

Part IV. Items of General Interest

Supplemental Instructions for Form 8606, Nondeductible IRAs

Announcement 99-18

This announcement provides supplemental instructions for the proper completion of Form 8606, Nondeductible IRAs, for Roth IRA conversions and recharacterizations. It also clarifies the proper computation of the 10% additional tax for early distributions in the case of Roth IRA conversions and subsequent withdrawals from Roth IRA accounts. Finally, it corrects the computation of modified AGI for purposes of Roth IRAs on page 2 and the Ed IRA Contribution Worksheet on page 3 in the separate instructions for Form 8606.

I. Reporting Roth IRA Conversions and Recharacterizations

Holders of traditional IRAs may convert these accounts to Roth IRAs if they meet the eligibility requirements and include any previously untaxed amounts converted in their gross income for the year of conversion. For conversions in 1998, the includible amount may be spread over 4 years, at the election of the taxpayer. A conversion may be undone by recharacterizing the converted amounts back to the traditional IRA.

Some questions have arisen about the proper reporting of conversions, recharacterizations, and reconversions to Roth IRAs, particularly regarding the reconciliation of amounts on Forms 1099-R issued by account trustees with amounts to be entered on Form 8606 and Form 1040.

The following comprehensive example clarifies this reporting.

Example: Mr. Smith has the following IRA activity in 1998:

<u>Date</u>	<u>Activity</u>
2/19/98	Mr. Smith contributes \$2,000 to a Roth IRA.
2/19/98	Mr. Smith converts the entire \$8,000 balance in his traditional IRA to a Roth IRA. The converted amount was placed into an account separate from the Roth contribution account. His total basis in the traditional IRA was \$2,000 (from a nondeductible contribution in an earlier year).
9/10/98	The fair market value of Mr. Smith's conversion account decreased from \$8,000 to \$7,000. Mr. Smith recharacterizes the entire remaining balance of \$7,000 to a traditional IRA.
9/10/98	Mr. Smith reconverts the \$7,000 from the traditional IRA back to a Roth IRA.

In 1999, Mr. Smith receives three Forms 1099-R: one for the original conversion of \$8,000, another for the \$7,000 recharacterization, and a third one for the subsequent reconversion of \$7,000.

Completion of Form 8606: Mr. Smith should complete the identifying information above Part I. He should leave Part I blank. Mr. Smith completes Part II of Form 8606 as follows:

Line 14a. Mr. Smith enters \$15,000 on this line. This is the sum of the amounts reported to him in box 1 of the Forms 1099-R he received for the \$8,000 conversion on February 19, 1998, and the \$7,000 reconversion on September 10, 1998.

Line 14b. Although Mr. Smith recharacterized \$7,000 from his Roth conversion account to his traditional IRA, he reports \$8,000 on line 14b. This is because line 14a includes \$8,000 from his original conversion and he recharacterized the entire remaining balance of \$7,000. He enters \$8,000 on line 14b to “zero out” the conversion and subsequent recharacterization. Otherwise, Mr. Smith would be taxed on the \$1,000 decline in market value in his Roth conversion account before the recharacterization.

Line 14c. Mr. Smith reports \$7,000 on this line (\$15,000-\$8,000).

Line 15. Mr. Smith refers to the chart on page 5 of the Form 8606 instructions to determine the amount to enter on this line. As a result, he enters \$2,000, which is his prior year nondeductible contribution to a traditional IRA.

Line 16. The taxable amount of the conversion is \$5,000 (\$7,000-\$2,000).

Line 17. Mr. Smith elects to have the taxable amount spread over 4 years. In 1998 and in each of the next 3 years, Mr. Smith is taxed on \$1,250.

Part III. Mr. Smith does not complete Part III. Although he received a Form 1099-R for his recharacterization of \$7,000 from the Roth IRA to a traditional IRA, the recharacterization is not a distribution that is to be reported on line 18 of Part III. It is merely a trustee-to-trustee transfer of funds between IRA accounts.

Completion of Form 1040: Mr. Smith includes \$22,000 on line 15a. This is the total IRA distributions that were reported to him in box 1 of the Forms 1099-R he received. Mr. Smith includes \$1,250, the amount of the conversion that is taxable in 1998, on line 15b. This is the amount from line 17 of Form 8606.

II. Clarification of Amount Subject to 10% Additional Tax

The **Note** after line 26 of Form 8606 is incomplete. Regardless of whether you have an amount on line 22 or 25 of Form 8606, you may be subject to an additional 10% tax. The **Note** should read as follows:

“Note: If you receive a Roth IRA distribution before reaching age 59 ½, you may be subject to an additional 10% tax. See Form 5329. Include on line 1 of Form 5329 the **smaller** of the amount on line 20 **or** the sum of the amounts on lines 16 and 25.”

Please disregard the paragraph headed **Lines 22 and 25-Additional 10% Tax** on page 6 of the instructions for Form 8606, as well as the first complete paragraph in the middle column of page 3 of the instructions for Form 5329.

III. Correction to Computation of Modified AGI for Purposes of Roth IRAs

Under **Roth IRAs** on page 2 of the Form 8606 instructions, item **1** under **Modified AGI for purposes of Roth IRAs** should include a reference to Form 1040A, line 10b.

IV. Correction to Ed IRA Contribution Worksheet

Line 2 of the worksheet on page 3 of the Form 8606 instructions should read: “Enter \$150,000 if married filing jointly; or \$95,000 for all other filers.” The referenced amount for married filing separately should be deleted.