

INTERNAL REVENUE SERVICE
Uniform Issue List Number: 408A.00-00

Number: **INFO 2000-0180**
Release Date: 9/30/2000

[REDACTED]
World Trade Center
Suite 253
401 E. Pratt Street
Baltimore, MD 21202-3099

Attention: [REDACTED]

Dear [REDACTED]:

This letter is in response to your correspondence of [REDACTED], on behalf of your constituent, [REDACTED]. [REDACTED] complains about his IRA trustee's or custodian's use of the method in the Income Tax Regulations (the Regulations) for calculation of the net income for a contribution being recharacterized under section 408A(d)(6) of the Internal Revenue Code. We believe the following general explanation of the way to calculate the net income for contributions being recharacterized will help you respond to [REDACTED] complaints.

Two Methods Available For Calculating Net Income For A Contribution Being Recharacterized

The net income for a contribution being recharacterized must be transferred along with the contribution and calculated using one of the methods provided in section 1.408A-5 A-2(b)&(c) of the Regulations:

- Under the first method, if the contribution being recharacterized was contributed to a separate IRA and no distributions or additional contributions have been made from or to that IRA at any time, then the contribution is recharacterized by the trustee transferring the entire account balance. In this case, the net income (or loss) for the contribution being recharacterized is the difference between the original contribution and the amount transferred.
- Under the second method, which must be used in all other cases, the net income for a contribution being recharacterized is calculated as

prescribed by section 1.408-4(c)(2)(ii) of the Regulations (disregarding the parenthetical clause in section 1.408-4(c)(2)(iii)).

Calculating Net Income For Excess Contributions

The Regulations provide the method for calculating the net income for excess contributions made to an IRA and returned before the due date of the return. To use this method to calculate the net income for a contribution being recharacterized, you substitute the term “amount of the contribution being recharacterized” for the term “excess contribution.” As modified, section 1.408-4(c)(2)(ii) provides that the amount of net income for the contribution being recharacterized bears the same ratio to the net income earned by the account during the computation period as the amount of the contribution being recharacterized bears to the balance of the account as of the first day of the taxable year in which the contribution being recharacterized is made and the total contribution made for the taxable year. The term “computation period” means the period beginning on the first day of the taxable year when the contribution being recharacterized is made and ending on the date of the transfer from the account.

Under the Regulations, as modified for recharacterizations, the net income earned by the account during the computation period is the fair market value of the balance of the account immediately after the distribution increased by the amount of distributions from the account during the computation period, and reduced by the sum of:

- The fair market value of the balance of the account as of the first day of the taxable year in which the contribution being recharacterized was made.
- The contributions to the account during the computation period [Section 1.408-4(c)(2)(iii)].

Notice 2000-39 Provides A New Method For Calculating Net Income

The Internal Revenue Service (IRS) has received comments that the second method described above does not always reflect the actual earnings and losses of the IRA during the time it held the contribution being recharacterized. Under this method, account activity in the part of the year that precedes the date the contribution being recharacterized was made is taken into account in the calculation of the net income for the contribution. In response to these comments, the IRS and Treasury have recently issued Notice 2000-39, scheduled to be published in the 2000-30 issue of the Internal Revenue Bulletin on July 24, 2000 (copy enclosed). Notice 2000-39 provides a new method for calculating net income for a contribution on the actual earnings and losses of the IRA during the time it held the contribution. However, this new method only may be used to allocate net income to a contribution made to an IRA after December 31, 1999. In any event, it is not clear that this new method would produce a significantly different result from the pre-existing method used in your constituent's case because

the contribution he recharacterized was originally made in January, rather than later in the year.

Under both the old method and new method for calculating net income, calculations are based on the overall value of an IRA and the dollar amounts contributed, distributed, and recharacterized to or from the IRA, rather than on specific investments made with a particular contribution.

I hope the information included in this letter will help you. If you have additional questions or concerns, please contact me at (202) 622-6010 or Cathy Vohs of my staff at (202) 622-6090 (not toll-free numbers).

Sincerely,

MARY OPPENHEIMER
Assistant Chief Counsel
Office of the Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)

Enclosure