large pay-to-play schemes related to the selection of investment managers, private equity funds, and hedge funds were uncovered in New York, New Mexico, California and elsewhere. So-called "pay-to-play" schemes involve direct or indirect payments (or perquisites) by investment advisers, often through the use of placement agents or finders, to government or pension officials for the purpose of improperly influencing the award of government investment business. Beginning in March 2009, the SEC initiated several actions against pension fund fiduciaries, placement agents, and investment advisors alleging pay-to-play schemes.<sup>4</sup>

The facts learned through these investigations ultimately led to the SEC adopting a new rule governing pay-to-play on July 1, 2010. Rule 206(4)-5 (the "Rule") under the Investment Advisers Act of 1940 (the "Advisers Act") prohibits an investment adviser from (i) providing advisory services for compensation to a government entity client for two years after the adviser or certain of its executives or employees make a contribution to certain elected officials or candidates, (ii) providing direct or indirect payments to any third party that solicits government entities for advisory business unless this third party is a registered broker-dealer or investment adviser itself subject to "pay-to-play" restrictions, and (iii) soliciting from others, or coordinating, contributions to certain elected officials or candidates or payments to political parties where the adviser is providing or seeking government business.

After the announcement of the Public Pensions Unit, the SEC has brought several actions for violations of the pay-to-play rule and the Municipal Securities Rulemaking Board's Rule G-37, upon which Rule 206(4)-5 was based. This included a 2012 settled enforcement action against a securities firm based on undisclosed contributions made by a vice-president of the firm to the Treasurer of Massachusetts. The vice president also actively campaigned for the Treasurer and solicited campaign contributions from others. This all occurred at the same time that the securities firm was seeking business to underwrite bond offerings by the Commonwealth, which resulted in the firm underwriting over 30 bond offerings worth over \$9 billion. The securities

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<sup>4</sup> See, e.g., *SEC Charges Former New York State Official and Top Political Advisor with Defrauding the NY State Retirement Fund in Multimillion Dollar Kickback Scheme*, Lit. Release No. 20963 (Mar. 19, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr20963.htm>; *SEC Charges Former State Political Party Leader and Hedge Fund Manager in Kickback Scheme Involving New York Pension Fund*, Lit. Release No. 21001 (April 15, 2009), available at <http://www.sec.gov/litigation/litreleases/2009/lr21001.htm>; *SEC Charges Steven Rattner In Pay-To-Play Scheme Involving New York State Pension Fund*, Lit. Release No. 21748 (Nov. 18, 2010), available at <http://www.sec.gov/litigation/litreleases/2010/lr21748.htm>; *SEC Charges Former CalPERS CEO And Friend With Falsifying Letters In \$20 Million Placement Agent Fee Scheme*, Lit. Release No. 22342 (Apr. 23, 2011), available at <http://www.sec.gov/litigation/litreleases/2012/lr22342.htm>.

firm was required to pay disgorgement of \$7.5 million, plus interest, and pay a \$3.7 million civil penalty.<sup>5</sup> The SEC also filed an administrative proceeding against the vice president, which was then settled in May 2013. The vice president was barred from the industry for five years and had to pay a civil penalty of \$100,000.<sup>6</sup>

And the SEC's focus in this area continues, with recent charges for pay-to-play schemes related to the City of Detroit pension funds. In 2012, the SEC charged the former mayor and treasurer of Detroit (also trustees of the City pension funds) with funneling business to a real estate investment fund after receiving \$125,000 worth of private jet travel and other perks paid for by the investment manager. In addition, the SEC charged the investment manager with securities fraud violations and violations of the Investment Advisors Act.<sup>7</sup>

B. Enforcement Actions Regarding False or Misleading Disclosures About Pension Obligations.

One of the particular areas of focus for the Public Pensions Unit has been financial disclosures of pension obligations in bond offering statements for bonds issued by state or municipal governmental bodies. The following are summaries of these recent enforcement actions:

State of New Jersey. In August of 2010, the SEC brought a settled enforcement action against the State of New Jersey, the first time that the Commission had brought an action against a state. The SEC alleged that New Jersey misled investors in \$26 billion of municipal bonds by masking underfunding of its two biggest pension funds. The SEC concluded that the offering statements accompanying the bond offerings failed to disclose the pension plans' asset and funded ratio information on a market-value basis. And because that information was not provided on the basis of market value, the offering documents effectively concealed the magnitude of the pension funds' unfunded liability, which the SEC said hid the fact that the State would not be able to make required contribution amounts to the funds without raising taxes, cutting other services or otherwise drastically affecting its budget.<sup>8</sup>

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<sup>5</sup> *In re Goldman Sachs & Co.*, Exchange Act Release No. 67934 (Sept. 27, 2012), available at <http://www.sec.gov/litigation/admin/2012/34-67934.pdf>.

<sup>6</sup> *In re Neil M.M. Morrison*, Exchange Act Release No. 67935 (Sept. 27, 2012), available at <http://www.sec.gov/litigation/admin/2012/34-67935.pdf>; *In re Neil M.M. Morrison*, Exchange Act Release No. 69627 (May 23, 2013), available at <http://www.sec.gov/litigation/admin/2013/34-69627.pdf>.

<sup>7</sup> *SEC Charges Former Detroit Officials And Investment Adviser To City Pension Funds In Influence Peddling Scheme*, Lit. Release No. 22362 (May 9, 2012), available at <http://www.sec.gov/litigation/litreleases/2012/lr22362.htm>. The same investment advisor was subsequently charged by the SEC for stealing \$3.1 million from the City of Detroit Police Officers and Firefighters pension fund to buy real estate in California. *SEC Charges Top Officials At Investment Adviser in Scheme to Hide Theft From Pension Fund of Detroit Police and Firefighters*, Lit. Release No. 22720 (June 10, 2013), available at <http://www.sec.gov/litigation/litreleases/2013/lr22720.htm>.

<sup>8</sup> *In the matter of State of New Jersey*, Securities Act Release No. 33-9135 (Aug. 18, 2010); *SEC Charges State of New Jersey for Fraudulent Municipal Bond Offerings*, Release No. 2010-152, available at <http://www.sec.gov/news/press/2010/2010-152.htm>.

State of Illinois. In March of 2013, the SEC brought a similar settled enforcement action against the State of Illinois. Similar to the New Jersey case, the SEC alleged that Illinois "misled bond investors about the adequacy of its statutory plan to fund its pension obligations and the risks created by the State's underfunding of its pension systems" for general obligation bonds that it sold to investors from 2003 to 2009. Illinois failed to disclose material information about the structural underfunding of its pension system in the bond offering documents. According to the SEC's order instituting settled administrative proceedings against Illinois, the State established a 50-year pension contribution schedule in the Illinois Pension Funding Act that was enacted in 1994. The schedule proved insufficient to cover both the cost of benefits accrued in a current year and a payment to amortize the plans' unfunded actuarial liability. The statutory plan structurally underfunded the state's pension obligations and backloaded the majority of pension contributions far into the future. This structure imposed significant stress on the pension systems and the state's ability to meet its competing obligations – a condition that worsened over time. The SEC's order found that Illinois misled investors about the effect of changes to its funding plan, particularly pension holidays enacted in 2005. Although the state disclosed the pension holidays and other legislative amendments to the plan, Illinois did not disclose the effect of those changes on the contribution schedule and its ability to meet its pension obligations.<sup>9</sup>

City of San Diego. Although the initiation of SEC enforcement actions relating to disclosures in connection with municipal bonds issued by the City of San Diego pre-date the creation of the Public Pensions Unit in the SEC Enforcement Division, a significant settlement occurred after its creation, in October 2010. The settlement was the first time that the Commission had obtained financial penalties against City officials in a municipal bond fraud case. The SEC alleged that the City had misled investors in its municipal bonds about the City's fiscal problems related to its pension and retiree health benefit obligations. The SEC alleged that the officials knew the city had been intentionally under-funding its pension obligations so that it could increase pension benefits but defer the costs. They also were aware that the City would face severe difficulty funding its future pension and retiree health care obligations unless new revenues were obtained, benefits were reduced, or City services were cut. However, despite this extensive knowledge, they failed to inform municipal investors about the severe funding problems in 2002 and 2003 bond disclosure documents. Three former officials had to pay a civil penalty of \$25,000 each, and another former official had to pay a civil penalty of \$5,000.<sup>10</sup>

City of Harrisburg. Although not involving allegations of improper disclosure of public pension obligations, the SEC's enforcement action against the City of Harrisburg (Pa.) is significant in that the Commission, following on the heels of the settlement with the San Diego officials, again stressed that it would pursue claims against individuals responsible for disclosure violations. The SEC filed a settled enforcement action against the City for making misleading statements in the City's budget report, annual and mid-year financial statements, and a State of the City address that painted an unduly optimistic picture of the City's finances. The SEC noted

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<sup>9</sup> *In the matter of State of Illinois*, Securities Act Release No. 33-9389 (Mar. 11, 2013); *SEC Charges Illinois for Misleading Pension Disclosures*, Release No. 2013-37, available at <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1365171513202>.

<sup>10</sup> *Former San Diego Officials Agree to Pay Financial Penalties in Municipal Bond Fraud Case*, Release No. 2010-204 (Oct. 27, 2010), available at <https://www.sec.gov/news/press/2010/2010-204.htm>.

that this was the first municipal bond case where charges were brought for misleading statements made outside of its securities disclosure documents.<sup>11</sup>

Although the SEC did not charge any individuals in the Harrisburg case, in a report on the Harrisburg investigation the SEC stated:

Based upon information obtained during the investigation, the Commission deems it appropriate that it issue this Report of Investigation pursuant to Section 21(a) of the Exchange Act to address the obligations of public officials relating to their secondary market disclosures for municipal securities. Public officials should be mindful that their public statements, whether written or oral, may affect the total mix of information available to investors, and should understand that these public statements, if they are materially misleading or omit material information, can lead to potential liability under the antifraud provisions of the federal securities laws....

The statements by the Harrisburg public officials were part of, and could have altered, the total mix of information available to the market. There is a substantial likelihood that a reasonable investor would consider the financial condition of the City important in making an investment decision, and there were no other disclosures made by the City as part of the total mix of information available to enable investors to consider other information. These public officials' statements were the principal source of significant, current information about the issuer of the security and thus could reasonably be expected to influence investors and the secondary market. Because statements are evaluated for antifraud purposes in light of the circumstances in which they are made, the lack of other disclosures by the municipal entity may increase the risk that municipal officials' public statements may be misleading or may omit material information.

Given this potential for liability, public officials who make public statements concerning the municipal issuer should consider taking steps to reduce the risk of misleading investors. At a minimum, they should consider adopting policies and procedures that are reasonably designed to result in accurate, timely, and complete public disclosures; identifying those persons involved in the disclosure process; evaluating other public disclosures that the municipal securities issuer has made, including financial information and other statements, prior to public dissemination; and assuring that responsible individuals receive adequate training about their obligations under the federal securities laws. Public officials may also look to Commission enforcement actions or Commission guidance in developing the disclosure policies, procedures and controls that they choose to establish. Public officials may choose to identify and implement other practices or procedures that they believe are appropriate to meet their obligations under the federal securities laws. Harrisburg has since instituted formal and tailored written policies and procedures with respect to public statements regarding financial

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<sup>11</sup> *In the matter of City of Harrisburg, Pennsylvania*, Exchange Act Release No. 34-69515 (May 6, 2013).

information and other statements and its written undertakings pursuant to Rule 15c2-12 of the Exchange Act.<sup>12</sup>

City of Miami. The SEC has also recently pursued an enforcement action against the City of Miami and its budget director who was allegedly responsible for the misleading statements in bond offering materials. There, the SEC brought a civil case in federal court alleging that the City issued over \$100 million in bonds at a time when it had improperly transferred \$24 million into the City's general fund from other funds that the City Code had designated for specific purposes. The transfers were part of an alleged scheme to help Miami obtain positive bond ratings; when the transfers were later discovered and reversed, the City's bond rating declined. In addition to charging the City, the SEC charged the budget director that it said was responsible for all of the transfers and misrepresentations regarding the nature of the transfers in bond offering materials and during meetings with the public and other city officials.

Miami and the budget director moved to dismiss the case, but the district court denied those motions. In January 2014, the budget director filed an interlocutory appeal of the decision, arguing that he is entitled to qualified immunity from the SEC's suit because he was only acting in his official capacity when he made the transfers at issue and was not acting on his own or for his own benefit.<sup>13</sup>

#### C. Enforcement Actions Related to Hedge Funds and Private Equity.

As public pension funds have made an increasingly greater number of so-called alternative investments in things like private real estate funds, private equity funds, venture capital funds, and hedge funds, public pension funds are increasingly finding themselves involved in SEC investigations related to potential improprieties by investment managers operating these funds.

Pension funds may receive subpoenas for documents and/or testimony from its investment personnel or trustees. More often than not, the pension fund is viewed by the SEC as a "victim" of any potential securities fraud perpetrated by a wayward investment manager, but personnel and trustees are not immune from being targets of these investigations, such as in the pay-to-play investigations. And because the SEC has wide latitude in pursuing aiding and abetting claims, it is not out of the realm of possibility that a pension fund which is, for example, a large investor in a fund that is a target of the investigation to also have exposure in circumstances where, for example, the pension fund utilized its influence as a large investor to obtain some kind of benefit from its position.

Another recent phenomenon driving greater enforcement activity by the SEC in the public pension space is that purported "whistle-blowers" and other constituencies are pushing

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<sup>12</sup> *Report of Investigation in the Matter of the City of Harrisburg, Pennsylvania Concerning the Potential Liability of Public Officials with Regard to Disclosure Obligations in the Secondary Market*, Exchange Act Release No. 69516 (May 6, 2013), available at <http://www.sec.gov/litigation/investreport/34-69516.htm>.

<sup>13</sup> [http://www.law360.com/securities/articles/504601?nl\\_pk=8e6e080c-5eac-4683-81ae-013bb42face8&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=securities](http://www.law360.com/securities/articles/504601?nl_pk=8e6e080c-5eac-4683-81ae-013bb42face8&utm_source=newsletter&utm_medium=email&utm_campaign=securities).

SEC investigations in to public pension fund dealings with alternative investment managers.<sup>14</sup> Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act established a whistleblower bounty program. Under the program, the SEC will provide monetary awards to those who voluntarily provide original information that leads to successful Commission enforcement actions resulting in the imposition of monetary sanctions over \$1,000,000, and certain related successful actions. The SEC can make awards ranging from 10 to 30 percent of the monetary sanctions collected.

D. General SEC Enforcement Directives Under New SEC Chair.

The SEC's focus on issues that intersect with public pension funds must also be viewed in the broader enforcement context under new SEC Chair Mary Jo White, who was confirmed as Chair of the Commission on April 8, 2013. White is the first former criminal prosecutor to serve in the role as chair - she was the former United States Attorney for the Southern District of New York. And it appears that she is bringing new initiatives to the SEC derived from her criminal prosecution background.

First, in June 2013, White directed enforcement staff, which was then reported publicly, that the SEC would be reconsidering its longstanding practice of allowing defendants to settle enforcement cases without admitting or denying liability. Rather, under certain egregious (though undefined) circumstances, the SEC would require admissions in cases, even where there is no parallel criminal action being pursued.<sup>15</sup> The new policy may have significant consequences as a result of admissions of wrongdoing, particularly for individuals who may be denied access to directors and officers insurance or indemnification from the entities they serve.

Second, in an October 9, 2013, speech delivered by White she announced her goal of bringing a "broken windows" strategy, a criminal enforcement strategy most notably used by New York Mayor Rudy Giuliani and his Police Commissioner Bill Bratton, to the securities enforcement world. Referring to their work, she stated that "[t]hey essentially declared that no infraction was too small to be uncovered and punished. And, so the NYPD pursued infractions of law at every level – from street corner squeegee men to graffiti artists to subway turnstile jumpers to the biggest crimes in the city."

She noted her goal was that the SEC enforcement program be viewed similarly, as being "everywhere, pursuing all types of violations of our federal securities laws, big and small." She continued: "The same theory can be applied to our securities markets – minor violations that are overlooked or ignored can feed bigger ones, and, perhaps more importantly, can foster a culture

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<sup>14</sup> See, e.g., *R.I. Senator Ciccone asks SEC to probe state pension fund, 'excessive fees paid to brokers'*, The Providence Journal (Nov. 13, 2013) available at <http://www.providencejournal.com/breaking-news/content/20131113-r.i.-senator-ciccone-asks-sec-to-probe-state-pension-fund-excessive-fees-paid-to-brokers.ece> ; *NC employee union takes pension complaints to feds* (April 22, 2014), available at <http://www.wral.com/seanc-taking-pension-system-complaints-to-us-sec/13585342/>

<sup>15</sup> *S.E.C. Has a Message for Firms Not Used to Admitting Guilt*, New York Times (June 21, 2013), available at [http://www.nytimes.com/2013/06/22/business/secs-new-chief-promises-tougher-line-on-cases.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2013/06/22/business/secs-new-chief-promises-tougher-line-on-cases.html?pagewanted=all&_r=0).

where laws are increasingly treated as toothless guidelines. And so, I believe it is important to pursue even the smallest infractions."<sup>16</sup>

Third, White emphasized, in part as a corollary to the change in settlement policy on admissions, that the SEC intended to take more cases to trial. In a November speech titled, "The Importance of Trials to the Law and Public Accountability," White stated the SEC would be planning on taking more cases through trial. She noted that more full-scale trials "should mean greater public accountability and more instances of a full factual record of wrongdoing that should foster better development of the law."

In summary, in her short time as Chair of the SEC, White has attempted to foster an enforcement division that will be bolder, more tenacious, and pursue more claims and trials. The impact of these new initiatives on the work of the Public Pensions Unit of the enforcement division is unclear.

### III. Say-On-Pay.

Since the January 2011 SEC adoption of Say-on-Pay Rules to implement the applicable provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the topic of shareholder approval of executive compensation and "golden parachute" compensation arrangements has continued to garner the attention of institutional investors.

#### A. What are the Rules?

The rule amendments implement Section 951 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, which added Section 14A to the Exchange Act. Section 951 expressly states that a Say-On-Pay vote is a non-binding, advisory vote, and that it cannot be used to "create or imply any change to the fiduciary duties" of the company or its board of directors. This statute requires public companies subject to the federal proxy rules to:

- Provide their shareholders with an *advisory vote* on executive compensation, generally known as "Say-on-Pay" votes.
- Provide their shareholders with an *advisory vote* on the desired frequency of say-on-pay votes.
- Provide their shareholders with an *advisory vote* on compensation arrangements and understandings in connection with merger transactions, known as "golden parachute" arrangements. Such "golden parachute" arrangements would need to be disclosed in merger proxy statements.

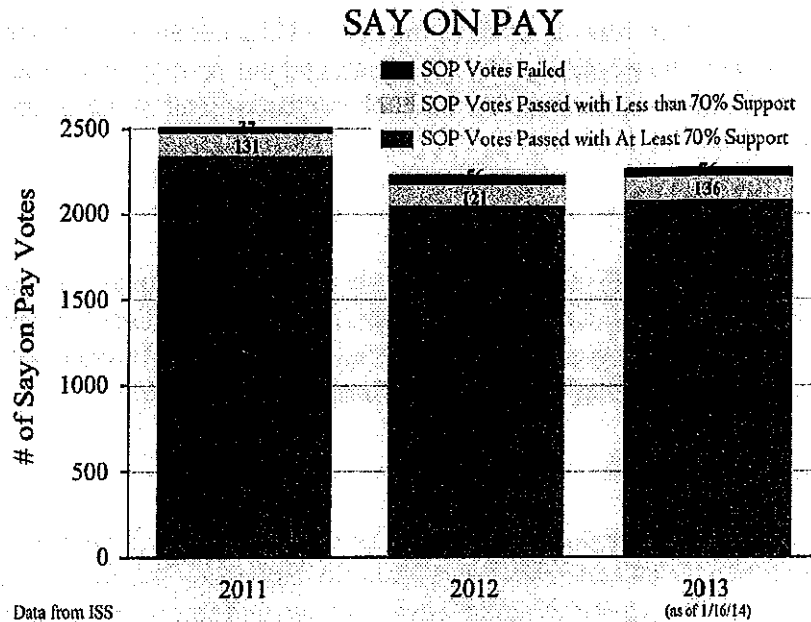
Advisory votes provide investors with an opportunity to express their views on whether the Board is adequately fulfilling its obligation to compensate senior management properly. The advisory vote can be an opportunity for boards to use feedback to refine pay practices.

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<sup>16</sup> Remarks at the Securities Enforcement Forum, Oct. 9, 2013, available at <http://www.sec.gov/News/Speech/Detail/Speech/1370539872100>.

B. After Adoption of the Rule has a Say-On Pay Vote failed?

As depicted in the graphic below, after the SEC adopted its Rules on Say-On-Pay, votes have failed at a small percentage of companies. Roughly 150 companies have failed to secure majority shareholder approval of their executive compensation proposals in the last three years. Those include 37 failures in 2011, 56 failures in 2012 and 56 failures in 2013. A vote is considered a failure when the proposed compensation package does not achieve 50% support from shareholders.



C. Under What Circumstances Are Shareholders Withholding Votes?

While most shareholders note that a vote against proposed compensation is the exception, among the factors shareholders cite when they withhold votes are:

- i. Egregious compensation practices and policies;
- ii. Management compensation is not sufficiently sensitive to long-term share performance;
- iii. Compensation practices are not aligned with shareholder value;
- iv. Compensation does not hold management accountable for poor performance;
- v. Failure to adequately explain to shareholders how the compensation committee developed, approved, monitored and disclosed the company's compensation philosophy with respect to the entire range of pay elements; and
- vi. Whether a company has engaged in multiple years of discussions with shareholders about magnitude of pay as well as magnitude of equity dilution;

D. Has Say-On-Pay Been Used in Litigation?

In 2011, approximately half of all failed Say-On-Pay votes resulted in litigation. Those early cases alleged breaches of fiduciary duty against directors who approved executive compensation plans despite a failed Say-On-Pay vote. For the most part, these cases are being dismissed at early stages of the litigation. The cases largely find that the directors' decisions to approve executive compensation are protected by the business judgment rule. Faced with these dismissals, a new wave of cases have emerged in 2012 and 2013 where plaintiffs alleged claims involving a variety of executive compensation issues, such as compliance with shareholder-approved equity compensation plans and/or policies, approval of tax "gross-up" provisions in employment contracts, deficiencies in the proxy materials related to the vote, and the implementation and/or timing of equity awards. Lately, plaintiffs have challenged directors' independence where non-employee directors are compensated via equity-based plans that they approve and implement in accordance with the plan. This second wave of cases is again largely being dismissed.

#### IV. Political Contribution Disclosure.

##### A. Why was disclosure of political contributions of interest to the SEC?

- i. In the summer of 2011, a group of law school professors petitioned the SEC asking it to force corporations to disclose political spending.
- ii. It is reported that the SEC received more than 600,000 public comments to the agenda item. That's more than any prior agenda item in the SEC's history. The majority of those comments were in favor of more disclosure.
- iii. In December 2012, the SEC added an agenda item to its calendar signaling that it might consider formally proposing a rule that would require publicly traded companies to disclose the specifics of their political spending to shareholders.
- iv. Disclosure rule garnered support from many public pensions, state and local elected officials, shareholder activists and campaign finance reformers, but was opposed by the U.S. Chamber of Commerce, the National Association of Manufacturers, and the Business Roundtable.
- v. Nevertheless, the topic was notably absent from the SEC's December 6, 2013 agenda setting forth the action items for the upcoming year.

##### B. Have political contribution disclosures been the topic of proxy votes?

Political disclosure is a popular proxy topic. There were 128 proposals filed last year and probably will be about the same this year. Approximately 50 last year asked companies to disclose spending and board policy on political activities, another 50 sought disclosure of lobbying activities, the rest were a hodgepodge (ex: ban on all giving). One or two received majority support from shareholders. Many were settled and withdrawn after companies agreed to disclose political giving.



## Tax Update – The Ins and Outs of 1099-Rs, Corrections, Reviewing Your 1099-R Practices and Special 1099-R Issues

- Moderator: Jonathan Needle, Houston Firefighters' Relief and Retirement Fund
- Presenters:
  - ❖ Luke Bailey, Strasburger & Price, LLP
  - ❖ Paul W. Madden, Whiteford, Taylor & Preston
  - ❖ Mary Alice McGreevy, Wisconsin Department of Employee Trust Funds

1

**[X] CORRECTED (if checked)**

PAYER'S name, street address, city or town, state or province, country, and ZIP or foreign postal code  <b>Plan's name and address go here</b>		<b>1</b> Gross distribution \$ total dollars paid		OMB No. 1545-0119  <b>2014</b>		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.	
		<b>2a</b> Taxable amount \$ Taxable portion		Form <b>1099-R</b>			
PAYER'S federal identification number Custodian may use its own EIN		RECIPIENT'S identification number Only last 4 of SSN may be shown, but IRS gets full social		<b>3</b> Capital gain (included in box 2a) \$		<b>4</b> Federal income tax withheld \$	
				<b>5a</b> Taxable amount not determined <input checked="" type="checkbox"/> Total distribution <input type="checkbox"/>		Copy A for IRS  Copy B for taxpayer	
RECIPIENT'S name:  Street address (including apt. no.)  City or town, state or province, country, and ZIP or foreign postal code		<b>6</b> Employee contributions (Designated Roth contributions or insurance premiums) \$		<b>6</b> Net unrealized appreciation in employer's securities \$			
						<b>7</b> Distribution code(s) Alpha/Numeric codes go here	
<b>10</b> Amount allocable to IR within 5 years \$		<b>11</b> 1st year of desig. Roth contrib. \$		<b>12</b> State tax withheld \$		<b>13</b> State/Payer's state no. \$	
Account number (see instructions)		<b>17</b> Local distribution \$		\$			

Form **1099-R** www.irs.gov/form1099r Department of the Treasury - Internal Revenue Service

2



## Responsibility for Filing 1099-R's (cont'd)

IRS instructions say:

**Transmitters, paying agents, etc.** A transmitter, service bureau, paying agent, or disbursing agent (hereafter referred to as "agent") may sign Form 1096 on behalf of any person required to file (hereafter referred to as "payer") if the conditions in 1 and 2 below are met.

1. The agent has the authority to sign the form under an agency agreement (oral, written, or implied) that is valid under state law and

2. The agent signs the form and adds the caption "For: (Name of payer)."

Signing of the form by an authorized agent on behalf of the payer does not relieve the payer of the liability for penalties for not filing a correct, complete, and timely Form 1096 and accompanying returns.

From 2014 General Instructions for Certain Information Returns

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## Responsibility for Filing 1099-R's (cont'd)

- Filers of 250 or more 1099-R's in year must file electronically using the FIRE system
- Achieving a high accuracy rate for 1099-R's is challenging
  - Plans may have complex distribution schemes, and application of IRS codes may in some cases be ambiguous
  - Determining appropriate codes also places stress on design of administrative software and collection of complete, accurate, detailed, electronically transmissible information regarding members and beneficiaries

6

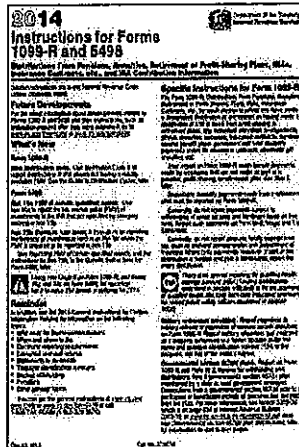
*Readers Tax Guide (has ch 121099-R)*

## Responsibility for Filing 1099-R's (cont'd)

- Review agreement with custodian or other agent, especially indemnification provisions
- Plan should not assume agent understands enough about plan to ensure 1099-R's are correct in all circumstances; plan staff should review potential issues and stay involved with agent and process

7

## Helpful Publications



### Attention:

This form is provided for informational purposes only. Copy A appears in red, similar to the official IRS form. Do not file copy A downloaded from this website. The official printed version of this IRS form is scanable, but the online version of it, printed from this website, is not. A penalty may be imposed for filing forms that can't be scanned. See part O in the current General Instructions for Certain Information Returns for more information about penalties.

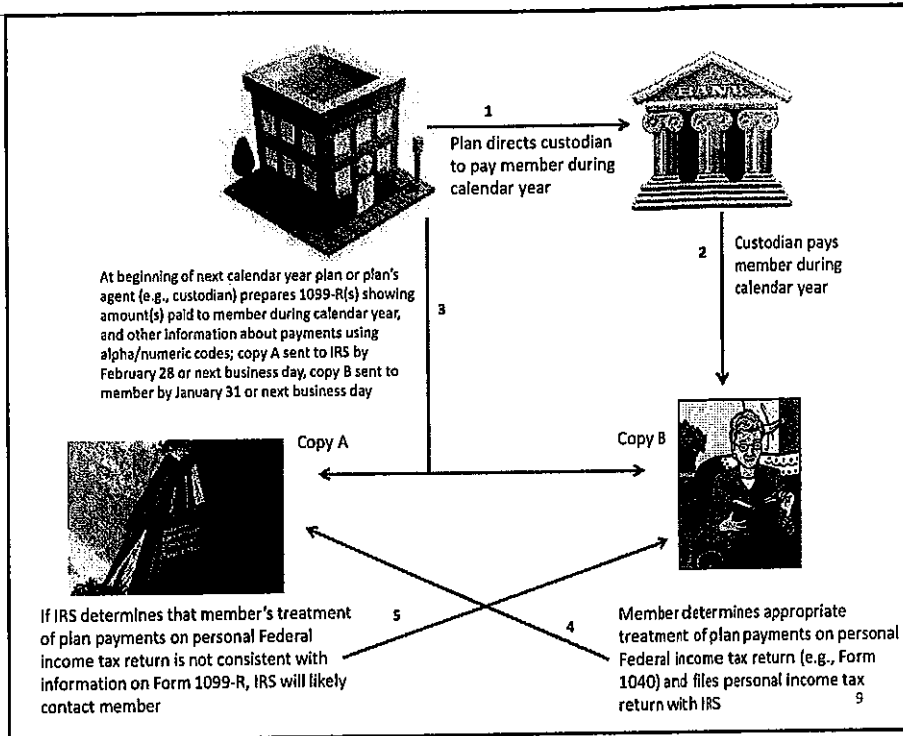
To order official IRS forms, call 1-800-TAX-FORM (1-800-829-3676) or Order Information Returns and Employer Returns Online, and we'll mail you the scanable forms and other products.

See IRS Publications 1141, 1167, 1179 and other IRS resources for information about printing these tax forms.

### IRS Form 1099-R Instructions



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## Preparing Form 1099-R

- **Box 1 – Gross amount distributed**
  - Amount paid to member, whether taxable or not, directly rolled over or not, etc.
- **Box 2 – Taxable amount**
  - Box 1 minus amounts directly rolled over to IRA, recovered tax basis, nontaxable on-duty disability benefits, etc.
  - Can be 0
  - If can't determine precise taxable amount, leave blank and check Box 2b
- **Box 2b itself contains two boxes**
  - Check first box if in Box 2a could not determine taxable portion of Box 1
  - Second box indicates total or final distribution

## Preparing Form 1099-R (contd.)

- Box 3 – Capital gain portion of Box 1
  - May apply to lump sum distributions to members born before January 2, 1936 (i.e., lump sums to individuals age 78 and above)
- Box 4 – Federal income tax withheld (“FITW”) (at W4-p rates, or 20% on nonperiodic distributions)
- Box 5 – Member’s tax basis (e.g., from after-tax contributions)
- Box 6 – Net unrealized appreciation (“NUA”) in employer securities (obviously not applicable to governmental retirement plans)

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## Preparing Form 1099-R (contd.)

- Box 7 – Distribution Codes
- Numeric Codes 1-9
  - Generally only numeric codes 1, 2, 3, 4, and 7 will be relevant to governmental retirement plans
- Letter Codes A-W
  - Generally only letter code G relevant to governmental defined benefit plans
  - Additional letter codes applicable to defined contribution plans

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## Selected Distribution Code Meanings

- Code 1: Early distribution, no known exception
  - Use if member was younger than 59 ½ at time of distribution and no exception to IRC §72(t) 10% early distribution tax applies
  - IRS instructions say use also if distributions constitute modification of “substantially equal periodic payments” (SEPP) before end of SEPP period (later of 59 ½ or 5 years)

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## Selected Distribution Code Meanings (cont'd)

- Code 2: Pre-59 ½ distribution, but exception to IRC §72(t) 10% early distribution tax applies, e.g.:
  - Distribution made after separation from service and member had reached age 55 (50 for public safety) by end of year in which separated
  - Disability
  - IRS levy
- Code 3: Disability under IRC §72(m)(7)
  - When is a distribution “on account” of disability?
  - Applies to on- and off-duty disabilities
  - Note potential overlap with Code 1, and note that 1 and 3 are not on IRS list of acceptable code combinations

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## Selected Distribution Code Meanings (cont'd)

- Code 4: Death
  - Use for distributions to beneficiaries
- Codes 5 and 6 irrelevant to governmental retirement plans
- Code 7: "Normal distribution"
  - Payments were to member who was alive, over age 59 ½, not disabled, and who did not change SEPP (if used SEPP) during SEPP period (later of five years or age 59 ½)
- Codes 8 and 9 irrelevant, except possibly 9 if plan provides current life insurance benefits in addition to retirement and survivor benefits

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## Selected Distribution Code Meanings (cont'd)

- Code E – Distribution under Employee Plans Compliance Resolution System
  - E.g., Section 415(c) defined contribution plan excess allocation
- Code G - Direct rollover
  - E.g., Member or beneficiary elected direct rollover to another employer-sponsored qualified plan or IRA or DROP or other nonperiodic payment
- Code H – Direct Roth account to Roth IRA rollover
- Code L – Deemed distribution of defaulted portion of participant loan
- Code P - Excess contributions plus earnings
  - E.g., Section 403(b) plan

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## Some (But Not All) Codes Can be Combined

- Numeric codes can be combined with other numeric, numeric with letter, and letter with letter
- No more than two alpha/numeric codes can be combined on one 1099-R – If need more than 2 codes for same participant in same year, need to use multiple 1099-R's for him/her for year
- Only certain alpha/numeric code combinations listed in IRS instructions are permitted
- The only permitted combination that seems potentially applicable to a governmental retirement plan is 4G, i.e. a distribution after member's death to beneficiary, where beneficiary chooses to roll over directly to another employer sponsored plan or IRA

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## Multiple 1099-Rs Sometimes Required

- Member separated from service before year in which attained age 55 (or 50 if public safety), not disabled, commenced pension before age 59 ½, and turns age 59 ½ during year
  - Report payments during portion of year before attainment of age 59 ½ on one 1099-R and code as "1"
  - Payments for rest of year would go on Second 1099-R using code 7
- Member over age 59 ½ entitled to and elects nonperiodic payment and elects to roll over part of nonperiodic payment directly to IRA
  - Amount rolled directly to IRA reported on one 1099-R using codes 7 and G
  - Amount not rolled over reported on another 1099-R using only Code 7

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## Potential Failures Relating to Forms 1099-R and 941

- Failures to withhold proper amounts -- IRC §3405
- Failures to file timely and correct informational returns (Forms 941) -- IRC §6721
- Failures to furnish timely and correct payee statements (Forms 1099-R) -- IRC §6722

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## Potential Liability and Penalties

- Payor is liable for payment of taxes required to be withheld -- IRC §3405(d)
- Penalties for failure to furnish timely and accurate Forms 1099-R -- IRC §6722
- Penalties for failure to file timely and accurate Forms 941 -- IRC § 6721

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## Potential Liability and Penalties

- Penalties for failures relating to Forms 1099-R and 941 are:
  - \$100 per return
  - \$1,500,000 per year maximum
- Lower penalties for prompt correction
  - \$30/\$250,000 for correction within 30 days
  - \$60/\$500,000 for correction by August 1

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## Potential Liability and Penalties

- Higher penalties for knowing or willful failure to furnish/file forms
  - Greater of \$250 per return or 10% of amount not reported or reported incorrectly
  - \$1,500,000 maximum does not apply
- Separate penalties for Forms 1099-R and 941.
- Penalties effectively double for a failure that affects both Forms

22

## Discovering a Failure

- Best case scenario: discovered internally shortly after failure, quickly corrected\*
- Second-best case scenario: discovered internally but after August 1, before penalty letter issued by Service
- Worst-case scenario: discovered by Service after August 1, penalty letter issued

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## Waiver of Penalties

- Penalties are waived if failure is due to reasonable cause and not due to willful neglect
- Reasonable cause means
  - there are significant mitigating factors or
  - failure arose from events beyond filer's control

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## Significant Mitigating Factors

- Never required to file this type of return or prepare this type of statement before, or
- Filer has established a history of compliance with filing and reporting requirements
  - Prior penalties are relevant
  - Improved error rate from year to year is relevant

25

## Reasonable Cause

- Reasonable cause requires filer to act responsibly both before and after the failure
  - Payor exercised prudent standard of care
  - Payor took significant steps to avoid or mitigate the failure

26

## Requesting a Waiver

- Standards for waiver and stiff potential penalties highlight the importance of robust oversight and checks-and-balances for 1099-R filings
- Waiver is typically all-or-nothing: partial waivers unusual as fact circumstances are typically identical for a filing failure

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## Requesting a Waiver

- Service will look for detailed explanation regarding significant mitigating factors
- Should be able to demonstrate record of compliance and safeguards to prevent failures
- Should be able to demonstrate prompt response to discovery of failure
- If request for waiver is denied, appeal is available

28

## Correcting Erroneous 1099-R's

- Why?
  - Had facts, e.g. amount, wrong
  - Used wrong code
- Must You?
  - IRC §6721 and the regulations thereunder prescribe monetary penalties for failure to file correct 1099-R, and also prescribe abatements of monetary penalties for prompt correction of failures to file correct 1099-R's
  - No requirement in Code or regulations to correct an erroneously filed 1099-R
  - EPCRS does not require 1099-R as part of correction for operational failures constituting "overpayments"

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## Correcting Erroneous 1099-R's (cont'd)

- IRS nevertheless in instructions to 1099-R urges correction, without any apparent limit as to time period and:

If you filed a return with the IRS and later discover you made an error on it, you must:

- Correct it as soon as possible and file Copy A and Form 1096 with your Internal Revenue Service Center (see part D).
- Furnish statements to recipients showing the correction.

From 2014 "General Instructions for Certain Information Returns"

- IRC §6047(d) authorizes Treasury to prescribe reporting requirements "by forms on regulations"
- How far back should you go?
  - Assuming member timely filed his/her 1040, would be relevant at least three calendar years back (e.g., could correct 2010 as late as April 15, 2014, since 2010 1040 return would have been done April 15, 2014)
  - If correction is of prior underreporting and additional amount exceeds 25% of member's income for year of original report, could be relevant six years back (See IRC §6501(e)(1))

30

*What is stat/limit re error corrected?*  
*3 yrs re recipient*  
*6 yrs re large amt*  
 Consider "PLR" (private letter ruling) note that recipient is proper party to request PLR

*see pages 15, 16 re IRS instructions for 1099-R, giving detailed descriptors/codes*

## Ethical Issues in 1099-R Preparation

- What if for particular payment or set of payments plan determines that correct code(s) for 1099-R cannot be determined with certainty because of tax law uncertainty and/or ambiguity of 1099-R instructions
  - Could occur, for example, with respect to “early distribution” Code 1
- Leaving box 2a blank and checking “Taxable amount not determined” in box 2b is usually not responsive unless issue is taxable portion of reported payments
- Applying for IRS private letter ruling may not practical, and may not even be possible since the issue is the member’s Federal income tax liability

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## Hypothetical #1

- Member retires at age 53 (not public safety) and receives regular monthly pension
  - Code 7? Code 2?
- Member retires at age 45 on account of disability (on- or off-duty)
  - Code 3? Code 2?

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## Hypothetical #2

- Police officer retires at age 49 and begins receiving monthly pension in year 1
  - Code 2 for years 1 through 3
- In year 4 receives substantial nonperiodic payment (e.g., from DROP)
  - In year 4, Code 1 for entire amount? Or use two 1099-Rs and report pension using Code 2 and DROP distribution using Code 1?
- What if annuitizes DROP using SEPP?

33

## Hypothetical #3

- Same facts as Hypothetical #2, but retired police officer demonstrates that became disabled after retiring and DROP distribution was made because had to quit retirement job
  - For DROP 1099-R, Code 1? Code 2? Code 3?
  - Still need two 1099-R's?

34

*substantially equal payments - excepted  
justifying use of  
code # 2*

## Hypothetical #4

- Same facts as Hypothetical #2, but nonperiodic payment is not from DROP, but is 13<sup>th</sup> check-type benefit that qualifies as an “independent payment” under Q & A – 6(b) (2) of Treas. Reg. §1.402(c)-2, i.e., exceeds greater of (a) 10% of “annual rate of payment” or (b) \$750, and meets other requirements

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## Hypothetical #5

- Member over 65 requests DROP distribution in March of year 1, and plan mails in April of year 1
- Three months later, without having cashed check, member contacts plan and requests that plan issue stop payment order because member no longer needs
- What if member doesn't request that distribution be undone, but does not cash check and, under plan policy, stop payment order is issued after six months?
- See Rev. Rul. 80-58 for “rescission doctrine” if payment and rescission occur in same taxable year
- What if member cashes check, but wants to return funds before end of calendar year? What if returned funds had been paid by mistake, i.e. not at member's request?

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## Hypothetical #6

- Same facts as Hypothetical #5, except distribution requested in December of year 1 and 1099-R filed in year 2 reporting distribution

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## Hypothetical #7

- Retired city manager receives pension; portion exceeds 415(b) limit and is paid by 415(m) plan

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## Hypothetical #8

- Survivor of member who died in line of duty receives during year ad hoc DROP distribution in addition to regular survivor pension payments
- What about 13<sup>th</sup> check-type payment?

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# 2014



Department of the Treasury  
Internal Revenue Service

## Instructions for Forms 1099-R and 5498

### Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., and IRA Contribution Information

Section references are to the Internal Revenue Code unless otherwise noted.

#### Future Developments

For the latest information about developments related to Forms 1099-R and 5498 and their instructions, such as legislation enacted after they were published, go to [www.irs.gov/form1099r](http://www.irs.gov/form1099r) or [www.irs.gov/form5498](http://www.irs.gov/form5498).

#### What's New

##### Form 1099-R

**New distribution code.** Use distribution Code K to report distributions of IRA assets not having a readily available FMV. See the *Guide to Distribution Codes*, later.

##### Form 5498

**Box 15a. FMV of certain specified assets.** Use box 15a to report the fair market value (FMV) of investments in the IRA that are specified by category code(s) in box 15b.

**Box 15b. Code(s).** Use codes A through H for reporting the type(s) of investments held in an IRA for which the FMV is required to be reported in box 15a.

See *Reporting FMV of certain specified assets*, and the *Instructions for box 15b*, in the *Specific Instructions for Form 5498*, later.



Using new Code K on Form 1099-R, and boxes 15a and 15b on Form 5498, for reporting hard-to-value IRA assets is optional for 2014.

#### Reminder

In addition, see the 2014 General Instructions for Certain Information Returns for information on the following topics.

- Who must file (nominee/middleman).
- When and where to file.
- Electronic reporting requirements.
- Corrected and void returns.
- Statements to recipients.
- Taxpayer identification numbers.
- Backup withholding.
- Penalties.
- Other general topics.

You can get the general instructions at [www.irs.gov/form1099r](http://www.irs.gov/form1099r) or [www.irs.gov/form5498](http://www.irs.gov/form5498) or call 1-800-TAX-FORM (1-800-829-3676).

#### Specific Instructions for Form 1099-R

File Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., for each person to whom you have made a designated distribution or are treated as having made a distribution of \$10 or more from profit-sharing or retirement plans, any individual retirement arrangements (IRAs), annuities, pensions, insurance contracts, survivor income benefit plans, permanent and total disability payments under life insurance contracts, charitable gift annuities, etc.

Also, report on Form 1099-R death benefit payments made by employers that are not made as part of a pension, profit-sharing, or retirement plan. See *Box 1*, later.

Reportable disability payments made from a retirement plan must be reported on Form 1099-R.

Generally, do not report payments subject to withholding of social security and Medicare taxes on this form. Report such payments on Form W-2, Wage and Tax Statement.

Generally, do not report amounts totally exempt from tax, such as workers' compensation and Department of Veterans Affairs (VA) payments. However, if part of the distribution is taxable and part is nontaxable, report the entire distribution.



There is no special reporting for qualified health savings account (HSA) funding distributions described in section 408(d)(9) or for the payment of qualified health and long-term care insurance premiums for retired public safety officers described in section 402(l).

**Military retirement annuities.** Report payments to military retirees or payments of survivor benefit annuities on Form 1099-R. Report military retirement pay awarded as a property settlement to a former spouse under the name and taxpayer identification number (TIN) of the recipient, not that of the military retiree.

**Governmental section 457(b) plans.** Report on Form 1099-R, not Form W-2, income tax withholding and distributions from a governmental section 457(b) plan maintained by a state or local government employer. Distributions from a governmental section 457(b) plan to a participant or beneficiary include all amounts that are paid from the plan. For more information, see Notice 2003-20 which is on page 894 of Internal Revenue Bulletin 2003-19, at [www.irs.gov/pub/irs-irbs/irb03-19.pdf](http://www.irs.gov/pub/irs-irbs/irb03-19.pdf). Also see *Governmental section 457(b) plan distributions*, later, for information on distribution codes.

**Nonqualified plans.** Report any reportable distributions from commercial annuities. Report distributions to employee plan participants from section 409A nonqualified deferred compensation plans (including nongovernmental section 457(b) plans) on Form W-2, not on Form 1099-R; for nonemployees, these payments are reportable on Form 1099-MISC. Also, report distributions to beneficiaries of deceased plan participants on Form 1099-MISC.

**Section 404(k) dividends.** Distributions of section 404(k) dividends from an employee stock ownership plan (ESOP), including a tax credit ESOP, are reported on Form 1099-R. Distributions other than section 404(k) dividends from the plan must be reported on a separate Form 1099-R.

Section 404(k) dividends paid directly from the corporation to participants or their beneficiaries are reported on Form 1099-DIV. See Announcement 2008-56, 2008-26 I.R.B. 1192, available at [www.irs.gov/irb/2008-26\\_IRB/ar11.html](http://www.irs.gov/irb/2008-26_IRB/ar11.html).

**Charitable gift annuities.** If cash or capital gain property is donated in exchange for a charitable gift annuity, report distributions from the annuity on Form 1099-R. See *Charitable gift annuities*, later.

**Life insurance, annuity, and endowment contracts.** Report payments of matured or redeemed annuity, endowment, and life insurance contracts. However, you do not need to file Form 1099-R to report the surrender of a life insurance contract if it is reasonable to believe that none of the payment is includible in the income of the recipient. If you are reporting the surrender of a life insurance contract, see *Code 7*, later.

Report premiums paid by a trustee or custodian for the cost of current life or other insurance protection. Costs of current life insurance protection are not subject to the 10% additional tax under section 72(t). See *Cost of current life insurance protection*, later.

Report charges or payments for a qualified long-term care insurance contract against the cash value of an annuity contract or the cash surrender value of a life insurance contract, which is excludible from gross income under section 72(e)(11). See *Code W*, later.

**Section 1035 exchange.** A tax-free section 1035 exchange is the exchange of (a) a life insurance contract for another life insurance contract, or for an endowment or annuity contract, or for a qualified long-term care insurance contract; or (b) a contract of endowment insurance for another contract of endowment insurance that provides for regular payments to begin no later than they would have begun under the old contract, or for an annuity contract, or for a qualified long-term care insurance contract; or (c) an annuity contract for an annuity contract or for a qualified long-term care insurance contract; or (d) a qualified long-term care insurance contract for a qualified long-term care insurance contract. A contract shall not fail to be treated as an annuity contract or as a life insurance contract solely because a qualified long-term care insurance contract is a part of or a rider on such contract. However, the distribution of other property or the cancellation of a contract loan at the time

of the exchange may be taxable and reportable on a separate Form 1099-R.

These exchanges of contracts are generally reportable on Form 1099-R. However, reporting on Form 1099-R is not required if (a) the exchange occurs within the same company, (b) the exchange is solely a contract for contract exchange, as defined above, that does not result in a designated distribution, and (c) the company maintains adequate records of the policyholder's basis in the contracts. For example, a life insurance contract issued by Company X received in exchange solely for another life insurance contract previously issued by Company X does not have to be reported on Form 1099-R as long as the company maintains the required records. See Rev. Proc. 92-26, 1992-1 C.B. 744, for certain exchanges for which reporting is not required under section 6047(d). Also see Rev. Rul. 2007-24, 2007-21 I.R.B. 1282, available at [www.irs.gov/irb/2007-21\\_IRB/ar15.html](http://www.irs.gov/irb/2007-21_IRB/ar15.html) for certain transactions that do not qualify as tax-free exchanges. For more information on partial exchanges of annuity contracts, see Rev. Proc. 2011-38, 2011-30 I.R.B. 66, available at [www.irs.gov/irb/2011-30\\_IRB/ar09.html](http://www.irs.gov/irb/2011-30_IRB/ar09.html).


For more information on reporting taxable exchanges, see *Box 1*, later.

**Prohibited transactions.** If an IRA owner engages in a prohibited transaction with respect to an IRA, the assets of the IRA are treated as distributed on the first day of the tax year in which the prohibited transaction occurs. IRAs that include, or consist of, non-marketable securities and/or closely held investments, in which the IRA owner effectively controls the underlying assets of such securities or investments, have a greater potential for resulting in a prohibited transaction. Enter Code 5 in box 7.

### Designated Roth Account Contributions

An employer offering a section 401(k), 403(b), or governmental section 457(b) plan may allow participants to contribute all or a portion of the elective deferrals they are otherwise eligible to make to a separate designated Roth account established under the plan. Contributions made under a section 401(k) plan must meet the requirements of Regulations section 1.401(k)-1(f) (Regulations section 1.403(b)-3(c) for a section 403(b) plan). Under the terms of the section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan, the designated Roth account must meet the requirements of section 402A.

### IRA Distributions

 **TIP** For deemed IRAs under section 408(q), use the rules that apply to traditional IRAs or Roth IRAs as applicable. Simplified employee pension (SEP) IRAs and savings incentive match plan for employees (SIMPLE) IRAs, however, may not be used as deemed IRAs.

**Deemed IRAs.** For more information on deemed IRAs in qualified employer plans, see Regulations section 1.408(q)-1.

**IRAs other than Roth IRAs.** Unless otherwise instructed, distributions from any IRA that is not a Roth IRA must be reported in boxes 1 and 2a. Check the "Taxable amount not determined" box in box 2b. But see:

- *Traditional, SEP, or SIMPLE IRA*, later, for how to report the withdrawal of IRA contributions under section 408(d)(4),
- *Transfers*, later, for information on trustee-to-trustee transfers, including recharacterizations,
- Reporting a corrective distribution from an IRA under section 408(d)(5), later,
- Reporting IRA revocations or account closures due to Customer Identification Program failures on this page, and
- Reporting a transfer from a SIMPLE IRA to a non-SIMPLE IRA within the first 2 years of plan participation, later.

The direct rollover provisions beginning later do not apply to distributions from any IRA. However, taxable distributions from traditional IRAs and SEP IRAs may be rolled over into an eligible retirement plan. See section 408(d)(3). SIMPLE IRAs may also be rolled over into an eligible retirement plan, but only after the 2-year period described in section 72(t)(6).

An IRA includes all investments under one IRA plan or account. File only one Form 1099-R for distributions from all investments under one plan that are paid in 1 year to one recipient, unless you must enter different codes in box 7. You do not have to file a separate Form 1099-R for each distribution under the plan.

**Roth IRAs.** For distributions from a Roth IRA, report the gross distribution in box 1 but generally leave box 2a blank. Check the "Taxable amount not determined" box in box 2b. Enter Code J, Q, or T as appropriate in box 7. Do not use any other codes with Code Q or Code T. You may enter Code 8 or P with Code J. For the withdrawal of excess contributions, see *Roth IRA*, later. It is not necessary to mark the IRA/SEP/SIMPLE checkbox.

**Roth IRA conversions.** You must report a traditional, SEP, or SIMPLE IRA distribution that you know is converted 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.

**Distributions allocable to an in-plan Roth rollover (IRR).** The distribution of an amount allocable to the taxable amount of an in-plan Roth rollover (IRR), made within the 5-year period beginning with the first day of the participant's tax year in which the rollover was made, is treated as includible in gross income for purposes of applying section 72(t) to the distribution. The total amount allocable to such an IRR is reported in box 10. See the instructions for *Box 10*, later.



*A separate Form 1099-R must be used to report the total annual distribution from a designated Roth account.*

## 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 a 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.

## Deductible Voluntary Employee Contributions (DVECs)

If you are reporting a total distribution from a plan that includes a distribution of DVECs, you may file a separate Form 1099-R to report the distribution of DVECs. If you do, report the distribution of DVECs in boxes 1 and 2a on the separate Form 1099-R. For the direct rollover (explained later) of funds that include DVECs, a separate Form 1099-R is not required to report the direct rollover of the DVECs.

## Direct Rollovers

You must report a direct rollover of an eligible rollover distribution. A direct rollover is the direct payment of the

distribution from a qualified plan, a section 403(b) plan, or a governmental section 457(b) plan to a traditional IRA, Roth IRA, or other eligible retirement plan. For additional rules regarding the treatment of direct rollovers from designated Roth accounts, see *Designated Roth accounts*, later. A direct rollover may be made for the employee, for the employee's surviving spouse, for the spouse or former spouse who is an alternate payee under a qualified domestic relations order (QDRO) or for a nonspouse designated beneficiary, in which case the direct rollover can only be made to an inherited IRA. If the distribution is paid to the surviving spouse, the distribution is treated in the same manner as if the spouse were the employee. See Part V of Notice 2007-7, 2007-5 I.R.B. 395, available at [www.irs.gov/irb/2007-05\\_IRB/ar11.html](http://www.irs.gov/irb/2007-05_IRB/ar11.html), which has been modified by Notice 2009-82, 2009-41 I.R.B. 491, available at [www.irs.gov/irb/2009-41\\_IRB/ar12.html](http://www.irs.gov/irb/2009-41_IRB/ar12.html) for guidance on direct rollovers by nonspouse designated beneficiaries. See also Notice 2008-30, Part II, 2008-12 I.R.B. 638, available at [www.irs.gov/irb/2008-12\\_IRB/ar11.html](http://www.irs.gov/irb/2008-12_IRB/ar11.html), which has been amplified and clarified by Notice 2009-75, 2009-39 I.R.B. 436, available at [www.irs.gov/irb/2009-39\\_IRB/ar15.html](http://www.irs.gov/irb/2009-39_IRB/ar15.html), for questions and answers covering rollover contributions to Roth IRAs.



*Notice 2007-7 and Notice 2008-30 do not reflect changes made to section 402 by the Worker, Retiree, and Employer Recovery Act of 2008.*

An eligible rollover distribution is any distribution of all or any portion of the balance to the credit of the employee (including net unrealized appreciation (NUA)) from a qualified plan, a section 403(b) plan or a governmental section 457(b) plan except:

1. One of a series of substantially equal periodic payments made at least annually over:
  - a. The life of the employee or the joint lives of the employee and the employee's designated beneficiary,
  - b. The life expectancy of the employee or the joint life and last survivor expectancy of the employee and the employee's designated beneficiary, or
  - c. A specified period of 10 years or more.
2. A required minimum distribution (RMD) under section 401(a)(9). A plan administrator is permitted to assume there is no designated beneficiary for purposes of determining the minimum distribution.
3. Elective deferrals (under section 402(g)(3)), employee contributions, and earnings on each returned because of the section 415 limits.
4. Corrective distributions of excess deferrals (under section 402(g)) and earnings.
5. Corrective distributions of excess contributions under a qualified cash or deferred arrangement (under section 401(k)) and excess aggregate contributions (under section 401(m)) and earnings.
6. Loans treated as deemed distributions (under section 72(p)). But plan loan offset amounts can be eligible rollover distributions. See Regulations section 1.402(c)-2, Q/A-9.
7. Section 404(k) dividends.
8. Cost of current life insurance protection.

9. Distributions to a payee other than the employee, the employee's surviving spouse, a spouse or former spouse who is an alternate payee under a QDRO, or a nonspouse designated beneficiary.

10. Any hardship distribution.

11. A permissible withdrawal under section 414(w).

12. Prohibited allocations of securities in an S corporation that are treated as deemed distributions.

13. Distributions of premiums for accident or health insurance under Regulations section 1.402(a)-1(e).

Amounts paid under an annuity contract purchased for and distributed to a participant under a qualified plan can qualify as eligible rollover distributions. See Regulations section 1.402(c)-2, Q/A-10.

**Automatic rollovers.** Eligible rollover distributions may also include involuntary distributions that are more than \$1,000 but \$5,000 or less and are made from a qualified plan to an IRA on behalf of a plan participant. Involuntary distributions are generally subject to the automatic rollover provisions of section 401(a)(31)(B) and must be paid in a direct rollover to an IRA, unless the plan participant elects to receive the distribution directly.

For information on the notification requirements, see *Explanation to Recipients Before Eligible Rollover Distributions (Section 402(f) Notice)*, later. For additional information, also see Notice 2005-5, 2005-3 I.R.B. 337, available at [www.irs.gov/irb/2005-03\\_IRB/ar10.html](http://www.irs.gov/irb/2005-03_IRB/ar10.html), modified by Notice 2005-95, 2005-51 I.R.B. 1172, available at [www.irs.gov/irb/2005-51\\_IRB/ar12.html](http://www.irs.gov/irb/2005-51_IRB/ar12.html).

**Reporting a direct rollover.** Report a direct rollover in box 1 and a 0 (zero) in box 2a, unless the rollover is a direct rollover of a qualified rollover contribution other than from a designated Roth account. See *Qualified rollover contributions as defined in section 408A(e)*, later. You do not have to report capital gain in box 3 or NUA in box 6. Enter Code G in box 7 unless the rollover is a direct rollover from a designated Roth account to a Roth IRA. See *Designated Roth accounts* below. If the direct rollover is made by a nonspouse designated beneficiary, also enter Code 4 in box 7.

Prepare the form using the name and social security number (SSN) of the person for whose benefit the funds were rolled over (generally the participant), not those of the trustee of the traditional IRA or other plan to which the funds were rolled.

If part of the distribution is a direct rollover and part is distributed to the recipient, prepare two Forms 1099-R.

For more information on eligible rollover distributions, including substantially equal periodic payments, RMDs, and plan loan offset amounts, see Regulations sections 1.402(c)-2 and 1.403(b)-7(b). Also, see Rev. Rul. 2002-62 which is on page 710 of Internal Revenue Bulletin 2002-42 at [www.irs.gov/pub/irs-irbs/irb02-42.pdf](http://www.irs.gov/pub/irs-irbs/irb02-42.pdf) for guidance on substantially equal periodic payments.



**TIP** For information on distributions of amounts attributable to rollover contributions separately accounted for by an eligible retirement plan and if permissible timing restrictions apply, see Rev. Rul. 2004-12, 2004-7 I.R.B. 478, available at [www.irs.gov/irb/2004-07\\_IRB/ar08.html](http://www.irs.gov/irb/2004-07_IRB/ar08.html).

**Designated Roth accounts.** A direct rollover from a designated Roth account may only be made to another designated Roth account or to a Roth IRA. A distribution from a Roth IRA, however, cannot be rolled over into a designated Roth account. In addition, a plan is permitted to treat the balance of the participant's designated Roth account and the participant's other accounts under the plan as accounts held under two separate plans for purposes of applying the automatic rollover rules of section 401(a)(31)(B) and Q/A-9 through Q/A-11 of Regulations section 1.401(a)(31)-1. Thus, if a participant's balance in the designated Roth account is less than \$200, the plan is not required to offer a direct rollover election or to apply the automatic rollover provisions to such balance.

A distribution from a designated Roth account that is a qualified distribution is tax-free. A qualified distribution is a payment that is made both after age 59½ (or after death or disability) and after the 5-taxable-year period that begins with the first day of the first taxable year in which the employee makes a contribution to the designated Roth account. Certain amounts, including corrective distributions, cannot be qualified distributions. See Regulations section 1.402A-1.

If any portion of a distribution from a designated Roth account that is not includible in gross income is to be rolled over into a designated Roth account under another plan, the rollover must be accomplished by a direct rollover. Any portion not includible in gross income that is distributed to the employee, however, cannot be rolled over to another designated Roth account, though it can be rolled over into a Roth IRA within the 60-day period described in section 402(c)(3). In the case of a direct rollover, the distributing plan is required to report to the recipient plan the amount of the investment (basis) in the contract and the first year of the 5-taxable-year period, or that the distribution is a qualified distribution.

For a direct rollover of a distribution from a designated Roth account to a Roth IRA, enter the amount rolled over in box 1 and 0 (zero) in box 2a. Use Code H in box 7. For all other distributions from a designated Roth account, use Code B in box 7, unless Code E applies. If the direct rollover is from one designated Roth account to another designated Roth account, also enter Code G in box 7.

For a direct rollover of a distribution from a section 401(k) plan, a section 403(b) plan, or a governmental section 457(b) plan to a designated Roth account in the same plan, enter the amount rolled over in box 1, the taxable amount in box 2a, and any basis recovery amount in box 5. Use Code G in box 7.

**Qualified rollover contributions as defined in section 408A(e).** A qualified rollover contribution as defined in section 408A(e) is:

- A rollover contribution to a Roth IRA from another IRA that meets the requirements of section 408(d)(3) or

- A rollover contribution to a Roth IRA from an eligible retirement plan (other than an IRA) that meets the requirements of section 408A(e)(1)(B).

For reporting a rollover from an IRA other than a Roth IRA to a Roth IRA, see *Roth IRA conversions*, earlier and later.

For a direct rollover of an eligible rollover distribution to a Roth IRA (other than from a designated Roth account), report the total amount rolled over in box 1, the taxable amount in box 2a, and any basis recovery amount in box 5. (See the instructions for *Box 5*, later.) Use Code G in box 7. If the direct rollover is made on behalf of a nonspouse designated beneficiary, also enter Code 4 in box 7.

For reporting instructions for a direct rollover from a designated Roth account, see *Designated Roth accounts*, earlier.

### Explanation to Recipients Before Eligible Rollover Distributions (Section 402(f) Notice)

For qualified plans, section 403(b) plans, and governmental section 457(b) plans, the plan administrator must provide to each recipient of an eligible rollover distribution an explanation using either a written paper document or an electronic medium (section 402(f) notice). The explanation must be provided no more than 180 days and no fewer than 30 days before making an eligible rollover distribution or before the annuity starting date. However, if the recipient who has received the section 402(f) notice affirmatively elects a distribution, you will not fail to satisfy the timing requirements merely because you make the distribution fewer than 30 days after you provided the notice as long as you meet the requirements of Regulations section 1.402(f)-1, Q/A-2. The electronic section 402(f) notice must meet the requirements for using electronic media in Regulations section 1.401(a)-21.

The notice must explain the rollover rules, the special tax treatment for certain lump-sum distributions, the direct rollover option (and any default procedures), the mandatory 20% withholding rules, and an explanation of how distributions from the plan to which the rollover is made may have different restrictions and tax consequences than the plan from which the rollover is made. The notice is permitted to be sent either as a written paper document or through an electronic medium; see Regulations section 1.402(f)-1, Q/A-5.

For periodic payments that are eligible rollover distributions, you must provide the notice before the first payment and at least once a year as long as the payments continue. For section 403(b) plans, the payer must provide an explanation of the direct rollover option within the time period described earlier or some other reasonable period of time.

Notice 2009-68, 2009-39 I.R.B. 423, available at [www.irs.gov/irb/2009-39\\_IRB/ar14.html](http://www.irs.gov/irb/2009-39_IRB/ar14.html), contains two safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan in order to satisfy section 402(f). See also Notice 2009-75, and, if the plan offers IRRs, Notice 2010-84, Q/A-5, 2010-51 I.R.B. 872, which is available at [www.irs.gov/irb/2010-51\\_IRB/ar11.html](http://www.irs.gov/irb/2010-51_IRB/ar11.html).

**Involuntary distributions.** For involuntary distributions paid to an IRA in a direct rollover (automatic rollover) you may satisfy the notification requirements of section 401(a)(31)(B)(i) either separately or as a part of the section 402(f) notice. The notification must be in writing and may be sent using electronic media in accordance with Q/A-5 of Regulations section 1.402(f)-1. Also see Notice 2005-5, Q/A-15.

## Transfers

Generally, do not report a transfer between trustees or issuers that involves no payment or distribution of funds to the participant, including a trustee-to-trustee transfer from one IRA to another IRA, valid transfers from one section 403(b) plan in accordance with paragraphs 1 through 3 of Regulations section 1.403(b)-10(b), or for the purchase of permissive service credit under section 403(b)(13) or section 457(e)(17) in accordance with paragraph 4 of Regulations section 1.403(b)-10(b) and Regulations section 1.457-10(b)(8). However, you must report:

- Recharacterized IRA contributions;
- Roth IRA conversions;
- Direct rollovers from qualified plans, section 403(b) plans or governmental section 457(b) plans, including any direct rollovers from such plans that are IRRs or are qualified rollover contributions described in section 408A(e); and
- Direct payments from IRAs to accepting employer plans.

**IRA recharacterizations.** You must report each recharacterization of an IRA contribution. If a participant makes a contribution to an IRA (first IRA) for a year, the participant may choose to recharacterize the contribution by transferring, in a trustee-to-trustee transfer, any part of the contribution (plus earnings) to another IRA (second IRA). The contribution is treated as made to the second IRA (recharacterization). A recharacterization may be made with the same trustee or with another trustee. The trustee of the first IRA must report the recharacterization as a distribution on Form 1099-R and the contribution to the first IRA and its character on Form 5498.

Enter the fair market value (FMV) of the amount recharacterized in box 1, 0 (zero) in box 2a, and Code R in box 7 if reporting a recharacterization of a prior-year (2013) contribution or Code N if reporting a recharacterization of a contribution in the same year (2014). It is not necessary to check the IRA/SEP/SIMPLE checkbox. For more information on how to report, see Notice 2000-30 on page 1266 of Internal Revenue Bulletin 2000-25 at [www.irs.gov/pub/irs-irbs/irb00-25.pdf](http://www.irs.gov/pub/irs-irbs/irb00-25.pdf).

**Section 1035 exchange.** You may have to report exchanges of insurance contracts, including an exchange under section 1035, under which any designated distribution may be made. For a section 1035 exchange that is in part taxable, file a separate Form 1099-R to report the taxable amount. See *Section 1035 exchange*, earlier.

**SIMPLE IRAs.** Do not report a trustee-to-trustee transfer from one SIMPLE IRA to another SIMPLE IRA. However, you must report as a taxable distribution in boxes 1 and 2a a trustee-to-trustee transfer from a SIMPLE IRA to an IRA

that is not a SIMPLE IRA during the 2-year period beginning on the day contributions are first deposited in the individual's SIMPLE IRA by the employer. Use Code S in box 7 if appropriate.

**Transfer of an IRA to spouse.** If you transfer or re-designate an interest from one spouse's IRA to an IRA for the other spouse under a divorce or separation instrument, the transfer or re-designation as provided under section 408(d)(6) is tax free. Do not report such a transfer on Form 1099-R.

## Corrective Distributions

You must report on Form 1099-R corrective distributions of excess deferrals, excess contributions and excess aggregate contributions under section 401(a) plans, section 401(k) cash or deferred arrangements, section 403(a) annuity plans, section 403(b) salary reduction agreements, and salary reduction simplified employee pensions (SARSEPs) under section 408(k)(6). Excess contributions that are recharacterized under a section 401(k) plan are treated as distributed. Corrective distributions must include earnings through the end of the year in which the excess arose. These distributions are reportable on Form 1099-R and are generally taxable in the year of the distribution (except for excess deferrals under section 402(g)). Enter Code 8 or P in box 7 (with Code B if applicable) to designate the distribution and the year it is taxable.

Use a separate Form 1099-R to report a corrective distribution from a designated Roth account.



*The total amount of the elective deferral is reported in box 12 of Form W-2. See the Instructions for Forms W-2 and W-3 for more information.*

For more information about reporting corrective distributions see: the *Guide to Distribution Codes*, later; Notice 89-32, 1989-1 C.B. 671; Notice 88-33, 1988-1 C.B. 513; Notice 87-77, 1987-2 C.B. 385; and the Regulations under sections 401(k), 401(m), 402(g), and 457.

**Excess deferrals.** Excess deferrals under section 402(g) can occur in section 401(k) plans, section 403(b) plans or SARSEPs. If distributed by April 15 of the year following the year of deferral, the excess is taxable to the participant in the year of deferral (other than designated Roth contributions), but the earnings are taxable in the year distributed. Except for a SARSEP, if the distribution occurs after April 15, the excess is taxable in the year of deferral and the year distributed. The earnings are taxable in the year distributed. For a SARSEP, excess deferrals not withdrawn by April 15 are considered regular IRA contributions subject to the IRA contribution limits. Corrective distributions of excess deferrals are not subject to federal income tax withholding or social security and Medicare taxes. For losses on excess deferrals, see *Losses*, below. See Regulations section 1.457-4(e) for special rules relating to excess deferrals under governmental section 457(b) plans.

**Excess contributions.** Excess contributions can occur in a section 401(k) plan or a SARSEP. All distributions of the excess contributions plus earnings (other than

designated Roth contributions), including recharacterized excess contributions, are taxable to the participant in the year of distribution. Report the gross distribution in box 1 of Form 1099-R. In box 2a, enter the excess contribution and earnings distributed less any designated Roth contributions. For a SARSEP, the employer must notify the participant by March 15 of the year after the year the excess contribution was made that the participant must withdraw the excess and earnings. All distributions from a SARSEP are taxable in the year of distribution. An excess contribution not withdrawn by April 15 of the year after the year of notification is considered a regular IRA contribution subject to the IRA contribution limits.



*Regulations have not been updated for SARSEPs.*

**Excess aggregate contributions.** Excess aggregate contributions under section 401(m) can occur in section 401(a), section 401(k), section 403(a), and section 403(b) plans. A corrective distribution of excess aggregate contributions plus earnings is taxable to the participant in the year the distribution was made. Report the gross distribution in box 1 of Form 1099-R. In box 2a, enter the excess and earnings distributed less any after-tax contributions.

**Losses.** If a corrective distribution of an excess deferral is made in a year after the year of deferral and a net loss has been allocated to the excess deferral, report the corrective distribution amount in boxes 1 and 2a of Form 1099-R for the year of the distribution with the appropriate distribution code in box 7. If the excess deferrals consist of designated Roth contributions, report the corrective distribution amount in box 1, 0 (zero) in box 2a, and the appropriate distribution code in box 7. However, taxpayers must include the total amount of the excess deferral (unadjusted for loss) in income in the year of deferral, and they may report a loss on the tax return for the year the corrective distribution is made.

### **Distributions under Employee Plans Compliance Resolution System (EPCRS)**

The procedure for correcting excess annual additions under section 415 is explained in the latest EPCRS revenue procedure, Rev. Proc. 2013-12, 2013-4 I.R.B. 313, available at [www.irs.gov/irb/2013-04\\_IRB/ar06.html](http://www.irs.gov/irb/2013-04_IRB/ar06.html).

Distributions to correct a section 415 failure are not eligible rollover distributions although they are subject to federal income tax withholding under section 3405. They are not subject to social security, Medicare, or Federal Unemployment Tax Act (FUTA) taxes. In addition, such distributions are not subject to the 10% early distribution tax under section 72(t).

You may report the distribution of elective deferrals (other than designated Roth contributions) and employee contributions (and earnings attributable to such elective deferrals and employee contributions) on the same Form 1099-R. However, if you made other distributions during the year, report them on a separate Form 1099-R. Because the distribution of elective deferrals (other than designated Roth contributions) is fully taxable in the year distributed (no part of the distribution is a return of the

investment in the contract), report the total amount of the distribution in boxes 1 and 2a. Leave box 5 blank, and enter Code E in box 7. For a return of employee contributions (or designated Roth contributions) plus earnings, enter the gross distribution in box 1, the earnings attributable to the employee contributions (or designated Roth contributions) being returned in box 2a, and the employee contributions (or designated Roth contributions) being returned in box 5. Enter Code E in box 7. For more information, see Rev. Proc. 92-93, 1992-2 C.B. 505.

Similar rules apply to other corrective distributions under EPCRS. Also, special Form 1099-R reporting is available for certain plan loan failures. See Rev. Proc. 2013-12 for details.

If excess employer contributions (other than elective deferrals), and the earnings on them, under SEP, SARSEP, or SIMPLE IRA plans are returned to an employer (with the participant's consent), enter the gross distribution (excess and earnings) in box 1 and 0 (zero) in box 2a. Enter Code E in box 7.

### **Failing the ADP or ACP Test After a Total Distribution**

If you make a total distribution in 2014 and file a Form 1099-R with the IRS and then discover in 2015 that the plan failed either the section 401(k)(3) actual deferral percentage (ADP) test for 2014 and you compute excess contributions or the section 401(m)(2) actual contribution percentage (ACP) test and you compute excess aggregate contributions, you must recharacterize part of the total distribution as excess contributions or excess aggregate contributions. First, file a CORRECTED Form 1099-R for 2014 for the correct amount of the total distribution (not including the amount recharacterized as excess contributions or excess aggregate contributions). Second, file a new Form 1099-R for 2014 for the excess contributions or excess aggregate contributions and allocable earnings.

To avoid a late filing penalty if the new Form 1099-R is filed after the due date, enter in the bottom margin of Form 1096, Annual Summary and Transmittal of U.S. Information Returns, the words "Filed To Correct Excess Contributions."

You must also issue copies of the Forms 1099-R to the plan participant with an explanation of why these new forms are being issued. ADP and ACP test corrective distributions are exempt from the 10% early distribution tax under section 72(t).

### **Loans Treated as Distributions**

A loan from a qualified plan under sections 401(a) and 403(a) and (b), and a plan maintained by the United States, a state or political subdivision, or any agency or instrumentality of the United States, a state or political subdivision, made to a participant or beneficiary is not treated as a distribution from the plan if the loan satisfies the following requirements.

1. The loan is evidenced by an enforceable agreement,

2. The agreement specifies that the loan must be repaid within 5 years, except for a principal residence,
3. The loan must be repaid in substantially level installments (at least quarterly), and
4. The loan amount does not exceed the limits in section 72(p)(2)(A) (maximum limit is equal to the lesser of 50% of the vested account balance or \$50,000).

Certain exceptions, cure periods, and suspension of the repayment schedule may apply.

The loan agreement must specify the amount of the loan, the term of the loan, and the repayment schedule. The agreement may include more than one document.

If a loan fails to satisfy 1, 2, or 3, the balance of the loan is a deemed distribution. The distribution may occur at the time the loan is made or later if the loan is not repaid in accordance with the repayment schedule.

If a loan fails to satisfy 4 at the time the loan is made, the amount that exceeds the amount permitted to be loaned is a deemed distribution.

**Deemed distribution.** If a loan is treated as a deemed distribution, it is reportable on Form 1099-R using the normal taxation rules of section 72, including tax basis rules. The distribution also may be subject to the 10% early distribution tax under section 72(t). It is not eligible to be rolled over to an eligible retirement plan nor is it eligible for the 10-year tax option. On Form 1099-R, complete the appropriate boxes, including boxes 1 and 2a, and enter Code L in box 7. Also, enter Code 1 or Code B, if applicable.

Interest that accrues after the deemed distribution of a loan is not an additional loan, and, therefore, is not reportable on Form 1099-R.

Loans that are treated as deemed distributions or that are actual distributions are subject to federal income tax withholding. If such a distribution occurs after the loan is made, you must withhold only if you distributed cash or property (other than employer securities) at the time of the deemed or actual distribution. See section 72(p), section 72(e)(4)(A), and Regulations section 1.72(p)-1.

**Subsequent repayments.** If a participant makes any cash repayments on a loan that was reported on Form 1099-R as a deemed distribution, the repayments increase the participant's tax basis in the plan as if the repayments were after-tax contributions. However, such repayments are not treated as after-tax contributions for purposes of section 401(m) or 415(c)(2)(B).

For a deemed distribution that was reported on Form 1099-R but was not repaid, the deemed distribution does not increase the participant's basis.

If a participant's accrued benefit is reduced (offset) to repay a loan, the amount of the account balance that is offset against the loan is an actual distribution. Report it as you would any other actual distribution. Do not enter Code L in box 7.

### **Permissible Withdrawals Under Section 414(w)**

For permissible withdrawals from an eligible automatic contribution arrangement (EACA) under section 414(w):

- The distribution (except to the extent the distribution consists of designated Roth contributions) is included in the employee's gross income in the year distributed;
- Report principal and earnings in boxes 1 and 2a except, in the case of a distribution from a designated Roth account, report only earnings in box 2a;
- The distribution is not subject to the 10% additional tax, indicated by reporting Code 2 in box 7; and
- The distribution must be elected by the employee no later than 90 days after the first default elective contribution under the EACA, as specified in Regulations section 1.414(w)-1(c)(2).

If the distribution is from a designated Roth account, enter Code B as well as Code 2 in box 7.

### **Corrected Form 1099-R**

If you filed a Form 1099-R with the IRS and later discover that there is an error on it, you must correct it as soon as possible. For example, if you transmit a direct rollover and file a Form 1099-R with the IRS reporting that none of the direct rollover is taxable by entering 0 (zero) in box 2a, and you then discover that part of the direct rollover consists of RMDs under section 401(a)(9), you must file a corrected Form 1099-R reporting the eligible rollover distribution as the direct rollover and file a new Form 1099-R reporting the RMD as if it had been distributed to the participant. See part H in the 2014 General Instructions for Certain Information Returns or Pub. 1220, if filing electronically.

### **Filer**

The payer, trustee, or plan administrator must file Form 1099-R using the same name and employer identification number (EIN) used to deposit any tax withheld and to file Form 945, Annual Return of Withheld Federal Income Tax.

### **Beneficiaries**

If you make a distribution to a beneficiary, trust, or estate, prepare Form 1099-R using the name and TIN of the beneficiary, trust, or estate, not that of the decedent. If there are multiple beneficiaries, report on each Form 1099-R only the amount paid to the beneficiary whose name appears on the Form 1099-R, and enter the percentage in box 9a, if applicable.

**Disclaimers.** A beneficiary may make a qualified disclaimer of all or some of an IRA account balance if the disclaimed amount and income are paid to a new beneficiary or segregated in a separate account. A qualified disclaimer may be made after the beneficiary has previously received the RMD for the year of the decedent's death. For more information, see Rev. Rul. 2005-36, 2005-26 I.R.B. 1368, available at [www.irs.gov/irb/2005-26\\_IRB/ar11.html](http://www.irs.gov/irb/2005-26_IRB/ar11.html).

### **Alternate Payee under a Qualified Domestic Relations Order (QDRO)**

Distributions to an alternate payee who is a spouse or former spouse of the employee under a QDRO are reportable on Form 1099-R using the name and TIN of the alternate payee. If the alternate payee under a QDRO is a nonspouse, enter the name and TIN of the employee.

However, this rule does not apply to IRAs; see *Transfer of an IRA to spouse*, earlier.

## Nonresident Aliens

If income tax is withheld under section 3405 on any distribution to a nonresident alien, report the distribution and withholding on Form 1099-R. Also file Form 945 to report the withholding. See the Presumption Rules in part S of the 2014 General Instructions for Certain Information Returns.

However, any payments to a nonresident alien from any trust under section 401(a), any annuity plan under section 403(a), any annuity, custodial account, or retirement income account under section 403(b), or any IRA account under section 408(a) or (b) are subject to withholding under section 1441, unless there is an exception under a tax treaty. Report the distribution and withholding on Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons, and Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding.

For guidance regarding covered expatriates, see Notice 2009-85, 2009-45 I.R.B. 598, available at [www.irs.gov/irb/2009-45\\_IRB/ar10.html](http://www.irs.gov/irb/2009-45_IRB/ar10.html).

## Statements to Recipients

If you are required to file Form 1099-R, you must furnish a statement to the recipient. For more information about the requirement to furnish a statement to each recipient, see part M in the 2014 General Instructions for Certain Information Returns.

**Truncating recipient's identification number on paper payee statements.** Pursuant to proposed regulations § 301.6109-4 (REG-148873-09), all filers of Form 1099-R may truncate a recipient's identification number (social security number (SSN), individual taxpayer identification number (ITIN), or adoption taxpayer identification number (ATIN)) on payee statements. See part M in the 2014 General Instructions for Certain Information Returns, for more information.



**Do not enter a negative amount in any box on Form 1099-R.**

## Account Number

The account number is required if you have multiple accounts for a recipient for whom you are filing more than one Form 1099-R. Additionally, the IRS encourages you to designate an account number for all Forms 1099-R that you file. See part L in the 2014 General Instructions for Certain Information Returns.

## Box 1. Gross Distribution

Enter the total amount of the distribution before income tax or other deductions were withheld. Include direct rollovers, IRA direct payments to accepting employer plans, premiums paid by a trustee or custodian for the cost of current life or other insurance protection, including a recharacterization and a Roth IRA conversion. Also include in this box distributions to plan participants from governmental section 457(b) plans. However, in the case of a distribution by a trust representing certificates of

deposit (CDs) redeemed early, report the net amount distributed. Also, see *Box 6*, later.

Include in this box the value of U.S. Savings Bonds distributed from a plan. Enter the appropriate taxable amount in box 2a. Furnish a statement to the plan participant showing the value of each bond at the time of distribution. This will provide him or her with the information necessary to figure the interest income on each bond when it is redeemed.

Include in box 1 amounts distributed from a qualified retirement plan for which the recipient elects to pay health insurance premiums under a cafeteria plan or that are paid directly to reimburse medical care expenses incurred by the recipient (see Rev. Rul. 2003-62 on page 1034 of Internal Revenue Bulletin 2003-25 at [www.irs.gov/pub/irs-irb/irb03-25.pdf](http://www.irs.gov/pub/irs-irb/irb03-25.pdf)). Also include this amount in box 2a.

Include in box 1 charges or payments for qualified long-term care insurance contracts under combined arrangements. Enter Code W in box 7.

In addition to reporting distributions to beneficiaries of deceased employees, report here any death benefit payments made by employers that are not made as part of a pension, profit-sharing, or retirement plan. Also enter these amounts in box 2a; enter Code 4 in box 7.



**Do not report accelerated death benefits on Form 1099-R. Report them on Form 1099-LTC, Long-Term Care and Accelerated Death Benefits.**

For section 1035 exchanges that are reportable on Form 1099-R, enter the total value of the contract in box 1, 0 (zero) in box 2a, the total premiums paid in box 5, and Code 6 in box 7.

**Designated Roth account distributions.** If you are making a distribution from a designated Roth account, enter the gross distribution in box 1, the taxable portion of the distribution in box 2a, the basis included in the distributed amount in box 5, any amount allocable to an IRR made within the previous 5 years (unless an exception to section 72(t) applies) in box 10, and the first year of the 5-taxable-year period for determining qualified distributions in box 11. Also, enter the applicable code(s) in box 7.

**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. If there is a loss, see *Losses*, later.

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 and any after-tax employee contributions or designated Roth contributions in box 5.

**Charitable gift annuities.** If cash or capital gain property is donated in exchange for a charitable gift annuity, report the total amount distributed during the year in box 1. See *Charitable gift annuities* under *Box 3*, later.

## Box 2a. Taxable Amount



When determining the taxable amount to be entered in box 2a, do not reduce the taxable amount by any portion of the \$3,000 exclusion for which the participant may be eligible as a payment of qualified health and long-term care insurance premiums for retired public safety officers under section 402(l).

Generally, you must enter the taxable amount in box 2a. However, if you are unable to reasonably obtain the data needed to compute the taxable amount, leave this box blank. Do not enter excludable or tax-deferred amounts reportable in boxes 5, 6, and 8. Enter 0 (zero) in box 2a for:

- A direct rollover (other than an IRR) from a qualified plan, a section 403(b) plan, a governmental section 457(b) plan to another such plan or to a traditional IRA;
- A direct rollover from a designated Roth account to a Roth IRA;
- A traditional, SEP, or SIMPLE IRA directly transferred to an accepting employer plan;
- An IRA recharacterization;
- A nontaxable section 1035 exchange of life insurance, annuity, endowment or long-term care insurance contracts; or
- A nontaxable charge or payment, for the purchase of a qualified long-term care insurance contract, against the cash value of an annuity contract or the cash surrender value of a life insurance contract.

**Annuity starting date in 1998 or later.** If you made annuity payments from a qualified plan under section 401(a), 403(a), or 403(b) and the annuity starting date is in 1998 or later, you must use the simplified method under section 72(d)(1) to figure the taxable amount. Under this method, the expected number of payments you use to figure the taxable amount depends on whether the payments are based on the life of one or more than one person. See Notice 98-2, 1998-1 C.B. 266, and Pub. 575, Pension and Annuity Income, to help you figure the taxable amount to enter in box 2a.

**Annuity starting date after November 18, 1996, and before 1998.** Under the simplified method for figuring the taxable amount, the expected number of payments is based only on the primary annuitant's age on the annuity starting date. See Notice 98-2.

**Annuity starting date before November 19, 1996.** If you properly used the rules in effect before November 19, 1996, for annuities that started before that date, continue to report using those rules. No changes are necessary.

**Corrective distributions.** Enter in box 2a the amount of excess deferrals, excess contributions, or excess aggregate contributions (other than employee contributions or designated Roth contributions). See *Corrective Distributions*, earlier.

**Cost of current life insurance protection.** Include current life insurance protection costs (net premium costs) that were reported in box 1. However, do not report these costs and a distribution on the same Form 1099-R. Use a separate Form 1099-R for each. For the cost of current life insurance protection, enter Code 9 in box 7.

**DVECs.** Include DVEC distributions in this box. Also see *Deductible Voluntary Employee Contributions (DVECs)*, earlier.

**Designated Roth account.** Generally, a distribution from a designated Roth account that is not a qualified distribution is taxable to the recipient under section 402 in the case of a plan qualified under section 401(a), under section 403(b)(1) in the case of a section 403(b) plan and under section 457(a)(1)(A) in the case of a governmental section 457(b) plan. For purposes of section 72, designated Roth contributions are treated as employer contributions as described in section 72(f)(1) (that is, as includible in the participant's gross income).

**Examples.** Participant A received a nonqualified distribution of \$5,000 from the participant's designated Roth account. Immediately before the distribution, the participant's account balance was \$10,000, consisting of \$9,400 of designated Roth contributions and \$600 of earnings. The taxable amount of the \$5,000 distribution is \$300 ( $\$600/\$10,000 \times \$5,000$ ). The nontaxable portion of the distribution is \$4,700 ( $\$9,400/\$10,000 \times \$5,000$ ). The issuer would report on Form 1099-R:

- Box 1, \$5,000 as the gross distribution;
- Box 2a, \$300 as the taxable amount;
- Box 4, \$60 ( $\$300 \times 20\%$ ) as the withholding on the earnings portion of the distribution;
- Box 5, \$4,700 as the designated Roth contribution basis (nontaxable amount);
- Box 7, Code B; and
- The first year of the 5-taxable-year period in box 11.

Using the same facts as in the example above, except that the distribution was a direct rollover to a Roth IRA, the issuer would report on Form 1099-R:

- Box 1, \$5,000 as the gross distribution;
- Box 2a, 0 (zero) as the taxable amount;
- Box 4, no entry;
- Box 5, \$4,700 as the designated Roth contribution basis (nontaxable amount);
- Box 7, Code H; and
- The first year of the 5-taxable-year period in box 11.

**Losses.** If a distribution is a loss, do not enter a negative amount in this box. For example, if an employee's 401(k) account balance, consisting solely of stock, is distributed but the value is less than the employee's remaining after-tax contributions or designated Roth contributions, enter the value of the stock in box 1, leave box 2a blank, and enter the employee's contributions or designated Roth contributions in box 5.

For a plan with no after-tax contributions or designated Roth contributions, even though the value of the account may have decreased, there is no loss for reporting purposes. Therefore, if there are no employer securities distributed, show the actual cash and/or FMV of property distributed in boxes 1 and 2a, and make no entry in box 5. If only employer securities are distributed, show the FMV of the securities in boxes 1 and 2a and make no entry in box 5 or 6. If both employer securities and cash or other property are distributed, show the actual cash and/or FMV of the property (including employer securities) distributed in box 1, the gross less any NUA on employer securities in box 2a, no entry in box 5, and any NUA in box 6.

**Roth IRA.** 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, earlier. 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.** Report the total amount converted from a traditional IRA, SEP IRA, or SIMPLE IRA to a Roth IRA in box 2a. Check the "Taxable amount not determined" box in box 2b. A conversion is considered a distribution and must be reported even if it is with the same trustee and even if the conversion is done by a trustee-to-trustee transfer. When an individual retirement annuity described in section 408(b) is converted to a Roth IRA, the amount that is treated as distributed is the FMV of the annuity contract on the date the annuity contract is converted. This rule also applies when a traditional IRA holds an annuity contract as an account asset and the traditional IRA is converted to a Roth IRA. Determining the FMV of an individual retirement annuity issued by a company regularly engaged in the selling of contracts depends on the timing of the conversion as outlined in Q/A-14 of Regulations section 1.408A-4.

For a Roth IRA conversion, use Code 2 in box 7 if the participant is under age 59½ or Code 7 if the participant is at least age 59½. Also check the IRA/SEP/SIMPLE box in box 7.

**Traditional, SEP, or SIMPLE IRA.** Generally, you are not required to compute the taxable amount of a traditional, SEP, or SIMPLE IRA nor designate whether any part of a distribution is a return of basis attributable to nondeductible contributions. Therefore, except as provided below or elsewhere in these instructions, report the total amount distributed from a traditional, SEP, or SIMPLE IRA in box 2a. This will be the same amount reported in box 1. Check the "Taxable amount not determined" box in box 2b.

However, for a distribution by a trust representing CDs redeemed early, report the net amount distributed. Do not include any amount paid for IRA insurance protection in this box.

For a distribution of contributions plus earnings from an IRA before the due date of the return 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 or 4 also, if applicable.

For a distribution of excess 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" box in box 2b. Use Code 1 or 7 in box 7 depending on the age of the participant.

For an amount in a traditional IRA or a SEP IRA paid directly to an accepting employer plan, or an amount in a SIMPLE IRA paid directly to an accepting employer plan after the 2-year period (see section 72(t)(6)), enter the

gross amount in box 1, 0 (zero) in box 2a, and Code G in box 7.

### **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; but see *Traditional, SEP, or SIMPLE IRA*, on this page. 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 3. Capital Gain (Included in Box 2a)**

If any amount is taxable as a capital gain, report it in box 3.

**Charitable gift annuities.** Report in box 3 any amount from a charitable gift annuity that is taxable as a capital gain. Report in box 1 the total amount distributed during the year. Report in box 2a the taxable amount. Advise the annuity recipient of any amount in box 3 subject to the 28% rate gain for collectibles and any unrecaptured section 1250 gain. Report in box 5 any nontaxable amount. Enter Code F in box 7. See Regulations section 1.1011-2(c), Example 8.

**Special rule for participants born before January 2, 1936 (or their beneficiaries).** For lump-sum distributions from qualified plans only, enter the amount in box 2a eligible for the capital gain election under section 1122(h)(3) of the Tax Reform Act of 1986 and section 641(f)(3) of the Economic Growth and Tax Relief Reconciliation Act of 2001. Enter the full amount eligible for the capital gain election. You should not complete this box for a direct rollover.

To compute the months of an employee's active participation before 1974, count as 12 months any part of a calendar year in which an employee actively participated under the plan; for active participation after 1973, count as 1 month any part of a month in which the employee actively participated under the plan. See the *Example*, below.

Active participation begins with the first month in which an employee became a participant under the plan and ends with the earliest of:

- The month in which the employee received a lump-sum distribution under the plan;
- For an employee, other than a self-employed person or owner-employee, the month in which the employee separates from service;
- The month in which the employee dies; or
- For a self-employed person or owner-employee, the first month in which the employee becomes disabled within the meaning of section 72(m)(7).

**Method for Computing Amount Eligible for Capital Gain Election (See Box 3.)**

**Step 1. Total Taxable Amount**

A. Total distribution	XXXXX
B. Less:	
1. Current actuarial value of any annuity	XXXX
2. Employee contributions or designated Roth contributions (minus any amounts previously distributed that were not includible in the employee's gross income)	XXXX
3. Net unrealized appreciation in the value of any employer securities that was a part of the lump-sum distribution.	XXXX
C. Total of lines 1 through 3	XXXXX
D. Total taxable amount. Subtract line C from line A.	XXXXX

**Step 2. Capital Gain**

Total taxable amount	Months of active participation before 1974	
Line D	X	= Capital gain
	—	
	Total months of active participation	

**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 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 section 72(q), (t), or (v), you are not required to withhold that tax.

**TIP** *The amount withheld cannot be more than the sum of the cash and the FMV of property (excluding employer securities) received in the distribution. If a distribution consists solely of employer securities and cash (\$200 or less) in lieu of fractional shares, no withholding is required.*

To determine your withholding requirements for any designated distribution under section 3405, you must first determine whether the distribution is an eligible rollover distribution. See *Direct Rollovers*, earlier, for a discussion of eligible rollover distributions. If the distribution is not an eligible rollover distribution, the rules for periodic payments or nonperiodic distributions apply. For purposes of withholding, distributions from any IRA are not eligible rollover distributions.

**Eligible rollover distribution; 20% withholding.** If an eligible rollover distribution is paid directly to an eligible retirement plan in a direct rollover, do not withhold federal income tax. If any part of an eligible rollover distribution is not a direct rollover, you must withhold 20% of the part that is paid to the recipient and includible in gross income. This includes the earnings portion of any nonqualified

designated Roth account distribution that is not directly rolled over. The recipient cannot claim exemption from the 20% withholding but may ask to have additional amounts withheld on Form W-4P, Withholding Certificate for Pension or Annuity Payments. If the recipient is not asking that additional amounts be withheld, Form W-4P is not required for an eligible rollover distribution because 20% withholding is mandatory.

Employer securities and plan loan offset amounts that are part of an eligible rollover distribution must be included in the amount multiplied by 20%. However, the actual amount to be withheld cannot be more than the sum of the cash and the FMV of property (excluding employer securities and plan loan offset amounts). For example, if the only part of an eligible rollover distribution that is not a direct rollover is employer securities or a plan loan offset amount, no withholding is required. However, unless otherwise exempt, any cash that is paid in the distribution must be used to satisfy the withholding on the employer securities or plan loan offset amount.

Depending on the type of plan or arrangement, the payer or, in some cases, the plan administrator is required to withhold 20% of eligible rollover distributions from a qualified plan's distributed annuity and on eligible rollover distributions from a governmental section 457(b) plan. For additional information, see section 3405(d) and Regulations sections 35.3405-1T, A-13; and 31.3405(c)-1, Q/A 4 and 5. For governmental section 457(b) plans only, see Notice 2003-20.

Any NUA excludable from gross income under section 402(e)(4) is not included in the amount of any eligible rollover distribution that is subject to 20% withholding.

You are not required to withhold 20% of an eligible rollover distribution that, when aggregated with other eligible rollover distributions made to one person during the year, is less than \$200.

**IRAs.** The 20% withholding 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 a distribution from an IRA other than a Roth IRA is taxable (except for the distribution of contributions under section 408(d)(4), in which only the earnings are taxable, and section 408(d)(5), as applicable). Generally, Roth IRA distributions are not subject to withholding except on the earnings portion of excess contributions distributed under section 408(d)(4).

An IRA recharacterization is not subject to income tax withholding.

**Periodic payments.** For periodic payments that are not eligible rollover distributions, withhold on the taxable part as though the periodic payments were wages, based on the recipient's Form W-4P. The recipient may request additional withholding on Form W-4P or claim exemption from withholding. If a recipient does not submit a Form W-4P, withhold by treating the recipient as married with three withholding allowances. See Circular E, Employer's Tax Guide (Pub. 15), for wage withholding tables.



**Rather than Form W-4P, military retirees should give you Form W-4, Employee's Withholding Allowance Certificate.**

**Nonperiodic distributions.** Withhold 10% of the taxable part of a nonperiodic distribution that is not an eligible rollover distribution. In most cases, designated distributions from any IRA are treated as nonperiodic distributions subject to withholding at the 10% rate even if the distributions are paid over a periodic basis. See Regulations section 35.3405-1T, Q/A F-15. The recipient may request additional withholding on Form W-4P or claim exemption from withholding.

**Failure to provide TIN.** For periodic payments and nonperiodic distributions, if a payee fails to furnish his or her correct TIN to you in the manner required, or if the IRS notifies you before any distribution that the TIN furnished is incorrect, a payee cannot claim exemption from withholding. For periodic payments, withhold as if the payee was single claiming no withholding allowances. For nonperiodic payments, withhold 10%. Backup withholding does not apply.

### Box 5. Employee Contributions/Designated Roth Contributions or Insurance Premiums

Enter the employee's contributions, designated Roth contributions, or insurance premiums that the employee may recover tax free this year (even if they exceed the box 1 amount). The entry in box 5 may include any of the following: (a) designated Roth contributions or contributions actually made on behalf of the employee over the years under the plan that were required to be included in the income of the employee when contributed (after-tax contributions), (b) contributions made by the employer but considered to have been contributed by the employee under section 72(f), (c) the accumulated cost of premiums paid for life insurance protection taxable to the employee in previous years and in the current year under Regulations section 1.72-16 (cost of current life insurance protection) (only if the life insurance contract itself is distributed), and (d) premiums paid on commercial annuities. Do not include any DVECs, elective deferrals, or any contribution to a retirement plan that was not an after-tax contribution.

Generally, for qualified plans, section 403(b) plans, and nonqualified commercial annuities, enter in box 5 the employee contributions or insurance premiums recovered tax free during the year based on the method you used to determine the taxable amount to be entered in box 2a. On a separate Form 1099-R, include the portion of the employee's basis that has been distributed from a designated Roth account. See the *Examples* in the instructions for box 2a, earlier.

If periodic payments began before 1993, you are not required to, but you are encouraged to, report in box 5.



**If you made periodic payments from a qualified plan and the annuity starting date is after November 18, 1996, you must use the simplified method to figure the tax-free amount each year. See Annuity starting date in 1998 or later, earlier.**

If a total distribution is made, the total employee contributions or insurance premiums available to be recovered tax free must be shown only in box 5. If any previous distributions were made, any amount recovered tax free in prior years must not appear in box 5.

If you are unable to reasonably obtain the data necessary to compute the taxable amount, leave boxes 2a and 5 blank, and check the first box in box 2b.

For more information, see Rev. Proc. 92-86, 1992-2 C.B. 495 and section 72(d).

For reporting charitable gift annuities, see *Charitable gift annuities*, earlier.

### Box 6. Net Unrealized Appreciation (NUA) in Employer's Securities

Use this box if a distribution from a qualified plan (except a qualified distribution from a designated Roth account) includes securities of the employer corporation (or a subsidiary or parent corporation) and you can compute the NUA in the employer's securities. Enter all the NUA in employer securities if this is a lump-sum distribution. If this is not a lump-sum distribution, enter only the NUA in employer securities attributable to employee contributions. See Regulations section 1.402(a)-1(b) for the determination of the NUA. Also see Notice 89-25, Q/A-1, 1989-1 C.B. 662. Include the NUA in box 1 but not in box 2a except in the case of a direct rollover to a Roth IRA (see Notice 2009-75, Q/A 1). You do not have to complete this box for a direct rollover.

### Box 7. Distribution Code(s)

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.

**Enter the appropriate code(s) in box 7.** Use the *Guide to Distribution Codes*, later, 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 or a qualified plan for the surviving spouse of a deceased participant, or on behalf of a nonspouse designated beneficiary, enter Codes 4 and G (Codes 4 and H if from a designated Roth account to a Roth IRA). If two or more distribution codes are not valid combinations, you must file more than one Form 1099-R.



**Enter a maximum of two alpha/numeric codes in box 7. See the Guide to Distribution Codes, later, 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, parts of the distribution may be taxable in 2 different years. File separate Forms 1099-R using Code 8 or P to indicate the year the amount is taxable.

Even if the employee/taxpayer is age 59½ 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)), if you have been reporting distributions in previous years using Code 2.

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 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 59½.

If you do not know that the taxpayer meets the requirements for substantially equal periodic payments under section 72(t)(2)(A)(iv), use Code 1 to report the payments.



*For further guidance on what makes a series of substantially equal periodic payments, see Notice 89-25, Q/A-12, as modified by Rev. Rul. 2002-62, 2002-42 I.R.B. 710. Notice 2004-15, 2004-9 I.R.B. 526, available at [www.irs.gov/irb/2004-09\\_IRB/ar09.html](http://www.irs.gov/irb/2004-09_IRB/ar09.html), allows taxpayers to use one of three methods in Notice 89-25, as modified by Rev. Rul. 2002-62, to determine whether a distribution from a nonqualified annuity is part of a series of substantially equal periodic payments under section 72(q)(2)(D).*

If part of a distribution is paid in a direct rollover and part is not, you must file a separate Form 1099-R for each part showing the appropriate code on each form.

**Governmental section 457(b) plan distributions.** Generally, a distribution from a governmental section 457(b) plan is not subject to the 10% additional tax under section 72(t). However, an early distribution from a governmental section 457(b) plan of an amount that is attributable to a rollover from another type of eligible retirement plan or IRA is subject to the additional tax as if the distribution were from a plan described in section 401(a). See section 72(t)(9). If the distribution consists solely of amounts that are not attributable to such a rollover, enter Code 2 in box 7. If the distribution consists solely of amounts attributable to such a rollover, then enter the appropriate code in box 7 as if the distribution were from a plan described in section 401(a). If the distribution is made up of amounts from both sources, you must file separate Forms 1099-R for each part of the distribution unless Code 2 would be entered on each form.

### Box 8. Other

Enter the current actuarial value of an annuity contract that is part of a lump-sum distribution. Do not include this item in boxes 1 and 2a.

To determine the value of an annuity contract, show the value as an amount equal to the current actuarial value of the annuity contract, reduced by an amount equal to the excess of the employee's contributions over the cash and other property (not including the annuity contract) distributed.

If an annuity contract is part of a multiple recipient lump-sum distribution, enter in box 8, along with the current actuarial value, the percentage of the total annuity contract each Form 1099-R represents.

Also, enter in box 8 the amount of the reduction in the investment (but not below 0 (zero)) against the cash value of an annuity contract or the cash surrender value of a life insurance contract due to charges or payments for qualified long-term care insurance contracts.

### Box 9a. Your Percentage of Total Distribution

If this is a total distribution and it is made to more than one person, enter the percentage received by the person whose name appears on Form 1099-R. You need not complete this box for any IRA distributions or for a direct rollover.

### Box 9b. Total Employee Contributions

You are not required to enter the total employee contributions or designated Roth contributions in box 9b. However, because this information may be helpful to the recipient, you may choose to report them.

If you choose to report the total employee contributions or designated Roth contributions, do not include any amounts recovered tax free in prior years. For a total distribution, report the total employee contributions or designated Roth contributions in box 5 rather than in box 9b.

### Box 10. Amount Allocable to IRR Within 5 years

Enter the amount of the distribution allocable to an IRR made within the 5-year period beginning with the first day of the year in which the rollover was made. Do not complete this box if an exception under section 72(t) applies.

For further guidance on determining amounts allocable to an IRR, see Notice 2010-84, Q/A-13.

### Box 11. 1st Year of Desig. Roth Contrib.

Enter the first year of the 5-taxable-year period. This is the year in which the designated Roth account was first established by the recipient.


### Boxes 12-17. 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 12 and 15, as appropriate. In box 13, 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 16, enter

the name of the locality. In boxes 14 and 17, 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.

Guide to Distribution Codes		
Distribution Codes	Explanations	*Used with code ... (if applicable)
<b>1—Early distribution, no known exception.</b>	Use Code 1 only if the participant has not reached age 59½, and you do not know if any of the exceptions under Code 2, 3, or 4 apply. However, 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 which began with the first payment.	8, B, D, K, L, or P
<b>2—Early distribution, exception applies.</b>	Use Code 2 only if the participant has not reached age 59½ and you know the distribution is: <ul style="list-style-type: none"> <li>• A Roth IRA conversion (an IRA converted to a Roth IRA).</li> <li>• A distribution made from a qualified retirement plan or IRA because of an IRS levy under section 6331.</li> <li>• A governmental section 457(b) plan distribution that is not subject to the additional 10% tax. But see <i>Governmental section 457(b) plan distributions</i>, earlier, for information on distributions that may be subject to the 10% additional tax.</li> <li>• A distribution from a qualified retirement plan after separation from service in or after the year the participant has reached age 55.</li> <li>• A distribution from a governmental defined benefit plan to a public safety employee (as defined in 72(t)(10)(B)) after separation from service in or after the year the employee has reached age 50.</li> <li>• A distribution that is part of a series of substantially equal periodic payments as described in section 72(q), (t), (u), or (v).</li> <li>• A distribution that is a permissible withdrawal under an eligible automatic contribution arrangement (EACA).</li> <li>• 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.</li> </ul>	8, B, D, K, or P
<b>3—Disability.</b>	For these purposes, see section 72(m)(7).	D
<b>4—Death.</b>	Use Code 4 regardless of the age of the participant 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, K, L, or P
<b>5—Prohibited transaction.</b>	Use Code 5 if there was a prohibited transaction involving the IRA account. Code 5 means the account is no longer an IRA.	None
<b>6—Section 1035 exchange.</b>	Use Code 6 to indicate the tax-free exchange of life insurance, annuity, long-term care insurance, or endowment contracts under section 1035.	W

Guide to Distribution Codes		
Distribution Codes	Explanations	*Used with code ... (if applicable)
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 59 ½, (b) for a Roth IRA conversion if the participant is at least age 59 ½, 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, 2008-29 I.R.B. 160, available at <a href="http://www.irs.gov/irb/2008-29_IRB/ar19.html">www.irs.gov/irb/2008-29_IRB/ar19.html</a> . Generally, use Code 7 if no other code applies. Do not use Code 7 for a Roth IRA. <b>Note:</b> Code 1 must be used even if a taxpayer is 59 ½ 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 which began with the first payment.	A, B, D, or K
8—Excess contributions plus earnings/excess deferrals (and/or earnings) taxable in 2014.	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 P applies. See <i>Corrective Distributions</i> , earlier, and <i>IRA Revocation or Account Closure</i> , earlier, for more information.	1, 2, 4, B, J, or K
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 the instructions for box 2a, earlier, 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, Tax on Lump-Sum Distributions). 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. But use Code E for a section 415 distribution under EPCRS (see Code E) or Code H for a direct rollover to a Roth IRA.	1, 2, 4, 7, 8, G, L, P, or U
D—Annuity payments from nonqualified annuities and distributions from life insurance contracts that may be subject to tax under section 1411.	Use Code D for a distribution from any plan or arrangement not described in sections 401(a), 403(a), 403(b), 408, 408A, or 457(b).	1, 2, 3, 4, or 7
E—Distributions under Employee Plans Compliance Resolution System (EPCRS).	See <i>Distributions under Employee Plans Compliance Resolution System (EPCRS)</i> , earlier.	None
F—Charitable gift annuity.	See <i>Charitable gift annuities</i> , earlier.	None
G—Direct rollover and direct payment.	Use Code G for a direct rollover from a qualified plan, a section 403(b) plan or a governmental section 457(b) plan to an eligible retirement plan (another qualified plan, a section 403(b) plan, a governmental section 457(b) plan, or an IRA). See <i>Direct Rollovers</i> , earlier. Also use Code G for a direct payment from an IRA to an accepting employer plan, and for IRAs that are direct rollovers. <b>Note:</b> Do not use Code G for a direct rollover from a designated Roth account to a Roth IRA. Use Code H.	4, B, or K
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
K—Distribution of IRA assets not having a readily available FMV.	Use Code K to report distributions of IRA assets not having a readily available FMV. These assets may include: <ul style="list-style-type: none"> <li>• stocks, short or long-term obligations, ownership interests in limited liability companies (LLCs), partnerships, trusts, or similar entities, not readily tradable on an established US or foreign securities market,</li> <li>• real estate, or</li> <li>• option contracts or similar products not offered for trade on an established US or foreign option exchange.</li> </ul> 	1, 2, 4, 7, or G
	Use of Code K is optional for 2014.	

Guide to Distribution Codes		
Distribution Codes	Explanations	*Used with code ... (if applicable)
<b>L—Loans treated as deemed distributions under section 72(p).</b>	Do not use Code L to report a loan offset. See <i>Loans Treated as Distributions</i> , earlier.	1, 4, or B
<b>N—Recharacterized IRA contribution made for 2014.</b>	Use Code N for a recharacterization of an IRA contribution made for 2014 and recharacterized in 2014 to another type of IRA by a trustee-to-trustee transfer or with the same trustee.	None
<b>P—Excess contributions plus earnings/excess deferrals taxable in 2013.</b>	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
<b>Q—Qualified distribution from a Roth IRA.</b>	Use Code Q for a distribution from a Roth IRA if you know that the participant meets the 5-year holding period and: <ul style="list-style-type: none"> <li>• The participant has reached age 59½,</li> <li>• The participant died, or</li> <li>• The participant is disabled.</li> </ul> <b>Note: If any other code, such as 8 or P, applies, use Code J.</b>	None
<b>R—Recharacterized IRA contribution made for 2013.</b>	Use Code R for a recharacterization of an IRA contribution made for 2013 and recharacterized in 2014 to another type of IRA by a trustee-to-trustee transfer or with the same trustee.	None
<b>S—Early distribution from a SIMPLE IRA in the first 2 years, no known exception.</b>	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
<b>T—Roth IRA distribution, exception applies.</b>	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: <ul style="list-style-type: none"> <li>• The participant has reached age 59½,</li> <li>• The participant died, or</li> <li>• The participant is disabled.</li> </ul> <b>Note: If any other code, such as 8 or P, applies, use Code J.</b>	None
<b>U—Dividends distributed from an ESOP under section 404(k).</b>	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. <b>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>	B
<b>W—Charges or payments for purchasing qualified long-term care insurance contracts under combined arrangements.</b>	Use Code W for charges or payments for purchasing qualified long-term care insurance contracts under combined arrangements which are excludible 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, earlier.

## Specific Instructions for Form 5498

File Form 5498, IRA Contribution Information, with the IRS by June 1, 2015, for each person for whom in 2014 you maintained any individual retirement arrangement (IRA), including a deemed IRA under section 408(q).

An IRA includes all investments under one IRA plan. It is not necessary to file a Form 5498 for each investment under one plan. For example, if a participant has three certificates of deposit (CDs) under one IRA plan, only one Form 5498 is required for all contributions and the fair market values (FMVs) of the CDs under the plan. However, if a participant has established more than one IRA plan with the same trustee, a separate Form 5498 must be filed for each plan.

**Contributions.** You must report contributions to any IRA on Form 5498. See the instructions under boxes 1, 2, 3, 4, 8, 9, 10, 13a, and 14a, later. If no reportable contributions were made for 2014, complete only boxes 5 and 7, and boxes 11, 12a, 12b, 15a, and 15b, if applicable. See *Reporting FMV of certain specified assets*, later.



**You are required to file Form 5498 even if required minimum distributions (RMDs) or other annuity or periodic payments have started.**

Report contributions to a Kay Bailey Hutchinson Spousal IRA under section 219(c) on a separate Form 5498 using the name and taxpayer identification number (TIN) of the spouse.

For contributions made between January 1 and April 15, 2015, trustees and issuers should obtain the participant's designation of the year for which the contributions are made.

**Direct rollovers, transfers, and recharacterizations.** You must report the receipt of a direct rollover from a qualified plan, section 403(b) plan or governmental section 457(b) plan to an IRA. Report a direct rollover in box 2.

If you receive a direct rollover to a qualified plan, a section 403(b) plan, or a governmental section 457(b) plan, no report is required. For information on direct rollovers of eligible rollover distributions, see *Direct Rollovers*, earlier.

If a rollover or trustee-to-trustee transfer is made from a savings incentive match plan for employees (SIMPLE) IRA to an IRA that is not a SIMPLE IRA and the trustee has adequately substantiated information that the participant has not satisfied the 2-year period specified in section 72(t)(6), report the amount as a regular contribution in box 1 even if the amount exceeds \$5,500 (\$6,500 for participants 50 or older).

**Transfers.** Do not report on Form 5498 a direct trustee-to-trustee transfer from (a) a traditional IRA to another traditional IRA or to a simplified employee pension (SEP) IRA, (b) a SIMPLE IRA to another SIMPLE IRA, (c) a SEP IRA to another SEP IRA or to a traditional IRA, or (d) a Roth IRA to another Roth IRA. For reporting purposes, contributions and rollovers do not include these transfers.

**Recharacterizations.** You must report each recharacterization of an IRA contribution. If a participant makes a contribution to an IRA (first IRA) for a year, the participant may choose to recharacterize the contribution by transferring, in a trustee-to-trustee transfer, any part of the contribution (plus earnings) to another IRA (second IRA). The contribution is treated as made to the second IRA (recharacterization). A recharacterization may be made with the same trustee or with another trustee. The trustee of the first IRA must report the amount contributed before the recharacterization as a contribution on Form 5498 and the recharacterization as a distribution on Form 1099-R. The trustee of the second IRA must report the amount received (FMV) in box 4 on Form 5498 and check the type of IRA in box 7.

All recharacterized contributions received by an IRA in the same year must be totaled and reported on one Form 5498 in box 4. You may report the FMV of the account on the same Form 5498 you use to report a recharacterization of an IRA contribution and any other contributions made to the IRA for the year.

**Catch-up contributions.** Participants who are age 50 or older by the end of the year may be eligible to make catch-up IRA contributions or catch-up elective deferral contributions. The annual IRA regular contribution limit of \$5,500 is increased to \$6,500 for participants age 50 or older. Catch-up elective deferral contributions reported on Form 5498 may be made under a salary reduction SEP (SARSEP) or under a SIMPLE IRA plan. For 2014, up to \$5,500 in catch-up elective deferral contributions may be made under a SARSEP, and up to \$2,500 to a SIMPLE IRA plan. For more information on catch-up elective deferral contributions, see Regulations section 1.414(v)-1.

Include any catch-up amounts when reporting contributions for the year in boxes 1, 8, 9, or 10, or for a prior year in box 13a.

**Roth IRA conversions.** You must report the receipt of a conversion from an IRA to a Roth IRA even if the conversion is with the same trustee. Report the total amount converted from a traditional IRA, SEP IRA, or SIMPLE IRA to a Roth IRA in box 3.

**IRA revocation or account closure.** If a traditional IRA, Roth IRA, or SIMPLE IRA is revoked during its first 7 days (under Regulations section 1.408-6(d)(4)(ii)) or closed at any time by the IRA trustee pursuant to its resignation or

such other event mandating the closure of the account, Form 5498 must be filed to report any regular, rollover, IRA conversion, SEP IRA, or SIMPLE IRA contributions to the IRA. For information about reporting a distribution from a revoked or closed IRA, see *IRA Revocation or Account Closure*, earlier.

**Total distribution, no contributions.** Generally, if a total distribution was made from an account during the year and no contributions, including rollovers, recharacterizations, or Roth IRA conversion amounts, were made for that year, you need not file Form 5498 nor furnish the annual statement to reflect that the FMV on December 31 was zero.

**Required minimum distributions (RMDs).** An IRA (other than a Roth IRA) owner/participant must begin taking distributions for each calendar year beginning with the calendar year in which the participant attains age 70½. The distribution for the 70½ year must be made no later than April 1 of the following calendar year; RMDs for any other year must be made no later than December 31 of the year. See Regulations section 1.401(a)(9)-6 for RMDs from annuity contracts.

For each IRA you held as of December 31 of the prior year, if an RMD is required for the year, you must provide a statement to the IRA participant by January 31 regarding the RMD using one of two alternative methods described below. You are not required to use the same method for all IRA participants; you can use Alternative one for some IRA participants and Alternative two for the rest. Under both methods, the statement must inform the participant that you are reporting to the IRS that an RMD is required for the year. The statement can be provided in conjunction with the statement of the FMV.

If the IRA participant is deceased, and the surviving spouse is the sole beneficiary, special rules apply for RMD reporting. If the surviving spouse elects to treat the IRA as the spouse's own, then report with the surviving spouse as the owner. However, if the surviving spouse does not elect to treat the IRA as the spouse's own, then you must continue to treat the surviving spouse as the beneficiary. Until further guidance is issued, no reporting is required for IRAs of deceased participants (except where the surviving spouse elects to treat the IRA as the spouse's own as described above).

**Alternative one.** Under this method, include in the statement the amount of the RMD with respect to the IRA for the calendar year and the date by which the distribution must be made. The amount may be calculated assuming the sole beneficiary of the IRA is not a spouse more than 10 years younger than the participant. Use the value of the account as of December 31 of the prior year to compute the amount. See boxes 11, 12a, and 12b, later, for how to report.

**Alternative two.** Under this method, the statement informs the participant that a minimum distribution with respect to the IRA is required for the calendar year and the date by which such amount must be distributed. You must include an offer to furnish the participant with a calculation of the amount of the RMD if requested by the participant.

**Electronic filing.** These statements may be furnished electronically using the procedures described in part F of

the 2014 General Instructions for Certain Information Returns.

**Reporting to the IRS.** If an RMD is required, check box 11. See page 22. For example, box 11 is checked on the Form 5498 for a 2015 RMD. You are not required to report to the IRS the amount or the date by which the distribution must be made. However, see the *Caution* following the *Box 11* instructions, later, for reporting RMDs to participants.

For more details, see Notice 2002-27 on page 814 of Internal Revenue Bulletin 2002-18 at [www.irs.gov/pub/irs-irbs/irb02-18.pdf](http://www.irs.gov/pub/irs-irbs/irb02-18.pdf) as clarified by Notice 2003-3 on page 258 of Internal Revenue Bulletin 2003-2 at [www.irs.gov/pub/irs-irbs/irb03-02.pdf](http://www.irs.gov/pub/irs-irbs/irb03-02.pdf).

**Inherited IRAs.** In the year an IRA participant dies, you, as an IRA trustee or issuer, generally must file a Form 5498 and furnish an annual statement for the decedent and a Form 5498 and an annual statement for each nonspouse beneficiary. An IRA holder must be able to identify the source of each IRA he or she holds for purposes of figuring the taxation of a distribution from an IRA. Thus, the decedent's name must be shown on the beneficiary's Form 5498 and annual statement. For example, you may enter "Brian Willow as beneficiary of Joan Maple" or something similar that signifies that the IRA was once owned by Joan Maple. You may abbreviate the word "beneficiary" as, for example, "bene."

For a spouse beneficiary, unless the spouse makes the IRA his or her own, treat the spouse as a nonspouse beneficiary for reporting purposes. If the spouse makes the IRA his or her own, do not report the beneficiary designation on Form 5498 and the annual statement.

An IRA set up to receive a direct rollover for a nonspouse designated beneficiary is treated as an inherited IRA.

**Fair market value (FMV).** On the decedent's Form 5498 and annual statement, you must enter the FMV of the IRA on the date of death in box 5. Or you may choose the alternate reporting method and report the FMV as of the end of the year in which the decedent died. This alternate value will usually be zero because you will be reporting the end-of-year valuation on the beneficiary's Form 5498 and annual statement. The same figure should not be shown on both the beneficiary's and decedent's forms. If you choose to report using the alternate method, you must inform the executor or administrator of the decedent's estate of his or her right to request a date-of-death valuation.

On the beneficiary's Form 5498 and annual statement, the FMV of that beneficiary's share of the IRA as of the end of the year must be shown in box 5. Every year thereafter that the IRA exists, you must file Form 5498 and furnish an annual statement for each beneficiary who has not received a total distribution of his or her share of the IRA showing the FMV at the end of the year and identifying the IRA as described above.

However, if a beneficiary takes a total distribution of his or her share of the IRA in the year of death, you need not file a Form 5498 nor furnish an annual statement for that beneficiary, but you must still file Form 5498 for the decedent.

If you have no knowledge of the death of an IRA participant until after you are required to file Form 5498 (June 1, 2015), you are not required to file a corrected Form 5498 nor furnish a corrected annual statement. However, you must still provide the date-of-death valuation in a timely manner to the executor or administrator upon request.

In the case of successor beneficiaries, apply the preceding rules by treating the prior beneficiary as the decedent and the successor beneficiary as the beneficiary. Using the example above (Brian Willow as beneficiary of Joan Maple), when that account passes to Brian's successor beneficiary, Maurice Poplar, Form 5498 and the annual statement for Maurice should state "Maurice Poplar as beneficiary of Brian Willow." The final Form 5498 and annual statement for Brian Willow will state "Brian Willow as beneficiary of Joan Maple" and will show the FMV as of the date of Brian's death or year-end valuation, depending on the method chosen.

For more information about the reporting requirements for inherited IRAs, see Rev. Proc. 89-52, 1989-2 C.B. 632.

**Disaster relief reporting.** Special tax law provisions and reporting instructions may apply when the president declares a location to be a major disaster area. To determine the location of and special rules applicable to individual federally declared disaster areas, go to IRS.gov and enter the keyword "disaster" in the upper right hand corner. Then click on "Tax Relief in Disaster Situations." The information provided includes:

- A list of the areas for which relief has recently been granted,
- News Releases detailing the scope of the relief and any special reporting instructions, and
- A link to the Federal Emergency Management Agency's list of federal disaster declarations.

See the instructions for boxes 13a through 13c for reporting postponed contributions, later.

**Qualified settlement income.** Qualified settlement income received in connection with the Exxon Valdez litigation may be contributed to a traditional or Roth IRA. See P.L. 110-343, Division C, sec. 504 for contribution limitations and *Box 2. Rollover contributions*, later.

**Airline payment amount.** Subject to certain limitations, qualified airline employees may contribute the amounts received (money or other property) with respect to the employee's interest in a bankruptcy claim against the airline carrier, to a Roth IRA or traditional IRA. See P.L. 110-458, sec. 125 for contribution limitations to Roth IRAs, P.L. 112-95, sec. 1106 for contribution limitations to traditional IRAs, and *Box 2. Rollover contributions*, later.

**Special reporting for U.S. Armed Forces in designated combat zones.** A participant who is serving in or in support of the Armed Forces in a designated combat zone or qualified hazardous duty area has an additional period after the normal contribution due date of April 15 to make IRA contributions for a prior year. The period is the time the participant was in the designated zone or area plus at least 180 days. The participant must designate the IRA contribution for a prior year to claim it as a deduction on the income tax return.

Under section 219(f), combat zone compensation that is excluded from gross income under section 112 is treated as includible compensation for purposes of determining IRA contributions.

A qualifying participant is:

- Serving, or has served in a combat zone,
- Serving, or has served in a qualifying hazardous duty area, or
- Serving, or has served in an active direct support area.

If a qualifying participant makes a contribution to an IRA after April 15 and designates the contribution for a prior year, you must report the type of IRA (box 7) and the amount on Form 5498. Report the amount either for (1) the year for which the contribution was made or (2) a subsequent year. See boxes 13a, 13b, and 13c, later.


1. If you report the contribution for the year it is made, no special reporting is required. Include the contribution in box 1 or box 10 of an original Form 5498 or of a corrected Form 5498 if an original was previously filed.

2. If you report the contribution on Form 5498 in a subsequent year, you must include the year for which the contribution was made, the amount of the contribution, and one of the following indicators.

a. Use "EO13239" for Afghanistan and those countries in direct support, including Djibouti, Jordan, Kyrgyzstan, Pakistan, Somalia, Syria, Tajikistan, Uzbekistan, Yemen, and the Philippines. For the Philippines only, personnel must be deployed in conjunction with Operation Enduring Freedom supporting military operations in the Afghanistan combat zone.

b. Use "EO12744" for the Arabian Peninsula, including air space and adjacent waters (the Persian Gulf, the Red Sea, the Gulf of Oman, the Gulf of Aden, the portion of the Arabian Sea that lies north of 10 degrees north latitude and west of 68 degrees east longitude, and the total land areas of Iraq, Kuwait, Saudi Arabia, Oman, Bahrain, Qatar, the United Arab Emirates), and Jordan which is in direct support of the Arabian Peninsula.

c. Use "EO13119" or Public Law 106-21 "PL106-21" for the Federal Republic of Yugoslavia (Serbia and Montenegro), Albania, Kosovo, the Adriatic Sea, and the Ionian Sea north of the 39th parallel. (**Note:** the combat zone designation for Montenegro and Kosovo (previously a province within Serbia) under Executive Order 13119 remains in force even though Montenegro and Kosovo became independent nations since EO 13119 was signed.)

 For additions to, or subtractions from, the list of combat zones or qualified hazardous duty areas implemented by executive orders and public laws, and direct support areas designated by the Secretary of Defense, after the publication date of these instructions, go to [www.irs.gov/form5498](http://www.irs.gov/form5498).

**Example.** For a \$4,000 IRA contribution designated by a participant who served under EO 13239 for the tax year 2011, enter "4000" in box 13a, "2011" in box 13b, and "EO13239" in box 13c only. Make no entry in box 1 or box 10.

**Repayment of qualified reservist distributions.** Report any repayment of a qualified reservist distribution

as described in section 72(t)(2)(G) in boxes 14a (amount) and 14b (with indicator code "QR").

**Military death gratuities and servicemembers' group life insurance (SGLI) payments.** Recipients of military death gratuities and SGLI payments may contribute amounts received to a Roth IRA, up to the amount of the gratuity or SGLI payment less any amounts contributed to Coverdell ESAs. Report the amount of the rollover contribution in box 2 only. See section 408A(e)(2), and Notice 2010-15, 2010-06 I.R.B. 390, available at [www.irs.gov/irb/2010-06\\_IRB/ar09.html](http://www.irs.gov/irb/2010-06_IRB/ar09.html), for more information on limitations.

**Electronic filers.** You may request an automatic waiver from filing Forms 5498 for combat zone participants by submitting Form 8508, Request for Waiver From Filing Information Returns Electronically. Once you have received the waiver, you may report all Forms 5498 for combat zone participants on paper. Alternatively, you may report contributions made by the normal contribution due date electronically and report the contributions made after the normal contribution due date on paper. You may also report prior year contributions by combat zone participants on a corrected Form 5498 electronically or on paper.

See part F in the 2014 General Instructions for Certain Information Returns for information on how to request a waiver on Form 8508.

**Reporting FMV of certain specified assets.** Assets held in an IRA that are not readily tradable on an established US or foreign securities market or option exchange, or that do not have a readily available FMV, must be reported at the FMV determined as of December 31, 2014. See the instructions for boxes 15a and 15b, later.



Use of boxes 15a and 15b for reporting FMV of certain specified IRA assets is optional for 2014.

**Corrected Form 5498.** If you file a Form 5498 with the IRS and later discover that there is an error on it, you must correct it as soon as possible. See part H in the 2014 General Instructions for Certain Information Returns or Pub. 1220, if filing electronically. For example, if you reported contributions as rollover contributions in box 2, and you later discover that part of the contribution was not eligible to be rolled over and was, therefore, a regular contribution that should have been reported in box 1 (even if the amount exceeds the regular contribution limit), you must file a corrected Form 5498.

**Statements to participants.** If you are required to file Form 5498, you must provide a statement to the participant. By February 2, 2015, you must provide participants with a statement of the December 31, 2014, value of the participant's account and RMD, if applicable. Trustees of SIMPLE IRAs also must provide a statement of the account activity by February 2, 2015. Contribution information for all other types of IRAs must be provided by June 1, 2015. You are not required to provide information to the IRS or to participants as to whether a contribution is deductible or nondeductible. In addition, the participant is not required to tell you whether a contribution is deductible or nondeductible.

If you furnished a statement of the FMV of the account, and RMD if applicable, to the participant by February 2, 2015, and no reportable contributions, including rollovers, recharacterizations, or Roth IRA conversions, were made for 2014, you need not furnish another statement (or Form 5498) to the participant to report zero contributions. However, you must file Form 5498 with the IRS by June 1, 2015, to report the December 31, 2014, FMV of the account and, for years after 2014, the FMV of hard-to-value assets. This rule also applies to beneficiary accounts under the inherited IRA rules, earlier.



*If you do not furnish another statement to the participant because no reportable contributions were made for the year, the statement of the FMV of the account must contain a legend designating which information is being filed with the IRS.*

**Truncating recipients identification number on paper payee statements.** Pursuant to proposed regulations § 301.6109-4 (REG-148873-09), all filers of Form 5498 may truncate a recipient's identification number (social security number (SSN), individual taxpayer identification number (ITIN), or adoption taxpayer identification number (ATIN)) on payee statements. See part M in the 2014 General Instructions for Certain Information Returns.

For more information about the requirement to furnish statements to participants and truncation, see part M in the 2014 General Instructions for Certain Information Returns.

### Account Number

The account number is required if you have multiple accounts for a recipient for whom you are filing more than one Form 5498. Additionally, the IRS encourages you to designate an account number for all Forms 5498 that you file. See part L in the 2014 General Instructions for Certain Information Returns.

### Box 1. IRA Contributions (Other Than Amounts in Boxes 2-4, 8-10, 13a, and 14a)

Enter contributions to a traditional IRA made in 2014 and through April 15, 2015, designated for 2014.

Report gross contributions, including the amount allocable to the cost of life insurance (see box 6) and including any excess contributions, even if the excess contributions were withdrawn. If an excess contribution is treated as a contribution in a subsequent year under section 219(f)(6), do not report it on Form 5498 for the subsequent year. It has already been reported as a contribution on Form 5498 for the year it was actually contributed.

Also include employee contributions to an IRA under a SEP plan. These are contributions made by the employee, not by the employer, that are treated as regular IRA contributions subject to the 100% of compensation and \$5,500 (\$6,500 for participants 50 or older) limits of section 219. Do not include employer SEP IRA contributions or SARSEP contributions under section 408(k)(6). Instead, include them in box 8.

Also, do not include in box 1 contributions to a SIMPLE IRA (report them in box 9) and a Roth IRA (report them in

box 10). In addition, do not include in box 1 rollovers and recharacterizations (report rollovers in box 2 and recharacterizations in box 4), or a Roth IRA conversion amount (report in box 3).

### Box 2. Rollover Contributions

Enter any rollover contributions (or contributions treated as rollovers) to any IRA received by you during 2014. These contributions may be any of the following:

- A 60-day rollover between IRAs of the same type.
- A direct or indirect rollover from a qualified plan, section 403(b) plan or governmental section 457(b) plan.
- Any qualified rollover contribution as defined in section 408A(e) from an eligible retirement plan (other than an IRA) to a Roth IRA.
- A military death gratuity.
- An SGLI payment.
- Qualified settlement income received in connection with the Exxon Valdez litigation.
- Airline payment amounts.

For the rollover of property, enter the FMV of the property on the date you receive it. This value may be different from the value of the property on the date it was distributed to the participant.

For more details, see Pub. 590.

### Box 3. Roth IRA Conversion Amount

Enter the amount converted from a traditional IRA, SEP IRA, or SIMPLE IRA to a Roth IRA during 2014. Do not include a rollover from one Roth IRA to another Roth IRA, or a qualified rollover contribution under section 408A(e) from an eligible retirement plan (other than an IRA) to a Roth IRA. These rollovers are reported in box 2.

### Box 4. Recharacterized Contributions

Enter any amounts recharacterized plus earnings from one type of IRA to another.

### Box 5. Fair Market Value of Account

Enter the FMV of the account on December 31, 2014. For inherited IRAs, see *Inherited IRAs*, earlier.



*Trustees and custodians are responsible for ensuring that all IRA assets (including those not traded on established markets or with otherwise readily determinable market value) are valued annually at their fair market value.*

### Box 6. Life Insurance Cost Included in Box 1

For endowment contracts only, enter the amount included in box 1 allocable to the cost of life insurance.

### Box 7. Checkboxes

Check the appropriate box.

**IRA.** Check "IRA" if you are filing Form 5498 to report information about a traditional IRA account.

**SEP.** Check "SEP" if you are filing Form 5498 to report information about a SEP IRA. If you do not know whether the account is a SEP IRA, check the "IRA" box.

**SIMPLE.** Check "SIMPLE" if you are filing Form 5498 to report information about a SIMPLE IRA account. Do not file Form 5498 for a SIMPLE 401(k) plan. See section 408(p).

**Roth IRA.** Check "Roth IRA" if you are filing Form 5498 to report information about a Roth IRA account.

### Box 8. SEP Contributions

Enter employer contributions made to a SEP IRA (including salary deferrals under a SARSEP) during 2014 including contributions made in 2014 for 2013, but not including contributions made in 2015 for 2014. Trustees and issuers are not responsible for reporting the year for which SEP contributions are made. Do not enter employee contributions to an IRA under a SEP plan. Report any employee contributions to an IRA under a SEP plan in box 1. Also include in box 8 SEP contributions made by a self-employed person to his or her own account.

### Box 9. SIMPLE Contributions

Enter contributions, including deferrals, made to a SIMPLE IRA during 2014. Trustees and issuers are not responsible for reporting the year for which SIMPLE contributions are made. Do not include contributions to a SIMPLE 401(k) plan.

### Box 10. Roth IRA Contributions

Enter any contributions made to a Roth IRA in 2014 and through April 15, 2015, designated for 2014. However, report Roth IRA conversion amounts in box 3. Report a qualified rollover contribution made under section 408A(e) from an eligible retirement plan (other than an IRA) to a Roth IRA in box 2.

### Box 11. Check if RMD for 2015

Check the box if the participant must take an RMD for 2015. You are required to check the box for the year in which the IRA participant reaches age 70½ even though the RMD for that year need not be made until April 1 of the following year. Then check the box for each subsequent year an RMD is required to be made.



*Boxes 12a and 12b are provided for your use to report RMD dates and amounts to participants. You may choose to complete these boxes, or continue to provide a separate Form 5498, or a separate statement, to report the information required by Alternative one or Alternative two, earlier. To determine the RMD, see the regulations under sections 401(a)(9) and 408(a)(6) and (b)(3).*

### Box 12a. RMD Date

Enter the RMD date if you are using Form 5498 to report the additional information. See page 18.

### Box 12b. RMD Amount

Enter the RMD amount if you are using Form 5498 to report the additional information under *Alternative one*. See page 18.

### Box 13a. Postponed Contribution

Report the amount of any postponed contribution made in 2014 for a prior year. If contributions were made for more than 1 prior year, each prior year's postponed contribution must be reported on a separate form.

### Box 13b. Year

Enter the year for which the postponed contribution in box 13a was made.

### Box 13c. Code

Enter the reason the participant made the postponed contribution.

- For participants' service in a combat zone, hazardous duty area, or direct support area, enter the appropriate executive order or public law as defined under *Special reporting for U.S. Armed Forces in designated combat zones*, earlier.
- For participants who are "affected taxpayers," as described in an IRS News Release relating to a federally designated disaster area, enter FD.

### Box 14a. Repayments

Enter the amount of any repayment of a qualified reservist distribution or of a designated disaster distribution (for example, a qualified disaster recovery assistance distribution).

### Box 14b. Code

Enter QR for the repayment of a qualified reservist distribution, or DD for repayment of a federally designated disaster distribution.

### Box 15a. FMV of Certain Specified Assets

Enter the FMV of the investments in the IRA that are specified in the categories identified below.

### Box 15b. Code(s)

Enter the code for the type(s) of investments held in the IRA for which the FMV is reported in Box 15a. A maximum of two codes can be entered in box 15b. If more than two codes apply, enter code H.

- A — Stock or other ownership interest in a corporation that is not readily tradable on an established securities market.
- B — Short or long-term debt obligation that is not traded on an established securities market.
- C — Ownership interest in a limited liability company or similar entity (unless the interest is traded on an established securities market).
- D — Real estate.
- E — Ownership interest in a partnership, trust, or similar entity (unless the interest is traded on an established securities market).
- F — Option contract or similar product that is not offered for trade on an established option exchange.
- G — Other asset that does not have a readily available FMV.
- H — More than two types of assets (listed in A through G) are held in this IRA.

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# Current Traps for the Unwary in Alternative Investments

*National Association of Public Pension Attorneys  
Legal Education Conference*

*June 2014*

## Introduction

---

- Our presentation will focus on recent developments in alternative investment documents that make it difficult for investors to parse through potentially undesirable terms
- We are not trying to discuss all alternative investment document issues

## Consents

---

- Deemed consent if no response (negative consent)
  - Failure to respond within the specified time period will be a vote in favor of and consent to the proposed amendment

---

2 | Current Traps for the Unwary in Alternative Investments

## Consents

---

- Short timelines applied to negative consent
  - Limited Partners may not have sufficient time to review, receive any required advice or recommendation from a consultant and respond to a request for consent
  - Consent or amendment requests are often sent before holidays and popular vacation times, leaving even less time for review and response

---

3 | Current Traps for the Unwary in Alternative Investments

## Consents

---

- Counting only those who vote
  - Excludes commitments of those Limited Partners who do not participate in a vote
    - Included in definition of "Majority in Interest," which can drastically affect a vote

---

4 | Current Traps for the Unwary in Alternative Investments

## Consents

---

- General Partner and affiliates not excluded from the voting pool
  - General Partner and affiliate votes not excluded at all
  - General Partner and affiliate votes excluded selectively but may vote on critical issues where it is not appropriate (such as removal of the General Partner)

---

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## Voting

---

- Limited Partner v. Limited Partner Advisory Committee
  - Commitment size of Limited Partner
  - Total commitments of Partnership
  - Percentage of vote
  - Override provisions
  - Membership of LPAC

---

6 | Current Traps for the Unwary in Alternative Investments

## Amendment

---

- Amendments to key economic terms
  - Permitted by general amendment standard
  - Without requirement of obtaining the consent of affected Limited Partners

---

7 | Current Traps for the Unwary in Alternative Investments

## Amendment

---

- Increasingly broad amendments permitted without Limited Partner consent
    - No consent required as long as amendment does not materially adversely affect the interests of the Limited Partners as a whole
    - No consent required as long as amendment addresses change in applicable law, regulation or accounting practice
    - No consent required for amendments negotiated with Limited Partners in subsequent closings
- 

8 | Current Traps for the Unwary in Alternative Investments

## Amendment

---

- Amendments permitted so long as do not disproportionately alter or affect the rights of a Limited Partner (including economic rights)

*(i.e. No consent required where amendments equally bad for everyone, such as increase in management fees)*

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## Buried Substantive Provisions in Subscription Documents

---

- Broad and continuing representation on accuracy of information
  - All information that the Investor has provided is true, correct and complete as of each date that the Investor is required to make a capital contribution or receives a distribution

*to broad*

---

10 | Current Traps for the Unwary in Alternative Investments

## Buried Substantive Provisions in Subscription Documents

---

- Broad representation regarding applicability of laws to the Partnership

---

11 | Current Traps for the Unwary in Alternative Investments

## Buried Substantive Provisions in Subscription Documents

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- If Subscriber is an “employee benefit plan” as defined in Section 3(3) of ERISA that is not subject to either Title I of ERISA or Section 4975 of the Code (including a governmental plan or foreign plan), the Subscriber represents and warrants that neither the Partnership nor any person who manages the assets of the Partnership will be subject to any laws, rules or regulations applicable to such Subscriber solely as a result of the investment in the Partnership by such Subscriber

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*too broad,  
can't possibly  
know all*

## Buried Substantive Provisions in Subscription Documents

---

- If the investment in the Interest is being made on behalf of a plan established and maintained by any U.S. state, its political subdivisions, or any agency or instrumentality of such a state or its political subdivisions, for the benefit of its employees, there is no provision in the instruments governing such plan or any U.S. federal, state or local or non-U.S. law, rule, regulation, or constitutional provision applicable to the plan that could in any

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## Buried Substantive Provisions in Subscription Documents

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respect affect the operation of the Partnership by the General Partner or prohibit any action contemplated by the operational documents and related disclosure of the Partnership, including, without limitation, the investments that may be made pursuant to the Partnership's investment strategies, the concentration of investments for the Partnership and the payment by the plan of incentive or other fees

---

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## Buried Substantive Provisions in Subscription Documents

---

- Breadth of the representation could be read to include securities laws or any state law applicable to any investor, not just a public pension plan
- 

15 | Current Traps for the Unwary in Alternative Investments

## Buried Substantive Provisions in Subscription Documents

---

- Broad representation regarding applicability of registration or filing requirements
  - Each Limited Partner represents and warrants that there are no governmental orders, consents, or authorizations that are required to be obtained, and no registrations or other filings are required to be made in connection with the Investor's status as a Limited Partner

---

16 | Current Traps for the Unwary In Alternative Investments

## Buried Substantive Provisions in Subscription Documents

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- Broad power of attorney
  - Any misstatement or breach of any of the representations, warranties, acknowledgements and confirmations by a Limited Partner in the Subscription Agreement may entitle the General Partner to transfer such Limited Partner's commitment

---

17 | Current Traps for the Unwary In Alternative Investments

## Buried Substantive Provisions in Subscription Documents

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- Confidentiality provisions that vary from the Partnership Agreement

*side let  
should cover  
both Subscription  
Agmt &  
Partnership Agmt*

---

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## Buried Substantive Provisions in Partnership Agreements

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- Waivers or limitations of fiduciary duties hidden in unusual places
  - Included in section regarding management and control of the Partnership: Actions taken by the General Partner are considered binding and conclusive and are not subject to question or review by Limited Partners in any suit or proceeding, with limited exception

---

19 | Current Traps for the Unwary in Alternative Investments

## Buried Substantive Provisions in Partnership Agreements

---

- Included in key man, removal, conflicts and amendment sections of a Partnership Agreement: Actions taken by a General Partner pursuant to such sections will not constitute a breach of any duty owed by the General Partner

---

20 | Current Traps for the Unwary In Alternative Investments

## Buried Substantive Provisions in Partnership Agreements

---

- Default to sole and absolute discretion
  - Every power vested in the General Partner will be construed as a power to act in its sole and absolute discretion

---

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RAM?  
IMA?

## Buried Substantive Provisions in Other Documents

---

- Examples of provisions found in subscription documents and private placement memoranda but not in the Partnership Agreement (where they would typically be):
  - Waiver of right to trial by jury
  - Consent to jurisdiction and venue
  - Broader power of attorney

---

22 | Current Traps for the Unwary in Alternative Investments

*LPAC: limited partner advisory comm?*

## Buried Substantive Provisions in Other Documents

---

- Waiver of conflicts
  - By acquiring an interest in the Partnership, a Limited Partner will be deemed to have acknowledged the existence of any conflicts of interest and to have waived any claim with respect to such conflict of interest

---

23 | Current Traps for the Unwary in Alternative Investments

## Early Closing Discounts

---

- Early closing discounts
  - Enticing Limited Partners with reduced management fee if participate in first close
  - Pressures agreement on business terms or risk losing the discount
  - Provides General Partners a benefit to publicize large first close and resist changes from subsequent closing partners

---

24 | Current Traps for the Unwary in Alternative Investments

## Expenses

---

- More expenses explicitly included in Partnership Expenses
  - Travel expenses “including, where appropriate, the chartering of private aircraft”
  - Research expenses
    - Expenses incurred in obtaining systems, research and other information utilized for portfolio management purposes

---

25 | Current Traps for the Unwary in Alternative Investments

## Expenses

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- Costs and expenses associated with outsourcing of certain services to affiliated and unaffiliated service providers
- Internal legal costs

---

26 | Current Traps for the Unwary in Alternative Investments

## Deal Fees and Fee Sharing

---

- Deal Fees and Fee Sharing
  - SEC issues
  - Types of fees shared should be broadly defined
  - Recipients of fees

---

27 | Current Traps for the Unwary in Alternative Investments

## Offsets to Management Fee

---

- End of Partnership
  - Distribution of excess fees should be to fee-paying Limited Partners
  - Distribution through waterfall.
  - Carry over to successor or related partnerships

---

28 | Current Traps for the Unwary in Alternative Investments

## Recycling and Termination of Commitment Period

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- Recycling
  - Returned capital or all proceeds
  - Unrestrained by termination of commitment period
  - Unrestrained after cause event or key person event
  - Failure to clearly define termination of commitment period

---

29 | Current Traps for the Unwary in Alternative Investments

## Side Letters

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- Carve outs expanding (agreements excluded from a side letter for purposes of the MFN)
  - New:
    - Reporting
    - Withdrawal rights
    - Excuse
    - Regulatory rights
    - Transfer rights

---

30 | Current Traps for the Unwary in Alternative Investments

## Side Letters

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- Limited MFN Packets (e.g., General Partner selects side letter provisions applicable to Investor's MFN)
- Side Letter provision v. Partnership Agreement provision
  - Enforceability issues
  - Other concerns

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*ask for:  
side letter  
opinion*

## Due Diligence Letter in Lieu of Side Letter

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- General Partners provide a separate disclosure letter “in response to the due diligence inquiry” from a Limited Partner covering provisions typically included in a side letter
  - Interest in co-investment opportunities
  - Representations regarding litigation
  - Information to be provided at the request of the Limited Partner

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## Due Diligence Letter in Lieu of Side Letter

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- Confirmations regarding intended interpretation of Partnership Agreement provisions
- Questions regarding enforceability

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## Opinions

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- Previous opinion vs. subsequent fund opinion
  - Disclosure by law
  - Documents being opined on
  - Provide different opinion or no opinion to some Limited Partners

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## Parallel Funds

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- Different economic terms may be permitted (either explicitly or implicitly) for Parallel Funds
  - Different terms may not be disclosed to Limited Partners as a matter of course
  - Different terms may not be subject to the MFN

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*often  
created to benefit  
particular investor*