

Part III -- Administrative, Procedural and Miscellaneous
Roth IRA Guidance

Notice 98-49

PURPOSE AND BACKGROUND

This notice provides guidance relating to Service-approved Roth IRA documents and IRA reporting requirements. In addition, this notice summarizes a number of recent changes in the law governing all IRAs, which affect Notice 87-13, 1987-1 C.B. 432, and Notice 87-16, 1987-1 C.B. 446.

Roth IRAs are a new type of IRA, described in § 408A of the Internal Revenue Code ("Code"), that individuals can use beginning in 1998. Section 408A was added to the Code by § 302 of the Taxpayer Relief Act of 1997 ("TRA 97"), Pub. L. 105-34, to authorize a new type of individual retirement arrangement (the "Roth IRA"). This notice reflects changes relating to Roth IRAs contained in the Internal Revenue Service Restructuring and Reform Act of 1998 (the "IRS Restructuring Act"), Pub. L. 105-206.

The Internal Revenue Service recently issued proposed regulations, §§ 1.408A-1 through 1.408A-9, relating to Roth IRAs, which were published in the Federal Register on September 3, 1998. This notice incorporates definitions and terms that are contained in those proposed regulations.

For more information on IRAs, including Roth IRAs, see Publication 590, Individual Retirement Arrangements (IRAs), and Publication 553, Highlights of 1997 Tax Changes.

SECTION A. SERVICE-APPROVED ROTH IRA DOCUMENTS

Q. A-1. Are there model forms available for establishing a Roth IRA?

A. A-1. Yes. The Service has issued three model forms, Form 5305-R, Form 5305-RA and Form 5305-RB, that can be used to establish a Roth IRA as a trust account, a custodial account or an annuity, respectively. In the case of Form 5305-RB, the model form is used as an endorsement to an insurance company's annuity contract. Model forms issued by the Service contain pre-approved language that, if followed, will satisfy the applicable statutory requirements.

Q. A-2. Can the model forms be amended?

A. A-2. Article IX of each of these model forms permits certain amendments to be made to provisions of the Roth IRA in accordance with the instructions to the model forms. For example, under the model forms, a spouse who is the sole designated beneficiary is deemed to have elected to treat the Roth IRA, upon the death of the owner, as his or her own. The model forms can be amended to give a surviving spouse who is the sole designated beneficiary the option of not treating the Roth IRA, upon the death of the owner, as his or her own.

Q. A-3. Is the Service currently accepting applications for opinion letters on prototype Roth IRAs?

A. A-3. The Service is not currently accepting applications for opinion letters on prototype Roth IRAs. Announcement 97-122, 1997-50 I.R.B. 63, states that transitional relief similar to that provided under Rev. Proc. 97-29, 1997-1 C.B. 698, will be provided to sponsors and their customers who establish Roth IRAs with documents that have not been pre-approved by the Service. Thus, for example, if in January 1998 an individual made a contribution to a trust or custodial account or purchased an annuity using documents or associated written material that clearly designates the account or annuity as a Roth IRA, then, provided certain requirements are met, the individual will be deemed to have established a Roth IRA on that date using a document approved by the Service for use as a Roth IRA.

SECTION B. IRA REPORTING REQUIREMENTS

Q. B-1. What reporting requirements apply to the trustees in the case of a recharacterization of a contribution from a FIRST IRA to a SECOND IRA as described in § 1.408A-5 of the proposed Income Tax Regulations?

A. B-1. The general reporting requirements for Roth IRAs are described in proposed regulation § 1.408A-7. In addition, the following reporting requirements apply to the trustees of the FIRST IRA and the SECOND IRA when the IRA owner elects to treat a contribution as having been made to the SECOND IRA and not to the FIRST IRA in accordance with the rules in § 1.408A-5. To the extent that the instructions for the 1998 Forms 1099-R and 5498 are inconsistent with the instructions for completing those forms provided in this Q&A B-1, trustees must follow the guidance provided in this notice.

(1) Reporting by the trustee of the FIRST IRA. The trustee of the FIRST IRA reports the contribution on Form 5498 showing the character of the contribution (rollover, conversion amount, or regular). If the recharacterization (i.e., the transfer) occurs in calendar year 1998, the trustee reports the recharacterization as a distribution on Form 1099-R showing Code G for direct rollover and showing the gross amount (contribution and earnings) in Box 1-Gross distribution and 0 (zero) in Box 2a-Taxable amount. For recharacterizations that occur in later years, the trustee reports in accordance with applicable Federal tax forms and instructions. For recharacterizations that occur in 1999, it is anticipated that the instructions to Form 1099-R will indicate that the trustee reports the recharacterization as a distribution on Form 1099-R showing new Code R for recharacterization and showing the gross amount (contribution and earnings) in Box 1-Gross distribution and 0 (zero) in Box 2a-Taxable amount.

(2) Reporting by the trustee of the SECOND IRA. For recharacterized amounts received on or before December 31, 1998, that are recharacterized as amounts contributed in calendar year 1998, the trustee of the SECOND IRA reports the contribution as a rollover contribution on a 1998 Form 5498. For recharacterized amounts received after December 31, 1998, the trustee reports in accordance with applicable Federal tax forms and instructions. It is anticipated that the instructions to the 1999 Form 5498 will provide that a recharacterized amount received by the trustee of the SECOND IRA will continue to be reported as a rollover contribution, but that (a) the checkbox entitled "Roth conv." on the 1998 Form 5498 will be retitled to identify a contribution as a recharacterization, (b) the trustee of the SECOND IRA will check both the box identifying the contribution as a recharacterization contribution and the box that identifies the type of IRA involved, and (c) the recharacterization must be reported on a Form 5498 that is separate from any Form 5498 otherwise required for the SECOND IRA.

Q. B-2. How does a trustee report on Form 1099-R a distribution from a Roth IRA that contains both regular and 1998 conversion contributions?

A. B-2. In the case of a distribution from a Roth IRA that contains both regular and 1998 conversion contributions, the trustee must use Code K in Box 7 of Form 1099-R.

SECTION C. OTHER RECENT CHANGES TO IRAS

Q. C-1. What effect does the recharacterization of a contribution (as described in § 1.408A-5 of the proposed Income Tax Regulations) have on the rules governing the nontaxable return of basis in the case of traditional IRA distributions?

A. C-1. Part III, "Distributions," of Notice 87-16, sets forth the rules for calculating the nontaxable return of basis in the case of distributions from traditional IRAs. These rules continue to apply except as modified below.

The total IRA account balances, the total nondeductible contributions, and the distribution amount (as these terms are used in Notice 87-16) for an individual for a taxable year are each adjusted to reflect recharacterized amounts contributed to, or distributed from, the traditional IRAs. For purposes of making this adjustment, the contribution that is being recharacterized as a contribution to the SECOND IRA is treated as having been originally contributed to the SECOND IRA on the same date and (in the case of a regular contribution) for the same taxable year that the contribution was made to the FIRST IRA. If the recharacterization transaction occurs after the close of the taxable year and if the recharacterization transaction involves a regular contribution for the prior taxable year, the recharacterization is disregarded for the prior taxable year in determining the total IRA account balances.

Q. C-2. Are there any new exceptions to the 10-percent additional tax on early distributions from IRAs?

A. C-2. Yes. Section 203 of TRA 97 added § 72(t)(2)(E) to the Code, which provides that the additional 10-percent tax does not apply to IRA distributions for qualified higher education expenses of the IRA owner, the owner's spouse, or a child or grandchild of either. Qualified higher education expenses include tuition, supplies, and, for students who are at least half-time, room and board. (See Notice 97-60, 1997-46 I.R.B. 8.)

Section 303 of TRA 97 added § 72(t)(2)(F) to the Code, which provides that the additional 10-percent tax does not apply to an IRA distribution to acquire a first-time home for the IRA owner or a member of his or her family. To qualify, the distribution must be used for costs normally associated with acquiring a principal residence and the IRA owner (and if married, the owner's spouse), generally, must not have had an ownership interest in a principal residence for the previous 2 years. If the distributed money is not used for such purpose, the money can be recontributed by the 120th day after the distribution to the IRA without

incurring the 10-percent tax. This exception for a first-time home purchase is subject to a lifetime cap of \$10,000 for each IRA owner; thus, an individual and his or her spouse would each be subject to a separate \$10,000 lifetime cap.

In addition, § 3436 of the IRS Restructuring Act added § 72(t)(2)(A)(vii) to the Code, which provides that the additional 10-percent tax does not apply to a distribution from a qualified retirement plan, including an IRA, that is made on account of a levy under § 6331 on the qualified retirement plan. The provision applies to distributions made after December 31, 1999.

Previous guidance relating to § 72(t) was provided in Part D of Notice 87-13. These rules continue to apply except as modified above.

Q. C-3. What changes are there in the "active participant" rules?

A. C-3. Section 301 of TRA 97 amended § 219 of the Code to provide for increased deductible contributions to traditional IRAs that can be made by active participants in employer-sponsored retirement plans. In 1998, the IRA deduction available to an unmarried active participant is phased out ratably between adjusted gross income of \$30,000 and \$40,000. This phase-out range is increased annually until 2005 when the phase-out range will be \$50,000 to \$60,000. In the case of joint returns, the phase-out range is \$50,000 to \$60,000 for 1998, rising to \$80,000 to \$100,000 for 2007 and later years. In addition, an individual who is not an active participant but is married to someone who is can make a fully deductible traditional IRA contribution if their combined adjusted gross income is not more than \$150,000, or a partially deductible traditional IRA contribution if their combined adjusted gross income is between \$150,000 and \$160,000.

Previous guidance relating to the active participant rules was provided in Part IA of Notice 87-16. These rules continue to apply except as modified above.

Q. C-4. Are there any changes to the permissible investments available in an IRA?

A. C-4. Yes. Section 304 of TRA 97 amended § 408(m) of the Code to permit IRAs to invest in certain platinum coins and in gold, silver, platinum or palladium bullion, provided the bullion is in the physical possession of an IRA trustee.

Previous guidance relating to collectibles was provided in Part V of Notice 87-16. These rules continue to apply except as modified above.

EFFECT ON OTHER DOCUMENTS

Notice 87-16 and Notice 87-13 are modified.

REQUEST FOR COMMENTS

The Service and Treasury invite comments and suggestions concerning the guidance provided in this notice. Any correspondence received will be evaluated to determine whether additional guidance on Roth IRAs is necessary.

In particular, comments are requested on appropriate reporting of recharacterization transactions described in proposed regulation § 1.408A-5. The Service and Treasury recognize that recharacterization transactions present novel reporting issues for IRA trustees, and this notice provides for reporting such transactions in a manner that most closely approximates reporting for ordinary IRA distributions, contributions and trustee-to-trustee transfers. However, the Service and Treasury are considering other possible reporting alternatives for recharacterization transactions. For example, it might be appropriate to require that the recharacterized contribution be reported by the trustee of the SECOND IRA on a Form 5498 for the year for which it is treated as having been contributed, even if the recharacterization occurs in the subsequent year. Another possible approach would be to require only the reporting by the trustee of the SECOND IRA involved in the recharacterization transaction that would have been required if the contribution had initially been made to the SECOND IRA and never had been made to the FIRST IRA.

Comments can be addressed to CC:DOM:CORP:R (Notice 98-49), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98-49), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information

regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.