

MEMO# 10260

September 4, 1998

INTERNAL REVENUE SERVICE RELEASES NOTICE ON ROTH IRA REPORTING ISSUES

[10260] VIA FAX September 4, 1998 TO: PENSION OPERATIONS ADVISORY COMMITTEE No. 43-98 RE: INTERNAL REVENUE SERVICE RELEASES NOTICE ON ROTH IRA REPORTING ISSUES _____

The Internal Revenue Service released Notice 98-49, providing guidance on Roth IRA reporting requirements. In addition, this notice summarizes a number of recent changes in the law governing all IRAs, which affect Notice 87-13, 1987-1 C.B. 432, and Notice 87-16 C.B. 446. The reporting guidance is in the form of questions and answers and addresses the following issues: (1) Service-approved Roth IRA documents; (2) IRA reporting requirements; (3) other recent changes to IRAs; and (4) request for comments. Model Forms With respect to the model Roth IRA forms, the notice states that the model forms can be amended under Article IX. For example, the under the model forms, a spouse who is the sole beneficiary is deemed to have elected to treat the Roth IRA, upon death of the owner, as his or her own. The model forms can be amended to give a surviving spouse who is the sole designated beneficiary the option of not treating the Roth IRA, upon the death of the owner, as his or her own. With respect to applications for opinion letters on prototype Roth IRAs, the Service is not currently accepting applications for opinion letters on prototype Roth IRAs.

Transitional relief will be provided to sponsors and their customers who establish Roth IRAs with documents that have not been pre-approved by the Service, similar to that provided under Rev. Proc. 97-29, 1997-1 C.B. 698. IRA Reporting Requirements The notice states that the general reporting requirements for Roth IRAs are described in Proposed Regulation section 1.408A-7. The following reporting requirements apply to the trustees of the First IRA and Second IRA when the IRA owner elects to treat a contribution as having been made to the Second IRA and not to the First IRA, in accordance with the rules in section 1.408A-5: to the extent that the instructions for the 1998 Forms 1099-R and 5498 are inconsistent with the instructions for completing those forms provided in the notice, trustees must follow the guidance provided in the notice. The trustee of the First IRA reports the contribution on Form 5498 showing the character of the contribution (rollover, conversion amount or regular). If the recharacterization occurs in calendar year 1998, the trustee reports the recharacterization as a distribution on Form 1099-R showing Code G for direct rollover and showing the gross amount (contribution and earnings) in Box 1-Gross distribution and 0 (zero) in Box 2a-Taxable amount. For recharacterizations that occur in later years, the trustee reports in accordance with applicable Federal tax forms and instructions. For recharacterizations that occur in 1999, it is anticipated that the instructions to Form 1099-R will indicate that the trustee reports the recharacterization as a distribution on Form 1099-R showing new Code R for recharacterization and - 2 - showing the gross amount (contribution and earnings) in Box 1-Gross distribution and 0 (zero) in Box 2a-Taxable amount. For recharacterized amounts received on or before December 31, 1998 that are

recharacterized as amounts contributed in calendar year 1998, the trustee of the Second IRA reports the contribution as a rollover contribution on a 1998 Form 5498. For recharacterized amounts received after December 31, 1998, the trustee reports in accordance with applicable Federal tax forms and instructions. It is anticipated that instructions to the 1999 Form 5498 will provide that a recharacterized amount received by the trustee of the Second IRA will continue to be reported as a rollover contribution, but that (a) the checkbox entitled "Roth conv." on the 1998 Form 5498 will be retitled to identify a contribution as a recharacterization; (b) the trustee of the Second IRA will check both the box identifying the contribution as a recharacterization contribution and the box that identifies the type of IRA involved; and (c) the recharacterization must be reported on a Form 5498 that is separate from any Form 5498 otherwise required for the Second IRA. The notice also clarifies that for distributions from commingled accounts, i.e., accounts containing both contributory Roth IRA contributions and Roth IRA conversion contributions, trustees must use Code K in Box 7 of Form 1099-R.

Other Recent Changes to IRA The notice addresses the effect of the recharacterization contribution on the rules governing the nontaxable return of basis in the case of traditional IRA distributions. The current rules continue to apply except that the total IRA account balances, the total nondeductible contributions and the distribution amount for an individual for a taxable year are each adjusted to reflect recharacterized amounts contributed to, or distributed from, the traditional IRAs. For purposes of this adjustment, the contribution that is being recharacterized as a contribution to the Second IRA is treated as having been originally contributed to the Second IRA on the same date and for the same taxable year that the contribution was made to the First IRA. If the recharacterization transaction occurs after the close of the taxable year and if the recharacterization transaction involves a regular contribution for the prior taxable year, the recharacterization is disregarded for the prior taxable year in determining the total IRA account balances. The notice addresses the additional exceptions to the 10% penalty under section 72(t) of the Code, specifically the higher education expenses exception and the first-time homebuyer exception pursuant to the Taxpayer Relief Act of 1997 ("TRA '97). With respect to the "active participant" rules, the notice discusses the increases to the income limits applicable to taxpayers eligible to make deductible contributions to an IRA who are active participants in employer-sponsored retirement plans under TRA '97. The notice also addresses the "spousal delink" provision and the changes to permissible investments for IRAs pursuant to TRA '97.

Request For Comments The Service and Treasury Department invite comments concerning the guidance provided in this notice. In particular, comments are requested on appropriate reporting of recharacterization transactions described in Proposed Regulations Section 1.408A-5. The notice provides for reporting such transactions in a manner that most closely resembles reporting for ordinary IRA distributions, contributions and trustee-to-trustee transfers. However, the Service and Treasury are considering other possible reporting alternatives for recharacterization transactions. For example, the Service and Treasury propose that it may be appropriate to require that the recharacterized contribution be reported by the - 3 - trustee of the Second IRA on a Form 5498 for the year for which it is treated as having been contributed, even if the recharacterization occurs in the subsequent year. Another possible approach would be to require only the reporting by the trustee of the Second IRA involved in the recharacterization transaction that would have been required if the contribution had initially been made to the Second IRA and never had been made to the First IRA. Comments can be addressed to CC:DOM:CORP:R (Notice 98-49) Room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand-delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98-49), Courier's Desk, Internal Revenue Service 1111 Constitution Avenue, N.W., Washington, D.C. Taxpayers may also transmit comments electronically via the IRS Internet site at

http://www.irs.ustreas.gov/prod/tax_regs/comments.html. A copy of the Notice is attached.
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