

MEMO# 10553

December 11, 1998

IRS HEARING ON ROTH IRA PROPOSED REGULATIONS

[10553] December 11, 1998 TO: PENSION COMMITTEE No. 86-98 PENSION OPERATIONS ADVISORY COMMITTEE No. 69-98 AD-HOC COMMITTEE ON ROTH IRA OCTOBER 22 MEETING ATTENDEES ON ROTH IRA RE: IRS HEARING ON ROTH IRA PROPOSED REGULATIONS

The Internal Revenue Service held a hearing on the Roth IRA proposed regulations on December 10, 1998. The Service was represented by Roger Kuehnle, Senior Technical Reviewer, Employee Plans Division; Marjorie Hoffman, Associate Chief Counsel Branch 1, Employee Benefits and Exempt Organization; and Cathy Vohs, Associate Chief Counsel Branch 1, Employee Benefits and Exempt Organization. The Treasury Department was represented by Deborah Walker, Acting Deputy Benefits Tax Counsel, Benefits Tax Counsel and Michael Doran, Attorney-Advisory, Benefits Tax Counsel. Witnesses included Susan Diehl of PenServe, Inc., Lynne Faigen for the insurance industry, Kathleen Schluter of Northwestern Mutual Life and Mervin Wilf for himself. Each witness was allowed to testify for 10 minutes and then answered any questions from the Service and Treasury representatives. The hearing lasted approximately one hour. The oral testimonies of the witnesses are summarized below, in addition to applicable questions and answers. The Service did not provide copies of witness testimony or written comments. Susan Diehl of PenServe noted that in its written comments, PenServe requested guidance on eight issues. Ms. Diehl testified on the following issues: 1. . If a taxpayer is taking substantially equal payments from an IRA and converts to a Roth IRA in 1998 and elects the 4-year spread, are the substantially equal payments subject to income acceleration when a distribution is made during the 4-year period? In addition, what is the effect of a partial conversion of an IRA where substantially equal payments are made? 2. The Service should provide examples regarding the calculation of gains and losses for partial conversions and partial recharacterizations. 3. What is the effect of converting a traditional IRA with basis on a remaining conduit IRA for purposes of rollover to an employer plan? For example, a taxpayer with multiple IRAs, with at least one conduit IRA, converts an IRA containing basis to a Roth IRA. What is the effect of the conversion on the remaining IRAs in terms of attributable basis and can the taxpayer subsequently roll the conduit IRA to an employer plan? 4. With respect to the 5-year aging rule, if a taxpayer makes a contribution to a Roth IRA and after 5 years makes a qualified distribution of the entire account, does the 5 year aging period begin again with a later contribution to a Roth IRA? 5. Is a beneficiary permitted to recharacterize a Roth IRA or traditional IRA on behalf of the decedent Roth IRA holder? 6. With respect to excess contributions to IRAs, may a prior year excess contribution to a traditional IRA be recharacterized as a current year Roth IRA contribution? 7. May a spouse, who is not the sole beneficiary of the Roth IRA, treat the Roth IRA as his or her own IRA? 8. The statement in the proposed regulations that the 2-year holding period

for SIMPLEs is applied to each employer represents new recordkeeping requirements for IRA trustees and custodians. Lynn Faigen of NY Life testified on behalf of the insurance industry on the following issues: 1. Notice 98-49's proposal to issue separate Forms 5498 and 1099-R for each recharacterization transaction imposes a significant reporting burden on insurance companies. She noted that currently, IRA transactions are reported on an aggregate basis representing a year's worth of transactions. She suggested that the Service give financial institutions the option of reporting recharacterizations under the current mechanism, i.e., aggregate reporting, or under the Notice 98-49 approach. She emphasized that the reporting system suggested in Notice 98-49 for recharacterization transactions would impose expensive systems changes on financial institutions, interfere with current Y2K compliance programs and create taxpayer confusion. 2. Proposed regulation section 1.408A-7, Q&A 1, states that trustees maintaining Roth IRAs are permitted to rely on reasonable representations of a Roth IRA contributor or distributee for purposes of fulfilling reporting obligations. The Service should clarify, however, that a financial institution should be permitted to report Roth IRA contributions and distributions based on its own records and not on information provided to it by its customers. 3. The withholding rules should not apply to qualified distributions from a Roth IRA, or alternatively, a taxpayer should be deemed to elect out of withholding in such circumstances. Questions and Answers: A Service representative asked that assuming flexibility was permitted with respect to recharacterization reporting, i.e., using the aggregate approach or the Notice 98-49 approach, could financial institutions notify taxpayers as to which method they utilize? For example, a taxpayer with investments with multiple financial institutions could receive different types of Form 5498 and 1099-R reports, i.e., some under the aggregate approach and some under the Notice 98-49 approach, which could result in taxpayer confusion. Ms. Faigen indicated that this should be possible. A follow-up question was asked whether a financial institution would report Forms 5498 and 1099-R using a single method, i.e., the aggregate approach or the Notice 98-49 approach. Ms. Faigen responded that for some companies, including her own, separate divisions may choose different reporting mechanisms. Finally, a Service representative asked whether the taxable amount could be reported for recharacterizations transactions and Ms. Faigen responded that this was possible. Kathleen Hyland Schluter of Northwestern Mutual Life testified on the following issues: 1. The Service should impose the "tracing method" (tracing of actual gains and losses) for the calculation of gains and losses on recharacterization transactions regardless of whether the recharacterization transaction represents the entire account or a portion of the account. 2. With regard to the definition of "designation" of a Roth IRA regarding recharacterization transactions, the Service should clarify that taxpayers are not required to enter into a new contract as a result of a recharacterization. The insurance industry imposes certain costs, i.e., surrender costs, for closed contracts. 3. Individuals should be permitted to open a Roth IRA on behalf of a minor. According to Schluter, the proposed regulations appear to limit Roth IRA eligibility to "individuals" with an exception only for employers. Merv Wilf did not testify on any issue in particular, but wanted to enter into a "dialogue" with the Service. Mr. Wilf did suggest that the \$100,000 AGI limit applicable to Roth IRA conversions should be applied on an individual basis for married individuals filing jointly. A Treasury representative indicated that the Service has a mandate to interpret this limit for both single and married individuals based on the legislative history to the statute and the blue book language. Mr. Wilf responded that the Service is not bound by legislative history or blue book language in interpreting the statute, as court cases have found that such interpretive methods are not binding. Kathryn A. Ricard Assistant Counsel

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