[4830-01-u]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-115393-98]

RIN 1545-AW62

Roth IRAs

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to Roth IRAs. Roth IRAs were created by the Taxpayer Relief Act of 1997 as a new type of IRA that individuals can use beginning in 1998. The proposed regulations reflect changes relating to Roth IRAs contained in the Internal Revenue Service Restructuring and Reform Act of 1998. The proposed regulations affect individuals establishing Roth IRAs, beneficiaries under Roth IRAs, and trustees, custodians or issuers of Roth IRAs. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by December 2, 1998. Outlines of topics to be discussed at the public hearing scheduled for Thursday, December 10, 1998, at 10 a.m. must be received by Thursday, November 19, 1998.

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-115393-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-106177-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Cathy A. Vohs, (202) 622-6030; concerning the public hearing, Michael Slaughter (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by November 2, 1998. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collections of information in these proposed regulations are in §§1.408A-2, 1.408A-4, 1.408A-5, and 1.408A-7. This information is required by the IRS to comply with the provisions of the Taxpayer Relief Act of 1997, and in particular, with section 408A(b), (c), and (d). This information will be used by individuals and businesses or other for-profit institutions, and not-for-profit institutions, such as trustees, custodians or issuers of Roth IRAs, in establishing Roth IRAs and recharacterizing IRA contributions. This information will also be used by: (1) the IRS and individuals converting traditional IRAs to Roth IRAs to calculate the amount includible in gross income on account of such conversions, (2) the IRS and individuals receiving distributions from Roth IRAs to calculate the amount includible in gross income on account of such distributions, (3) the IRS and individuals recharacterizing IRA contributions to properly account for such recharacterizations, and (4) the IRS and trustees, custodians or issuers of Roth IRAs to properly report (a) the amount of contributions to and distributions from Roth IRAs, and (b) recharacterizations of IRA contributions (including Roth IRA contributions). The collections of information are required to obtain the benefit of having a Roth IRA. The likely respondents and/or recordkeepers are individuals, and trustees, custodians, or issuers of Roth IRAs. The burden for (1) calculating the amount includible in gross income on account of conversions and Roth IRA distributions, and (2) accounting for recharacterizations is reflected in the burden for Form 8606. The burden for electing to continue the 4-year spread of income inclusion (only applicable to certain spousal beneficiaries) is reflected in the burden for either Form 8606 or Form 1040, whichever is applicable. The burden for reporting contributions is reflected in the burden for Form 5498. The burden for reporting distributions is reflected in the burden for Form 1099-R.

Estimated total annual reporting/recordkeeping burden: 125,000 hours (50,000 hours for designating an IRA as a Roth IRA, plus 75,000 hours for recharacterizing an IRA contribution).

Estimated average annual burden per respondent/recordkeeper:

1 minute for designating an IRA as a Roth IRA and 30 minutes for recharacterizing an IRA contribution.

Estimated number of respondents/recordkeepers: 3,150,000 (3,000,000 respondents for designating an IRA as a Roth IRA, plus 150,000 respondents for recharacterizing an IRA contribution).

Estimated annual frequency of responses: on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 408A of the Internal Revenue Code (Code), which was added by section 302 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788), establishes the Roth IRA as a new type of individual retirement plan, effective for taxable years beginning on or after January 1, 1998. The provisions of section 408A were amended by the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685).

A Roth IRA generally is treated under the Code like a traditional IRA with several significant exceptions. Similar to traditional IRAs, income on undistributed amounts accumulated under a Roth IRA is exempt from Federal income tax, and contributions to Roth IRAs are subject to specific limitations. Unlike traditional IRAs, contributions to Roth IRAs cannot be deducted from gross income, but qualified distributions from Roth IRAs are excludable from gross income. These proposed regulations set forth specific rules for Roth IRAs in accordance with the provisions of section 408A.

Explanation of Provisions

General Provisions and Establishment of Roth IRAs

Proposed §1.408A-1 contains general provisions regarding Roth IRAs, and proposed §1.408A-1 contains provisions regarding the establishment of Roth IRAs. As described in proposed §1.408A-1, a Roth IRA is treated for Federal tax purposes in the same manner as an individual retirement plan except as otherwise provided in section 408A and the proposed regulations. Thus, all the rules of section 408 and the regulations under section 408 apply to Roth IRAs to the extent they are not inconsistent with section 408A or these proposed regulations.

Section 408A(b) defines a Roth IRA as an individual retirement plan which is designated at the time of its establishment as a Roth IRA. That section also grants the Secretary of the Treasury authority to prescribe the manner for designating an individual retirement plan as a Roth IRA. Proposed §1.408A-2 provides that a Roth IRA instrument must clearly designate the IRA as a Roth IRA, and that designation cannot later be changed. Thus, a taxpayer may not designate an

IRA as a Roth IRA and later redesignate the Roth IRA as a traditional IRA or otherwise treat the Roth IRA as though it were a traditional IRA for Federal tax purposes.

Regular Contributions

Proposed §1.408A-3 sets forth rules regarding regular (i.e., non-conversion) contributions to a Roth IRA. Unlike contributions to traditional IRAs, contributions to Roth IRAs are not deductible under any circumstances. A taxpayer's regular contributions to all his or her Roth IRAs for a year are limited to the lesser of $2,000 or the taxpayer's compensation for that year. As with traditional IRAs, a special rule for married taxpayers permits one spouse to treat the other spouse's compensation as his or her own for purposes of the limit on regular contributions. The limit is reduced by any amounts that the taxpayer contributes for that year to an individual retirement plan other than a Roth IRA (although employer contributions, including elective contributions, to a SEP or SIMPLE IRA Plan do not reduce the contribution limit). Additionally, the contribution limit (determined without regard to any reduction for traditional IRA contributions) is phased out for modified adjusted gross income between $95,000 and $110,000 for single taxpayers, between $150,000 and $160,000 for married taxpayers filing joint returns, and between $0 and $10,000 for married taxpayers filing separate returns. Any contribution in excess of the contribution limit is subject to the 6-percent excise tax under section 4973 unless it is distributed to the taxpayer (with allocable net income) under section 408(d)(4) by the Federal income tax return due date (with extensions) for the year of the contribution.

The proposed regulations define the terms compensation and modified adjusted gross income. The definition of compensation is the same as that applicable under section 219(f)(1) for determining the amount, if any, that a taxpayer may contribute to a traditional IRA. This definition does not include amounts transferred from one individual to another by gift (for example, a gift from a parent to a child). The definition of modified adjusted gross income is based on the definition of adjusted gross income applicable under section 219(g)(3)(A) for determining the amount, if any, that a taxpayer may deduct for a contribution to a traditional IRA where the taxpayer is an active participant in an employee plan. However, the definition of modified adjusted gross income applicable to Roth IRAs provides that any amount includible in gross income because of a Roth IRA conversion is disregarded in determining modified adjusted gross income. Additionally, for taxable years beginning after December 31, 2004, modified adjusted gross income does not include the amount of any required minimum distribution from an IRA for purposes of determining conversion eligibility.

As with traditional IRAs, regular contributions to a Roth IRA may be made as late as the Roth IRA owner’s Federal income tax return due date (not including extensions) for the taxable year to which they relate. Thus, Roth IRA contributions may be made by most taxpayers for taxable year 1998 at any time until April 15, 1999. Unlike traditional IRAs, contributions to a Roth IRA may be made after the Roth IRA owner has reached age 70-1/2.

Conversions

Proposed §1.408A-4 provides rules regarding Roth IRA conversions. In general, a taxpayer whose modified adjusted gross income does not exceed $100,000 may "convert" an amount held in a non-Roth IRA (i.e., a traditional IRA or SIMPLE IRA) to a Roth IRA. The conversion may be made in one of three ways: (1) a distribution from a non-Roth IRA may be rolled over to a Roth IRA within 60 days; (2) an amount in a non-Roth IRA of one financial institution may be transferred in a trustee-to-trustee transfer to a Roth IRA of a different financial institution; or (3) an amount in a non-Roth IRA may be transferred to a Roth IRA of the same financial institution. (In the third case, no physical transfer of assets is necessary, but the instrument governing the non-Roth IRA must, of course, be replaced by a Roth IRA instrument.) The conversion amount must be a qualified rollover contribution under section 408A(e) and, therefore, must satisfy section 408(d)(3) (other than the one-rollover-per-year rule of that section). Any amount distributed from a non-Roth IRA prior to the 1998 taxable year may not be contributed to a Roth IRA as a conversion contribution.

In the case of a conversion made by means of a distribution and rollover contribution, the $100,000 limit applies to the year in which the distribution from the non-Roth IRA is made. For married taxpayers, the $100,000 limit applies to the joint modified adjusted gross income of the couple, and a married taxpayer filing a separate return is not allowed to convert regardless of modified adjusted gross income (although a taxpayer who has lived apart from his or her spouse for the entire taxable year is treated as not married for these purposes).

The proposed regulations provide that amounts held in a SEP IRA or a SIMPLE IRA may be converted to a Roth IRA. In the case of a SIMPLE IRA, a conversion may be done only after the expiration of the 2-year period described in section 72(t)(6). See Q&A I-2 of Notice 98-4 (1998-2 I.R.B. 25). Once a SEP IRA or SIMPLE IRA has been converted to a Roth IRA, the SEP IRA or the SIMPLE IRA becomes a Roth IRA and ceases to be part of a SEP or a SIMPLE IRA Plan; thus, no SEP or SIMPLE IRA Plan contributions may be made to the Roth IRA. Amounts held in retirement plans other than IRAs--such as section 401(a) qualified plans and section 403(b) annuity contracts--cannot be directly converted to a Roth IRA.

Any amount converted from a non-Roth IRA to a Roth IRA is treated as distributed from the non-Roth IRA and rolled over to the Roth IRA regardless of the actual means by which the conversion is effected. The conversion amount is generally includible in gross income for the year of the conversion under sections 408(d)(1) and 408(d)(2). For this purpose, in the case of a conversion effected by an actual distribution and rollover contribution (rather than a trustee-to-trustee transfer or a transfer between IRAs of the same financial institution), the year of the distribution from the non-Roth IRA is the year that the conversion amount is includible in gross income.

The conversion amount generally is not subject to the 10-percent additional tax under section 72(t). However, section 408A(d)(3)(F) provides that the 10-percent tax applies to a distribution of a conversion amount made within the 5-taxable-year period beginning with the taxable year in which the conversion to which it is attributable was made. Additionally, the proposed regulations provide that a taxpayer’s conversion of an amount from a non-Roth IRA from which the taxpayer was receiving a series of substantially equal periodic payments under section 72(t)(2)(A)(iv) will not be treated as a modification of that series under section 72(t)(4) and thus will not trigger recapture of the section 72(t) tax on previous distributions from the non-Roth IRA as long as the series of substantially equal periodic payments is continued under the Roth IRA (or if section 72(t)(4) would otherwise not apply).

Taxpayers making conversions during 1998 are eligible for a 4-year spread under which a conversion amount can be included in income ratably over taxable years 1998 through 2001 rather than solely in 1998. Special rules apply to this 4-year spread if a taxpayer dies before inclusion of the full conversion amount. In such a case, any remaining includible portion of the conversion amount generally must be included in the taxpayer’s gross income for the taxable year that includes the date of his or her death.

However, if the taxpayer’s surviving spouse is the sole beneficiary of all the taxpayer’s Roth IRAs (as determined under the aggregation rule of section 408A(d)(4)(A)), the spouse may elect to continue application of the 4-year spread. Finally, the distribution of any amount attributable to a 1998 conversion to which the 4-year spread applies will accelerate the inclusion of any amount otherwise deferred to a later taxable year.

A required minimum distribution may not be converted to a Roth IRA because section 408(d)(3)(E) prohibits the rollover of any such distribution. Under the proposed regulations, if a non-Roth IRA owner has reached age 70-1/2, any amount distributed (or treated as distributed because of a conversion) from the IRA for that year consists of the required minimum distribution to the extent that an amount equal to the required minimum distribution for that year has not yet been distributed (or treated as distributed). Thus, if a taxpayer who is required to receive a minimum distribution of $10,000 from his or her non-Roth IRA for a taxable year attempts to convert $11,000 to a Roth IRA prior to receiving the required minimum distribution, $10,000 of the conversion amount would be treated as the required minimum distribution and would be ineligible for conversion. This result is not affected by the means through which the taxpayer effects the conversion or by whether an amount greater than or equal to $10,000 remains in the taxpayer’s non-Roth IRA after the conversion.

Recharacterizations of IRA Contributions

Proposed §1.408A-5 provides special rules for the recharacterization of IRA contributions (including Roth IRA regular and conversion contributions). Section 408A(d)(6) provides that, except as otherwise provided by the Secretary of the Treasury, an IRA contribution that is transferred to another IRA in a trustee-to-trustee transfer on or before the Federal income tax return due date (with extensions) for the taxable year of the contribution is treated as made to the transferee IRA and not the transferor IRA. Section 408A(d)(6) requires that the transfer include allocable net income on the contribution and that no deduction be allowed for the contribution to the transferor IRA. This statutory provision was intended to permit a taxpayer who had converted an amount held in a non-Roth IRA to a Roth IRA and later discovered that his or her modified adjusted gross income for the year of the conversion exceeded $100,000 to correct the conversion by retransferring the converted amount to a non-Roth IRA. The proposed regulations interpret section 408A(d)(6) liberally to provide broad relief to taxpayers who wish to change the nature of an IRA contribution (and not only to allow taxpayers to correct Roth IRA conversions for which they were ineligible). Moreover, the proposed regulations make application of section 408A(d)(6) elective by the taxpayer and permit the taxpayer to recharacterize all or any portion of an IRA contribution.

Under the proposed regulations, a taxpayer may elect whether to recharacterize a contribution made to one type of IRA by having it transferred in a trustee-to-trustee transfer to a different type of IRA. As with a conversion, a recharacterization can be effected simply by transferring IRA assets between two IRAs of a single financial institution. Regardless of how effected, a recharacterization transfer is not considered a rollover for purposes of the one-rollover-per-year rule of section 408(d)(3). The taxpayer makes the election to recharacterize by notifying both the transferor IRA trustee and the transferee IRA trustee and by providing certain information to these trustees (including a direction to make the transfer). Notification to the trustees constitutes the taxpayer's election to apply section 408A(d)(6), and the taxpayer cannot revoke or modify that election after the recharacterization transfer has been made. A recharacterized contribution will be treated for Federal income tax purposes as having been contributed to the transferee IRA (rather than the transferor IRA) on the same date and for the same taxable year that the contribution was initially made to the transferor IRA. In effect, the transferee IRA "steps into the shoes" of the transferor IRA with respect to the taxpayer's original contribution.

The recharacterization transfer must include allocable earnings on the original contribution, and the proposed regulations provide that the rules of Treasury Regulations §1.408-4(c)(2)(ii) apply for determining such allocable earnings. If the original contribution has experienced net losses as of the time of the recharacterization, the transfer of the entire original contribution less such losses will generally constitute a transfer of the entire contribution. The taxpayer must treat the contribution as made to the transferee IRA on his or her Federal income tax return for the year to which the original contribution (to the transferor IRA) relates.

Amounts that cannot be recharacterized include amounts paid into an IRA by tax-free rollover or transfer (other than a rollover or transfer from a traditional IRA to a SIMPLE IRA) and employer contributions under a SIMPLE IRA Plan or a SEP. The proposed regulations also provide that, once an amount has been contributed to an IRA, any tax-free rollover or transfer of that amount to another IRA may be disregarded in applying the recharacterization rules. Thus, for example, if a taxpayer contributes $2,000 to a Roth IRA during a taxable year and rolls that contribution over to another Roth IRA during the following taxable year, the rollover between Roth IRAs is disregarded, and the taxpayer may recharacterize the $2,000 Roth IRA contribution by having it transferred from the second Roth IRA to a traditional IRA in accordance with section 408A(d)(6) and the proposed regulations.

Distributions

Proposed §1.408A-6 provides rules for the treatment of Roth IRA distributions. Under section 408A(d), qualified distributions from a Roth IRA are not includible in gross income. A qualified distribution is a distribution that is both (1) made after the end of the 5-taxable-year period that begins with the first taxable year for which an individual first makes any regular or conversion contribution to a Roth IRA and (2) made at any time after the Roth IRA owner has reached age 59-1/2, made to a beneficiary (or to the Roth IRA owner's estate) after the Roth IRA owner's death, attributable to the Roth IRA owner's being disabled within the meaning of section 72(m)(7), or made for a first-time home purchase to which section 72(t)(2)(F) applies. The proposed regulations provide that any distribution from a Roth IRA made to the surviving spouse of a Roth IRA owner who has elected to treat the Roth IRA as his or her own in accordance with the terms of the trust instrument or under Q&A-4 of Proposed Treasury Regulations §1.408-8 is not treated as made after the Roth IRA owner's death.

The proposed regulations provide that the 5-taxable-year period for determining whether a distribution is a qualified distribution is not recalculated when a Roth IRA owner dies. Thus, if a Roth IRA owner contributes an amount to a Roth IRA in 1998 and dies in 2004, a distribution made to a beneficiary in 2004 will be a qualified distribution. Generally, the 5-taxable-year period with respect to a beneficiary's inherited Roth IRA is determined independently of the 5-taxable-year period for any Roth IRA of which the beneficiary is the owner. However, if the beneficiary of a Roth IRA is the surviving spouse of the Roth IRA owner and if the surviving spouse owns his or her own Roth IRA, the 5-taxable-year period for both the Roth IRA of which the surviving spouse is the beneficiary and the Roth IRA of which the surviving spouse is the owner ends with the earlier of the 5-taxable-year periods for the two Roth IRAs.

A Roth IRA distribution other than a qualified distribution is generally includible in the taxpayer’s gross income to the extent that the distribution, when added to all prior distributions from the taxpayer’s Roth IRAs (whether or not those distributions were qualified distributions) exceeds the taxpayer’s total contributions to all his or her Roth IRAs. To the extent includible in gross income, such a distribution will also be subject to the 10-percent additional tax of section 72(t) unless there is an applicable exception under that section. Such a distribution, however, will not be includible in gross income if it is rolled over to another Roth IRA in accordance with section 408(d)(3). Also, a distribution of an excess contribution under section 408(d)(4) is not includible in gross income (although the allocable net income that must be distributed with the excess contribution is includible in gross income for the taxable year of the excess contribution).

The proposed regulations provide aggregation and ordering rules for Roth IRAs in accordance with section 408A(d)(4). Under these rules, a Roth IRA is not aggregated with a non-Roth IRA, but all a taxpayer’s Roth IRAs are aggregated with each other. Roth IRA distributions are treated as made first from Roth IRA contributions and second from earnings. Distributions that are treated as made from contributions are treated as made first from regular contributions and then from conversion contributions on a first-in, first-out basis. A distribution allocable to a particular conversion contribution is treated as consisting first of the portion (if any) of the conversion contribution that was includible in gross income by reason of the conversion.

The proposed regulations provide that, in applying these aggregation and ordering rules: all distributions from all of a taxpayer's Roth IRAs during a taxable year are aggregated; all regular contributions made for the same taxable year to all the individual's Roth IRAs are aggregated and added to the undistributed total regular contributions for prior taxable years; all conversion contributions received during the same taxable year by all the individual's Roth IRAs are aggregated (with a special rule for a conversion contribution made by distribution during 1998 and rollover during 1999 to which the 4-year spread applies); and rollovers between Roth IRAs are disregarded. The proposed regulations also provide special rules for applying the aggregation and ordering rules in the case of recharacterizations under section 408A(d)(6). Distributions of excess contributions and allocable net income pursuant to section 408(d)(4) are treated differently under the ordering rules. Specifically, an excess contribution that is distributed under section 408(d)(4) is treated as though it was never contributed, and any allocable net income thereon is includible in gross income for the taxable year of the contribution without regard to whether the taxpayer still has undistributed basis in his or her Roth IRAs. The proposed regulations provide that, for purposes of these ordering rules, different types of contributions are allocated pro rata among multiple Roth IRA beneficiaries after the Roth IRA owner’s death.

Unlike traditional IRAs, the pre-death minimum distribution rules of sections 408(a)(6) and 408(b)(3) (which incorporate the rules of section 401(a)(9)) do not apply to Roth IRAs. Under the proposed regulations, on the death of a Roth IRA owner, the rules in Proposed Treasury Regulations §1.408-8 apply as though the Roth IRA owner died before his or her required beginning date. Thus, the entire amount of the Roth IRA must generally be distributed within five years of the Roth IRA owner’s death unless it is distributed over the life expectancy of a designated beneficiary beginning prior to the end of the calendar year following the year of the owner’s death. The proposed regulations also provide that, where the sole beneficiary of a Roth IRA is the Roth IRA owner’s surviving spouse, the spouse may delay distributions until the Roth IRA owner would have reached age 70-1/2 or may treat the Roth IRA as his or her own. Under the proposed regulations, section 401(a)(9) applies separately to Roth IRAs and other retirement plans; it also applies separately to Roth IRAs inherited by a beneficiary from one decedent and any other Roth IRAs of which the beneficiary is either the beneficiary of another decedent or the owner.

The proposed regulations provide that section 3405 withholding applies to distributions from Roth IRAs and to Roth IRA conversions (although transition relief is provided for 1998 conversions effected by means of direct transfers of funds between IRAs). The proposed regulations provide that the basis of property distributed from a Roth IRA is its fair market value as of the date of the distribution and that any amount distributed from a Roth IRA and contributed to a retirement plan other than a Roth IRA is not a rollover contribution under section 408(d)(3) or a qualified rollover contribution under section 408A(e). The proposed regulations also provide that a transfer of a Roth IRA by gift would constitute an assignment of the Roth IRA, with the effect that the assets of the Roth IRA would be deemed to be distributed to the Roth IRA owner and, accordingly, treated as no longer held in a Roth IRA.

Reporting Requirements

Proposed 1.408A-7 sets out the reporting requirements applicable to Roth IRAs. In general, Roth IRA trustees (including custodians and issuers) are subject to the same reporting requirements that apply to trustees of traditional IRAs. However, the instructions to applicable Federal tax forms modify the information generally required from Roth IRA trustees (as well as Roth IRA owners) in certain circumstances. For example, conversions require the filing of a Form 1099-R and a Form 8606. The proposed regulations include special rules for reporting of recharacterization transactions. Trustees are permitted to rely on reasonable representations of a Roth IRA owner or distributee in discharging their reporting obligations.

The IRS is issuing additional guidance on the reporting requirements applicable to Roth IRAs and on other changes in the laws relating to IRAs. This guidance will be in the form of a notice published in the Internal Revenue Bulletin.

Reliance

Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

Proposed Effective Date

These regulations are applicable to taxable years beginning on or after January 1, 1998, the effective date for section 408A.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Further, it is hereby certified, pursuant to sections 603(a) and 605(b) of the Regulatory Flexibility Act, that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. The cost of the collection information is insignificant because the primary reporting burden is on the individual and not the small entity. Therefore the collection of information will not have a substantial economic impact.

Therefore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Thursday, December 10, 1998, beginning at 10 a.m. in room 2615 of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by Thursday, November 19, 1998.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of the proposed regulations is Cathy A. Vohs, Office of Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§1.408A-1 also issued under 26 U.S.C. 408A.

§1.408A-2 also issued under 26 U.S.C. 408A.

§1.408A-3 also issued under 26 U.S.C. 408A.

§1.408A-4 also issued under 26 U.S.C. 408A.

§1.408A-5 also issued under 26 U.S.C. 408A.

§1.408A-6 also issued under 26 U.S.C. 408A.

§1.408A-7 also issued under 26 U.S.C. 408A.

§1.408A-8 also issued under 26 U.S.C. 408A.

§1.408A-9 also issued under 26 U.S.C. 408A. * * *

Par. 2. An undesignated centerheading and §§1.408A-0 through 1.408A-9 are added to read as follows:

Roth IRAs; Questions and Answers

§1.408A-0 Table of contents.

This table of contents lists the regulations relating to Roth IRAs under section 408A of the Internal Revenue Code as follows:

§1.408A-1 Roth IRAs in general.

Q-1 What is a Roth IRA?

A-1. (a) A Roth IRA is a new type of individual retirement plan that individuals can use, beginning in 1998. Roth IRAs are described in section 408A, which was added by the Taxpayer Relief Act of 1997 (TRA 97), Public Law 105-34 (111 Stat. 788).

(b) Roth IRAs are treated like traditional IRAs except where the Internal Revenue Code specifies different treatment. For example, aggregate contributions (other than by a conversion or other rollover) to all an individual’s Roth IRAs are not permitted to exceed $2,000 for a taxable year. Further, income earned on funds held in a Roth IRA is generally not taxable. Similarly, the rules of section 408(e), such as the loss of exemption of the account where the owner engages in a prohibited transaction, apply to Roth IRAs in the same manner as to traditional IRAs.

Q-2. What are the significant differences between traditional IRAs and Roth IRAs?

A-2. There are several significant differences between traditional IRAs and Roth IRAs under the Internal Revenue Code. For example, eligibility to contribute to a Roth IRA is subject to special modified AGI (adjusted gross income) limits; contributions to a Roth IRA are never deductible; qualified distributions from a Roth IRA are not includible in gross income; the required minimum distribution rules under section 408(a)(6) and (b)(3) (which generally incorporate the provisions of section 401(a)(9)) do not apply to a Roth IRA during the lifetime of the owner; and contributions to a Roth IRA can be made after the owner has attained age 70½.

§1.408A-2 Establishing a Roth IRA.

Q-1. Who can establish a Roth IRA?

A-1. Except as provided in A-3 of this section, only an individual can establish a Roth IRA. In addition, in order to be eligible to contribute to a Roth IRA for a particular year, an individual must satisfy certain compensation requirements and adjusted gross income limits (see §1.408A-3 A-3).

Q-2. How is a Roth IRA established?

A-2. A Roth IRA can be established with any bank, insurance company, or other person authorized in accordance with §1.408-2(e) to serve as a trustee with respect to IRAs. The document establishing the Roth IRA must clearly designate the IRA as a Roth IRA, and this designation cannot be changed at a later date. Thus, an IRA that is designated as a Roth IRA cannot later be treated as a traditional IRA. However, see §1.408A-5 of this section for rules for recharacterizing certain IRA contributions.

Q-3. Can an employer or an association of employees establish a Roth IRA to hold contributions of employees or members?

A-3. Yes. Pursuant to section 408(c), an employer or an association of employees can establish a trust to hold contributions of employees or members made under a Roth IRA. Each employee's or member's account in the trust is treated as a separate Roth IRA that is subject to the generally applicable Roth IRA rules. The employer or association of employees may do certain acts otherwise required by an individual, for example, establishing and designating a trust as a Roth IRA.

Q-4. What is the effect of a surviving spouse of a Roth IRA owner treating an IRA as his or her own?

A-4. If the surviving spouse of a Roth IRA owner treats a Roth IRA as his or her own as of a date, from that date forward, the Roth IRA is treated as though it were established for the benefit of the surviving spouse and not the original Roth IRA owner. Thus, for example, the surviving spouse is treated as the Roth IRA owner for purposes of applying the minimum distribution requirements under section 408(a)(6) and (b)(3). Similarly, the surviving spouse is treated as the Roth IRA owner rather than a beneficiary for purposes of determining the amount of any distribution from the Roth IRA that is includible in gross income and whether the distribution is subject to the 10-percent additional tax under section 72(t).

§1.408A-3 Contributions to Roth IRAs.

Q-1. What types of contributions are permitted to be made to a Roth IRA?

A-1. There are two types of contributions that are permitted to be made to a Roth IRA: regular contributions and qualified rollover contributions (including conversion contributions). The term regular contributions means contributions other than qualified rollover contributions.

Q-2. When are contributions permitted to be made to a Roth IRA?

A-2. (a) The provisions of section 408A are effective for taxable years beginning on or after January 1, 1998. Thus, the first taxable year for which contributions are permitted to be made to a Roth IRA by an individual is the individual's taxable year beginning in 1998.

(b) Regular contributions for a particular taxable year must generally be contributed by the due date (not including extensions) for filing a Federal income tax return for that taxable year. (See §1.408A-5 regarding recharacterization of certain contributions.)

Q-3. What is the maximum aggregate amount of regular contributions an individual is eligible to contribute to a Roth IRA for a taxable year?

A-3. (a) The maximum aggregate amount that an individual is eligible to contribute to all his or her Roth IRAs as a regular contribution for a taxable year is the same as the maximum for traditional IRAs: $2,000 or, if less, that individual's compensation for the year.

(b) For Roth IRAs, the maximum amount described in paragraph (a) of this A-3 is phased out between certain levels of modified AGI. For an individual who is not married, the dollar amount is phased out ratably between modified AGI of $95,000 and $110,000; for a married individual filing a joint return, between modified AGI of $150,000 and $160,000; and for a married individual filing separately, between modified AGI of $0 and $10,000. For this purpose, a married individual who has lived apart from his or her spouse for the entire taxable year and who files separately is treated as not married. Under section 408A(c)(3)(A), in applying the phase-out, the maximum amount is rounded up to the next higher multiple of $10 and is not reduced below $200 until completely phased out.

(c) If an individual makes regular contributions to both traditional IRAs and Roth IRAs for a taxable year, the maximum limit for the Roth IRA is the lesser of--

(1) The amount described in paragraph (a) of this A-3 reduced by the amount contributed to traditional IRAs for the taxable year; and

(2) The amount described in paragraph (b) of this A-3. Employer contributions, including elective deferrals, made under a SEP or SIMPLE IRA Plan on behalf of an individual (including a self-employed individual) do not reduce the amount of the individual's maximum regular contribution.

(d) The rules in this A-3 are illustrated by the following examples:

Example 1. In 1998, unmarried, calendar-year taxpayer B, age 60, has modified AGI of $40,000 and compensation of $5,000. For 1998, B can contribute a maximum of $2,000 to a traditional IRA, a Roth IRA or a combination of traditional and Roth IRAs.

Example 2. The facts are the same as in Example 1. However, assume that B violates the maximum regular contribution limit by contributing $2,000 to a traditional IRA and $2,000 to a Roth IRA for 1998. The $2,000 to B's Roth IRA would be an excess contribution to B's Roth IRA for 1998 because an individual's contributions are applied first to a traditional IRA, then to a Roth IRA.

Example 3. The facts are the same as in Example 1, except that B's compensation is $900. The maximum amount B can contribute to either a traditional IRA or a Roth (or a combination of the two) for 1998 is $900.

Example 4. In 1998, unmarried, calendar-year taxpayer C, age 60, has modified AGI of $100,000 and compensation of $5,000. For 1998, C contributes $800 to a traditional IRA and $1,200 to a Roth IRA. Because C's $1,200 Roth IRA contribution does not exceed the phased-out maximum Roth IRA contribution of $1,340 and because C’s total IRA contributions do not exceed $2,000, C’s Roth IRA contribution does not exceed the maximum permissible contribution.

Q-4. How is compensation defined for purposes of the Roth IRA contribution limit?

A-4. For purposes of the contribution limit described in A-3 of this section, an individual’s compensation is the same as that used to determine the maximum contribution an individual can make to a traditional IRA. This amount is defined in section 219(f)(1) to include wages, commissions, professional fees, tips, and other amounts received for personal services, as well as taxable alimony and separate maintenance payments received under a decree of divorce or separate maintenance. Compensation also includes earned income as defined in section 401(c)(2), but does not include any amount received as a pension or annuity or as deferred compensation. In addition, under section 219(c), a married individual filing a joint return is permitted to make an IRA contribution by treating his or her spouse’s higher compensation as his or her own, but only to the extent that the spouse’s compensation is not being used for purposes of the spouse making a contribution to a Roth IRA or a deductible contribution to a traditional IRA.

Q-5. What is the significance of modified AGI and how is it determined?

A-5. Modified AGI is used for purposes of the phase-out rules described in A-3 of this section and for purposes of the $100,000 modified AGI limitation described in §1.408A-4 A-2(a) (relating to eligibility for conversion). As defined in section 408A(c)(3)(C)(i), modified AGI is the same as adjusted gross income under section 219(g)(3)(A) (used to determine the amount of deductible contributions that can be made to a traditional IRA by an individual who is an active participant in an employer-sponsored retirement plan), except that any conversion is disregarded in determining modified AGI. For example, the deduction for contributions to an IRA is not taken into account for purposes of determining adjusted gross income under section 219 and thus does not apply in determining modified AGI for Roth IRA purposes.

Q-6. Is a required minimum distribution from an IRA for a year included in income for purposes of determining modified AGI?

A-6. (a) Yes. For taxable years beginning before January 1, 2005, any required minimum distribution from an IRA under section 408(a)(6) and (b)(3) (which generally incorporate the provisions of section 401(a)(9)) is included in income for purposes of determining modified AGI.

(b) For taxable years beginning after December 31, 2004, and solely for purposes of the $100,000 limitation applicable to conversions, modified AGI does not include any required minimum distributions from an IRA under section 408(a)(6) and (b)(3).

Q-7. Does an excise tax apply if an individual exceeds the aggregate regular contribution limits for Roth IRAs?

A-7. Yes. Section 4973 imposes an annual 6-percent excise tax on aggregate amounts contributed to Roth IRAs that exceed the maximum contribution limits described in A-3 of this section. Any contribution that is distributed, together with net income, from a Roth IRA on or before the tax return due date (plus extensions) for the taxable year of the contribution is treated as not contributed. Net income described in the previous sentence is includible in gross income for the taxable year in which the contribution is made. Section 4973 applies separately to an individual's Roth IRAs and other IRAs.

§1.408A-4 Converting amounts to Roth IRAs.

Q-1. Can an individual convert an amount in his or her traditional IRA to a Roth IRA?

A-1. (a) Yes. An amount in a traditional IRA may be converted to an amount in a Roth IRA if two requirements are satisfied. First, the IRA owner must satisfy the modified AGI limitation described in A-2(a) of this section and, if married, the joint filing requirement described in A-2(b) of this section. Second, the amount contributed to the Roth IRA must satisfy the definition of a qualified rollover contribution in section 408A(e) (i.e., it must satisfy the requirements for a rollover contribution as defined in section 408(d)(3), except that the one-rollover-per-year limitation in section 408(d)(3)(B) does not apply).

(b) An amount can be converted by any of three methods--

(1) An amount distributed from a traditional IRA is contributed (rolled over) to a Roth IRA within 60 days after the distribution;

(2) An amount in a traditional IRA is transferred in a trustee-to-trustee transfer from the trustee of the traditional IRA to the trustee of the Roth IRA; or

(3) An amount in a traditional IRA is transferred to a Roth IRA maintained by the same trustee.

(c) Any converted amount is treated as a distribution from the traditional IRA and a qualified rollover contribution to the Roth IRA for purposes of section 408 and section 408A, even if the conversion is accomplished by means of a trustee-to-trustee transfer or a transfer between IRAs of the same trustee.

Q-2. What are the modified AGI limitation and joint filing requirements for conversions?

A-2. (a) An individual with modified AGI in excess of $100,000 for a taxable year is not permitted to convert an amount to a Roth IRA during that taxable year. This $100,000 limitation applies to the taxable year that the funds are paid from the traditional IRA, rather than the year they are contributed to the Roth IRA.

(b) If the individual is married, he or she is permitted to convert an amount to a Roth IRA during a taxable year only if the individual and the individual’s spouse file a joint return for the taxable year that the funds are paid from the traditional IRA. In this case, the modified AGI subject to the $100,000 limit is the modified AGI derived from the joint return using the couple’s combined income. The only exception to this joint filing requirement is for an individual who has lived apart from his or her spouse for the entire taxable year. If the married individual has lived apart from his or her spouse for the entire taxable year, then such individual can treat himself or herself as not married for purposes of this paragraph, file a separate return and be subject to the $100,000 limit on his or her separate modified AGI. In all other cases, a married individual filing a separate return is not permitted to convert an amount to a Roth IRA, regardless of the individual’s modified AGI.

Q-3. Is a remedy available to an individual who, intending to make a conversion, contributes amounts from a traditional IRA to a Roth IRA, but who is ineligible to make a conversion (a failed conversion)?

A-3. (a) Yes. See §1.408A-5 for rules permitting a failed conversion amount to be recharacterized as a contribution to a traditional IRA. If the requirements in §1.408A-5 are satisfied, the failed conversion amount will be treated as having been contributed to the traditional IRA and not to the Roth IRA.

(b) If the contribution is not recharacterized in accordance with §1.408A-5, the contribution will be treated as a regular contribution to the Roth IRA and, thus, an excess contribution subject to the excise tax under section 4973 to the extent that it exceeds the individual's regular contribution limit. Additionally, the distribution from the traditional IRA will not be eligible for the 4-year spread and will be subject to the additional tax under section 72(t) (unless an exception under that section applies).

Q-4. Do any special rules apply to a conversion of an amount in an individual’s SEP IRA or SIMPLE IRA to a Roth IRA?

A-4. (a) An amount in an individual’s SEP IRA can be converted to a Roth IRA on the same terms as an amount in any other traditional IRA.

(b) An amount in an individual’s SIMPLE IRA can be converted to a Roth IRA on the same terms as a conversion from a traditional IRA, except that an amount distributed from a SIMPLE IRA during the 2-year period described in section 72(t)(6), which begins on the date that the individual first participated in any SIMPLE IRA Plan maintained by the individual’s employer, cannot be converted to a Roth IRA. Pursuant to section 408(d)(3)(G), a distribution of an amount from an individual’s SIMPLE IRA during this 2-year period is not eligible to be rolled over into an IRA that is not a SIMPLE IRA and thus cannot be a qualified rollover contribution. This 2-year period of section 408(d)(3)(G) applies separately to the contributions of each of an individual’s employers maintaining a SIMPLE IRA Plan.

(c) Once an amount in a SEP IRA or SIMPLE IRA has been converted to a Roth IRA, it is treated as a contribution to a Roth IRA for all purposes. Future contributions under the SEP or under the SIMPLE IRA Plan may not be made to the Roth IRA.

Q-5. Can amounts in other kinds of retirement plans be converted to a Roth IRA?

A-5. No. Only amounts in another IRA can be converted to a Roth IRA. For example, amounts in a qualified plan or annuity plan described in section 401(a) or 403(a) cannot be converted directly to a Roth IRA. Also, amounts held in an annuity contract or account described in section 403(b) cannot be converted directly to a Roth IRA.

Q-6. Can an individual who has attained at least age 70½ by the end of a calendar year convert an amount distributed from a traditional IRA during that year to a Roth IRA before receiving his or her required minimum distribution with respect to the traditional IRA for the year of the conversion?

A-6. (a) No. In order to be eligible for a conversion, an amount first must be eligible to be rolled over. Section 408(d)(3) prohibits the rollover of a required minimum distribution. If a minimum distribution is required for a year with respect to an IRA, the first dollars distributed during that year are treated as consisting of the required minimum distribution until an amount equal to the required minimum distribution for that year has been distributed.

(b) As provided in A-1(c) of this section, any amount converted is treated as a distribution from a traditional IRA and a rollover contribution to a Roth IRA and not as a trustee-to-trustee transfer for purposes of section 408 and section 408A. Thus, in a year for which a minimum distribution is required (including the calendar year in which the individual attains age 70½), an individual may not convert the assets of an IRA (or any portion of those assets) to a Roth IRA to the extent that the required minimum distribution for the traditional IRA for the year has not been distributed.

(c) If a required minimum distribution is contributed to a Roth IRA, it is treated as having been distributed, subject to the normal rules under section 408(d)(1) and (2), and then contributed as a regular contribution to a Roth IRA. The amount of the required minimum distribution is not a conversion contribution.

Q-7. What are the tax consequences when an amount is converted to a Roth IRA?

A-7. (a) Any amount that is converted to a Roth IRA is includible in gross income as a distribution according to the rules of section 408(d)(1) and (2) for the taxable year in which the amount is distributed or transferred from the traditional IRA. Thus, any portion of the distribution or transfer that is treated as a return of basis under section 408(d)(1) and (2) is not includible in gross income as a result of the conversion.

(b) The 10-percent additional tax under section 72(t) generally does not apply to the taxable conversion amount. But see §1.408A-6 A-5 for circumstances under which the taxable conversion amount would be subject to the additional tax under section 72(t).

(c) Pursuant to section 408A(e), a conversion is not treated as a rollover for purposes of the one-rollover-per-year rule of section 408(d)(3)(B).

Q-8. Is there an exception to the income-inclusion rule described in A-7 of this section for 1998 conversions?

A-8. Yes. In the case of a distribution (including a trustee-to-trustee transfer) from a traditional IRA on or before December 31, 1998, that is converted to a Roth IRA, instead of having the entire taxable conversion amount includible in income in 1998, an individual includes in gross income for 1998 only one quarter of that amount and one quarter of that amount for each of the next 3 years. This 4-year spread also applies if the conversion amount was distributed in 1998 and contributed to the Roth IRA within 60 days, but after December 31, 1998. However, see §1.408A-6 A-6 for special rules requiring acceleration of inclusion if an amount subject to the 4-year spread is distributed from the Roth IRA before 2001.

Q-9. Is the taxable conversion amount included in income for all purposes?

A-9. Except as provided below, any taxable conversion amount includible in gross income for a year as a result of the conversion (regardless of whether the individual is using a 4-year spread) is included in income for all purposes. Thus, for example, it is counted for purposes of determining the taxable portion of social security payments under section 86 and for purposes of determining the phase-out of the $25,000 exemption under section 469(i) relating to the disallowance of passive activity losses from rental real estate activities. However, as provided in §1.408A-3 A-5, the taxable conversion amount (and any resulting change in other elements of adjusted gross income) is disregarded for purposes of determining modified AGI for section 408A.

Q-10. Can an individual who makes a 1998 conversion elect not to have the 4-year spread apply and instead have the full taxable conversion amount includible in gross income for 1998?

A-10. Yes. Instead of having the taxable conversion amount for a 1998 conversion included over 4 years as provided under A-8 of this section, an individual can elect to include the full taxable conversion amount in income for 1998. The election is made on Form 8606 and cannot be made or changed after the due date (including extensions) for filing the 1998 Federal income tax return.

Q-11. What happens when an individual who is using the 4-year spread dies before the full taxable conversion amount has been included in gross income?

A-11. (a) If an individual who is using the 4-year spread described in A-8 of this section dies before the full taxable conversion amount has been included in gross income, then the remainder must be included in the individual's gross income for the taxable year that includes the date of death.

(b) However, if the sole beneficiary of all the decedent's Roth IRAs is the decedent's spouse, then the spouse can elect to continue the 4-year spread. Thus, the spouse can elect to include in gross income the same amount that the decedent would have included in each of the remaining years of the 4-year period. Where the spouse makes such an election, the amount includible under the 4-year spread for the taxable year that includes the date of the decedent’s death remains includible in the decedent’s gross income and is reported on the decedent’s final Federal income tax return. The election is made on either Form 8606 or Form 1040, in accordance with the instructions to the applicable form, for the taxable year that includes the decedent’s date of death and cannot be changed after the due date (including extensions) for filing the Federal income tax return for the spouse’s taxable year that includes the decedent’s date of death.

Q-12. Can an individual convert a traditional IRA to a Roth IRA if he or she is receiving substantially equal periodic payments within the meaning of section 72(t)(2)(A)(iv) from that traditional IRA?

A. Yes. Not only is the conversion amount itself not subject to the early distribution tax under section 72(t), but the conversion amount is also not treated as a distribution for purposes of determining whether a modification within the meaning of section 72(t)(4)(A) has occurred. However, if the original series of substantially equal periodic payments does not continue to be distributed in substantially equal periodic payments from the Roth IRA after the conversion, the series of payments will have been modified and, if this modification occurs within 5 years of the first payment or prior to the individual becoming disabled or attaining age 59½, the taxpayer will be subject to the recapture tax of section 72(t)(4)(A).

Q-13. Can a 1997 distribution from a traditional IRA be converted to a Roth IRA in 1998?

A-13. No. An amount distributed from a traditional IRA in 1997 that is contributed to a Roth IRA in 1998 would not be a conversion contribution. See A-3 of this section regarding the remedy for a failed conversion.

§1.408A-5 Recharacterized contributions.

Q-1. Can an IRA owner recharacterize certain contributions (i.e., treat a contribution made to one type of IRA as made to a different type of IRA) for a taxable year?

A-1. (a) Yes. In accordance with section 408A(d)(6), except as otherwise provided in this section, if an individual makes a contribution to an IRA (the FIRST IRA) for a taxable year and then transfers the contribution (or a portion of the contribution) in a trustee-to-trustee transfer from the trustee of the FIRST IRA to the trustee of another IRA (the SECOND IRA), the individual can elect to treat the contribution as having been made to the SECOND IRA, instead of to the FIRST IRA, for Federal tax purposes. A transfer between the FIRST IRA and the SECOND IRA will not fail to be a trustee-to-trustee transfer merely because both IRAs are maintained by the same trustee.

(b) This recharacterization election can be made only if the trustee-to-trustee transfer from the FIRST IRA to the SECOND IRA is made on or before the due date (including extensions) for filing the individual’s Federal income tax return for the taxable year for which the contribution was made to the FIRST IRA. For purposes of this section, a conversion that is accomplished through a rollover of a distribution from a traditional IRA in a taxable year that, within 60 days after the distribution, is contributed to a Roth IRA in the next taxable year is treated as a contribution for the earlier taxable year.

Q-2. What is the proper treatment of the net income attributable to the contribution that is being recharacterized?

A-2. (a) The net income attributable to the contribution that is being recharacterized must be transferred to the SECOND IRA along with the contribution.

(b) If the amount of 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 of the FIRST IRA transferring the entire account balance of the FIRST IRA to the trustee of the SECOND IRA. In this case, the net income (or loss) attributable to the contribution being recharacterized is the difference between the amount of the original contribution and the amount transferred.

(c) If paragraph (b) of this A-2 does not apply, then the net income attributable to the contribution is calculated in the manner prescribed by §1.408-4(c)(2)(ii).

Q-3. What is the effect of recharacterizing a contribution made to the FIRST IRA as a contribution made to the SECOND IRA?

A-3. 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 (in the case of a regular contribution) for the same taxable year that the contribution was made to the FIRST IRA. Thus, for example, no deduction would be allowed for a contribution to the FIRST IRA, and any net income transferred with the recharacterized contribution is treated as earned in the SECOND IRA, and not the FIRST IRA.

Q-4. Can an amount contributed to an IRA in a tax-free transfer be recharacterized under A-1 of this section?

A-4. No. If an amount is contributed to the FIRST IRA in a tax-free transfer, the amount cannot be recharacterized as a contribution to the SECOND IRA under A-1 of this section. However, if an amount is erroneously rolled over or transferred from a traditional IRA to a SIMPLE IRA, the contribution can subsequently be recharacterized as a contribution to another traditional IRA.

Q-5. Can an amount contributed by an employer under a SIMPLE IRA Plan or a SEP be recharacterized under A-1 of this section?

A-5. No. Employer contributions (including elective deferrals) under a SIMPLE IRA Plan or a SEP cannot be recharacterized as contributions to another IRA under A-1 of this section.

Q-6. How does a taxpayer make the election to recharacterize a contribution to an IRA for a taxable year?

A-6. (a) An individual makes the election described in this section by notifying, on or before the date of the transfer, both the trustee of the FIRST IRA and the trustee of the SECOND IRA, that the individual has elected to treat the contribution as having been made to the SECOND IRA, instead of the FIRST IRA, for Federal tax purposes. The notification of the election must include the following information: the type and amount of the contribution to the FIRST IRA that is to be recharacterized; the date on which the contribution was made to the FIRST IRA and the year for which it was made; a direction to the trustee of the FIRST IRA to transfer, in a trustee-to-trustee transfer, the amount of the contribution and net income allocable to the contribution to the trustee of the SECOND IRA; and the name of the trustee of the FIRST IRA and the trustee of the SECOND IRA and any additional information needed to make the transfer.

(b) The election and the trustee-to-trustee transfer must occur on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the recharacterized contribution was made to the FIRST IRA, and the election cannot be revoked after the transfer. An individual who makes this election must report the recharacterization, and must treat the contribution as having been made to the SECOND IRA, instead of the FIRST IRA, on the individual's Federal income tax return for the taxable year described in the preceding sentence in accordance with the applicable Federal tax forms and instructions.

Q-7. If an amount is initially contributed to an IRA for a taxable year, then is moved (with net income attributable to the contribution) in a tax-free transfer to another IRA (the FIRST IRA for purposes of A-1 of this section), can the tax-free transfer be disregarded, so that the initial contribution that is transferred from the FIRST IRA to the SECOND IRA is treated as a recharacterization of that initial contribution?

A-7. Yes. In applying section 408A(d)(6), tax-free transfers between IRAs are disregarded. Thus, if a contribution to an IRA for a year is followed by one or more tax-free transfers between IRAs prior to the recharacterization, then for purposes of section 408A(d)(6), the contribution is treated as if it remained in the initial IRA. Consequently, an individual may elect to recharacterize an initial contribution made to the initial IRA that was involved in a series of tax-free transfers by making a trustee-to-trustee transfer from the last IRA in the series to the SECOND IRA. In this case the contribution to the SECOND IRA is treated as made on the same date (and for the same taxable year) as the date the contribution being recharacterized was made to the initial IRA.

Q-8. If a contribution is recharacterized, is the recharacterization treated as a rollover for purposes of the one-rollover-per-year limitation of section 408(d)(3)(B)?

A-8. No, recharacterizing a contribution under A-1 of this section is never treated as a rollover for purpose of the one-rollover-per-year limitation of section 408(d)(3)(B), even if the contribution would have been treated as a rollover contribution by the SECOND IRA if it had been made directly to the SECOND IRA, rather than as a result of a recharacterization of a contribution to the FIRST IRA.

Q-9. Are there examples to illustrate the rules in this section?

A-9. The rules in this section are illustrated by the following examples:

Example 1. In 1998, Individual C converts the entire amount in his traditional IRA to a Roth IRA. Individual C thereafter determines that his modified AGI for 1998 exceeded $100,000 so that he was ineligible to have made a conversion in that year. Accordingly, prior to the due date (plus extensions) for filing the individual's Federal income tax return for 1998, he decides to recharacterize the conversion contribution. He instructs the trustee of the Roth IRA (FIRST IRA) to transfer in a trustee-to-trustee transfer the amount of the contribution, plus net income, to the trustee of a new traditional IRA (SECOND IRA). The individual notifies the trustee of the FIRST IRA and the trustee of the SECOND IRA that he is recharacterizing his IRA contribution (and provides the other information described in A-6 of this section). On the individual's Federal income tax return for 1998, he treats the original amount of the conversion as having been contributed to the SECOND IRA and not the Roth IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the SECOND IRA and not to the Roth IRA. The result would be the same if the conversion amount had been transferred in a tax-free transfer to another Roth IRA prior to the recharacterization.

Example 2. In 1998, an individual makes a $2,000 regular contribution for 1998 to his traditional IRA (FIRST IRA). Prior to the due date (plus extensions) for filing the individual's Federal income tax return for 1998, he decides that he would prefer to contribute to a Roth IRA instead. The individual instructs the trustee of the FIRST IRA to transfer in a trustee-to-trustee transfer the amount of the contribution, plus attributable net income, to the trustee of a Roth IRA (SECOND IRA). The individual notifies the trustee of the FIRST IRA and the trustee of the SECOND IRA that he is recharacterizing his $2,000 contribution for 1998 (and provides the other information described in A-6 of this section). On the individual's Federal income tax return for 1998, he treats the $2,000 as having been contributed to the Roth IRA for 1998 and not to the traditional IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the Roth IRA for 1998 and not to the traditional IRA. The result would be the same if the conversion amount had been transferred in a tax-free transfer to another traditional IRA prior to the recharacterization.

Example 3. The facts are the same as in Example 2, except that the $2,000 regular contribution is initially made to a Roth IRA and the recharacterizing transfer is made to a traditional IRA. On the individual's Federal income tax return for 1998, he treats the $2,000 as having been contributed to the traditional IRA for 1998 and not the Roth IRA. As a result, for Federal tax purposes, the contribution is treated as having been made to the traditional IRA for 1998 and not the Roth IRA. The result would be the same if the contribution had been transferred in a tax-free transfer to another Roth IRA prior to the recharacterization, except that the only Roth IRA trustee the individual must notify is the one actually making the recharacterization transfer.

Example 4. In 1998, an individual receives a distribution from traditional IRA 1 and contributes the entire amount to traditional IRA 2 in a rollover contribution described in section 408(d)(3). In this case, the individual cannot elect to recharacterize the contribution by transferring the contribution amount, plus net income, to a Roth IRA, because an amount contributed to an IRA in a tax-free transfer cannot be recharacterized. However, the individual may convert (other than by recharacterization) the amount in traditional IRA 2 to a Roth IRA at any time, provided the requirements of §1.408A-4 A-1 are satisfied.

§1.408A-6 Distributions.

Q-1. How are distributions from Roth IRAs taxed?

A-1. (a) The taxability of a distribution from a Roth IRA generally depends on whether or not the distribution is a qualified distribution. This A-1 provides rules for qualified distributions and certain other nontaxable distributions. A-4 of this section provides rules for the taxability of distributions that are not qualified distributions.

(b) A distribution from a Roth IRA is not includible in the owner's gross income if it is a qualified distribution or to the extent that it is a return of the owner's contributions to the Roth IRA (determined in accordance with A-8 of this section). A qualified distribution is one that is both--

(1) Made after a 5-taxable-year period (defined in A-2 of this section); and

(2) Made on or after the date on which the owner attains age 59½, made to a beneficiary or the estate of the owner on or after the date of the owner's death, attributable to the owner's being disabled within the meaning of section 72(m)(7), or to which section 72(t)(2)(F) applies (exception for first-time home purchase).

(c) An amount distributed from a Roth IRA will not be included in gross income to the extent it is rolled over to another Roth IRA on a tax-free basis under the rules of sections 408(d)(3) and 408A(e).

(d) Excess contributions that are returned to the Roth IRA owner in accordance with section 408(d)(4) (corrective distributions) are not includible in gross income, but any net income required to be distributed under section 408(d)(4) together with the excess contribution is includible in gross income for the taxable year in which the excess contribution was made.

Q-2. When does the 5-taxable-year period described in A-1 of this section (relating to qualified distributions) begin and end?

A-2. The 5-taxable-year period described in A-1 of this section begins on the first day of the individual’s taxable year for which the first regular contribution is made to any Roth IRA of the individual or, if earlier, the first day of the individual’s taxable year in which the first conversion contribution is made to any Roth IRA of the individual. The 5-taxable-year period ends on the last day of the individual’s fifth consecutive taxable year beginning with the taxable year described in the preceding sentence. For example, if an individual whose taxable year is the calendar year makes a first-time regular Roth IRA contribution any time between January 1, 1998, and April 15, 1999, for 1998, the 5-taxable-year period begins on January 1, 1998. Thus, each Roth IRA owner has only one 5-taxable-year period described in A-1 of this section for all the Roth IRAs of which he or she is the owner. Further, because of the requirement of the 5-taxable-year period, no qualified distributions can occur before taxable years beginning in 2003.

Q-3. If a distribution is made to an individual who is the sole beneficiary of his or her deceased spouse's Roth IRA and the individual is treating the Roth IRA as his or her own, can the distribution be a qualified distribution based on being made to a beneficiary on or after the owner’s death?

A-3. No. If a distribution is made to an individual who is the sole beneficiary of his or her deceased spouse’s Roth IRA and the individual is treating the Roth IRA as his or her own, then, in accordance with §1.408A-2 A-4, the distribution is treated as coming from the individual's own Roth IRA and not the deceased spouse's Roth IRA. Therefore, for purposes of determining whether the distribution is a qualified distribution, it is not treated as made to a beneficiary on or after the owner's death.

Q-4. How is a distribution from a Roth IRA taxed if it is not a qualified distribution?

A-4. A distribution that is not a qualified distribution, and is neither contributed to another Roth IRA in a qualified rollover contribution nor constitutes a corrective distribution, is includible in the owner's gross income to the extent that the amount of the distribution, when added to the amount of all previous distributions from the owner's Roth IRAs (whether or not they were qualified distributions), exceeds the owner's contributions to all his or her Roth IRAs. For purposes of this A-4, any amount distributed as a corrective distribution is treated as if it was never contributed.

Q-5. Will the additional tax under 72(t) apply to the amount of a distribution that is not a qualified distribution?

A-5. (a) The 10-percent additional tax under section 72(t) will apply (unless the distribution is excepted under section 72(t)) to any distribution from a Roth IRA includible in gross income.

(b) The 10-percent additional tax under section 72(t) also applies to a nonqualified distribution, even if it is not then includible in gross income, to the extent it is allocable to a conversion contribution, if the distribution is made within the 5-taxable-year period beginning with the first day of the individual’s taxable year in which the conversion contribution was made. The 5-taxable-year period ends on the last day of the individual’s fifth consecutive taxable year beginning with the taxable year described in the preceding sentence. For purposes of applying the tax, only the amount of the conversion includible in gross income as a result of the conversion is taken into account. The exceptions under section 72(t) also apply to such a distribution.

(c) The 5-taxable-year period described in this A-5 for purposes of determining whether section 72(t) applies to a distribution allocable to a conversion contribution is separately determined for each conversion contribution, and need not be the same as the 5-taxable-year period used for purposes of determining whether a distribution is a qualified distribution under A-1(b) of this section. For example, if a calendar-year taxpayer who received a distribution from a traditional IRA on December 31, 1998, makes a conversion contribution by contributing the distributed amount to a Roth IRA on February 25, 1999 in a qualifying rollover contribution and makes a regular contribution for 1998 on the same date, the 5-taxable-year period for purposes of this A-5 begins on January 1, 1999, while the 5-taxable-year period for purposes of A-1(b) of this section begins on January 1, 1998.

Q-6. Is there a special rule for taxing distributions allocable to a 1998 conversion?

A-6. Yes. In the case of a distribution from a Roth IRA in 1998, 1999 or 2000 of amounts allocable to a 1998 conversion with respect to which the 4-year spread for the resultant income inclusion applies (see §1.408A-4 A-8), any income deferred as a result of the election to years after the year of the distribution is accelerated so that it is includible in gross income in the year of the distribution up to the amount of the distribution allocable to the 1998 conversion (determined under A-8 of this section). This amount is in addition to the amount otherwise includible in the owner's gross income for that taxable year as a result of the conversion. However, this rule will not require the inclusion of any amount to the extent it exceeds the total amount of income required to be included over the 4-year period. The acceleration of income inclusion described in this A-6 applies in the case of a surviving spouse who elects to continue the 4-year spread in accordance with §1.408A-4 A-11(b).

Q-7. Is the 5-taxable-year period described in A-1 of this section redetermined when a Roth IRA owner dies?

A-7. (a) No. The beginning of the 5-taxable-year period described in A-1 of this section is not redetermined when the

Roth IRA owner dies. Thus, in determining the 5-taxable-year period, the period the Roth IRA is held in the name of a beneficiary, or in the name of a surviving spouse who treats the decedent's Roth IRA as his or her own, includes the period it was held by the decedent.

(b) The 5-taxable-year period for a Roth IRA held by an individual as a beneficiary of a deceased Roth IRA owner is determined independently of the 5-taxable-year period for the beneficiary's own Roth IRA. However, if a surviving spouse treats the Roth IRA as his or her own, the 5-taxable-year period with respect to any of the surviving spouse's Roth IRAs (including the one that the surviving spouse treats as his or her own) ends at the earlier of the end of either the 5-taxable-year period for the decedent or the 5-taxable-year period applicable to the spouse's own Roth IRAs.

Q-8. How is it determined whether an amount distributed from a Roth IRA is allocated to regular contributions, conversion contributions, or earnings?

A-8. (a) Any amount distributed from an individual's Roth IRA is treated as made in the following order (determined as of the end of a taxable year and exhausting each category before moving to the following category)--

(1) From regular contributions;

(2) From conversion contributions, on a first-in-first-out basis; and

(3) from earnings.

(b) To the extent a distribution is treated as made from a particular conversion contribution, it is treated as made first from the portion, if any, that was includible in gross income as a result of the conversion.

Q-9. Are there special rules for determining the source of distributions under A-8 of this section?

A-9. Yes. For purposes of determining the source of distributions, the following rules apply:

(a) All distributions from all an individual’s Roth IRAs made during a taxable year are aggregated.

(b) All regular contributions made for the same taxable year to all the individual’s Roth IRAs are aggregated and added to the undistributed total regular contributions for prior taxable years. Regular contributions for a year include contributions made in the following taxable year that are identified as made for the taxable year. For example, a regular contribution made in 1999 for 1998 is aggregated with the contributions made in 1998 for 1998.

(c) All conversion contributions received during the same taxable year by all the individual’s Roth IRAs are aggregated. Notwithstanding the preceding sentence, all conversion contributions made by an individual during 1999 that were distributed from a traditional IRA in 1998 and with respect to which the 4-year spread applies are treated for purposes of A-8(b) of this section as contributed to the individual’s Roth IRAs prior to any other conversion contributions made by the individual during 1999.

(d) A distribution from an individual’s Roth IRA that is rolled over to another Roth IRA of the individual is disregarded for purposes of determining the amount of both contributions and distributions.

(e) Any amount distributed as a corrective distribution (including net income), as described in A-1(d) of this section, is disregarded in determining the amount of contributions, earnings, and distributions.

(f) If an individual recharacterizes a contribution made to a traditional IRA (FIRST IRA) by transferring the contribution to a Roth IRA (SECOND IRA) in accordance with §1.408A-5, then, pursuant to §1.408A-5 A-3, the contribution to the Roth IRA is taken into account for the same taxable year for which it would have been taken into account if the contribution had originally been made to the Roth IRA and had never been contributed to the traditional IRA. Thus, the contribution to the Roth IRA is treated as contributed to the Roth IRA on the same date and for the same taxable year that the contribution was made to the traditional IRA.

(g) If an individual recharacterizes a regular or conversion contribution made to a Roth IRA (FIRST IRA) by transferring the contribution to a traditional IRA (SECOND IRA) in accordance with §1.408A-5, then pursuant to §1.408A-5 A-3, the contribution to the Roth IRA and the recharacterizing transfer are disregarded in determining the amount of both contributions and distributions for the taxable year with respect to which the original contribution was made to the Roth IRA.

(h) Pursuant to §1.408A-5 A-3, the effect of income or loss (determined in accordance with §1.408A-5 A-2) occurring after the contribution to the FIRST IRA is disregarded in determining the amounts described in paragraphs (f) and (g) of this A-9. Thus, for purposes of paragraphs (f) and (g), the amount of the contribution is determined based on the original contribution.

Q-10. Are there examples to illustrate the ordering rules described in A-8 and A-9 of this section?

A-10. Yes. The following examples illustrate these ordering rules:

Example 1. In 1998, individual B converts $80,000 in his traditional IRA to a Roth IRA. B has a basis of $20,000 in the conversion amount and so must include the remaining $60,000 in gross income. He decides to spread the $60,000 income by including $15,000 in each of the 4 years 1998-2001, under the rules of §1.408A-4 A-8. B also makes a regular contribution of $2,000 in 1998. If a distribution of $2,000 is made to B anytime in 1998, it will be treated as made entirely from the regular contributions, so there will be no Federal income tax consequences as a result of the distribution.

Example 2. The facts are the same as in Example 1, except that the distribution made in 1998 is $5,000. The distribution is treated as made from $2,000 of regular contributions and $3,000 of conversion contributions that were includible in gross income. As a result, B must include $18,000 in gross income for 1998: $3,000 as a result of the acceleration of amounts that otherwise would have been included in later years under the 4-year-spread rule and $15,000 includible under the regular 4-year-spread rule. In addition, because the $3,000 is allocable to a conversion made within the previous 5 taxable years, the 10-percent additional tax under section 72(t) would apply to this $3,000 distribution as if it were includible in gross income for 1998, unless an exception applies. Under the 4-year-spread rule, B would now include in gross income $15,000 for 1999 and 2000, but only $12,000 for 2001, because of the accelerated inclusion of the $3,000 distribution.

Example 3. The facts are the same as in Example 1, except that B makes an additional $2,000 regular contribution in 1999 and he does not take a distribution in 1998. In 1999, the entire balance in the account, $90,000 ($84,000 of contributions and $6,000 of earnings), is distributed to B. The distribution is treated as made from $4,000 of regular contributions, $60,000 of conversion contributions that were includible in gross income, $20,000 of conversion contributions that were not includible in gross income, and $6,000 of earnings. Because a distribution has been made within the 4-year-spread period, B must accelerate the income inclusion under the 4-year-spread rule and must include in gross income the $45,000 remaining under the 4-year-spread rule in addition to the $6,000 of earnings. Because $60,000 of the distribution is allocable to a conversion made within the previous 5 taxable years, it is subject to the 10-percent additional tax under section 72(t) as if it were includible in gross income for 1999, unless an exception applies. The $6,000 allocable to earnings would be subject to the tax under section 72(t), unless an exception applies. Under the 4-year-spread rule, no amount would be includible in gross income for 2000 or 2001 because the entire amount of the conversion that was includible in gross income has already been included.

Example 4. The facts are the same as in Example 1, except that B also makes a $2,000 regular contribution in each year 1999 through 2002 and he does not take a distribution in 1998. A distribution of $85,000 is made to B in 2002. The distribution is treated as made from the $10,000 of regular contributions (the total regular contributions made in the years 1998-2002), $60,000 of conversion contributions that were includible in gross income, and $15,000 of conversion contributions that were not includible in gross income. As a result, no amount of the distribution is includible in gross income; however, because the distribution is allocable to a conversion made within the previous 5 years, the $60,000 is subject to the 10-percent additional tax under section 72(t) as if it were includible in gross income for 2002, unless an exception applies.

Example 5. The facts are the same as in Example 4, except no distribution occurs in 2002. In 2003, the entire balance in the account, $170,000 ($90,000 of contributions and $80,000 of earnings), is distributed to B. The distribution is treated as made from $10,000 of regular contributions, $60,000 of conversion contributions that were includible in gross income, $20,000 of conversion contributions that were not includible in gross income, and $80,000 of earnings. As a result, for 2003, B must include in gross income the $80,000 allocable to earnings, unless the distribution is a qualified distribution; and if it is not a qualified distribution, the $80,000 would be subject to the 10-percent additional tax under section 72(t), unless an exception applies.

Example 6. Individual C converts $20,000 to a Roth IRA in 1998 and $15,000 (in which amount C had a basis of $2,000) to another Roth IRA in 1999. No other contributions are made. In 2003, a $30,000 distribution, that is not a qualified distribution, is made to C. The distribution is treated as made from $20,000 of the 1998 conversion contribution and $10,000 of the 1999 conversion contribution that was includible in gross income. As a result, for 2003, no amount is includible in gross income; however, because $10,000 is allocable to a conversion contribution made within the previous 5 taxable years, that amount is subject to the 10-percent additional tax under section 72(t) as if the amount were includible in gross income for 2003, unless an exception applies. The result would be the same whichever of C's Roth IRAs made the distribution.

Example 7. The facts are the same as in Example 6, except that the distribution is a qualified distribution. The result is the same as in Example 6, except that no amount would be subject to the 10-percent additional tax under section 72(t), because, to be a qualified distribution, the distribution must be made on or after the date on which the owner attains age 59½, made to a beneficiary or the estate of the owner on or after the date of the owner's death, attributable to the owner's being disabled within the meaning of section 72(m)(7), or to which section 72(t)(2)(F) applies (exception for a first-time home purchase). Under section 72(t)(2), each of these conditions is also an exception to the tax under section 72(t).

Example 8. Individual D makes a $2,000 regular contribution to a traditional IRA on January 1, 1999, for 1998. On April 15, 1999, when the $2,000 has increased to $2,500, D recharacterizes the contribution by transferring the $2,500 to a Roth IRA (pursuant to §1.408A-5 A-1). In this case, D's regular contribution to the Roth IRA for 1998 is $2,000. The $500 of earnings is not treated as a contribution to the Roth IRA. The results would be the same if the $2,000 had decreased to $1,500 prior to the recharacterization.

Example 9. In December 1998, individual E receives a distribution from his traditional IRA of $300,000 and in January 1999 he contributes the $300,000 to a Roth IRA as a conversion contribution. In April 1999, when the $300,000 has increased to $350,000, E recharacterizes the conversion contribution by transferring the $350,000 to a traditional IRA. In this case, E’s conversion contribution for 1998 is $0, because the $300,000 conversion contribution and the earnings of $50,000 are disregarded. The results would be the same if the $300,000 had decreased to $250,000 prior to the recharacterization. Further, since the conversion is disregarded, the $300,000 is not includible in gross income in 1998.

Q-11. If the owner of a Roth IRA dies prior to the end of the 5-taxable-year period described in A-1 of this section (relating to qualified distributions) or prior to the end of the 5-taxable-year period described in A-5 of this section (relating to conversions), how are different types of contributions in the Roth IRA allocated to multiple beneficiaries?

A-11. Each type of contribution is allocated to each beneficiary on a pro-rata basis. Thus, for example, if a Roth IRA owner dies in 1999, when the Roth IRA contains a regular contribution of $2,000, a conversion contribution of $6,000 and earnings of $1,000, and the owner leaves his Roth IRA equally to four children, each child will receive one quarter of each type of contribution. Pursuant to the ordering rules in A-8 of this section, an immediate distribution of $2,000 to one of the children will be deemed to consist of $500 of regular contributions and $1,500 of conversion contributions.

Q-12. How do the withholding rules under section 3405 apply to Roth IRAs?

A-12. Distributions from a Roth IRA are distributions from an individual retirement plan for purposes of section 3405 and thus are designated distributions unless one of the exceptions in section 3405(e)(1) applies. Pursuant to section 3405 (a) and (b), nonperiodic distributions from a Roth IRA are subject to 10-percent withholding by the payor and periodic payments are subject to withholding as if the payments were wages. However, an individual can elect to have no amount withheld in accordance with section 3405(a)(2) and (b)(2).

Q-13. Do the withholding rules under section 3405 apply to conversions?

A-13. Yes. A conversion by any method described in §1.408A-4 A-1 is considered a designated distribution subject to section 3405. However, a conversion occurring in 1998 by means of a trustee-to-trustee transfer of an amount from a traditional IRA to a Roth IRA established with the same or a different trustee is not required to be treated as a designated distribution for purposes of section 3405. Consequently, no withholding is required with respect to such a conversion (without regard to whether or not the individual elected to have no withholding).

Q-14. What minimum distribution rules apply to a Roth IRA?

A-14. (a) No minimum distributions are required to be made from a Roth IRA under section 408(a)(6) and (b)(3) (which generally incorporate the provisions of section 401(a)(9)) while the owner is alive. The post-death minimum distribution rules under section 401(a)(9)(B) that apply to traditional IRAs, with the exception of the at-least-as-rapidly rule described in section 401(a)(9)(B)(i), also apply to Roth IRAs.

(b) The minimum distribution rules apply to the Roth IRA as though the Roth IRA owner died before his or her required beginning date. Thus, generally, the entire interest in the Roth IRA must be distributed by the end of the fifth calendar year after the year of the owner’s death unless the interest is payable to a designated beneficiary over a period not greater than that beneficiary’s life expectancy and distribution commences before the end of the calendar year following the year of death. If the sole beneficiary is the decedent’s spouse, such spouse may delay distributions until the decedent would have attained age 70½ or may treat the Roth IRA as his or her own.

(c) Distributions to a beneficiary that are not qualified distributions will be includible in the beneficiary's gross income according to the rules in A-4 of this section.

Q-15. Does section 401(a)(9) apply separately to Roth IRAs and individual retirement plans that are not Roth IRAs?

A-15. Yes. An individual required to receive minimum distributions from his or her own traditional or SIMPLE IRA cannot choose to take the amount of the minimum distributions from any Roth IRA. Similarly, an individual required to receive minimum distributions from a Roth IRA cannot choose to take the amount of the minimum distributions from a traditional or SIMPLE IRA. In addition, an individual required to receive minimum distributions as a beneficiary under a Roth IRA can only satisfy the minimum distributions for one Roth IRA by distributing from another Roth IRA if the Roth IRAs were inherited from the same decedent.

Q-16. How is the basis of property distributed from a Roth IRA determined for purposes of a subsequent disposition?

A-16. The basis of property distributed from a Roth IRA is its fair market value (FMV) on the date of distribution, whether or not the distribution is a qualified distribution. Thus, for example, if a distribution consists of a share of stock in XYZ Corp. with an FMV of $40.00 on the date of distribution, for purposes of determining gain or loss on the subsequent sale of the share of XYZ Corp. stock, it has a basis of $40.00.

Q-17. What is the effect of distributing an amount from a Roth IRA and contributing it to another type of retirement plan other than a Roth IRA?

A-17. Any amount distributed from a Roth IRA and contributed to another type of retirement plan (other than a Roth IRA) is treated as a distribution from the Roth IRA that is neither a rollover contribution for purposes of section 408(d)(3) nor a qualified rollover contribution within the meaning of section 408A(e) to the other type of retirement plan. This treatment also applies to any amount transferred from a Roth IRA to any other type of retirement plan unless the transfer is a recharacterization described in §1.408A-5.

Q-18. Can an amount be transferred directly from an education IRA to a Roth IRA (or distributed from an education IRA and rolled over to a Roth IRA)?

A-18. No amount may be transferred directly from an education IRA to a Roth IRA. A transfer of funds (or distribution and rollover) from an education IRA to a Roth IRA constitutes a distribution from the education IRA and a regular contribution to the Roth IRA (rather than a qualified rollover contribution to the Roth IRA).

Q-19. What are the Federal income tax consequences of a Roth IRA owner transferring his or her Roth IRA to another individual by gift?

A-19. A Roth IRA owner’s transfer of his or her Roth IRA to another individual by gift constitutes an assignment of the owner’s rights under the Roth IRA. At the time of the gift, the assets of the Roth IRA are deemed to be distributed to the owner and, accordingly, are treated as no longer held in a Roth IRA. In the case of any such gift of a Roth IRA made prior to October 1, 1998, if the entire interest in the Roth IRA is reconveyed to the Roth IRA owner prior to January 1, 1999, the Internal Revenue Service will treat the gift and reconveyance as never having occurred for estate tax, gift tax, and generation-skipping tax purposes and for purposes of this A-19.

§1.408A-7 Reporting.

Q-1. What reporting requirements apply to Roth IRAs?

A-1. Generally, the reporting requirements applicable to IRAs other than Roth IRAs also apply to Roth IRAs, except that, pursuant to section 408A(d)(3)(D), the trustee of a Roth IRA must include on Forms 1099-R and 5498 additional information as described in the instructions thereto. Any conversion of amounts from an IRA other than a Roth IRA to a Roth IRA is treated as a distribution for which a Form 1099-R must be filed by the trustee maintaining the non-Roth IRA. In addition, the owner of such IRAs must report the conversion by completing Form 8606. In the case of a recharacterization described in §1.408A-5 A-1, IRA owners must report such transactions in the manner prescribed in the instructions to the applicable Federal tax forms.

Q-2. Can a trustee rely on reasonable representations of a Roth IRA contributor or distributee for purposes of fulfilling reporting obligations?

A-2. A trustee maintaining a Roth IRA is permitted to rely on reasonable representations of a Roth IRA contributor or distributee for purposes of fulfilling reporting obligations.

<u>§1.408A-8 Definitions</u>.

Q-1. Are there any special definitions that govern in applying the provisions of §§1.408A-1 through 1.408A-7 and this section?

A-1. Yes, the following definitions govern in applying the provisions of §§1.408A-1 through 1.408A-7 and this section. Unless the context indicates otherwise, the use of a particular term excludes the use of the other terms.

(a) <u>Different types of IRAs</u>--(1) <u>IRA</u>. Sections 408(a) and (b), respectively, describe an individual retirement account and an individual retirement annuity. The term IRA means an IRA described in either section 408(a) or (b), including each IRA described in paragraphs (a)(2) through (5) of this A-1. However, the term IRA does not include an education IRA described in section 530.

(2) Traditional IRA. The term traditional IRA means an individual retirement account or individual retirement annuity described in section 408(a) or (b), respectively. This term includes a SEP IRA but does not include a SIMPLE IRA or a Roth IRA.

(3) SEP IRA. Section 408(k) describes a simplified employee pension (SEP) as an employer-sponsored plan under which an employer can make contributions to IRAs established for its employees. The term SEP IRA means an IRA that receives contributions made under a SEP. The term SEP includes a salary reduction SEP (SARSEP) described in section 408(k)(6).

(4) SIMPLE IRA. Section 408(p) describes a SIMPLE IRA Plan as an employer-sponsored plan under which an employer can make contributions to SIMPLE IRAs established for its employees. The term SIMPLE IRA means an IRA to which the only contributions that can be made are contributions under a SIMPLE IRA Plan or rollovers or transfers from another SIMPLE IRA.

(5) Roth IRA. The term Roth IRA means an IRA that meets the requirements of section 408A.

(b) Other defined terms or phrases--(1) 4-year spread. The term 4-year spread is described in §1.408A-4 A-8.

(2) Conversion. The term conversion means a transaction satisfying the requirements of §1.408A-4 A-1.

(3) Conversion amount or conversion contribution. The term conversion amount or conversion contribution is the amount of a distribution and contribution with respect to which a conversion described in §1.408A-4 A-1 is made.

(4) Modified AGI. The term modified AGI is defined in §1.408A-3 A-5.

(5) Recharacterization. The term recharacterization means a transaction described in §1.408A-5 A-1.

(6) Recharacterized amount or recharacterized contribution. The term recharacterized amount or recharacterized contribution means an amount or contribution treated as contributed to an IRA other than the one to which it was originally contributed pursuant to a recharacterization described in §1.408A-5 A-1.

(7) Taxable conversion amount. The term taxable conversion amount means the portion of a conversion amount includible in income on account of a conversion, determined under the rules of section 408(d)(1) and (2).

(8) Tax-free transfer. The term tax-free transfer means a tax-free rollover described in section 402(c), 402(e)(6), 403(a)(4), 403(a)(5), 403(b)(8), 403(b)(10) or 408(d)(3), or a tax-free trustee-to-trustee transfer.

(9) Treat an IRA as his or her own. The phrase treat an IRA as his or her own means to treat an IRA of a surviving spouse for which one is the beneficiary as his or her own IRA after the death of the IRA owner in accordance with the terms of the IRA

instrument or in the manner provided in the regulations under section 408(a)(6) or (b)(3).

(10) Trustee. The term trustee includes a custodian or issuer (in the case of an annuity) of an IRA (except where the context clearly indicates otherwise).

§1.408A-9 Effective date.

Q-1. To what taxable years do §§1.408A-1 through 1.408A-8 apply?

A-1 Sections 1.408A-1 through 1.408A-8 apply to taxable years beginning on or after January 1, 1998.

Michael P. Dolan

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