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Julie Jason: What happens when an RMD rollover isn't true to 'form'?

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The subject of a reader's question has to do with 2020 RMDs that should not be taxable because they were reversed.

D.R. normally takes her required minimum distributions (RMDs) from her individual retirement accounts in December of each year, but in 2020, she decided to take them early.

"In January ... I withdrew the 2020 RMDs from my IRAs because I was worried that the 2019 rise in the markets was not sustainable. (I thought the markets might crash, and withdrawing the RMDs early in the year would require selling a smaller percentage of my IRA portfolio.)"

D.R. does not rely on her RMDs to cover living expenses, so when she heard in March that RMDs were suspended for 2020 through the Coronavirus Aid, Relief and Economic Security Act, she was happy to put that money back into her IRAs, something she accomplished in July 2020, ahead of an Aug. 31 deadline established by IRS Notice 2020-51.

All was good until just recently, when she received her tax-reporting documents from her IRA custodian.

She writes: "I have now received 1099-Rs for the IRAs that indicate the RMDs taken in January 2020 are fully taxable. I have not found any IRS guidance on how to report the return of the RMDs on my IRS Form 1040 or how to avoid paying tax on them.

"Do you have any advice on how to report the return of the 2020 RMDs? Many thanks in advance."

It is not unusual for Form 1099-R to reflect amounts distributed as taxable that have been timely rolled over to a qualifying account, according to CPA Michael D'Addio of Marcum LLP's New Haven, Connecticut, office. Marcum is a national accounting and advisory firm.

“So long as the amount was properly rolled over by the appropriate 60-day deadline (or by Aug. 31 for an early 2020 distribution), it is not taxable regardless of what is reported on Form 1099-R,” explained D’Addio.

Here are some general rules on how to handle a tax return in this situation, but be cautious. Since tax returns are specific to individual taxpayers, you’ll need to rely on the advice of your own accountant.

The total distribution is entered on IRS Form 1040’s line 4a for IRA distributions (line 5a for qualified plan distributions). The taxable amount is entered on line 4b (5b for 401(k)s). (That would be zero if the entire distribution was rolled over on a timely basis.) Then write the word “Rollover” in the space to the left of line 4b (or 5b for a 401(k)).

A spokesperson for Fidelity Investments, an IRA custodian to millions, confirmed that their clients will receive a 1099-R form for RMD amounts taken in 2020. If they rolled all or part of their RMD back into their retirement account in 2020, they will also receive IRS Form 5498, which displays the amount as a rollover contribution.

Note that you may not receive Form 5498 until May 31, 2021. Be sure to keep it in your tax records.

What if the 2020 distribution was not timely rolled over? It is subject to being taxed. However, it is possible the rollover could fall under coronavirus-related distribution rules — a subject for a later column if there is interest (let me know).

Before I sign off, I have to share D.R.’s note to me:

“Dear Ms. Jason, I very much enjoy your column, which I read in The Union Leader of Manchester, N.H. Thank you for your commonsense approach to financial topics.”

Love those reader letters!

With more than 1,000 weekly columns under my belt, the column is still a joy to write, in large part due to your correspondence. If you have thoughts to share or questions to ask, please write to me at readers@juliejason.com.

Julie Jason, JD, LLM, a personal money manager (Jackson, Grant of Stamford) and author, welcomes your questions/comments (readers@juliejason.com). Her awards include the 2020 Clarion Award, symbolizing excellence in clear, concise communications. Her latest book, a curated collection of Julie’s columns, is “Retire Securely: Insights on Money Management From an Award-Winning Financial Columnist.” To hear Julie speak, visit juliejason.com/events.