

Special Analyses

It has been determined that these final regulations are 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. Because § 1.408–11 and A–2(c) of § 1.408A–5 impose no new collection of information on small entities, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these final 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 Cathy A. Vohs of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other

personnel from the IRS and Treasury participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read in part as follows:

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

§ 1.408–4 also issued under 26 U.S.C. 408.

§ 1.408–11 also issued under 26 U.S.C. 408. * * *

■ **Par. 2.** In § 1.408–4, paragraph (c)(1) is amended by adding two sentences before the current first sentence to read as follows:

§ 1.408–4 Treatment of distributions from individual retirement arrangements.

* * * * *

(c) * * * (1) * * * The rules in this paragraph (c) apply for purposes of determining net income attributable to IRA contributions made before January 1, 2004, and returned pursuant to section 408(d)(4). The rules in § 1.408–11 apply for purposes of determining net income attributable to IRA contributions made on or after January 1, 2004, and returned pursuant to section 408(d)(4). * * *

* * * * *

■ **Par. 3.** Section 1.408–11 is added to read as follows:

§ 1.408–11 Net income calculation for returned or recharacterized IRA contributions.

(a) *Net income calculation for returned IRA contributions—*(1) *General rule.* For purposes of returned contributions under section 408(d)(4), the net income attributable to a contribution made to an IRA is determined by allocating to the contribution a *pro rata* portion of the earnings on the assets in the IRA during the period the IRA held the contribution. This attributable net income is calculated by using the following formula:

$$\text{Net Income} = \text{Contribution} \times \frac{(\text{Adjusted Closing Balance} - \text{Adjusted Opening Balance})}{\text{Adjusted Opening Balance.}}$$

(2) *Special rule.* If an IRA is established with a contribution and no other contributions, distributions or transfers are made to or from that IRA, then the subsequent distribution of the entire account balance of the IRA pursuant to section 408(d)(4) will satisfy the requirement of that Internal Revenue Code section that the return of a contribution be accompanied by the amount of net income attributable to the contribution.

(b) *Definitions.* For purposes of this section the following definitions apply:

(1) *Adjusted opening balance.* The term *adjusted opening balance* means the fair market value of the IRA at the beginning of the computation period plus the amount of any contributions or transfers (including the contribution that is distributed as a returned contribution pursuant to section 408(d)(4) and recharacterizations of contributions pursuant to section 408A(d)(6)) made to the IRA during the computation period.

(2) *Adjusted closing balance.* The term *adjusted closing balance* means the fair market value of the IRA at the end of the computation period plus the amount of any distributions or transfers

(including recharacterizations of contributions pursuant to section 408A(d)(6)) made from the IRA during the computation period.

(3) *Computation period.* The term *computation period* means the period beginning immediately prior to the time that the contribution being returned was made to the IRA and ending immediately prior to the removal of the contribution. If more than one contribution was made as a regular contribution and is being returned from the IRA, the computation period begins immediately prior to the time the first contribution being returned was contributed.

(4) *Regular contribution.* The term *regular contribution* means 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.

(c) *Additional rules.* (1) 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 this section, notwithstanding A–3 of § 1.408A–5, recharacterized contributions are taken into account for the period they are actually held in a particular IRA.

(2) In the case of an IRA that has received more than one regular contribution for a particular taxable year, the last regular contribution made to the IRA for the year is deemed to be the contribution that is distributed as a returned contribution under section 408(d)(4), up to the amount of the contribution identified by the IRA owner as the amount distributed as a returned contribution.

(3) In the case of an individual who owns multiple IRAs, the net income calculation is performed only on the IRA containing the contribution being returned, and that IRA is the IRA that must distribute the contribution.

(d) *Examples.* The following examples illustrate the net income calculation under section 408(d)(4) and this section:

Example 1. (i) On May 1, 2004, 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, 2004, contribution be returned to her