

October 20, 1998

ADVANCE COPY OF INTERNAL REVENUE BULLETIN ITEM

Attached is an advance copy of Notice 98-50, describing Roth IRA guidance.

It will appear in Internal Revenue Bulletin 1998-44, dated November 2, 1998.

You may release this notice immediately.

Communications Division

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

Notice 98-50

PURPOSE

This notice responds to questions that have arisen regarding whether a taxpayer who has converted an amount from a traditional IRA to a Roth IRA may not only transfer the amount back to a traditional IRA in a recharacterization but also subsequently "reconvert" that amount from the traditional IRA to a Roth IRA.

BACKGROUND

Section 408A of the Internal Revenue Code (the "Code"), which was added by § 302 of the Taxpayer Relief Act of 1997, Pub. L. 105-34, 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 § 408A were amended by the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206. On September 3, 1998, proposed regulations relating to Roth IRAs, §§ 1.408A-1 through 1.408A-9, were published in the Federal Register (63 FR 46937). This notice incorporates definitions and terms used in those proposed regulations.

Section 408A(d)(3) of the Code and § 1.408A-4 of the proposed regulations prescribe rules for the conversion of an amount from a traditional IRA to a Roth IRA. Any amount converted from a traditional IRA to a Roth IRA is treated as distributed from the traditional IRA and rolled over to the Roth IRA and is generally includible in gross income for the year in which the amount is distributed or transferred from the traditional IRA (subject to a "4-year spread" for 1998 conversions, unless the taxpayer elects otherwise).

Section 408A(d)(6) of the Code and § 1.408A-5 of the proposed regulations prescribe rules for "recharacterizations" of IRA contributions, including Roth IRA 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 date prescribed by law for filing the taxpayer's Federal income tax return, including extensions, (the "due date") for the taxable year of the contribution is treated as made to the transferee IRA and not the transferor IRA. The proposed regulations interpret § 408A(d)(6) to make its application elective by the taxpayer, permit the taxpayer to recharacterize most types of IRA contributions, and permit the taxpayer to recharacterize all or any portion of an IRA contribution.

TREATMENT OF RECONVERSIONS

The question has arisen whether a taxpayer who has converted an amount from a traditional IRA to a Roth IRA may not only transfer the amount back to a traditional IRA in a recharacterization but also subsequently "reconvert" that amount from the traditional IRA to a Roth IRA. The proposed regulations do not specifically address this question, and the Service and Treasury are considering whether final regulations should permit reconversions under any circumstances. However, effective as of November 1, 1998, the interim rules set forth below will apply for 1998 and 1999. Any future guidance that either prohibits reconversions or imposes conditions on reconversions more restrictive than those imposed under this notice will not apply to reconversions completed before issuance of that guidance.

If a taxpayer converts (or reconverts) an amount, transfers that amount back to a traditional IRA by means of a recharacterization, and reconverts that amount in a transaction for which the taxpayer is not eligible under the interim rules set forth in this notice, the reconversion will be deemed an "excess reconversion." However, any reconversions that a taxpayer has made before November 1, 1998, will not be treated as excess reconversions and will not be taken into account in determining whether any later reconversion is an excess reconversion.

A taxpayer who converts an amount from a traditional IRA to a Roth IRA during 1998 and then transfers that amount back to a traditional IRA by means of a recharacterization is eligible to reconvert that amount to a Roth IRA once (but no more than once) on or after November 1, 1998, and on or before December 31, 1998; the taxpayer also is eligible to reconvert that amount once (but no more than once) during 1999. (Any conversion of that amount during 1999 would constitute a reconversion because the taxpayer previously converted that amount during 1998.) This rule applies without regard to whether the taxpayer's initial conversion or recharacterization of the amount occurs before, on, or after November 1, 1998, and (as indicated above) even if the taxpayer has made one or more reconversions before November 1, 1998.

A taxpayer who converts an amount from a traditional IRA to a Roth IRA during 1999 that has not been converted previously and then transfers that amount back to a traditional IRA by means of a recharacterization is eligible to reconvert that amount to a Roth IRA once (but no more than once) on or before December 31, 1999. In determining whether a taxpayer has made a previous conversion for purposes of these interim rules, a failed conversion, as described in proposed regulations § 1.408A-4, Q&A-3 (that is, an attempted conversion for which the taxpayer is not eligible for reasons set forth in proposed regulations § 1.408A-4), will not be treated as a conversion.

Any excess reconversion of an amount during 1998 or 1999 will not change the taxpayer's taxable conversion amount (as defined in proposed regulations § 1.408A-8, Q&A-1(b)(7)). Instead, the excess reconversion and the last preceding recharacterization will not be taken into account for purposes of determining the taxpayer's taxable conversion amount, and the taxpayer's taxable conversion amount will be based on the last reconversion that was not an excess reconversion (unless, after the excess reconversion, the amount is transferred back to a traditional IRA by means of a recharacterization). An excess reconversion will otherwise be treated as a

valid reconversion.

Any conversion, recharacterization, or reconversion of an amount under this notice must satisfy the provisions of § 408A and the proposed regulations. For example, a taxpayer making a conversion or reconversion must satisfy the \$100,000 modified AGI limitation of § 408A(c)(3)(B)(i) and proposed regulations § 1.408A-4, Q&A-2, and a taxpayer transferring a contribution from one IRA to another IRA by means of a recharacterization must make the transfer on or before the due date for the taxable year of the contribution, as required by § 408A(d)(6) and proposed regulations § 1.408A-5, Q&A-1. In determining the portion of any amount held in a Roth IRA or a traditional IRA that a taxpayer is not eligible to reconvert under the interim rules set forth in this notice, any amount previously converted (or reconverted) is adjusted for subsequent net gains or losses thereon.

Example 1. On May 1, 1998, T converted an amount in a traditional IRA (Traditional IRA 1) to a Roth IRA (Roth IRA 1). T did not contribute any other amount to Roth IRA 1. On October 15, 1998, T transferred the amount in Roth IRA 1 to a traditional IRA (Traditional IRA 2) by means of a recharacterization. T is eligible to reconvert the amount in Traditional IRA 2 to a Roth IRA once (but no more than once) at any time on or after November 1, 1998, and on or before December 31, 1998. Any additional reconversion during 1998 would be an excess reconversion. This result would not be different if the recharacterization had occurred on or after November 1, 1998, instead of before November 1, 1998.

Example 2. The facts are the same as in Example 1, except that, on November 25, 1998, T reconverts the amount in Traditional IRA 2 to a Roth IRA (Roth IRA 2). After that reconversion, T may transfer the amount from Roth IRA 2 back to a traditional IRA by means of a recharacterization, but any subsequent reconversion of that amount to a Roth IRA before January 1, 1999, would be an excess reconversion. If T does transfer the amount from Roth IRA 2 back to a traditional IRA by means of a recharacterization, T is eligible to reconvert that amount once (but no more than once) during 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

Example 3. The facts are the same as in Example 2, except that, on December 4, 1998, T transfers the amount from Roth IRA 2 back to a traditional IRA (Traditional IRA 3) by means of a recharacterization. If T does not reconvert that amount to a Roth IRA on or before December 31, 1998, T cannot use the 4-year spread available for 1998 conversions.

Example 4. The facts are the same as in Example 3. The value of the amount converted on May 1, 1998, was \$X, and the value of the amount converted on November 25, 1998, was \$Y. On December 8, 1998, T reconverts the amount in Traditional IRA 3 (which then has a value of \$Z) to a Roth IRA (Roth IRA 3). Under the interim rules set forth in this notice, T is not eligible to make the December 8, 1998, reconversion, and that excess reconversion will not be taken into account for purposes of determining T's taxable conversion amount (although it is otherwise treated as a valid conversion). Instead, T's taxable conversion amount will be based on T's November 25, 1998, reconversion.

Therefore, T's taxable conversion amount will be \$Y. Because it is a 1998 conversion, the November 25, 1998, reconversion is eligible for the 4-year spread (unless T again transfers the amount from Roth IRA 3 to a traditional IRA by means of a recharacterization).

Example 5. The facts are the same as in *Example 2*, except that T's modified AGI for 1998 was \$110,000. Therefore, T was not eligible to convert an amount from a traditional IRA to a Roth IRA in 1998, and T's attempted conversion (on May 1, 1998) and reconversion (on November 25, 1998) are failed conversions, as described in proposed regulations § 1.408A-4, Q&A-3. Therefore, if T transfers the amount of the failed conversion in Roth IRA 2 back to a traditional IRA by means of a recharacterization and converts that amount from the traditional IRA to a Roth IRA during 1999, T will be eligible to reconvert that amount once (but no more than once) on or before December 31, 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

Example 6. On November 5, 1998, R converts an amount in a traditional IRA (Traditional IRA 1) to a Roth IRA (Roth IRA 1). On November 25, 1998, R transfers the amount in Roth IRA 1 back to a traditional IRA (Traditional IRA 2) by means of a recharacterization. R is then eligible to reconvert the amount in Traditional IRA 2 to a Roth IRA at any time on or before December 31, 1998. After that reconversion, R may transfer the amount back to a traditional IRA by means of a recharacterization, but any subsequent reconversion of that amount to a Roth IRA before January 1, 1999, would be an excess reconversion. If R does transfer the amount back to a traditional IRA by means of a recharacterization (whether before or after the end of 1998), R will be eligible to reconvert that amount once (but no more than once) during 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

Example 7. On January 5, 1999, S converts an amount in a traditional IRA (Traditional IRA 1) to a Roth IRA (Roth IRA 1). S had not previously converted that amount. On February 17, 1999, S transfers the amount in Roth IRA 1 back to a traditional IRA (Traditional IRA 2) by means of a recharacterization. After the recharacterization, S is eligible to reconvert the amount in Traditional IRA 2 once (but no more than once) at any time on or before December 31, 1999. Any additional reconversion of that amount during 1999 would be an excess reconversion.

This notice is intended to clarify and supplement the guidance provided in the proposed regulations under § 408A and may be relied upon as if it were incorporated in those regulations. In accordance with the procedures for submitting comments on the proposed regulations, interested parties are invited to submit comments on whether final regulations should permit reconversions (and, if so, under what circumstances and conditions). Possible approaches to reconversions in final regulations might include providing that a taxpayer is not eligible to reconvert an amount before the end of the taxable year in which the amount was first converted (or the due date for that taxable year) or that a taxpayer who transfers a converted amount back to a traditional IRA in a recharacterization must wait until the passage of a fixed number of days (e.g., 30 or 60 days) before reconverting. Additionally, such approaches might include providing

that an excess reconversion would be treated as a failed conversion that would be subject to the consequences described in proposed regulations § 1.408A-4, Q&A-3, and that could be remedied as described therein.

DRAFTING INFORMATION

The principal authors of this notice are Roger Kuehnle of the Employee Plans Division and Cathy A. Vohs of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the Internal Revenue Service and the Treasury Department participated in its development. 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, or Ms. Vohs at (202) 622-6030 (also not toll-free).