DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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[redacted]

Dear [redacted]:

This letter is in response to your correspondence of [redacted], asking whether the IRS has issued any guidance subsequent to Notice 2000-39, 2002-2 C.B. 132, regarding the method(s) used to calculate net income attributable to an IRA contribution that is being removed under section 408(d)(4) of the Internal Revenue Code (the "Code").

Under Code section 408(d)(4), an IRA contribution (including a Roth IRA contribution) will not be included in the IRA owner's gross income when distributed as a returned contribution if certain conditions are met. One of these conditions is that 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 (the old method) for calculating the amount of net income attributable to a contribution distributed pursuant to section 408(d)(4). 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. In addition, under the old rule, net income may not be negative.

The old method produced anomalous results for contributions made late in the year. 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 net income attributable to the contribution. In order to rectify these anomalous results, the IRS issued Notice 2000-39, which provides 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. Under this new method, net income can be negative. In addition, under Notice 2000-39, taxpayers are permitted to use the old or the new method.

On July 23, 2002, the IRS issued §1.408-4 of the Proposed Income Tax Regulations (67 F.R. 48067) (copy enclosed) regarding the method(s) used to calculate net income attributable to an IRA contribution that is being removed under Code section 408(d)(4). This proposed regulation incorporates, with certain minor modifications, the new methods provided in Notice 2000-39. Under this proposed regulation, the amount of net income attributable to a contribution is based on the actual earnings and losses of the IRA during the time it held the contribution. The proposed regulation also provides that a single computation period may be used in the case of multiple contributions and clarifies how transfers in and out of IRAs are treated under the new methods.

The proposed regulation is proposed to be effective for distributions made on or after January 1, 2004. For purposes of determining net income attributable to IRA contributions made during 2002 and 2003, taxpayers may continue to apply the rules set forth in Notice 2000-39 or may rely on the proposed regulations.

We hope the information included in this letter will be of assistance to you. However, this letter does not constitute a ruling on any of the matters discussed.

If you have additional questions or concerns, please contact [redacted] of my staff at [redacted].

Sincerely,
Michael J. Roach
Chief, Qualified Plans Branch 1
(Employee Benefits)
Office of the Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)