

**MEMO# 13222**

March 2, 2001

## **GUIDANCE ON ROTH IRA ISSUES**

[13222] March 2, 2001 TO: PENSION MEMBERS No. 14-01 PENSION OPERATIONS ADVISORY COMMITTEE No. 21-01 RE: GUIDANCE ON ROTH IRA ISSUES The Internal Revenue Service and the New Jersey Division of Taxation have recently released guidance on various issues concerning Roth IRAs. The guidance is summarized below: Roth IRA 5-Year Testing Period: In Information Letter 2000-0159, the IRS describes the five-year period for determining whether a Roth IRA distribution is a qualified distribution. Under Treasury regulation 1.408A-6, A-2, the 5-year period begins on the first day of the taxpayer's taxable year for which the first regular contribution is made to any Roth IRA of the taxpayer, or if earlier, the first day of the taxpayer's taxable year for which the first conversion contribution is made to any Roth IRA of the taxpayer. The same 5-year period is used to determine the qualified status of distributions from any Roth IRA owned by the taxpayer. Calculating Net Income Attributable to Recharacterizations In Information Letters 2000-0163 and 2000-0180, the IRS explains that Treasury regulation 1.408A-5, A-2(b) and (c) provides two methods for calculating the net income attributable to a contribution that is being recharacterized under 408A(d)(6). Under the first method, if the contribution being recharacterized was contributed to a separate IRA and no distributions or additional contributions have been made from or to that IRA at any time, then the contribution is recharacterized by the trustee transferring the entire account balance. The net income or loss for the contribution being recharacterized is the difference between the original contribution and the amount transferred. Under the second method, which is required in all other cases, the net income for a contribution being recharacterized is calculated under Treasury regulation 1.408A-4(c)(2)(ii) (disregarding parenthetical clause in 1.408-4(c)(iii)). The letters also discuss the calculations applicable to calculating the net income for excess contributions made to an IRA and returned before the due date. The letter references the proposed new method for such calculation under Notice 2000-39. 2Abatement of Individual Estimated Tax Penalties Relating to Conversions In Service Center Advice 200105062, IRS counsel has advised Service Centers that it cannot abate individual estimated tax penalties that result from income from conversion of traditional IRAs to Roth IRAs. IRS Counsel was asked for advice regarding the significant number of requests for abatements from taxpayers who were assessed estimated tax underpayment penalties for 1999 for failing to include income recognized from Roth IRA conversions in figuring their estimated tax payments. IRS Counsel advised that conversion to a Roth IRA is a taxable distribution from the traditional IRA. Income from such an event must be included in estimated tax calculations absent a waiver from the IRS. Section 6654(e)(3) limits waiver of estimated tax penalties to situations in which the underpayment results from "casualty, disaster, or other unusual circumstances." Thus, the waiver provisions would not apply to Roth conversions. New Jersey Clarifies Rules for Roth and Traditional IRAs The New Jersey Division of Taxation has released Tax Topic Bulletin GIT-2, IRA Withdrawals, which provides guidance concerning the tax treatment of IRA contributions and withdrawals. The bulletin states that contributions to both a

traditional and Roth IRA are subject to New Jersey income tax in the year they are made. It clarifies that the New Jersey Gross Income Act does not include any provisions similar to the Internal Revenue Code, which permits an individual to deduct contributions to a traditional IRA. Therefore, amounts that are withdrawn from either type of account are not taxable as they were taxed at the time of contribution. However, interest, dividends, and other earnings credited to the account, as well as amounts "rolled over" into an IRA account from a pension plan are subject tax upon withdrawal. An exception exists where the interest received by a taxpayer on an IRA distribution is from exempt obligations which are directly owned by the taxpayer in the IRA plan. Copies of the IRS and New Jersey Division of Taxation guidance are attached. Kathryn A. Ricard Associate Counsel Attachments Note: Not all recipients receive the attachment. To obtain a copy of the attachment to which this memo refers, please call the ICI Library at (202) 326-8304 and request the attachment for memo 13222. ICI Members may retrieve this memo and its attachment from ICINet (<http://members.ici.org>). Attachment (in .pdf format)

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