

Can an IMRF member take a tax deduction for purchasing IMRF service or paying for ERI?

This letter explains how to report the payment for purchased or reinstated IMRF service credit on an IMRF member's federal tax return.

A member can purchase or reinstate IMRF service credit in three different ways:

- a lump sum payment with after-tax dollars (such as a personal check)
- a unit payment with after-tax dollars (such as a personal check)
- with a rollover from an IRA, 401(k), 457 or 403(b) account.

The method a member uses to pay for the service credit determines how to report the payment on his or her federal tax return.

After-tax dollars

If a member uses after-tax dollars to pay for purchased or reinstated service credit, either with a lump sum or unit payment(s), the payments **cannot** be used as a deduction on his or her tax return. Although this money cannot be used as a deduction, the member will not have to pay tax twice on it. When IMRF receives this type of payment from a member, we record it as "previously taxed."

After a member retires, if he or she used after-tax dollars to purchase or reinstate service credit, a portion of each monthly retirement payment is *not* subject to federal income tax. The IRS considers that portion of a pension payment that is *not* subject to federal income tax as a 'return' to the member of his or her after-tax ("previously taxed") contributions to IMRF.

IMRF calculates the portion that is not subject to federal income tax and includes what amount on the 1099-R that IMRF issues each January. A summary of this calculation can be found in IMRF Tax Letter Number 8, "Simplified General Rule," which can be viewed on www.imrf.org. The IRS explanation can be found in IRS Publication 575, "Pension and Annuity Income."



Rollover

There are two types of rollovers: a **direct** rollover and an **indirect** rollover.

- **Direct Rollover** – With a direct rollover, the financial institution holding the funds makes the check payable directly to IMRF. For this type of rollover, the member should receive an IRS Form 1099-R showing a gross amount of the rollover (i.e. \$1,000.00) in box 1, and a taxable amount of **zero** in box 2a. By transferring the gross and taxable amounts from the 1099-R to the appropriate boxes on the 1040/1040A, the member will not be taxed on the rollover.
- **Indirect Rollover** – With an indirect rollover, the financial institution holding the funds makes the check payable to the member. The member then has 60 days to make a payment to IMRF using these funds.

When the member fills out his or her tax return, he or she should reduce the amount shown in box 2a on the IRS Form 1099-R by the amount he or she paid to IMRF from these funds, and show the lower amount on the tax return. For example:

1. The member withdrew \$1,000 from an IRA.
2. Within 60 days, he or she used \$600.00 of this money to purchase or reinstate service with IMRF.
3. The member then received a 1099-R that shows the \$1,000.00 he or she received from the IRA (box 1 and box 2a show \$1,000.00)
4. Since the member sent \$600.00 to IMRF as a rollover to purchase/reinstate service, on the 1040 tax return he or she would enter \$1,000.00 in box 15a (IRA distributions), but would enter \$400.00 (\$1,000.00 less the \$600.00 rollover) in box 15b (taxable amount).

(If the member sent the entire \$1,000.00 to IMRF as a rollover to purchase/reinstate service, he or she would enter zero in box 15b.)

Note: Before IMRF can accept any rollover monies, specific information must be submitted for an eligibility review. **Do not withdraw any funds or send any rollover distributions to IMRF before we advise you of your eligibility to do so.**

Additional questions

If you have additional questions, please call an IMRF Member Services Representative at 1-800-ASK-IMRF (1-800-275-4673). You may also contact the IRS for additional income tax information at 1-800-829-1040, or visit their website at www.irs.gov.

