

**MEMO# 12220**

July 12, 2000

## **IRS RELEASES GUIDANCE ON CALCULATING INCOME FOR EXCESS CONTRIBUTIONS AND RECHARACTERIZATIONS; JULY 26 CONFERENCE CALL SCHEDULED**

[12220] July 12, 2000 TO: PENSION COMMITTEE No. 47-00 PENSION OPERATIONS ADVISORY COMMITTEE No. 49-00 AD HOC COMMITTEE ON ROTH IRAS RE: IRS RELEASES GUIDANCE ON CALCULATING INCOME FOR EXCESS CONTRIBUTIONS AND RECHARACTERIZATIONS; JULY 26 CONFERENCE CALL SCHEDULED The Internal Revenue Service recently released Notice 2000-39, which sets forth a new method for calculating net income attributable to IRA contributions made after 1999 that are distributed as returned contributions under 408(d)(4) or recharacterized under 408A(d)(6). Notice 2000-39 states that until further guidance is issued, net income may continue to be calculated under the existing method set forth in the Internal Revenue Code. The Service has requested comments on the new calculation method and its effective date. We have scheduled a conference call to discuss these issues on Wednesday, July 26, 2000 at 2:00 pm EST. I. Returned contributions under 408(d)(4) The new method generally bases the calculation of the amount of net income attributable to a contribution on the actual earnings and losses of the IRA during the time it held the contribution. Under the new method, net income may be a negative number. For purposes of returned contributions under 408(d)(4), the net income attributable to a contribution made to an IRA after December 31, 1999 is determined by allocating to the contribution a pro-rata portion of earnings accrued by the IRA during the period the IRA held the contribution. The new method utilizes the following formula: 
$$\text{Net income} = \frac{\text{contribution} \times \text{adjusted closing balance} - \text{adjusted opening balance}}{\text{adjusted opening balance}}$$
 The adjusted opening balance is the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions made to the IRA during the computation period (including the contribution that is distributed as a returned contribution under 408(d)(4)). The adjusted closing balance is the fair market value of the IRA at the end of the computation period plus the amount of any distributions made from the IRA during the computation period. The computation period is the period beginning immediately prior to the time the particular contribution is made to the IRA and ending immediately prior to the removal of the contribution being returned. For purposes of this calculation, when an IRA asset is not valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent regularly determined fair market value of the asset determined as of the date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of determining net

income, recharacterized contributions are taken into account for the period they are actually held in a particular IRA. In the case of multiple regular contributions to an IRA, the last regular contribution made to the IRA for a particular taxable year is deemed to be the contribution that is distributed as a returned distribution under 408(d)(4) up to the amount of contribution identified by the IRA owner as the amount distributed as a returned contribution. In the case of an individual who owns multiple IRAs, the net income calculation is performed only on the IRA designated by the IRA owner as containing the contribution that is to be distributed as a returned contribution, and that IRA is the IRA that must distribute the contribution. Notice 2000-39 contains two examples involving the new method of calculation. II. Recharacterized contributions under section 408A(d)(6) For recharacterizations, the new method calculates net income allocable to a contribution made to an IRA after December 31, 1999 using the formula described above. The Notice also states that in the case of multiple contributions made to an IRA for a particular year that are eligible for recharacterization, the IRA owner can choose (by dollar amount, not by specific assets acquired by those dollars) which contribution, or portion thereof, is to be recharacterized. Notice 2000-39 includes various examples of the new method of calculation as applied to recharacterization transactions. III. Comments and conference call The Service has requested comments on this guidance. Although the Service will allow net income to be calculated using the old method or the new method, the Notice states that it is intended that future guidance will provide that the new method will be the only method for calculating net income, and comments are requested regarding the new method and its effective date. A copy of Notice 2000-39 is attached. A conference call is scheduled for Wednesday, July 26, 2000 at 2:00 pm EST to discuss the new calculation method and effective date. If you would like to participate in the call, please fill out the response form below and fax it to Melanie Washington by Monday July 24, 2000 at (202) 326-5841. If you have any questions or comments regarding Notice 2000-39 or the conference call, please call Russ Galer at (202) 326-5835 or myself at (202) 218-3563. Kathryn A. Ricard Associate Counsel Attachments 3RESPONSE FORM FOR INSTITUTE CONFERENCE CALL ON NOTICE 2000-39 WEDNESDAY, JULY 26, 2000, 2PM Please fax this form by Monday July 24, 2000 to Melanie Washington at (202) 326-5841. Yes, I will participate in the conference call on Wednesday, July 26, 2000 at 2:00 pm EST. To participate in the call, dial 1-800-949-5539 and ask for the Investment Company Institute call, confirmation number #4411704. Committee Member Company Phone Number Attachment (in .pdf format)