REV. RUL. 2000-33-“Negative Election”-457 Plan

July 31, 2000

ISSUE

Will a deferred compensation plan fail to be an "eligible deferred compensation plan" described in § 457(b) of the Internal Revenue Code merely because deferrals are made under an arrangement whereby a fixed percentage of an employee's compensation is deferred on the employee's behalf under the plan unless the employee affirmatively elects to receive the amount in cash?

FACTS

County M, a political subdivision of State X, maintains Plan A, an eligible deferred compensation plan described in § 457(b). Under Plan A, any employee of County M, including a newly hired employee, may choose to enter into an agreement pursuant to which the employee's taxable compensation is reduced and deferrals to the employee's account in Plan A are credited by County M on the employee's behalf. The employee may designate a percentage of the employee's compensation as elective deferrals, subject to the limitations of § 457(b). Plan A does not permit any other type of deferrals, and no other plan of County M permits employees to make elective deferrals. Deferrals under Plan A are immediately nonforfeitable and are subject to the limitations and requirements of § 457(b).

County M proposes to implement, effective the next January 1, an automatic election feature in Plan A under which, if a newly hired or current employee has not affirmatively elected to receive cash compensation or to have at least 2 percent of compensation deferred under Plan A, his or her compensation will automatically be reduced by 2 percent, and this amount will be credited to the employee's account in Plan A. An election not to make deferrals or to defer a different percentage of compensation can be made at any time. Elections filed at a later date are effective for the month next following the date the election is filed.

In the case of a new employee, the election not to make deferrals will be effective for the first month after the individual first became an employee and for subsequent months (until superseded by a subsequent election) if filed within a reasonable period of time ending before the beginning of the month. Thus, if a new employee files an election to receive cash in lieu of making deferrals and the election is filed a reasonable period ending before the beginning of the first month after the individual first becomes an employee, then no deferrals for that (or any subsequent) month are made on the employee's behalf to Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. At the time the employee is hired, the employee will receive a notice that explains the automatic election and the employee's right to elect to have no such deferrals made under the plan or to alter the amount of those deferrals, including the procedure for exercising that right and the timing for implementation of any such election.

The proposed amendment to Plan A also provides that, with respect to current employees, if the employee files an election to receive cash in lieu of making deferrals and the election is filed during the reasonable period ending on the January 1 effective date, then no deferrals for the period beginning on or after the January 1 effective date are made on the employee's behalf under Plan A until the employee makes a subsequent affirmative election to reduce his or her compensation. At the beginning of the reasonable period ending on the January 1 effective date, each current employee receives a notice that explains the new automatic election and the employee's right to elect to have no such deferrals made under the plan or to alter the amount of those deferrals, including the procedure for exercising that right and the timing for implementation of any such election.

Thereafter, each employee is notified annually of his or her deferral percentage, and of his or her right to change the percentage or to elect not to make deferrals, including the procedure for exercising that right and the timing for implementation of any such election.

Plan A provides that deferrals will be invested in accordance with the participant's election among a broad range of investment funds held by the trustee of Plan A or, if no investment election is made by a participant, in the trust's balanced fund which includes both diversified equity and fixed income investments.

LAW AND ANALYSIS

Section 457(a) provides that in the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or other beneficiary.

Section 457(b) defines the term "eligible deferred compensation plan." Section 457(b)(4) and § 1.457-2(g) of the Income Tax Regulations provide that an "eligible deferred compensation plan" must provide that compensation will be deferred for any calendar month only if an agreement providing for the deferral has been entered into before the beginning of such month.

No provision of § 457(b) limits deferrals under an eligible plan to elective or voluntary deferrals, nor do the provisions of § 457(b) (including the limitations of § 457(b)(2) and (3)) distinguish between elective or voluntary deferrals and other types of deferrals. See Notice 87-13, Q &A 26, 1987-1 C.B. 432, 444. In the case of these other types of deferrals, the requirements of § 457(b)(4) are satisfied without the employee entering into an agreement to defer compensation. Rather, the obligation of the employer (or the obligation of the employee as a condition of employment) satisfies § 457(b)(4).

Similarly, the automatic election procedure described above will not cause a plan to fail the requirements of § 457(b)(4). In the absence of an affirmative election to the contrary entered into before the beginning of the month, deferrals with respect to compensation for the month will be made pursuant to the automatic election procedure. Alternatively, if an employee makes an affirmative election to change the automatic election and receive a corresponding amount in cash, the employee's affirmative election will govern any deferrals for the month. In either case, the deferrals for a month with respect to an employee are clearly established before the beginning of the month, and the requirements of § 457(b)(4) are satisfied.

HOLDING

Where, as under the proposed amendment to Plan A, the obligation to make deferrals with respect to an employee's compensation for a month is established before the beginning of a month by either an automatic election or by an agreement to alter the terms of the automatic election and receive cash in lieu of making deferrals, an eligible deferred compensation plan will satisfy the requirements of § 457(b)(4).

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue ruling has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1695.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue ruling is in the third, fourth, and fifth paragraphs in the section headed "FACTS". The collection of information is necessary to ensure that the increased retirement savings due to automatic enrollment is truly voluntary. The collection of information is needed to obtain a benefit. The likely respondents are state and local governmental entities, and to a lesser extent, not-for-profit organizations.

The estimated total annual reporting burden is 500 hours. The estimated average annual burden per respondent is 1 hour. The estimated number of respondents is 500. The estimated annual frequency of responses is on occasion.

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.

DRAFTING INFORMATION

The principal author of this revenue ruling is John Tolleris of the Office of Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact him at (202) 622-6060 (not a toll free number).

Announcement 2000-60 Automatic Enrollment Features in Prototype Section 401(k) Plans

Automatic Enrollment Features in Prototype Section 401(k) Plans

July 31, 2000

The Service would like to bring to the attention of prototype plan sponsors and employers that currently maintain, or are considering adopting, § 401(k) plans the availability of automatic enrollment features in pre-approved § 401(k) plans. In general, § 401(k) plans that have automatic enrollment features reportedly have had significantly higher employee participation rates than § 401(k) plans without such features.

Under an automatic enrollment feature in an employer's § 401(k) plan, a participant's compensation is automatically reduced by a specified percentage, and that amount is contributed as an elective contribution on the participant's behalf to the plan, unless the participant affirmatively elects not to have his or her compensation reduced or to have it reduced by a different amount. See Rev. Rul. 2000-8, 2000-7 I.R.B. 617 (February 14, 2000).

The Service "pre-approves" certain tax-qualified retirement plans, including § 401(k) plans, under the Service's prototype plan program, which is set forth in Rev. Proc. 2000-20, 2000-6 I.R.B. 553. Prototype plans are submitted by sponsors to the Service for review for compliance with applicable laws and procedures. Sponsors, who may be financial institutions or others, offer their Service-approved prototype plans to employers to adopt for the benefit of employees.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

Current Developments- 401(a)(31), Distributions and Roth IRA

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Relief From Disqualification for Plans Accepting Rollovers-Final regulations under section 401(a)(31)

65 FR 21312

DATE: Friday, April 21, 2000

ACTION: Final regulations.

SUMMARY:

This document contains final regulations under section 401(a)(31) of the Internal Revenue Code. These final regulations provide specific rules that grant relief from disqualification to an eligible retirement plan that inadvertently accepts an invalid rollover contribution. The final regulations also clarify that it is not necessary for a distributing plan to have a favorable IRS determination letter in order for a plan administrator of a receiving plan to reach a reasonable conclusion that a contribution is a valid rollover contribution.

DATES: These regulations are effective on April 21, 2000.

FOR FURTHER INFORMATION CONTACT: Pamela R. Kinard, (202) 622-6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On September 22, 1995, the Treasury Department and the IRS published in the Federal Register (60 FR 49199) Final Income Tax Regulations (TD 8619) under sections 401(a)(31) and 402(c). The final regulations provide guidance for complying with the Unemployment Compensation Amendments of 1992 (UCA). A proposed amendment to the regulations (REG-245562-96) under section 401(a)(31) was published in the Federal Register (61 FR 49279) on September 19, 1996. The 1996 proposed regulations under sections 401(a)(31) and 402(c) expand and clarify the guidance previously issued in the Final Income Tax Regulations. On December 17, 1998, an amendment to the proposed regulations (REG-245562-96) under section

401(a)(31) was published in the Federal Register (63 FR 69584). This amendment to the proposed regulations was issued in response to the congressional directive in section 1509 of Taxpayer Relief Act of 1997 (TRA '97), which directs the IRS to issue guidance clarifying that it is not necessary for a distributing plan to have a favorable IRS determination letter in order for a plan administrator of a [*21313] receiving plan to reasonably conclude that a contribution is a valid rollover contribution. Written comments responding to the 1996 proposed regulations were received. There were no written comments responding to the 1998 amendment to the proposed regulations. No public hearing was requested or held. After consideration of the comments, the amended proposed regulations under section 401(a)(31) are adopted by this Treasury decision.

Explanation of Provisions and Summary of Comments

A. RELIEF FROM DISQUALIFICATION

The final regulations under section 401(a)(31) of the Internal Revenue Code provide that an eligible retirement plan which accepts a direct rollover from another plan will not fail to satisfy section 401(a) or 403(a) merely because the plan making the distribution is, in fact, not qualified under section 401(a) or 403(a) at the time of the distribution if, prior to accepting the rollover, the plan administrator of the receiving plan reasonably concluded that the distributing plan was qualified under section 401(a) or 403(a).

The proposed regulations clarify and expand upon this relief. Under the proposed regulations, an eligible retirement plan that accepts an invalid rollover contribution, whether as a direct rollover or as a rollover contribution other than a direct rollover, will be treated, for purposes of section 401(a) or 403(a), as accepting a valid rollover contribution, if the plan administrator of the receiving plan satisfies two conditions. First, when accepting the rollover contribution, the plan administrator of the receiving plan must reasonably conclude that the rollover contribution is a valid rollover contribution. Second, if the plan administrator of the receiving plan later determines that the rollover contribution was an invalid rollover contribution, the plan must distribute the amount of the invalid rollover contribution, plus earnings attributable thereto, to the employee within a reasonable period of time.

B. DOCUMENTATION OFFERED AS EVIDENCE TO SUPPORT A REASONABLE CONCLUSION

The 1996 proposed regulations do not mandate any particular documentation or procedures that a plan administrator must use in order to reach a reasonable conclusion that a rollover contribution is a valid rollover contribution. The 1996 proposed regulations contain a series of examples to illustrate the types of documentation and procedures that would be sufficient to support a reasonable conclusion. In each example, the employee making the rollover contribution provides the plan administrator of the receiving plan with a letter from the plan administrator of the distributing plan stating that the distributing plan has received an IRS determination letter indicating that the distributing plan is qualified under section 401(a).

Several commentators stated that the examples in the 1996 proposed regulations appear to imply that the acknowledgment of the receipt of a favorable IRS determination letter by a distributing plan is a prerequisite to a plan administrator of a receiving plan reaching a reasonable conclusion that a rollover contribution is a valid rollover contribution. Commentators argued that the public policy goal of pension portability would be impeded if an eligible retirement plan is subject to complex administrative procedures when accepting rollover contributions. These concerns were addressed in the 1998 amendment to the proposed regulations implementing the congressional directive in section 1509 of TRA '97. That amendment clarifies that it is not necessary for a distributing plan to have a favorable IRS determination letter in order for a plan administrator of a receiving plan to reach a reasonable conclusion that a contribution is a valid rollover contribution. In addition, an example was added to the proposed regulations in which an employee does not provide a statement from the distributing plan administrator that the distributing plan has received a favorable IRS determination letter, but instead the employee provides a statement from the distributing plan administrator relating to the qualification of the distributing plan. In the preamble to the 1998 amendment to the proposed regulations, it is stressed that none of the examples in the proposed regulations are intended to describe the only types of information that a plan administrator can find to be sufficient and the examples are not intended to preclude reliance on other types of information, such as opinions or statements regarding the plan's qualification provided by appropriate professionals with expertise in plan qualification requirements.

C. MISCELLANEOUS COMMENTS

One commentator stated that both Examples 1 and 3 in the proposed regulations, which provide that Employee A will not have attained age 70 1/2 by the end of the year in which the rollover contribution will occur, imply that if an employee were age 70 1/2 or older, a rollover option would be unavailable. This implication was not intended. The fact was included merely to illustrate the more common scenario of an employee who is under age 70 1/2 and rolls over a retirement plan distribution.

Some commentators proposed that guidance is needed regarding the procedures for correcting invalid rollover contributions. One commentator suggested that relief, similar to that provided to plans receiving invalid rollover contributions, should also be afforded to plans receiving assets and liability transfers in the event that a transferor's plan does not satisfy the qualification requirements under the Code. These comments will be taken into account in developing future guidance priorities.

Special Analyses

It has been determined that this Treasury decision 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, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

DRAFTING INFORMATION

The principal author of these regulations is Pamela R. Kinard, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in their development.
List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 31

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 31 are amended as follows: [*21314]

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

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

Par. 2. Section 1.401(a)(31)-1 is amended as follows:

1. Under the heading "List of Questions," redesignating Q-14 through Q-18 as Q-15 through Q-19, respectively, and adding new Q-14.

2. Under the heading "Questions and Answers," removing the paragraph designation (a) and the paragraph heading, and removing paragraph (b) from A-13.

3. Under the heading "Questions and Answers," redesignating Q&A-14 through Q&A-18 as Q&A-15 through Q&A-19, respectively, and adding new Q&A-14.

4. Under the heading "Questions and Answers," removing the language "Q&A-15" in the fourth sentence of the newly designated A-16 and adding "Q&A-16" in its place.

5. Under the heading "Questions and Answers," removing the language "Q&A-17" in the first sentence of the newly designated A-18 and adding "Q&A-18" in its place.

The additions read as follows:

§ 1.401(a)(31)-1 -- Requirement to offer direct rollover of eligible rollover distributions; questions and answers.

* * * * *

List of Questions
* * * * *

Q-14. If a plan accepts an invalid rollover contribution, whether or not as a direct rollover, how will the contribution be treated for purposes of applying the qualification requirements of section 401(a) or 403(a) to the plan?

* * * * *

Questions and Answers

* * * * *

Q-14. If a plan accepts an invalid rollover contribution, whether or not as a direct rollover, how will the contribution be treated for purposes of applying the qualification requirements of section 401(a) or 403(a) to the plan?

A-14.

(a) Acceptance of invalid rollover contribution. If a plan accepts an invalid rollover contribution, the contribution will be treated, for purposes of applying the qualification requirements of section 401(a) or 403(a) to the receiving plan, as if it were a valid rollover contribution, if the following two conditions are satisfied. First, when accepting the amount from the employee as a rollover contribution, the plan administrator of the receiving plan reasonably concludes that the contribution is a valid rollover contribution. While evidence that the distributing plan is the subject of a determination letter from the Commissioner indicating that the distributing plan is qualified would be useful to the receiving plan administrator in reasonably concluding that the contribution is a valid rollover contribution, it is not necessary for the distributing plan to have such a determination letter in order for the receiving plan administrator to reach that conclusion. Second, if the plan administrator of the receiving plan later determines that the contribution was an invalid rollover contribution, the amount of the invalid rollover contribution, plus any earnings attributable thereto, is distributed to the employee within a reasonable time after such determination.

(b) Definitions. For purposes of this Q&A-14:

(1) An invalid rollover contribution is an amount that is accepted by a plan as a rollover within the meaning of § 1.402(c)-2, Q&A-1 (or as a rollover contribution within the meaning of section 408(d)(3)(A)(ii)) but that is not an eligible rollover distribution from a qualified plan (or an amount described in section 408(d)(3)(A)(ii)) or that does not satisfy the other requirements of section 401(a)(31), 402(c), or 408(d)(3) for treatment as a rollover or a rollover contribution.

(2) A valid rollover contribution is a contribution that is accepted by a plan as a rollover within the meaning of § 1.402(c)-2, Q&A-1 or as a rollover contribution within the meaning of section 408(d)(3) and that satisfies the requirements of section 401(a)(31), 402(c), or 408(d)(3) for treatment as a rollover or a rollover contribution.

(c) Examples. The provisions of paragraph (a) of this Q&A-14 are illustrated by the following examples:

Example 1.

(i) Employer X maintains for its employees Plan M, a profit sharing plan qualified under section 401(a). Plan M provides that any employee of Employer X may make a rollover contribution to Plan M. Employee A is an employee of Employer X, will not have attained age 700 1/2 by the end of the year, and has a vested account balance in Plan O (a plan maintained by Employee A's prior employer). Employee A elects a single sum distribution from Plan O and elects that it be paid to Plan M in a direct rollover.

(ii) Employee A provides the plan administrator of Plan M with a letter from the plan administrator of Plan O stating that Plan O has received a determination letter from the Commissioner indicating that Plan O is qualified.

(iii) Based upon such a letter, absent facts to the contrary, a plan administrator may reasonably conclude that Plan O is qualified and that the amount paid as a direct rollover is an eligible rollover distribution.

Example 2.

(i) The facts are the same as Example 1, except that, instead of the letter provided in paragraph (ii) of Example 1, Employee A provides the plan administrator of Plan M with a letter from the plan administrator of Plan O representing that Plan O satisfies the requirements of section 401(a) (or representing that Plan O is intended to satisfy the requirements of section 401(a) and that the administrator of Plan O is not aware of any Plan O provision or operation that would result in the disqualification of Plan O).

(ii) Based upon such a letter, absent facts to the contrary, a plan administrator may reasonably conclude that Plan O is qualified and that the amount paid as a direct rollover is an eligible rollover distribution.

Example 3.

(i) Same facts as Example 1, except that Employee A elects to receive the distribution from Plan O and wishes to make a rollover contribution described in section 402 rather than a direct rollover.

(ii) When making the rollover contribution, Employee A certifies that, to the best of Employee A's knowledge, Employee A is entitled to the distribution as an employee and not as a beneficiary, the distribution from Plan O to be contributed to Plan M is not one of a series of periodic payments, the distribution from Plan O was received by Employee A not more than 60 days before the date of the rollover contribution, and the entire amount of the rollover contribution would be includible in gross income if it were not being rolled over.

(iii) As support for these certifications, Employee A provides the plan administrator of Plan M with two statements from Plan O. The first is a letter from the plan administrator of Plan O, as described in Example 1, stating that Plan O has received a determination letter from the Commissioner indicating that Plan O is qualified. The second is the distribution statement that accompanied the distribution check. The distribution statement indicates that the distribution is being made by Plan O to Employee A, indicates the gross amount of the distribution, and indicates the amount withheld as Federal income tax. The amount withheld as Federal income tax is 20 percent of the gross amount of the distribution. Employee A contributes to Plan M an amount not greater than the gross amount of the distribution stated in the letter from Plan O and the contribution is made within 60 days of the date of the distribution statement from Plan O.

(iv) Based on the certifications and documentation provided by Employee A, absent facts to the contrary, a plan administrator may reasonably conclude that Plan O is qualified and that the distribution otherwise satisfies the requirements of section 402(c) for treatment as a rollover contribution.

Example 4.

(i) (i) The facts are the same as in Example 3, except that, rather than contributing the distribution from Plan O to Plan M, Employee A contributes the distribution from Plan O to IRA P, an individual retirement account described in [*21315] section 408(a). After the contribution of the distribution from Plan O to IRA P, but before the year in which Employee A attains age 70 1/2, Employee A requests a distribution from IRA P and decides to contribute it to Plan M as a rollover contribution. To make the rollover contribution, Employee A endorses the check received from IRA P as payable to Plan M.

(ii) In addition to providing the certifications described in Example 3 with respect to the distribution from Plan O, Employee A certifies that, to the best of Employee A's knowledge, the contribution to IRA P was not made more than 60 days after the date Employee A received the distribution from Plan O, no amount other than the distribution from Plan O has been contributed to IRA P, and the distribution from IRA P was received not more than 60 days earlier than the rollover contribution to Plan M.

(iii) As support for these certifications, in addition to the two statements from Plan O described in Example 3, Employee A provides copies of statements from IRA P. The statements indicate that the account is identified as an IRA, the account was established within 60 days of the date of the letter from Plan O informing Employee A that an amount had been distributed, and the opening balance in the IRA does not exceed the amount of the distribution described in the letter from Plan O. There is no indication in the statements that any additional contributions have been made to IRA P since the account was opened. The date on the check from IRA P is less than 60 days before the date that Employee A makes the contribution to Plan M.

(iv) Based on the certifications and documentation provided by Employee A, absent facts to the contrary, a plan administrator may reasonably conclude that Plan O is qualified and that the contribution by Employee A is a rollover contribution described in section 408(d)(3)(A)(ii) that satisfies the other requirements of section 408(d)(3) for treatment as a rollover contribution.

* * * * *

Par. 3. Section 1.402(c)-2 is amended as follows:

1. Section 1.402(c)-2 is amended by adding a sentence to the end of A-11.

2. Under the heading "List of Questions," removing the language "§ 1.401(a)(31)-1, Q&A-17" in Q-15 and adding "§ 1.401(a)(31)-1, Q&A-18" in its place.

3. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-15" in the third sentence of A-9(a) and adding "§ 1.401(a)(31)-1, Q&A-16" in its place.

4. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-15" in the introductory text of A-9(c) and adding "§ 1.401(a)(31)-1, Q&A-16" in its place.

5. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-15" in the last sentence of Example 1 (b) of A-9(c) and adding "§ 1.401(a)(31)-1, Q&A-16" in its place.

6. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-16" in the last sentence of A-10(b) and adding "§ 1.401(a)(31)-1, Q&A-17" in its place.

7. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-17" in the last sentence of A-14 and adding "§ 1.401(a)(31)-1, Q&A-18" in its place.

8. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-17" in Q-15 and adding "§ 1.401(a)(31)-1, Q&A-18" in its place.

9. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-17" in the third sentence of A-15 and adding "§ 1.401(a)(31)-1, Q&A-18" in its place.

The addition reads as follows:

§ 1.402(c)-2 -- Eligible rollover distributions; questions and answers.

* * * * *

A-11. * * * See § 1.401(a)(31)-1, Q&A-14, for guidance concerning the qualification of a plan that accepts a rollover contribution.

* * * * *

§ 1.403(b)-2 -- [Amended]

Par. 4. Section 1.403(b)-2 is amended as follows:

1. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-14" in the next to last sentence of A-2(a) and adding "§ 1.401(a)(31)-1, Q&A-15" in its place.

2. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-18" in the second sentence of A-4(a)(1) and adding "§ 1.401(a)(31)-1, Q&A-19" in its place.

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX

AT SOURCE

Par. 5. The authority citation for part 31 continues to read in part as follows:

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

§ 31.3405(c)-1 -- [Amended]

Par. 6. Section 31.3405(c)-1 is amended as follows:
1. Under the heading "Questions and Answers," removing the language "Q&A-17 of § 1.401(a)(31)-1" in the next to last sentence of A-10(a) and adding "Section 1.401(a)(31)-1, Q&A-18" in its place.

2. Under the heading "Questions and Answers," removing the language "§ 1.401(a)(31)-1, Q&A-16" in the third sentence of A-13 and adding "§ 1.401(a)(31)-1, Q&A-17" in its place.

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Approved: April 6, 2000.

Jonathan Talisman,

Acting Assistant Secretary of the Treasury (Tax Policy).

Notice 2000-11 SAFE HARBOR EXPLANATION - CERTAIN QUALIFIED PLAN DISTRIBUTIONS

February 7, 2000

PURPOSE

This notice contains a "Safe Harbor Explanation" that plan administrators may provide to recipients of eligible rollover distributions from qualified plans in order to satisfy § 402(f) of the Internal Revenue Code. It is an updated version of the Safe Harbor Explanation that was published in Notice 92-48, 1992-2 C.B. 377.

BACKGROUND

Section 402(f) requires a plan administrator to provide a written explanation to any recipient of a payment that could be rolled over (an "eligible rollover distribution") to an individual retirement arrangement described in Code § 408(a) or (b) ("traditional IRA") or to a qualified employer plan described in Code § 401(a) or an annuity described in Code § 403(a) ("qualified employer plan"). The written explanation must cover the direct rollover rules, the mandatory income tax withholding on distributions not directly rolled over, and the tax treatment of distributions not rolled over (including the special tax treatment available for certain lump sum distributions). Section 402(f) provides that this explanation must be given within a reasonable period of time before the plan makes an eligible rollover distribution.

Section 521(d) of the Unemployment Compensation Amendments of 1992, P.L. 102-318 (UCA) directed the Secretary of the Treasury to develop a model explanation that could be used to satisfy the requirements of § 402(f) of the Code, as amended. The model explanation was originally published as Notice 92-48 and is referred to in that Notice as a Safe Harbor Explanation.

This updated notice is being issued to reflect changes made to the Code and Income Tax Regulations that affect the information provided in the Safe Harbor Explanation. The Small Business Job Protection Act of 1996, P.L. 104-188, section 1401(a), amended Code § 401(a)(9) to alter the rules relating to the commencement of minimum required distributions and also amended Code § 402(d) to eliminate the special five-year averaging tax treatment for lump sum distributions (although transition rules retain ten-year special averaging for individuals who satisfy certain requirements). The Internal

Revenue Service Restructuring and Reform Act of 1998 ("RRA"), P.L. 105-206, section 3436, amended Code § 72(t) to provide an additional exception to the early withdrawal tax for tax levies on qualified plans. RRA, section 6005(c)(2)(A), also amended Code § 402(c)(4) to provide that certain hardship distributions are not eligible for rollover.

Temporary and Proposed Income Tax Regulations under Code §§ 401(a)(31), 402(f), 403(b) and 3405(c), which were published in conjunction with Notice 92-48, have since been finalized. Final regulations under Code §§ 402(c) and 3405(c) now address withholding on employer securities and the treatment of plan loan offset amounts, and new regulations have been published under Code § 401(a)(31), and also under § 402(f) (relating to paperless technologies).

SAFE HARBOR AND ALTERNATIVE EXPLANATION

This notice contains an updated model written explanation ("Safe Harbor Explanation") that meets the requirements of Code § 402(f) if it is provided to the recipient of an eligible rollover distribution within a reasonable period of time before the distribution is made. In general, under § 1.402(f)-1 of the regulations, a reasonable period of time for providing an explanation is no less than 30 days and no more than 90 days before the date on which a distribution is made.

In using the Safe Harbor Explanation, a plan administrator may "customize" the Safe Harbor Explanation by omitting any portion that could not apply to the plan. For example, if the plan does not hold after-tax employee contributions, the paragraph headed "Non-taxable Payments" could be eliminated. Similarly, if the plan does not provide for distributions of employer stock or other employer securities, the paragraph headed "Employer Stock or Securities" could be eliminated. Other paragraphs that may not be relevant to a particular plan include, for example, "Payments Spread Over Long Periods," "Direct Rollover of a Series of Payments," "Special Tax Treatment," "Hardship Distributions," and "Repayment of Plan Loans." In addition, a plan administrator may provide additional information with the Safe Harbor Explanation, if the information is not inconsistent with the Safe Harbor Explanation.

Alternatively, a plan administrator can satisfy § 402(f) by providing distributees with an explanation that is different from the Safe Harbor Explanation. Any explanation must contain the information required by § 402(f) and must be written in a manner designed to be easily understood.

If the law governing the tax treatment of distributions or the other provisions covered by the Safe Harbor Explanation is amended after publication of this notice, the Safe Harbor Explanation will not satisfy § 402(f) to the extent that the Safe Harbor Explanation no longer accurately describes the relevant law.

EFFECT ON OTHER DOCUMENT

Notice 92-48 is obsoleted.

REQUEST FOR COMMENTS

The preamble to the proposed regulations under § 402(f) that were issued in December 1998 included an example of a summary § 402(f) notice that the Service and Treasury believe satisfies the requirements for a summary notice set forth in those proposed regulations. See 63 Fed. Reg. 70071, 70074 (December 18, 1998). The example was not intended as a model summary or as the exclusive form for such a summary. However, the Service and the Treasury believe that additional guidance providing one or more additional examples of summary notices may be appropriate. Accordingly, the Service and Treasury invite comments and suggestions from interested parties concerning the development of additional examples for use in the circumstances described in those proposed regulations. We encourage interested parties to submit examples of summary notices that may be used in the development of further guidance.

Comments related to this notice, including comments with respect to summary § 402(f) notices, can be addressed to CC:DOM:CORP:R (Notice 2000-11), 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 2000-11), 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/taxregs/comments.html.

DRAFTING INFORMATION

The principal authors of this notice are Steven Linder of the Tax Exempt and Government Entities Division (T:EP) and Amy L. Speetjens of the Office of Chief Counsel (EBEO). For further information regarding this notice, contact the Employee Plans taxpayer assistance telephone service between the hours of 1:30 and 3:30 P.M. Eastern time, Monday through Thursday by calling (202) 622-6074. Mr. Linder can be reached at (202) 622-6214. Ms. Speetjens can be reached at (202) 622-6090. (These telephone numbers are not toll-free numbers.)

TEXT OF THE SAFE HARBOR EXPLANATION

SPECIAL TAX NOTICE REGARDING PLAN PAYMENTS

This notice contains important information you will need before you decide how to receive your Plan benefits.

This notice is provided to you by [INSERT NAME OF PLAN ADMINISTRATOR] (your "Plan Administrator") because all or part of the payment that you will soon receive from the [INSERT NAME OF PLAN] (the "Plan") may be eligible for rollover by you or your Plan Administrator to a traditional IRA or another qualified employer plan. A "traditional IRA" does not include a Roth IRA, SIMPLE IRA, or education IRA.

If you have additional questions after reading this notice, you can contact your plan administrator at [INSERT PHONE NUMBER OR OTHER CONTACT INFORMATION]

SUMMARY

There are two ways you may be able to receive a Plan payment that is eligible for rollover:

(1) certain payments can be made directly to a traditional IRA or, if you choose, another qualified employer plan that will accept it ("DIRECT ROLLOVER"), or

(2) the payment can be PAID TO YOU.

If you choose a DIRECT ROLLOVER, Your payment will not be taxed in the current year and no income tax will be withheld.

Your payment will be made directly to your traditional IRA or, if you choose, to another qualified employer plan that accepts your rollover. Your Plan payment cannot be rolled over to a Roth IRA, a SIMPLE IRA, or an education IRA because these are not traditional IRAs.

I. Your payment will be taxed later when you take it out of the traditional IRA or the qualified employer plan.

If you choose to have a Plan payment that is eligible for rollover PAID TO YOU

You will receive only 80% of the payment, because the Plan Administrator is required to withhold 20% of the payment and send it to the IRS as income tax withholding to be credited against your taxes.

Your payment will be taxed in the current year unless you roll it over. Under limited circumstances, you may be able to use special tax rules that could reduce the tax you owe. However, if you receive the payment before age 59-1/2, you also may have to pay an additional 10% tax.

You can roll over the payment by paying it to your traditional IRA or to another qualified employer plan that accepts your rollover within 60 days after you receive the payment. The amount rolled over will not be taxed until you take it out of the traditional IRA, or the qualified employer plan.

1 If you want to roll over 100% of the payment to a traditional IRA or another qualified employer plan, you must find other money to replace the 20% that was withheld. If you roll over only the 80% that you received, you will be taxed on the 20% that was withheld and that is not rolled over.

MORE INFORMATION

1 PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER [ ]

I. DIRECT ROLLOVER [ ]

I. PAYMENT PAID TO YOU [ ]

I. SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES [ ]

I. PAYMENTS THAT CAN AND CANNOT BE ROLLED OVER

Payments from the Plan may be "eligible rollover distributions." This means that they can be rolled over to an IRA or to another employer plan that accepts rollovers. Payments from a plan cannot be rolled over to a Roth IRA, a SIMPLE IRA, or an education IRA. Your Plan administrator should be able to tell you what portion of your payment is an eligible rollover distribution.

THE FOLLOWING TYPES OF PAYMENTS CANNOT BE ROLLED OVER:

Non-taxable Payments. In general, only the "taxable portion" of your payment can be rolled over. If you have made "after-tax" employee contributions to the Plan, these contributions will be non-taxable when they are paid to you, and they cannot be rolled over. (After-tax employee contributions generally are contributions you made from your own pay that were already taxed.) Your Plan Administrator should be able to tell you how much of your payment is the taxable portion and how much is the after-tax employee contribution portion.

Payments Spread over Long Periods. You cannot roll over a payment if it is part of a series of equal (or almost equal) payments that are made at least once a year and that will last for

- your lifetime (or your life expectancy), or
- your lifetime and your beneficiary's lifetime (or life expectancies), or
- a period of ten years or more.

Required Minimum Payments. Beginning when you reach age 70-1/2 or retire, whichever is later, a certain portion of your payment cannot be rolled over because it is a "required minimum payment" that must be paid to you. Special rules apply if you own 5% or more of your employer.

Hardship Distributions. A hardship distribution from your employer's 401(k) plan may not be eligible for rollover. Your Plan Administrator should be able to tell you if your payment includes amounts which cannot be rolled over.

II. DIRECT ROLLOVER

A DIRECT ROLLOVER is a direct payment of the amount of your Plan benefits to a traditional IRA or another qualified employer plan that will accept it. You can choose a DIRECT ROLLOVER of all or any portion of your payment that is an eligible rollover distribution, as described in Part I above. You are not taxed on any portion of your payment for which you choose a DIRECT ROLLOVER until you later take it out of the traditional IRA or qualified employer plan. In addition, no income tax withholding is required for any portion of your Plan benefits for which you choose a DIRECT ROLLOVER.

DIRECT ROLLOVER to a Traditional IRA. You can open a traditional IRA to receive the direct rollover. If you choose to have your payment made directly to a traditional IRA, contact an IRA sponsor (usually a financial institution) to find out how to have your payment made in a direct rollover to a traditional IRA at that institution. If you are unsure of how to invest your money, you can temporarily establish a traditional IRA to receive the payment. However, in choosing a traditional IRA, you may wish to consider whether the traditional IRA you choose will allow you to move all or a part of your payment to another traditional IRA at a later date, without penalties or other limitations. See IRS Publication 590, Individual Retirement Arrangements, for more information on traditional IRAs (including limits on how often you can roll over between IRAs).

DIRECT ROLLOVER to a Plan. If you are employed by a new employer that has a qualified employer plan, and you want a direct rollover to that plan, ask the Plan Administrator of that plan whether it will accept your rollover. A qualified employer plan is not legally required to accept a rollover. If your new employer's plan does not accept a rollover, you can choose a DIRECT ROLLOVER to a traditional IRA.

DIRECT ROLLOVER of a Series of Payments. If you receive a payment that can be rolled over to a traditional IRA or another qualified employer plan that will accept it, and it is paid in a series for less than ten years, your choice to make or not make a DIRECT ROLLOVER for a payment will apply to all later payments in the series until you change your election. You are free to change your election for any later payment in the series.

III. PAYMENT PAID TO YOU

If your payment can be rolled over under Part I above and the payment is made to you in cash, it is subject to 20% income tax withholding. The payment is taxed in the year you receive it unless, within 60 days, you roll it over to a traditional IRA or another qualified employer plan that accepts rollovers. If you do not roll it over, special tax rules may apply.

Income Tax Withholding:

Mandatory Withholding. If any portion of your payment can be rolled over under Part I above and you do not elect to make a DIRECT ROLLOVER, the Plan is required by law to withhold 20% of that amount. This amount is sent to the IRS as income tax withholding. For example, if you can roll over a payment of $ 10,000, only $ 8,000 will be paid to you because the Plan must withhold $ 2,000 as income tax. However, when you prepare your income tax return for the year, you must report the full $ 10,000 as a payment from the Plan. You must report the $ 2,000 as tax withheld, and it will be credited against any income tax you owe for the year.

Voluntary Withholding. If any portion of your payment is taxable but cannot be rolled over under Part I above, the mandatory withholding rules described above do not apply. In this case, you may elect not to have withholding apply to that portion. To elect out of withholding, ask the Plan Administrator for the election form and related information.

Sixty-Day Rollover Option. If you receive a payment that can be rolled over under Part I above, you can still decide to roll over all or part of it to a traditional IRA or another qualified employer plan that accepts rollovers. If you decide to roll over, you must contribute the amount of the payment you received to a traditional IRA or another qualified plan within 60 days after you receive the payment. The portion of your payment that is rolled over will not be taxed until you take it out of the traditional IRA or the qualified employer plan.

You can roll over up to 100% of your payment that can be rolled over under Part I above, including an amount equal to the 20% that was withheld. If you choose to roll over 100%, you must find other money within the 60-day period to contribute to the traditional IRA or the qualified employer plan, to replace the 20% that was withheld. On the other hand, if you roll over only the 80% that you received, you will be taxed on the 20% that was withheld.

Example: The portion of your payment that can be rolled over under Part I above is $ 10,000, and you choose to have it paid to you. You will receive $ 8,000, and $ 2,000 will be sent to the IRS as income tax withholding. Within 60 days after receiving the $ 8,000, you may roll over the entire $ 10,000 to a traditional IRA or a qualified employer plan. To do this, you roll over the $ 8,000 you received from the Plan, and you will have to find $ 2,000 from other sources (your savings, a loan, etc.). In this case, the entire $ 10,000 is not taxed until you take it out of the traditional IRA or the qualified employer plan. If you roll over the entire $ 10,000, when you file your income tax return you may get a refund of part or all of the $ 2,000 withheld.

If, on the other hand, you roll over only $ 8,000, the $ 2,000 you did not roll over is taxed in the year it was withheld. When you file your income tax return you may get a refund of part of the $ 2,000 withheld. (However, any refund is likely to be larger if you roll over the entire $ 10,000.)

Additional 10% Tax If You Are under Age 59-1/2. If you receive a payment before you reach age 59-1/2 and you do not roll it over, then, in addition to the regular income tax, you may have to pay an extra tax equal to 10% of the taxable portion of the payment. The additional 10% tax generally does not apply to (1) payments that are paid after you separate from service with your employer during or after the year you reach age 55, (2) payments that are paid because you retire due to disability, (3) payments that are paid as equal (or almost equal) payments over your life or life expectancy (or your and your beneficiary's lives or life expectancies), (4) dividends paid with respect to stock by an employee stock ownership plan (ESOP) as described in Code section 404(k), (5) payments that are paid directly to the government to satisfy a federal tax levy, (6) payments that are paid to an alternate payee under a qualified domestic relations order, or (7) payments that do not exceed the amount of your deductible medical expenses. See IRS Form 5329 for more information on the additional 10% tax.

Special Tax Treatment If You Were Born before January 1, 1936. If you receive a payment that can be rolled over under Part I and you do not roll it over to a traditional IRA or other qualified employer plan that will accept it, the payment will be taxed in the year you receive it. However, if the payment qualifies as a "lump sum distribution," it may be eligible for special tax treatment. (See also "Employer Stock or Securities", below.) A lump sum distribution is a payment, within one year, of your entire balance under the Plan (and certain other similar plans of the employer) that is payable to you after you have reached age 59-1/2 or because you have separated from service with your employer (or, in the case of a self-employed individual, after you have reached age 59-1/2 or have become disabled). For a payment to be treated as a lump sum distribution, you must have been a participant in the plan for at least five years before the year in which you received the distribution. The special tax treatment for lump sum distributions that may be available to you is described below.

Ten-Year Averaging. If you receive a lump sum distribution and you were born before January 1, 1936, you can make a one-time election to figure the tax on the payment by using "10-year averaging" (using 1986 tax rates). Ten-year averaging often reduces the tax you owe.

Capital Gain Treatment. If you receive a lump sum distribution and you were born before January 1, 1936 and if you were a participant in the Plan before 1974, you may elect to have the part of your payment that is attributable to your pre-1974 participation in the Plan taxed as long-term capital gain at a rate of 20%.

There are other limits on the special tax treatment for lump sum distributions. For example, you can generally elect this special tax treatment only once in your lifetime, and the election applies to all lump sum distributions that you receive in that same year. If you have previously rolled over a distribution from the Plan (or certain other similar plans of the employer), you cannot use this special averaging treatment for later payments from the Plan. If you roll over your payment to a traditional IRA, you will not be able to use special tax treatment for later payments from the traditional IRA. Also, if you roll over only a portion of your payment to a traditional IRA, this special tax treatment is not available for the rest of the payment. See IRS Form 4972 for additional information on lump sum distributions and how you elect the special tax treatment.

Employer Stock or Securities. There is a special rule for a payment from the Plan that includes employer stock (or other employer securities). To use this special rule, 1) the payment must qualify as a lump sum distribution, as described above, except that you do not need five years of plan participation, or 2) the employer stock included in the payment must be attributable to "after-tax" employee contributions, if any. Under this special rule, you may have the option of not paying tax on the "net unrealized appreciation" of the stock until you sell the stock. Net unrealized appreciation generally is the increase in the value of the employer stock while it was held by the Plan. For example, if employer stock was contributed to your Plan account when the stock was worth $ 1,000 but the stock was worth $ 1,200 when you received it, you would not have to pay tax on the $ 200 increase in value until you later sold the stock.

You may instead elect not to have the special rule apply to the net unrealized appreciation. In this case, your net unrealized appreciation will be taxed in the year you receive the stock, unless you roll over the stock. The stock (including any net unrealized appreciation) can be rolled over to a traditional IRA or another qualified employer plan, either in a direct rollover or a rollover that you make yourself.

If you receive only employer stock in a payment that can be rolled over, no amount will be withheld from the payment. If you receive cash or property other than employer stock, as well as employer stock, in a payment that can be rolled over, the 20% withholding amount will be based on the entire amount paid to you (including the employer stock but excluding the net unrealized appreciation). However, the amount withheld will be limited to the cash or property (excluding employer stock) paid to you.

If you receive employer stock in a payment that qualifies as a lump sum distribution, the special tax treatment for lump sum distributions described above (such as 10-year averaging) also may apply. See IRS Form 4972 for additional information on these rules.

Repayment of Plan Loans. If you end your employment and have an outstanding loan from your Plan, your employer may reduce (or "offset") your balance in the Plan by the amount of the loan you have not repaid. The amount of your loan offset is treated as a distribution to you at the time of the offset and will be taxed unless you roll over an amount equal to the amount of your loan offset to another qualified employer plan or a traditional IRA within 60 days of the date of the offset. If the amount of your loan offset is the only amount you receive or are treated as having received, no amount will be withheld from it. If you receive other payments of cash or property from the Plan, the 20% withholding amount will be based on the entire amount paid to you, including the amount of the loan repayment. The amount withheld will be limited to the amount of other cash or property paid to you (other than any employer securities).

IV. SURVIVING SPOUSES, ALTERNATE PAYEES, AND OTHER BENEFICIARIES

In general, the rules summarized above that apply to payments to employees also apply to payments to surviving spouses of employees and to spouses or former spouses who are "alternate payees." You are an alternate payee if your interest in the Plan results from a "qualified domestic relations order," which is an order issued by a court, usually in connection with a divorce or legal separation. Some of the rules summarized above also apply to a deceased employee's beneficiary who is not a spouse. However, there are some exceptions for payments to surviving spouses, alternate payees, and other beneficiaries that should be mentioned.

If you are a surviving spouse, you may choose to have a payment that can be rolled over, as described in Part I above, paid in a DIRECT ROLLOVER to a traditional IRA or paid to you. If you have the payment paid to you, you can keep it or roll it over yourself to a traditional IRA but you cannot roll it over to a qualified employer plan. If you are an alternate payee, you have the same choices as the employee. Thus, you can have the payment paid as a direct rollover or paid to you. If you have it paid to you, you can keep it or roll it over yourself to a traditional IRA or to another qualified employer plan that accepts rollovers.

If you are a beneficiary other than the surviving spouse, you cannot choose a direct rollover, and you cannot roll over the payment yourself.

If you are a surviving spouse, an alternate payee, or another beneficiary, your payment is generally not subject to the additional 10% tax described in section III above, even if you are younger than age 59-1/2.

If you are a surviving spouse, an alternate payee, or another beneficiary, you may be able to use the special tax treatment for lump sum distributions and the special rule for payments that include employer stock, as described in section III above. If you receive a payment because of the employee's death, you may be able to treat the payment as a lump sum distribution if the employee met the appropriate age requirements, whether or not the employee had 5 years of participation in the Plan.

HOW TO OBTAIN ADDITIONAL INFORMATION

This notice summarizes only the federal (not state or local) tax rules that might apply to your payment. The rules described above are complex and contain many conditions and exceptions that are not included in this notice. Therefore, you may want to consult with the Plan Administrator or a professional tax advisor before you take a payment of your benefits from your Plan. Also, you can find more specific information on the tax treatment of payments from qualified retirement plans in IRS Publication 575, Pension and Annuity Income, and IRS Publication 590, Individual Retirement Arrangements.

EMPLOYEE PLANS CPE TECHNICAL TOPICS FOR 2001

These publications are available from your local IRS office, on the IRS's Internet Web Site at www.irs.gov, or by calling 1-800-TAX-FORMS.

FEDERAL REGISTER
Vol. 65, No. 139

Rules and Regulations

DEPARTMENT OF THE TREASURY
Internal Revenue Service (IRS)

26 CFR Parts 1 and 31

[TD 8891]
RIN 1545-AW59

Final Regulations-Increase In Cash-Out Limit Under Sections 411(a)(7), 411(a)(11), and417(e)(1) for Qualified Retirement Plans

65 FR 44679; Treas. Dec. Int. Rev. 8891

DATE: Wednesday, July 19, 2000

ACTION: Final regulations.

SUMMARY:

This document contains final regulations relating to the increase from $ 3,500 to $ 5,000 of the limit on distributions from qualified retirement plans that can be made without participant or spousal consent. This increase is contained in the Taxpayer Relief Act of 1997. In addition, these regulations eliminate the "lookback rule" pursuant to which certain qualified plan benefits are deemed to exceed this limit on involuntary distributions. The final regulations affect sponsors and administrators of qualified retirement plans, and participants in those plans.

DATES: Effective Date: These regulations are effective October 17, 2000.

Applicability Date: These regulations generally apply to distributions made on or after October 17, 2000.

FOR FURTHER INFORMATION CONTACT: Robert Walsh, (202) 622-6090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 21, 1998, a notice of proposed rulemaking (REG-113694-98) was published in the Federal Register (63 FR 70356) regarding the "cash-out limit" under sections 411(a)(7), 411(a)(11), and 417(e)(1) of the Internal Revenue Code. That same day, temporary and final regulations (TD 8794) were published in the Federal Register (63 FR 70335) which amended the Income Tax Regulations and the Employment Tax Regulations (26 CFR parts 1 and 31) relating to the increase in the cash-out limit enacted by section 1071 of the Taxpayer Relief Act of 1997, Public Law 105-34, 111 Stat. 788 (1997) (TRA '97). The text of the temporary regulations served as a portion of the text of the proposed regulations. Very few comments were submitted on the proposed regulations; no hearing was requested or held. After consideration of the comments, these final regulations adopt the provisions of the proposed regulations.

Explanation of Provisions

The temporary regulations made several changes to the cash-out rules under sections 411(a)(7), 411(a)(11), and 417(e)(1). In accordance with section 1071 of TRA '97, the temporary regulations increased the cash-out limit from $ 3,500 to $ 5,000. Thus, a qualified plan can generally distribute vested accrued benefits valued at $ 5,000 or less without participant or spousal consent. The temporary regulations also provided that, for purposes of section 411(a)(7)(B)(i), an involuntary distribution of an employee's vested accrued benefit valued at $ 5,000 or less could be treated as made due to termination of the employee's participation if the distribution could have been made at termination of [*44680] participation but for the fact that the benefit was then valued at more than $ 3,500. Finally, the temporary regulations amended § 1.411(a)-11(c)(3) to eliminate the "lookback rule" for distributions other than those made pursuant to an optional form of benefit under which at least one scheduled periodic distribution remained payable. Prior to this amendment, the lookback rule in § 1.411(a)-11(c)(3) provided that the present value of a vested accrued benefit was deemed to exceed the cash-out limit if it had exceeded the cash-out limit at the time of any previous distribution. The temporary regulations did not change the parallel lookback rule under § 1.417(e)-1(b)(2)(i).

The proposed regulations generally included the provisions of the temporary regulations, but they also proposed the complete removal (on a prospective basis) of the lookback rule under both § 1.411(a)-11(c)(3) and 1.417(e)-1(b)(2)(i). Thus, under the proposed regulations, the lookback rule would be eliminated both for plans subject to the spousal-consent provisions of sections 401(a)(11) and 417 and for plans not subject to those provisions. Under this removal of the lookback rule, a participant's vested accrued benefit valued at $ 5,000 or less could be distributed without consent even if the benefit had been valued at more than $ 5,000 at the time of a previous distribution. However, in accordance with section 417(e)(1), the proposed regulations also provided that, in the case of plans subject to sections 401(a)(11) and 417, consent would be required after the annuity starting date for the immediate distribution of the present value of an accrued benefit being distributed in any form, including a qualified joint and survivor annuity or a qualified preretirement survivor annuity, regardless of the amount of that present value.

Very few comments were received on the proposed regulations. One commentator inquired whether a cash-out could be made of a benefit presently valued at $ 4,500 that had been valued at $ 4,000 upon termination of the employee's employment more than two years earlier. As indicated in the preamble to the final and temporary regulations published with the proposed regulations, that benefit could be cashed out.

Another commentator indicated support for the content of the proposed regulations but expressed concern about the rule, derived from section 417(e)(1), prohibiting a cashout after the annuity starting date of a benefit being distributed in any form by a plan subject to sections 401(a)(11) and 417. The commentator observed that, under section 417(f)(2)(A), the annuity starting date for a benefit payable upon termination of employment in non-annuity form could be the date of termination. The commentator argued that the rule in the proposed regulations prohibiting a cashout after the annuity starting date could be read to preclude a cashout of a non-annuity benefit payable at termination, regardless of the present value of that benefit. To address this, the commentator urged the IRS and Treasury to redefine "annuity starting date" such that a cashout would be permitted as long as a benefit remains immediately distributable (that is, until the later of normal retirement age or age 62).

The provision in the proposed regulations prohibits a cashout after the annuity starting date of a benefit "being distributed in any form." The rule does not apply to any benefit that is not yet "being distributed"-that is, to any benefit with respect to which no payment has been made. If the present value of a benefit payable on or after termination of employment does not exceed the cashout limit, the rule of section 417(e)(1), as set forth in the proposed regulations, would not prohibit a cashout prior to the date on which a payment is first made (disregarding, obviously, the cashout payment itself). Thus, no change has been made to the regulations on this point.

Another commentator objected to the complete elimination of the lookback rule under the proposed regulations. The commentator cited three reasons for its opposition: first, that an amount distributed in a hardship or other type of distribution remains part of a participant's benefit; second, that a participant could manipulate a distribution in order to evade the spousal-consent requirements; and, third, that permitting cash-outs after a hardship or other distribution is contrary to the policy of discouraging non-retirement distributions.

In contrast, a comment received prior to the issuance of the proposed regulations noted problems faced by plan administrators due to the lookback rule. The commentator noted, for example, that if a plan provides for hardship distributions, the plan administrator must review its records to determine the value of the participant's benefits at the time of any prior distribution. The commentator added that this can be particularly difficult and costly where plans sponsored by other employers have merged into the plan.

The commentator further stated that the cash-out provisions are designed to allow plans to reduce their administrative costs by making lump sum payments to participants with small benefits and that the lookback rule is contrary to that design because the rule

(1) makes it more costly for administrators to determine whether the provisions apply and

(2) can prevent a plan from relying on the provisions in many cases where the value of the participant's current benefit is well below $ 5,000.

After consideration of the comments, the IRS and Treasury have decided to adopt the regulation eliminating the lookback rule as proposed. The IRS and Treasury believe that the statutory cash-out provisions represent a balancing of the interests of participants in maintaining their benefits in qualified plans with the reasonable administrative needs of plan sponsors and administrators. The lookback rule prevents plans from cashing out a benefit currently valued below the cash-out limit simply because it had been valued above the cash-out limit at the time of an earlier distribution. This creates disparity in the treatment of benefits of equivalent value and requires plans to incur additional recordkeeping and other administrative costs.

The IRS and Treasury note that removal of the lookback rule is unlikely to present significant opportunities for participants to evade the spousal-consent rules. In the case of any plan subject to the spousal-consent provisions of sections 401(a)(11) and 417, a distribution that draws a participant's accrued benefit from a value above the cash-out limit to a value at or below the cash-out limit will itself require spousal consent. Furthermore, these final regulations strengthen the spousal-consent rules by clarifying that a plan subject to sections 401(a)(11) and 417 may not distribute a benefit after the annuity starting date without consent. This prohibition on cash-outs after the annuity starting date, which is statutory in source, applies without regard to the value of the benefit at the annuity starting date and without regard to the distribution form.

Finally, the IRS and Treasury note that concerns about non-retirement distributions of benefits are mitigated by the availability of rollovers. In almost all cases, an amount distributed from a qualified plan in a cash-out distribution will be an eligible rollover distribution that can be paid directly (or indirectly, through a 60-day rollover) to another qualified retirement plan or individual retirement arrangement. [*44681]

Special Analyses

It has been determined that this Treasury decision 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 AdministrativeProcedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Robert M. Walsh, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.
List of Subjects

26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 31 are amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for § 1.411(a)-7T and by adding a new entry in numerical order to read in part as follows:

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

§ 1.411(a)-7 also issued under 26 U.S.C. 411(a)(7)(B)(i). * * *

Par. 2. Section 1.411(a)-7 is amended as follows:

1. Paragraph (d)(4)(i) is revised;

2. Paragraphs (d)(4)(vi) and (d)(4)(vii) are added.

The revision and additions read as follows:

§ 1.411(a)-7 -- Definitions and special rules.

* * * * *

(d) * * *

(4) Certain cash-outs of accrued benefits -(i) Involuntary cash-outs. For purposes of determining an employee's right to an accrued benefit derived from employer contributions under a plan, the plan may disregard service performed by the employee with respect to which-

(A) The employee receives a distribution of the present value of his entire nonforfeitable benefit at the time of the distribution;

(B) The requirements of section 411(a)(11) are satisfied at the time of the distribution;

(C) The distribution is made due to the termination of the employee's participation in the plan; and

(D) The plan has a repayment provision which satisfies the requirements of paragraph (d)(4)(iv) of this section in effect at the time of the distribution.

* * * * *

(vi) For purposes of paragraph (d)(4)(i) of this section, a distribution shall be deemed to be made due to the termination of an employee's participation in the plan if it is made no later than the close of the second plan year following the plan year in which such termination occurs, or if such distribution would have been made under the plan by the close of such second plan year but for the fact that the present value of the nonforfeitable accrued benefit then exceeded the cash-out limit in effect under § 1.411(a)-11(c)(3)(ii). For purposes of determining the entire nonforfeitable benefit, the plan may disregard service after the distribution, as illustrated in paragraph (d)(2)(i) of this section.

(vii) Effective date. Paragraphs (d)(4)(i) and (vi) of this section apply to distributions made on or after March 22, 1999. However, an employer is permitted to apply paragraphs (d)(4)(i) and (vi) of this section to plan years beginning on or afterAugust 6, 1997. Otherwise, for distributions prior to March 22, 1999, §§ 1.411(a)-7 and 1.411(a)-7T, in effect prior to October 17, 2000 (as contained in 26 CFR part 1, revised as of April 1, 2000) apply.

* * * * *

§ 1.411(a)-7T -- [Removed]

Par. 3. Section 1.411(a)-7T is removed.

Par. 4. Section 1.411(a)-11 is amended by revising paragraph (c)(3) to read as follows:

§ 1.411(a)-11 -- Restriction and valuation of distributions.

* * * * *

(c) * * *

(3) Cash-out limit. (i) Written consent of the participant is required before the commencement of the distribution of any portion of an accrued benefit if the present value of the nonforfeitable total accrued benefit is greater than the cash-out limit in effect under paragraph (c)(3)(ii) of this section on the date the distribution commences. The consent requirements are deemed satisfied if such value does not exceed the cash-out limit, and the plan may distribute such portion to the participant as a single sum. Present value for this purpose must be determined in the same manner as under section 417(e); see § 1.417(e)-1(d).

(ii) The cash-out limit in effect for a date is the amount described in section 411(a)(11)(A) for the plan year that includes that date. The cash-out limit in effect for dates in plan years beginning on or after August 6, 1997, is $ 5,000. The cash-out limit in effect for dates in plan years beginning before August 6, 1997, is $ 3,500.

(iii) Effective date. Paragraphs (c)(3)(i) and (ii) of this section apply to distributions made on or after October 17, 2000. However, an employer is permitted to apply the $ 5,000 cash-out limit described in paragraph (c)(3)(ii) of this section to plan years beginning on or after August 6, 1997. Otherwise, for distributions prior to October 17, 2000, §§ 1.411(a)-11 and 1.411(a)-11T in effect prior to October 17, 2000 (as contained in 26 CFR Part 1 revised as of April 1, 2000) apply.

* * * * *

§ 1.411(a)-11T -- [Removed]

Par. 5. Section 1.411(a)-11T is removed.

Par. 6. Section 1.417(e)-1 is amended by revising the last sentence of paragraph (b)(2)(i) and by adding new paragraph (b)(2)(iii) to read as follows:

§ 1.417(e)-1 -- Restrictions and valuations of distributions from plans subject to sections 401(a)(11) and 417.

* * * * *

(b) * * *

(2) * * * (i) * * * After the annuity starting date, consent is required for the immediate distribution of the present value of the accrued benefit being distributed in any form, including a qualified joint and survivor annuity or a qualified preretirement survivor annuity, regardless of the amount of such present value.

* * * * *

(iii) Paragraph (b)(2)(i) of this section applies to distributions made on or after October 17, 2000. For distributions prior to October 17, 2000, § 1.417(e)-1(b)(2)(i) in effect prior to October 17, 2000 (as [*44682] contained in 26 CFR part 1 revised as of April 1, 2000) applies.

* * * * *

PARTS 1 AND 31--[AMENDED]

Par. 7. In the table below, for each section indicated in the left column, remove the language in the middle column and add the language in the right column:

Section	Remove	Add
1.401(a)-20, Q&A-8, paragraph (d), first sentence	**§ 1.411(a)-11T(c)(3)(ii)**	**§ 1.411(a)-11(c)(3)(ii).**
1.401(a)-20, Q&A-24, paragraph (a)(1), fourth sentence	**§ 1.411(a)- 1T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii).**
1.401(a)(4)-4, paragraph (b)(2)(ii)(C)).	**§ 1.411(a)- 11T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii)**
1.401(a)(26)-4,paragraph (d)(2), last sentence	**§ 1.411(a)- 11T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii).**
1.401(a)(26)-6,paragraph (c)(4), first sentence	**§ 1.411(a)- 1T(c)(3)(ii).**	**§ 1.411(a)- 11(c)(3)(ii)**
1.411(a)-11, paragraph (b),first sentence	**§ 1.411(a)-) 1T(c)(3)(ii)**	**paragraph (c)(3)(ii of this section**
1.411(a)-11, paragraph (c)(7), third sentence	**§ 1.411(a)-)11T(c)(3)(ii).**	**paragraph (c)(3)(ii of this section**
1.411(d)-4, Q&A-2, paragraph (b)(2)(v), second, third, and fourth sentences	**§ 1.411(a)- 11T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii).**
1.411(d)-4, Q&A-4, paragraph(a), eighth sentence	**§ 1.411(a)- 11T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii).**
1.417(e)-1, paragraph (b)(2)(i), first, fourth, and fifth sentences	**§ 1.411(a)- 11T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii).**
31.3121(b)(7)-2, paragraph (d)(2)(i), last sentence	**§ 1.411(a)- 11T(c)(3)(ii)**	**§ 1.411(a)- 11(c)(3)(ii).**

Robert E. Wenzel,

Deputy Commissioner of Internal Revenue.

Jonathan Talisman,

Deputy Assistant Secretary of the Treasury (Tax Policy).

[FR Doc. 00-18119 Filed 7-18-00; 8:45 am]

BILLING CODE 4830-01-U

Notice 2000-32 Eligible Rollover Distributions

June 26, 2000

I. PURPOSE

This notice provides additional relief relating to the exception to the definition of eligible rollover distribution for certain hardship distributions. This exception was added to §§ 402(c)(4) and 403(b)(8)(B) of the Internal Revenue Code (the "Code") by § 6005(c)(2)(A) and (B) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206 ("RRA 98"). Transition relief and guidance relating to the exception was initially provided in Notice 99-5, 1999-3 I.R.B. 10. In response to comments from representatives of plan sponsors and recordkeepers regarding their significant difficulties in implementing certain requirements of Notice 99-5, this notice provides permanent relief to sponsors of qualified plans where records pertaining to pre-1989 contributions are unavailable, and also provides transition relief to sponsors of both qualified plans and § 403(b) annuities from certain other requirements of Notice 99-5.

II. BACKGROUND

Section 401(a)(31) requires a qualified plan to permit distributees to elect to have an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee.

Section 403(b)(10) provides that a § 403(b) annuity must meet requirements similar to the requirements of § 401(a)(31).

Section 402(c)(4) generally provides that any distribution of all or any portion of the balance to the credit of an employee in a qualified plan is an eligible rollover distribution. However, as exceptions to this general rule, that section specifies certain distributions that are not eligible rollover distributions.

Prior to amendment by RRA 98, the only exceptions to the definition of eligible rollover distribution provided for in § 402(c) were any distribution that is one of a series of substantially equal periodic payments made for certain periods, any distribution to the extent such distribution is required under § 401(a)(9), and any distribution that is not includible in gross income (determined without regard to the exclusion for net unrealized appreciation described in § 402(e)(4)).

Section 403(b)(8) provides that rules similar to those in § 402(c)(4) apply for purposes of determining the amount eligible for rollover from a § 403(b) annuity.

Section 1.403(b)-2, Q&A-1 provides that an eligible rollover distribution from a § 403(b) annuity is an eligible rollover distribution described in § 402(c)(4) and § 1.402(c)-2, except that the distribution is from a § 403(b) annuity rather than a qualified plan.

Section 6005(c)(2)(A) of RRA 98 added § 402(c)(4)(C) to the Code, which specifies an additional exception to the definition of eligible rollover distribution for any hardship distribution described in § 401(k)(2)(B)(i)(IV), effective for distributions after December 31, 1998. Section 6005(c)(2)(B) of RRA 98 amended § 403(b)(8)(B) of the Code to include a specific reference to § 402(c)(4)(C). Thus, the new exception also applies to distributions from § 403(b) annuities.

Section 401(k)(2)(B)(i) provides that contributions made under a qualified cash or deferred arrangement ("CODA") are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 401(k)(2)(B)(i)(IV), an employee's elective contributions may be distributed upon the hardship of the employee. Section 1.401(k)-1(d)(2)(ii) provides that qualified nonelective and qualified matching contributions that were treated as elective contributions, plus earnings on these contributions and on elective contributions, credited to an employee's account as of a date specified in the plan containing the qualified CODA (which date generally was required to be before July 1, 1989) may also be distributed upon the hardship of the employee. The date described in the preceding sentence is hereinafter referred to as the "'89 date" and the amounts described in the preceding sentence are hereinafter referred to as "pre-'89 401(k) amounts." Contributions not made under a qualified CODA, such as matching contributions or profit-sharing contributions, are not described in § 401(k)(2)(B)(i)(IV).

Sections 403(b)(1) and 403(b)(11) provide that amounts contributed pursuant to a salary reduction agreement for years beginning after December 31, 1988, are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 403(b)(11)(B), such amounts may be distributed upon the hardship of the employee. Amounts held in an annuity contract described in § 403(b)(1) as of the close of the last year beginning before January 1, 1989, and amounts contributed to the contract as nonelective employer contributions are generally not subject to distribution restrictions.

Sections 403(b)(7) and 403(b)(11) provide that amounts contributed to a custodial account described in § 403(b)(7) are not permitted to be distributed earlier than the occurrence of certain specified events. Under §§ 403(b)(7) and 403(b)(11), contributions made pursuant to a salary reduction agreement, as well as any other amounts held in the custodial account as of the close of the last year beginning before January 1, 1989, may be distributed upon the hardship of the employee.

Notice 99-5 provided transition relief from the requirements of § 6005(c)(2)(A) and (B) of RRA 98 by permitting qualified plans and § 403(b) annuities to treat those distributions made in calendar year 1999 that would have been eligible rollover distributions under § 402(c)(4) immediately prior to its amendment by RRA 98 as eligible rollover distributions for all purposes under the Code.

Notice 99-5 also provided that, for purposes of § 6005(c)(2)(A) and (B) of RRA 98, "a hardship distribution described in § 401(k)(2)(B)(i)(IV)" includes only amounts described in § 1.401(k)-1(d)(2)(ii), including pre-'89 401(k) amounts, and does not include amounts that are distributable under the Code without regard to the hardship of the employee. Similar rules were provided with respect to § 403(b) annuities. In addition, Notice 99-5 provided that if another event occurs, such as the employee's separation from service or attainment of age 59 1/2, so that distribution of an amount is permitted under the Code, without regard to hardship, no amount distributed after that event is ineligible for rollover treatment on account of being a hardship distribution described in § 401(k)(2)(B)(i)(IV). Lastly, Notice 99-5 provided that if a portion of a distribution that includes a hardship distribution is not includible in gross income, the portion of the distribution that is not includible in gross income is first allocated to the hardship distribution. Notice 99-5 provided that the above rules were first applicable to distributions made after December 31, 1999.

III. DEFINITIONS

For purposes of this notice, a " § 403(b) annuity" includes an annuity contract, a custodial account, and a retirement income account described in § 403(b) (see § 1.403(b)-2, Q&A-1) and a "qualified plan" is an employees' trust described in § 401(a) that is exempt from tax under § 501(a) or an annuity plan described in § 403(a) (see § 1.402(c)-2, Q&A-2).

IV. RELIEF

Representatives of plan sponsors and recordkeepers have raised concerns about certain of the requirements of Notice 99-5. Those representatives indicated that, in many cases, plan records were inadequate to comply with the requirement that amounts treated as ineligible for rollover by reason of RRA 98 be limited to the amount described in § 1.401(k)-1(d)(2)(ii), particularly with respect to pre-'89 401(k) amounts. In addition, it was stated that, in light of the extensive revisions to computer systems required to prevent "Y2K" problems, plan sponsors and recordkeepers were unable to modify their systems to comply with certain other requirements of Notice 99-5 by January 1, 2000, the date transition relief under Notice 99-5 became no longer available.

In response to these concerns, the requirements of Notice 99-5 are modified as follows:

Pre-'89 401(k) Amounts. As noted, under Notice 99-5, amounts that are ineligible for rollover by reason of § 6005(c)(2)(A) of RRA 98 are limited to amounts described in § 1.401(k)-1(d)(ii), including pre-'89 401(k) amounts. Concerns have been raised that, in many instances, plan records do not make it possible to distinguish pre-'89 401(k) amounts from other amounts credited to an employee's account as of the '89 date.

Accordingly, if a qualified plan's records are not reasonably available to segregate an employee's pre-'89 401(k) amounts from other amounts that, as of the '89 date, were credited to the employee's account, then, for purposes of determining what is an eligible rollover distribution, the plan must treat the other amounts as described in § 401(k)(2)(B)(i)(IV). That is, the other amounts are treated the same as pre-'89 401(k) amounts and elective contributions and are therefore treated as ineligible for rollover when distributed on account of hardship.

Satisfaction of Another Statutory Distributable Event. Notice 99-5 provides that, if another event occurs, such as the employee's separation from service or attainment of age 59 1/2, so that distribution of an amount is permitted under § 401(k)(2)(B), § 403(b)(7) or § 403(b)(11) without regard to hardship, no amount distributed after that event is ineligible for rollover treatment on account of being a hardship distribution described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11). Plan sponsors and recordkeepers indicated to the Service that, in many instances, their systems are unable to track whether a distribution made on account of hardship under the terms of the plan might also be distributable under another statutory provision.

Therefore, as an alternative to the rule in Notice 99-5, until further guidance is issued, a distribution that is described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11) and that is made as a hardship distribution under the terms of a qualified plan or § 403(b) annuity may be treated as ineligible for rollover even though another event has occurred that could entitle the recipient to a distribution without regard to hardship under § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11). Thus, for example, if a profit-sharing plan containing a qualified CODA provides that in-service distributions are available only upon hardship, an in-service distribution made to a participant aged 62 may, to the extent of elective contributions and other amounts described in § 1.401(k)-1(d)(2)(ii) (including amounts described in (i) above that are treated as pre-'89 401(k) amounts), be treated as ineligible for rollover. Alternatively, if the rule in Notice 99-5 is followed, the distribution in this example to the age-62 participant may be treated as eligible for rollover.

Allocation of Basis. The plan sponsor and recordkeeper community also raised concerns about the feasibility of timely programming their systems to follow the basis allocation rules of Notice 99-5. Therefore, until further guidance is issued, if a portion of a hardship distribution from a qualified plan or a § 403(b) annuity is not includible in gross income, the portion of the distribution that is not includible in gross income may be allocated to the portion ineligible for rollover or the portion eligible for rollover (or between the two portions) using any reasonable method.

A qualified plan or § 403(b) annuity generally must, in applying the above rules, be consistent in the treatment of all distributions.

V. EFFECT ON OTHER DOCUMENTS

Notice 99-5 is modified.

VI. DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of the Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' 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.

Notice 99-5-Eligible Rollover Distributions

1999-1 C.B. 411;

January 19, 1999

I. PURPOSE

This notice provides transition relief and guidance relating to the exception to the definition of eligible rollover distribution for certain hardship distributions. This exception was added to § 402(c)(4) and 403(b)(8)(B) of the Internal Revenue Code (the "Code") by § 6005(c)(2)(A) and (B) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. 105-206 ("RRA 98"). The transition relief responds to significant comment activity evidencing the inability of many plan administrators and taxpayers to adjust their systems to accommodate the new exception by January 1, 1999. In general, the relief granted allows both § 401(a) plans and § 403(b) annuities to delay implementation of the exception as it applies to distributions occurring before January 1, 2000.

II. BACKGROUND

Section 401(a)(31) requires a plan to permit distributees to elect to have an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee.

Section 403(b)(10) provides that a § 403(b) annuity must meet requirements similar to the requirements of § 401(a)(31).

Section 402(c)(4) generally provides that any distribution of the balance to the credit of an employee is an eligible rollover distribution. However, as exceptions to this general rule, that section specifies certain distributions of the balance to the credit of an employee that are not eligible rollover distributions.

Prior to amendment by RRA 98, the exceptions to the definition of eligible rollover distribution provided for in § 402(c) were limited to any distribution that is one of a series of substantially equal periodic payments, any distribution to the extent such distribution is required under § 401(a)(9), and any distribution that is not includible in gross income (determined without regard to the exclusion for net unrealized appreciation described in § 402(e)(4)).

Section 403(b)(8) provides that rules similar to those in § 402(c)(4) apply for purposes of determining the amount eligible for rollover from a § 403(b) annuity. Section 1.403(b)-2, Q&A-1 provides that an eligible rollover distribution from a § 403(b) annuity is an eligible rollover distribution described in § 402(c)(4) and § 1.402(c)-2, except that the distribution is from a § 403(b) annuity rather than a qualified plan.

Section 6005(c)(2)(A) of RRA 98 added § 402(c)(4)(C) to the Code, which specifies an additional exception to the definition of eligible rollover distribution for any hardship distribution described in § 401(k)(2)(B)(i)(IV), effective for distributions after December 31, 1998. Section 6005(c)(2)(B) of RRA 98 amended § 403(b)(8)(B) of the Code to include a specific reference to § 402(c)(4)(C). Thus, the new exception also applies to distributions from § 403(b) annuities.

Section 401(k)(2)(B)(i) provides that contributions made under a qualified cash or deferred arrangement ("CODA") are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 401(k)(2)(B)(i)(IV), an employee's elective contributions may be distributed upon the hardship of the employee. Section 1.401(k)-1(d)(2)(ii) provides that certain amounts, including earnings, credited to an employee's account as of a date specified in the plan containing the qualified CODA (which date generally was required to be before July 1, 1989) may also be distributed upon the hardship of the employee. Contributions not made under a qualified CODA, such as matching contributions or profit-sharing contributions that are not qualified nonelective contributions or qualified matching contributions, are not described in § 401(k)(2)(B)(i)(IV).

Sections 403(b)(1) and 403(b)(11) provide that amounts contributed pursuant to a salary reduction agreement for years beginning after December 31, 1988, are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 403(b)(11)(B), such amounts may be distributed upon the hardship of the employee. Amounts held in an annuity contract described in § 403(b)(1) as of the close of the last year beginning before January 1, 1989, and amounts contributed to the contract as nonelective employer contributions are generally not subject to distribution restrictions.

Sections 403(b)(7) and 403(b)(11) provide that amounts contributed to a custodial account described in § 403(b)(7) are not permitted to be distributed earlier than the occurrence of certain specified events. Under § 403(b)(7) and 403(b)(11), contributions made pursuant to a salary reduction agreement, as well as any other amounts held in the custodial account as of the close of the last year beginning before January 1, 1989, may be distributed upon the hardship of the employee.

III. DEFINITIONS

For purposes of this notice, a "§ 403(b) annuity" includes an annuity contract, a custodial account, and a retirement income account described in § 403(b) (see § 1.403(b)-2, Q&A-1) and a "qualified plan" is an employees' trust described in § 401(a) that is exempt from tax under § 501(a) or an annuity plan described in § 403(a) (see § 1.402(c)-2, Q&A-2).

IV. TRANSITION RELIEF

Concerns have been raised by a significant number of plan administrators and recordkeepers about the infeasibility of changing plan systems in time to comply with the new exception to the definition of eligible rollover distribution. Comments have referred to the fact that frequently an amount that is a hardship distribution described in § 401(k)(2)(B)(i)(IV) or § 403(b) is distributed in combination with other amounts that are eligible for rollover under § 402(c). Many plan administrators and recordkeepers have indicated that it is not possible for them, in time for distributions to be made in 1999, both to develop systems to reflect the change in treatment for the portion of a distribution that is no longer eligible for rollover because it is a hardship distribution described in § 401(k)(2)(B)(i)(IV) and to develop procedures to explain this change to distributees.

In response to these concerns, for distributions during calendar year 1999, the Service and Treasury will allow any distribution from a qualified plan or § 403(b) annuity to be treated as an eligible rollover distribution within the meaning of § 402(c)(4) for all purposes under the Code to the extent that the distribution would have been an eligible rollover distribution under the definition of eligible rollover distribution under § 402(c)(4) immediately prior to its amendment by RRA 98. However, a qualified plan or § 403(b) annuity is permitted to determine the amount of any eligible rollover distribution in 1999 using the definition of eligible rollover distribution in § 402(c)(4) as amended by RRA 98. The use of the amended definition by the qualified plan or § 403(b) annuity in 1999 will not affect the eligibility of a distributee to determine the portion of the distribution that is an eligible rollover distribution using the definition in effect under § 402(c)(4) prior to its amendment by RRA 98, if the distributee chooses to roll over the distribution within 60 days pursuant to § 402(c) or § 403(b)(8).

V. HARDSHIP DESCRIBED IN SECTION 401(k)(2)(B)(i)(IV)

For distributions after December 31, 1999, the following rules apply to hardship distributions described in § 401(k)(2)(B)(i)(IV):

A. The portion of a distribution from a qualified plan that is ineligible for rollover treatment because it is "a hardship distribution described in § 401(k)(2)(B)(i)(IV)" is the amount described in § 1.401(k)-1(d)(2)(ii). Similarly, the portion of a distribution from a custodial account described in § 403(b)(7) made on account of hardship that is ineligible for rollover treatment is the amount of contributions made pursuant to a salary reduction agreement increased by any other amounts held in the custodial account as of the close of the last year beginning before January 1, 1989. However, in the case of an annuity contract described in § 403(b)(1), the portion of a hardship distribution that is ineligible for rollover treatment is the amount of contributions made pursuant to a salary reduction agreement in years beginning after December 31, 1988, and does not include amounts held in the contract as of the close of the last year beginning before January 1, 1989, or amounts attributable to nonelective employer contributions (because both of these amounts are distributable without regard to the hardship of the employee).

B. If another event occurs, such as the employee's separation from service or attainment of age 59 1/2, so that distribution of an amount is permitted, without regard to hardship, under § 401(k)(2)(B), § 403(b)(7) or § 403(b)(11), no amount distributed after that event is ineligible for rollover treatment on account of being a hardship distribution described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11). This rule applies regardless of whether the qualified plan or § 403(b) annuity characterizes the distribution as a hardship distribution described in § 401(k)(2)(B)(i)(IV), § 403(b)(7) or § 403(b)(11).

C. If a portion of a distribution that includes a hardship distribution is not includible in gross income, the portion of the distribution that is not includible in gross income is first allocated to the hardship distribution and then any remaining portion not includible in gross income is allocated to the portion of the distribution that is not a hardship distribution.

VI. REMEDIAL AMENDMENT PERIOD

Some plans may contain provisions that conflict with the definition of eligible rollover distribution in § 402(c)(4) of the Code as amended by § 6005(c)(2) of RRA 98. If these plans choose to comply in operation with the amended definition in 1999, they are not required to conform plan language to the amended definition prior to the date set forth below.

Section 1.401(b)-1T(b)(3) authorizes the Commissioner to designate a plan provision as a disqualifying provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements or (2) is integral to a qualification requirement that has been changed. Section 1.401(b)-1T(c)(3) authorizes the Commissioner, in the case of a disqualifying provision designated as described in the preceding sentence, to impose limits and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision.

Pursuant to § 1.401(b)-1T(b)(3) and (c)(3), a plan provision is hereby designated as a disqualifying provision if the plan provision is integral to the requirements of § 401(a)(31), but only to the extent such provision is amended to reflect the change made by § 6005(c)(2) of RRA 98, provided that the following conditions are satisfied. First, the plan provision must be amended to reflect the change made by § 6005(c)(2) of RRA 98 by no later than the last day of the first plan year beginning after December 31, 1998. (If an employer or plan administrator files a request for a determination letter on the qualified status of a plan by the last day of the first plan year beginning after December 31, 1998, then the date by which the plan provision must be amended shall be extended through the 91st day following the applicable date under § 1.401(b)-1(e)(3)(i) or (ii).) Second, the plan provision as amended must be effective as of the first day the plan operates in accordance with the change made by § 6005(c)(2) of RRA 98.

VII. 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.

Notice 2000-30 Reporting IRA Recharacterizations and Reconversions

June 5, 2000

I. PURPOSE

This notice specifies a new method to be used by IRA trustees, issuers and custodians (hereinafter referred to as "trustees") for reporting IRA recharacterizations and reconversions occurring after 2000. The new method is similar to current reporting practices and is designed to ensure consistent reporting among trustees. This notice does not otherwise affect the reporting rules governing conversions, contributions to or distributions from IRAs.

II. BACKGROUND

A. RECHARACTERIZATIONS AND RECONVERSIONS

A "recharacterization" is a trustee-to-trustee transfer, made in accordance with § 408A(d)(6) of the Internal Revenue Code and the regulations thereunder, of a contribution (or a portion of a contribution), plus earnings, from one IRA (the "FIRST IRA") to another IRA (the "SECOND IRA"). A properly recharacterized contribution is treated, for Federal tax purposes, as a contribution made to the SECOND IRA, instead of to the FIRST IRA. Recharacterizations are permitted only between different types of IRAs; for example, from a traditional IRA to a Roth IRA and vice versa. See § 1.408A-5 of the Income Tax Regulations.

A "conversion" is the transfer, by rollover or other means, of an amount in a nonRoth IRA to a Roth IRA. A "nonRoth IRA" is an individual retirement account or annuity described in § 408(a) or (b), other than a Roth IRA. Any converted amount is treated as a distribution from the nonRoth IRA and a rollover to the Roth IRA. See § 1.408A-4, Q&A-1.

A "reconversion" is a conversion from a nonRoth IRA to a Roth IRA of an amount that had previously been recharacterized as a contribution to the nonRoth IRA after having been earlier converted to a Roth IRA.

In general, a recharacterization of a contribution must be 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. (See §§ 1.408A-5, Q&A-1(b).) Section 1.408A-5, Q&A-9, sets forth special timing rules for reconversions.

B. IRA REPORTING GENERALLY

A distribution from an IRA is reported on a Form 1099-R by the trustee of the IRA from which the distribution is made. Amounts that are reported as distributions on Form 1099-R include a contribution that has been recharacterized from the FIRST IRA to the SECOND IRA. When a recharacterization occurs, the trustee of the FIRST IRA issues a Form 1099-R. The instructions to Form 1099-R provide detailed information on how the form should be completed.

A contribution to an IRA is reported on a Form 5498 by the trustee of the IRA to which the contribution is made. Contributions that are reported on Form 5498 include a contribution that has been recharacterized from the FIRST IRA to the SECOND IRA. When a recharacterization occurs, the trustee of the SECOND IRA issues a Form 5498. The instructions to Form 5498 provide detailed information on how the form should be completed.

C. PRIOR GUIDANCE ON REPORTING RECHARACTERIZATIONS AND RECONVERSIONS

Pursuant to §§ 408(i), 408A(d)(3)(D), and 6047 of the Code and § 1.408A-7 of the regulations, the Internal Revenue Service has previously issued guidance on the reporting of transactions involving IRAs, including guidance relating to the reporting of recharacterizations and reconversions. Notice 98-49, 1998-38 I.R.B. 5 (September 21, 1998), sets forth a general rule for reporting recharacterizations. Under Notice 98-49, the gross amount transferred in a recharacterization is reported by the trustee of the FIRST IRA on a Form 1099-R. That same amount is also reported by the trustee of the SECOND IRA on a Form 5498 that is separate from any Form 5498 otherwise required for the SECOND IRA.

Announcement 99-5, 1999-3 I.R.B. 16 (January 19, 1999), provides that, in lieu of the reporting method described in Notice 98-49, an alternative method of reporting may be used with respect to recharacterizations that occur in 1998 and 1999 using the same trustee. Announcement 99-106, 1999-45 I.R.B. 561 (November 8, 1999), extended the alternative method provided for in Announcement 99-5 through 2000. Announcements 99-5 and 99-106 also apply to reconversions.

III. FORMS 5498 AND 1099-R REPORTING REQUIREMENTS FOR IRA RECHARACTERIZATIONS AND RECONVERSIONS AFTER 2000

To simplify IRA administration and to enhance IRA owners' understanding of the Forms 5498 and 1099-R they receive from the financial institutions maintaining their IRAs, the Service and Treasury believe that there should be a consistent method for reporting recharacterizations and reconversions. After consideration of comments from trustees and other organizations involved in the administration of IRAs and from other interested parties, the Service and Treasury believe the following method best accommodates current industry practices and simplification of reporting these transactions.

The new reporting method generally retains the requirement of Notice 98-49 that amounts recharacterized be identified separately from other types of distributions and contributions. The new method replaces the alternative methods permitted by Announcements 99-5 and 99-106. It is effective for recharacterizations and reconversions that occur after 2000.

Each recharacterization or reconversion occurring after December 31, 2000 (including a recharacterization or reconversion of an amount contributed before January 1, 2001), whether or not using the same trustee, must be reported as provided in Forms 5498 and 1099-R and the accompanying instructions. It is anticipated that these forms and instructions will prescribe the rules set forth in A through C below.

A. FORM 1099-R REPORTING OF RECHARACTERIZATIONS BY THE TRUSTEE OF THE FIRST IRA

Gross Amount Reported. The gross amount transferred in a recharacterization (contribution plus earnings) is reported on Form 1099-R.

Prior and Current Year Recharacterizations Distinguished. Recharacterizations that occur after the year for which the contributions being recharacterized were made ("prior year recharacterizations") and recharacterizations that occur in the same year as the year for which the contributions being recharacterized were made ("same year recharacterizations") must be reported on separate Forms 1099-R. Prior year recharacterizations will be coded with the existing Code R in Box 7, while same year recharacterizations will be coded with a new code, N, in Box 7.

Because prior year recharacterizations and same year recharacterizations will be separately coded, these amounts may not be reported together on the same Form 1099-R. Similarly, because a recharacterization will have a different code than other reportable distributions, a recharacterization may not be reported together with another reportable distribution on the same Form 1099-R.

Combined Reporting of Similar Recharacterizations. All prior year recharacterizations from the same FIRST IRA must be reported together on a single Form 1099-R using Code R in Box 7. All same year recharacterizations from the same FIRST IRA must be reported on a single Form 1099-R using the new code in Box 7.

Example 1.

(i) On December 15, 2000, Taxpayer B makes an initial contribution of $ 2,000 to a traditional IRA (the FIRST IRA). On January 16, 2001, B makes another contribution to this IRA in the amount of $ 1,000 for the year 2001. On February 15, 2001, B makes another contribution to this IRA, again in the amount of $ 1,000 for the year 2001.

Pursuant to B's election, all three contributions are recharacterized as contributions to a Roth IRA (the SECOND IRA) on April 2, 2001. As of April 2, 2001, the earnings attributable to the initial contribution are $ 300, the earnings attributable to the second contribution are $ 200, and the earnings attributable to the third contribution are $ 150.

(ii) The trustee of the FIRST IRA issues B a 2001 Form 1099-R for the prior year recharacterization of the initial contribution. The gross amount of the transfer ($ 2,300) made in connection with the recharacterization of the initial contribution is shown in Box 1 and Code R is used in Box 7.

The trustee of the FIRST IRA also issues B a second 2001 Form 1099-R for the two same year recharacterizations. This Form 1099-R will show $ 2,350 (the combined gross amount of the transfers made in connection with the recharacterization of the two 2001 contributions ($ 1,000 + $ 200 + $ 1,000 + $ 150)) in Box 1 and will use the new Code N for same year recharacterizations in Box 7.

B. FORM 5498 REPORTING OF RECHARACTERIZATIONS BY THE TRUSTEE OF THE SECOND IRA

GROSS AMOUNT REPORTED.

The gross amount received in a recharacterization (contribution plus earnings) is reported on Form 5498.

Recharacterization Contributions Distinguished from Rollover Contributions. Recharacterizations will be reported in a new box on Form 5498 titled "Recharacterized contributions" (instead of in Box 2 as provided in Notice 98-49) and the checkbox titled "Rechar." will be eliminated.

Requirement of Separate Forms 5498 for each Recharacterization Eliminated. All recharacterized contributions received by an IRA in the same year are permitted to be totaled and reported on one Form 5498. Alternatively, each recharacterized contribution can be reported on a separate Form 5498.

Single Form 5498 Covering All Contributions Permitted. A single Form 5498 is permitted to be used to report all contributions (including recharacterized contributions) made to an IRA in a year. Alternatively, each contribution can be reported on a separate Form 5498.

Example 2.

(i) Taxpayer C has made two contributions to her traditional IRA (the FIRST IRA). The first contribution, in the amount of $ 2,000, was made on November 1, 2000. The second contribution, also in the amount of $ 2,000, was made on February 1, 2001, for 2001.

Pursuant to C's election, the November 1, 2000, contribution is recharacterized as a contribution to a Roth IRA (the SECOND IRA) on April 2, 2001, at which time the earnings attributable to the November 1, 2000 contribution are $ 100. Then, pursuant to C's election, the February 1, 2001, contribution is recharacterized as a contribution to the SECOND IRA on December 12, 2001, at which time the earnings attributable to the February 1, 2001, contribution are $ 850.

(ii) The trustee of the SECOND IRA issues C a single 2001 Form 5498 on which both recharacterizations are reported. That Form 5498 will show, in a new box, $ 4,950 ($ 2,000 + $ 100 + $ 2,000 + $ 850). Alternatively, consistent with Notice 98-49, the trustee of the SECOND IRA may issue two 2001 Forms 5498, one reporting $ 2,100 and one reporting $ 2,850.

C. Form 1099-R and Form 5498 Reporting of Reconversions

Reconversions are reported on Forms 1099-R and 5498 in the same manner as other conversions. The alternative method described in Announcements 99-5 and 99-106 will not be available for reconversions occurring in 2001 and thereafter.

EFFECT ON OTHER DOCUMENTS

Notice 98-49 is 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, together with the needs of the Service, to determine whether further guidance on this subject is needed.

Comments can be submitted to CC:DOM:CORP:R (Notice 2000-30), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000-30), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of Employee Plans (Tax Exempt and Government Entities Division). For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free) between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.

Notice 2000-39-EARNINGS CALCULATION FOR RETURNED OR RECHARACTERIZED IRA CONTRIBUTIONS

July 24, 2000

I. PURPOSE

This notice permits a new method to be used for calculating the net income attributable to IRA contributions made after 1999 that are distributed as a returned contribution pursuant to § 408(d)(4) of the Internal Revenue Code ("Code") or recharacterized pursuant to § 408A(d)(6). However, until further guidance is issued, net income may continue to be calculated under the existing method set forth in the Income Tax Regulations.

II. BACKGROUND

A. RETURNED CONTRIBUTIONS UNDER § 408(D)(4)

Section 408(d)(4) provides that an IRA contribution will not be included in the IRA owner's gross income when distributed as a returned contribution if (1) it is received by the IRA owner on or before the day prescribed by law, including extensions, for filing the owner's Federal income tax return for the year of the contribution, (2) no deduction is allowed with respect to the contribution, and (3) the distribution is accompanied by the amount of net income attributable to the contribution.

Section 1.408-4(c)(2)(ii) of the Income Tax Regulations prescribes the method for calculating the amount of net income attributable to a contribution distributed pursuant to § 408(d)(4). That method, referred to in this notice as the "old method," bases the calculation of the amount of net income attributable to a contribution on the income earned by the IRA during the period beginning on the first day of the taxable year in which the contribution is made and ending on the date of the distribution from the account. Under the old method, net income cannot be a negative amount.

B. RECHARACTERIZATIONS UNDER § 408A(D)(6)

Section 408A(d)(6) provides that a contribution made to one type of IRA may be recharacterized as having been made to another type of IRA if (1) the recharacterization transfer occurs on or before the date prescribed by law for filing the IRA owner's Federal income tax return for the year for which the contribution was made, (2) no deduction is allowed with respect to the contribution to the transferor IRA, and (3) the transfer is accompanied by any net income allocable to the contribution.

Section 1.408A-5, Q&A-2(c), provides that if a contribution being recharacterized is in an IRA that at any time contained other contributions, the net income attributable to the contribution being recharacterized is calculated in the manner prescribed by § 1.408-4(c)(2)(ii) (the old method), except that net income can be a negative amount. Section 1.408A, Q&A-2(b), provides that if an IRA is established with a contribution and no other contributions or distributions are made, then the subsequent recharacterization transfer of the entire account balance of the IRA will satisfy the requirement that the transfer be accompanied by any net income allocable to the contribution.

C. REQUESTS FOR ALTERNATIVE METHOD

The Internal Revenue Service has received comments that the old method for calculating net income attributable to an IRA contribution often does not reflect the actual earnings and losses of the IRA during the time it held the contribution. This is because, under the old method, account activity in the part of the year that precedes the date the contribution is made is taken into account in the calculation of the net income attributable to the contribution. In addition, IRA owners and other interested parties have indicated that net income should be permitted to be a negative amount.

In response to these comments, the Service and Treasury are providing a new method for calculating net income that generally bases the calculation of the amount of net income attributable to a contribution on the actual earnings and losses of the IRA during the time it held the contribution. Until further guidance is issued, net income may be calculated under either the new method or the old method. However, it is intended that future guidance will provide that the new method is the only method for calculating net income, and comments are requested regarding the new method and the effective date of mandatory use of the new method.

III. NEW METHOD FOR NET INCOME CALCULATION UNDER § 408(d)(4)

Under the new method, for purposes of returned contributions under § 408(d)(4), the net income attributable to a contribution made to an IRA after December 31, 1999, is determined by allocating to the contribution a pro-rata portion of the earnings accrued by the IRA during the period the IRA held the contribution. The new method is represented by the following formula:

Net Income = Contribution x Adjusted Closing Balance - Adjusted Opening Balance / Adjusted Opening Balance

The "adjusted opening balance" is the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions made to the IRA during the computation period (including the contribution that is distributed as a returned contribution pursuant to § 408(d)(4)).

The "adjusted closing balance" is the fair market value of the IRA at the end of the computation period plus the amount of any distributions made from the IRA during the computation period.

The "computation period" is the period beginning immediately prior to the time the particular contribution is made to the IRA and ending immediately prior to the removal of the contribution being returned.

For purposes of the above calculation, when an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of determining net income, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

Under the new method set forth above, net income may be a negative number.

In the case of multiple regular contributions to an IRA, the last regular contribution made to the IRA for a particular taxable year is deemed to be the contribution that is distributed as a returned contribution under § 408(d)(4), up to the amount of the contribution identified by the IRA owner as the amount distributed as a returned contribution. For purposes of this notice, a "regular contribution" is an IRA contribution made by the IRA owner that is neither a trustee-to-trustee transfer from another IRA nor a rollover from another IRA or retirement plan.

In the case of an individual who owns multiple IRAs, the net income calculation is performed only on the IRA designated by the owner as containing the contribution that is to be distributed as a returned contribution, and that IRA is the IRA that must distribute the contribution.

Under the new method described above, if an IRA is established with a contribution and no other contributions or distributions are made to or from that IRA, then the subsequent distribution of the entire account balance of the IRA pursuant to § 408(d)(4) will satisfy the requirement of that Code section that the return of a contribution be accompanied by the amount of net income attributable to the contribution.

The following examples illustrate the new method net income calculation under § 408(d)(4):

EXAMPLE 1.

(i) On May 1, 2000, when her IRA is worth $ 4,800, Taxpayer A makes a $ 1,600 regular contribution to her IRA. Taxpayer A requests that $ 400 of the May 1, 2000, contribution be returned to her pursuant to § 408(d)(4). Pursuant to this request, on February 1, 2001, when the IRA is worth $ 7,600, the IRA trustee distributes to Taxpayer A the $ 400 plus attributable net income. During this time, no other contributions have been made to the IRA and no distributions have been made.

(ii) The adjusted opening balance is $ 6,400 [$ 4,800 + $ 1,600] and the adjusted closing balance is $ 7,600. Thus, the net income attributable to the $ 400 May 1, 2000, contribution is $ 75 [$ 400 x ($ 7,600 - $ 6,400) / $ 6,400]. Therefore, the total to be distributed on February 1, 2001, pursuant to § 408(d)(4) is $ 475.

EXAMPLE 2.

(i) (i) Beginning in 2000, Taxpayer B contributes $ 200 on the 15th of each month by payroll deduction to an IRA for 2000, resulting in an excess regular contribution of $ 400 for the year. Taxpayer B requests that the $ 400 excess regular contribution be returned to her pursuant to § 408(d)(4). Pursuant to this request, on March 1, 2001, when the IRA is worth $ 16,000, the IRA trustee distributes to Taxpayer B the $ 400 plus attributable net income. The excess regular contributions to be returned are deemed to be the last two made in 2000: the $ 200 December 15 contribution, when the IRA was worth $ 12,000 immediately prior to the contribution; and the $ 200 November 15 contribution, when the IRA was worth $ 11,000 immediately prior to the contribution. No distributions have been made from the IRA and no contributions, other than the payroll deduction contributions (including $ 200 in January and February 2001), have been made.

(ii) For the December 15 contribution, the adjusted opening balance is $ 12,600 [$ 12,000 + $ 200 + $ 200 + $ 200] and the adjusted closing balance is $ 16,000. Thus, the net income attributable to the December 15 contribution is $ 54 [$ 200 x ($ 16,000 - $ 12,600) / $ 12,600]. For the November 15 contribution, the adjusted opening balance is $ 11,800 [$ 11,000 + $ 200 + $ 200 + $ 200 + $ 200] and the adjusted closing balance is $ 16,000. Thus, the net income attributable to the November 15 contribution is $ 71 [$ 200 x ($ 16,000 - $ 11,800) / $ 11,800]. Therefore, the total to be distributed as returned contributions on March 1, 2001, to correct the excess regular contribution is $ 525 [$ 200 + $ 200 + $ 54 + $ 71].

IV. NEW METHOD FOR NET INCOME CALCULATION UNDER § 408A(d)(6)

Under the new method, for purposes of recharacterizations under § 408A(d)(6), the net income allocable to a contribution made to an IRA after December 31, 1999, is determined by allocating to the contribution a pro-rata portion of the earnings accrued by the IRA during the period the IRA held the contribution. The new method is represented by the following formula:

Net Income = Contribution x Adjusted Closing Balance - Adjusted Opening Balance / Adjusted Opening Balance

The "adjusted opening balance" is the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions made to the IRA during the computation period (including the contribution that is recharacterized pursuant to § 408A(d)(6)).

The "adjusted closing balance" is the fair market value of the IRA at the end of the computation period plus the amount of any distributions made from the IRA during the computation period.

The "computation period" is the period beginning immediately prior to the time the particular contribution being recharacterized is made to the IRA and ending immediately prior to the recharacterizing transfer of the contribution.

For purposes of the above calculation, when an IRA asset is not normally valued on a daily basis, the fair market value of the asset at the beginning of the computation period is deemed to be the most recent, regularly determined, fair market value of the asset, determined as of a date that coincides with or precedes the first day of the computation period. In addition, solely for purposes of determining net income, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

In the case of an individual with multiple IRAs, the net income calculation is performed only on the IRA designated by the owner as containing the particular contribution to be recharacterized, and that IRA is the IRA from which the recharacterizing transfer must be made.

As under the old method, net income may be a negative amount. Also, as under the old method, in the case of multiple contributions made to an IRA for a particular year that are eligible for recharacterization, the IRA owner can choose (by dollar amount, not by specific assets acquired with those dollars) which contribution, or portion thereof, is to be recharacterized.

Also as under the old method, if an IRA is established with a contribution and no other contributions or distributions are made to or from that IRA, then the subsequent recharacterization transfer of the entire account balance of the IRA pursuant to § 408A(d)(6) will satisfy the requirement of that Code section that the transfer be accompanied by any net income allocable to the contribution.

The following examples illustrate the new method net income calculation under § 408A(d)(6):

EXAMPLE 3.

(i) On March 1, 2000, when her Roth IRA is worth $ 80,000, Taxpayer C makes a $ 160,000 conversion contribution to the Roth IRA. Subsequently, Taxpayer C discovers that she was ineligible to make a Roth conversion contribution in 2000 and so she requests that the $ 160,000 be recharacterized to a traditional IRA pursuant to § 408A(d)(6). Pursuant to this request, on March 1, 2001, when the IRA is worth $ 225,000, the Roth IRA trustee transfers to a traditional IRA the $ 160,000 plus allocable net income. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) The adjusted opening balance is $ 240,000 [$ 80,000 + $ 160,000] and the adjusted closing balance is $ 225,000. Thus the net income allocable to the $ 160,000 is -$ 10,000 [$ 160,000 x ($ 225,000 - $ 240,000) / $ 240,000]. Therefore, in order to recharacterize the March 1, 2000, $ 160,000 conversion contribution on March 1, 2001, the Roth IRA trustee must transfer from Taxpayer C's Roth IRA to her traditional IRA $ 150,000 [$ 160,000 - $ 10,000].

EXAMPLE 4.

(i) On April 1, 2000, when her traditional IRA is worth $ 100,000, Taxpayer D converts the entire amount, consisting of 100 shares of stock in ABC Corp. and 100 shares of stock in XYZ Corp., by transferring the shares to a Roth IRA. At the time of the conversion, the 100 shares of stock in ABC Corp. are worth $ 50,000 and the 100 shares of stock in XYZ Corp. are also worth $ 50,000. Taxpayer D decides that she would like to recharacterize the ABC Corp. shares back to a traditional IRA. However, D may choose only by dollar amount the contribution or portion thereof that is to be recharacterized. On the date of transfer, November 1, 2000, the 100 shares of stock in ABC Corp. are worth $ 40,000 and the 100 shares of stock in XYZ Corp. are worth $ 70,000. No other contributions have been made to the Roth IRA and no distributions have been made.

(ii) If D requests that $ 50,000 (which was the value of the ABC Corp. shares at the time of conversion) be recharacterized, the net income allocable to the $ 50,000 is $ 5,000 [$ 50,000 x ($ 110,000 - $ 100,000) / $ 100,000]. Therefore, in order to recharacterize $ 50,000 of the April 1, 2000, conversion contribution on November 1, 2000, the Roth IRA trustee must transfer from Taxpayer D's Roth IRA to a traditional IRA assets with a value of $ 55,000 [$ 50,000 + $ 5,000].

(iii) If, on the other hand, D requests that $ 40,000 (which was the value of the ABC Corp. shares on November 1) be recharacterized, the net income allocable to the $ 40,000 is $ 4,000 [$ 40,000 x ($ 110,000 - $ 100,000) / $ 100,000]. Therefore, in order to recharacterize $ 40,000 of the April 1, 2000, conversion contribution on November 1, 2000, the Roth IRA trustee must transfer from Taxpayer D's Roth IRA to a traditional IRA assets with a value of $ 44,000 [$ 40,000 + $ 4,000].

(iv) Regardless of the amount of the contribution recharacterized, the determination of that amount (or of the net income allocable thereto) is not affected by whether the recharacterization is accomplished by the transfer of shares of ABC Corp. or of shares of XYZ Corp.

V. REQUEST FOR COMMENTS

The Service and Treasury invite comments and suggestions concerning the new method described in this notice for calculating net income under §§ 408(d)(4) and 408A(d)(6) and also concerning the effective date for a rule that would establish the new method as the only method for calculating net income under §§ 408(d)(4) and

408A(d)(6). Any correspondence received will be evaluated, together with appropriate considerations relating to tax administration, to determine the scope of future guidance.

Comments can be submitted to CC:DOM:CORP:R (Notice 2000-39), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 2000-39), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. All comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Roger Kuehnle of Employee Plans (Tax Exempt and Government Entities Division). For further information regarding this notice, please contact the Employee Plans' 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.