

IRALERT

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TO: IRA Group Distribution

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RE: IRA Provisions Included in House Bill to Ease Tax Burden of Military

On November 1, the House Ways and Means Committee unanimously approved H.R. 3997, the "Heroes Earnings Assistance and Relief Tax Act of 2007." This bill contains many popular provisions that were included in a bill (S.1593) introduced in the Senate earlier this year by the Chairman and Ranking Member of the Senate Finance Committee, and it enjoys bipartisan support in Congress. With similar provisions having been introduced in the Senate, the full House and Senate appear ready to act on this legislation in the very near future. Among other things, the bill contains a number of provisions that provide tax relief to members of the military and volunteer firefighters and would affect the administration of Individual Retirement Accounts and Annuities. Key provisions in the bill affecting IRAs are described below:

- **Ability to Rollover Military Death Benefits to a Roth IRA.** The legislation would permit beneficiaries who receive military death benefits to contribute (as a rollover contribution) an amount which does not exceed the death benefit to either a Roth IRA or Coverdell education savings account and not be taxed on the contribution in the event a nonqualified distribution occurs. To be eligible for this special tax treatment, the contribution must be made to the Roth IRA or Coverdell account within one year of when the beneficiary receives the military death benefit.
- **Permanent Ability to Withdraw From Qualified Retirement Savings Vehicles.** Currently, distributions from an IRA or elective deferrals from a 401(k) or 403(b) plan to a military reservist called to active duty on or after September 11, 2001 and before December 31, 2007 for more than 179 days will not be subject to the 10 percent early withdrawal penalty tax if such distributions are made during the period of active duty. These amounts can be re-contributed to an IRA on an after-tax basis over the two-year period after the reservist's active duty ends and such re-contributed amounts will not affect the annual contribution limit. While originally set to expire at the end of 2007, the proposed provision would permanently allow individuals called up to active duty (who

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serve more than 179 days) to make penalty free withdrawals and re-contributions within the two year period following active duty.

- **Treatment of Differential Pay as Wages.** Some employers make "differential payments" to reservists called up to active military service in an amount equal to the differences between their civilian compensation and military compensation. The tax treatment of these payments has been controversial. The IRS currently allows these differential payments to be the basis for pension contributions and accruals but requires that they be reported on a Form 1099 which increases the burden for both employer and employee in reporting compensation. The proposed legislation would define differential payments as wages with reporting on the employee's annual W-2 beginning after 2007. For IRA and retirement plan purposes, the legislation would clarify that these differential payments would be treated as compensation and the employer and/or employee can make contributions based on this compensation.
- **Increased 1099-R Information Return Penalties.** Currently, if certain information returns, including the 1099-R used to report IRA and plan distributions, are filed after the prescribed filing date, then the filer will be subject to a per-return penalty. The amount of the penalty varies depending on when the information return is filed, and the basic penalty is \$50 per return, subject to a maximum penalty of \$250,000 per year. The bill would increase each penalty and the applicable maximum. The basic penalty would become \$100 per return subject to a \$600,000 maximum. In addition, the bill would increase the minimum penalty for intentional disregard of the applicable information reporting requirements to \$250 per return.

Please feel free to direct questions to any of the Groom principals listed above or to IRA@groom.com.