GROOM LAW GROUP

March 3, 2010

MEMORANDUM TO CLIENTS

RE: <u>IRS Pension Distribution Reporting Changes For 2010</u>

The IRS recently released the instructions for the 2010 Form 1099-R. The instructions clarify a number of important areas, including the new "truncated social security number" option, and how to report 2010 Roth conversions. Plan sponsors and administrators should review these changes and update distribution forms and procedures accordingly. The key changes are summarized below:

<u>Masking SSN for Privacy.</u> A recipient's Form 1099-R is permitted (but not required) to reflect only the last 4 digits of the recipient's social security number or individual taxpayer identification number. This approach can be taken for all or select reports – there is no consistency requirement.

<u>2010 Roth Conversions From Qualified Plans</u>. For 2010, a participant can roll over non-Roth amounts in a qualified plan to a Roth IRA and elect to defer taxation until 2011 and 2012. Moreover, the income limits and the filing status limits have been removed. The instructions provide for the following reporting treatment for these conversions – the gross distribution is reported in box 1, the taxable amount of the conversion is reported in box 2a (without regard to whether the amount is taxable in 2010 or spread over the 2011 and 2012 period), any amount withheld is reported in box 4, and generally enter Code G in box 7. No 1099-R reporting is required for 2011 or 2012 with respect to the 2010 conversion. Employers and participants should consider an income tax withholding election carefully. If the participant is taxed on the conversion in 2011 and 2012, electing withholding for 2010 would not offset the tax liability for those years, and may even result in a 10% early withdrawal tax if the participant is not yet age 59½ (because amounts withheld to pay taxes are generally treated as distributions), and may require two Form 1099-Rs for the year.

<u>2010 Roth Conversions From Other IRAs</u>. The instructions reinstate the pre-2009 reporting requirements for conversion of IRAs into Roth IRAs. Specifically, enter the amount of the conversion in boxes 1 and 2a (without regard to whether the amount is taxable in 2010 or spread over the 2011 and 2012 period), check "taxable amount not determined" in box 2b, and use code "2" or "7" in box 7 depending on the recipient's age. No 1099-R reporting is required for 2011 or 2012 with respect to the 2010 conversion. (The 2010 Instructions also revert back to the prior rule that, in general, an IRA distribution is reported in box 1 and 2a (rather than leaving box 2a blank), and checking the box "taxable amount not determined.")

<u>Mandatory Withholding for Non-Spouse Beneficiary</u>. The instructions explain that, beginning January 1, 2010, eligible rollover distributions from an employer's plan paid directly to a nonspouse beneficiary are subject to 20% mandatory withholding (rather than the historic voluntary withholding (e.g., 10% for non-periodic payments)). Specifically, a non-spouse beneficiary subject to the inherited IRA rules (which excludes estates, but covers a "qualified trust" under the section 401(a)(9) rules) who does not elect a direct rollover to an IRA is subject to mandatory 20% withholding. This change is technically effective for plan years beginning on or after January 1, 2010 following WRERA. Distribution forms should be updated accordingly.

Loss Reporting. The instructions clarify that, in the event that a plan or IRA distribution includes a loss (due to market fluctuations), the full basis is still reported in box 5. Therefore, the following approach should be taken for a loss distribution paid in a lump sum to a participant: the gross distribution is reported in box 1, the taxable amount reported in box 2b is zero, and the full basis (e.g., after-tax contributions) is reported in box 5.

EPCRS Corrections. The instructions clarify that it is permissible (but not required) to make an adjustment for losses on payouts of excess 415 annual additions, in accordance with Revenue Procedure 2008-50. Moreover, the instructions clarify that similar rules apply to other corrective distributions under EPCRS. Therefore, it appears reasonable to report distribution of "excess amounts" and "excess allocations" using Code E in box 7.

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