

**MEMO# 9903**

May 5, 1998

# **REPORTING REQUIREMENTS FOR THE PROPOSED ERROR CORRECTION PROVISION UNDER TECHNICAL CORRECTIONS LEGISLATION**

1 Note that the term "trustee-to-trustee transfer" technically refers to transfers between like plan types or to a change of trustee or custodian and not to transfers between Roth IRAs and traditional IRAs. As part of our comment to Treasury and the IRS, we will recommend the use of a different term for such error correction or adjustment transfers. [9903] May 5, 1998 TO: PENSION COMMITTEE No. 24-98 PENSION OPERATIONS ADVISORY COMMITTEE No. 16-98 AD HOC COMMITTEE ON ROTH IRA ISSUES RE: REPORTING REQUIREMENTS FOR THE PROPOSED ERROR CORRECTION PROVISION UNDER TECHNICAL CORRECTIONS LEGISLATION

As you are aware, the Taxpayer Relief Act of 1997 does not include an error correction provision applicable to ineligible contributions to a Roth IRA. Under current law, if a taxpayer makes a contribution to a Roth IRA, or converts a traditional IRA to a Roth IRA and subsequently becomes aware that his or her income exceeds the AGI eligibility limitations applicable to a Roth IRA, there is no error correction mechanism available to correct the ineligible contribution. However, both the House and Senate versions of the Technical Corrections bill would provide an error correction mechanism for taxpayers who erroneously convert traditional IRAs into Roth IRAs or otherwise wish to change the nature of an IRA contribution, i.e., "adjustment" transactions. The provision would allow taxpayers to transfer contributions, including the earnings thereon via a trustee-to-trustee transfer,<sup>1</sup> from any IRA to any IRA by the due date for the taxpayers return for the year of contribution, including extensions. Although the error correction provision is not yet effective, it has the support of both the House and the Senate and will most likely become the means to correct an IRA contribution made in error. In anticipation of the enactment of the proposed error correction provision under Technical Corrections legislation, the Institute is considering the regulatory issues associated with the proposal. Specifically, the Institute would like to make recommendations with respect to the reporting obligations of financial institutions for such error correction and adjustment transactions to the Treasury Department and the Internal Revenue Service. The Institute intends to submit a reporting proposal that would cover all IRA contribution error corrections and adjustments, including: ineligible Roth IRA conversions; ineligible Roth IRA contributions; adjustment transfers from a Roth IRA to a traditional IRA; transfers from a traditional IRA (deductible and non-deductible) to a Roth IRA; transfers between complexes; and transfers between funds. There are two alternatives for reporting error corrections or adjustments: (1) file all of the

forms (1099-Rs and/or 5498s) associated with the transaction. For Roth IRA conversions, this would include 2 Form 1099-Rs and 2 Form 5498s and for other IRA transfers, this would include 1 Form 1099-R and 2 Form 5498s, as demonstrated below: Roth IRA conversions: Distribution from IRA and convert to Roth -- Form 1099-R; contribution to Roth IRA -- Form 5498; Distribution from Roth -- Form 1099-R; rollover to IRA -- Form 5498; IRA transfers: Contribution to IRA-- Form 5498; distribution from IRA -- Form 1099-R; contribution to Roth IRA -- Form 5498; or (2) cancel or reverse the initial transaction and file the forms to reflect the final IRA contribution. For Roth IRA conversions, this would include 1 Form 1099-R and 1 Form 5498 and for other IRA contribution transfers, this would include 1 Form 5498 as demonstrated below: Roth IRA conversions: cancel/reverse initial reporting for conversion; distribution from Roth IRA --Form 1099-R; contribution to IRA-- Form 5498; IRA transfers: cancel/reverse reporting for initial contribution; contribution to IRA -- Form 5498. Please note that the option of "canceling" the transaction and the associated reporting is an alternative that is available for transfers executed within the same complex, made during the calendar year and transacted within the same fund. Because this option is available only in limited circumstances, the Institute will not propose this option to Treasury and the IRS. However, individual fund complexes may determine that the "cancel" option is the optimal alternative in such situations. We therefore seek your assistance in determining the recommended approach for financial institution reporting obligations for IRA contribution error correction. Please review the following proposal regarding error correction reporting and send us your comments by COB Thursday May 14, 1998. Please fax your comments to the undersigned at (202) 326-5841 or email them to ricard@ici.org. Reporting obligations of financial institutions for IRA contribution error correction transactions: financial institutions must report each portion of the error correction transaction for IRA contributions and subsequent transfers as required under current guidance. The following represent different reporting scenarios for error correction of IRA contributions: Error correction or adjustment transactions that "undo" a Roth IRA conversion will require the following reporting: an initial Form 1099-R to report the initial distribution from the traditional IRA; an initial Form 5498 to report the contribution to a Roth IRA; a second Form 1099-R to report the distribution from the Roth IRA (coded as K); and a second Form 5498 to report the contribution into the traditional IRA (as a rollover). Error correction or adjustment transactions that transfer Roth IRA contributions will require the following reporting: an initial Form 5498 to report the contribution (up to \$2,000) to a Roth IRA; an initial Form 1099- R to report the distribution from the Roth IRA (coded as J); and a second Form 5498 to report the contribution to the traditional IRA (as a rollover). Adjustment transfers of contributions from a traditional IRA to a Roth IRA will require the following reporting: an initial Form 5498 to report the contribution (up to \$2,000) to a traditional IRA; an initial Form 1099-R to report the distribution from the traditional IRA (coded as a premature distribution or normal); and a second Form 5498 to report the contribution to the Roth IRA (as a rollover). Note that under the proposal, rollovers are not eligible means to effectuate an error correction for IRA contributions. Under both the House and Senate proposals, these transactions must occur via trustee-to-trustee transfers. If you have any questions or comments, please call me at (202) 218-3563. Thank you for your attention to this matter. Kathryn A. Ricard Assistant Counsel