

THE Pension Digest

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"The Pension Specialists"



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3 Last Minute IRA Law Changes

Congress enacted and President Bush signed into law on December 23, 2008 the "Worker, Retiree, And Employer Recovery Act of 2008." This last minute law for 2008 contains numerous technical corrections related to the Pension Protection Act of 2006 and a number of new tax laws relating to IRAs and pension plans.

Law Change #1 Waiver of RMDs For 2009.

In order to partially alleviate the economic crisis, Congress has enacted a one year waiver for 2009 to the law mandating that IRA accountholders, inheriting IRA beneficiaries, retirement plan participants and inheriting beneficiaries of retirement plan participants must take a required distribution. There is no required distribution for 2009 and there will be no assessment of the 50% excise tax for missed required distributions. The RMD rules for 2008 still apply and such rules will again apply for 2010 and subsequent years unless a new tax law would be enacted modifying the one year waiver.

An individual who attains age 70½ in 2009 will not be required to take his or her RMD for 2009. He or she will need to take his or her RMD for 2010 by December 31, 2010. An individual may certainly take a distribution during 2009 even though it is not a required distribution.

An individual who attains age 70½ in 2008, but who was intending to take his

or her RMD by April 1, 2009, will still be required to do so since that is the RMD deadline for 2008. There is no waiver of the 2008 RMD. He or she will not have a RMD for 2009. The next RMD will be for 2010 with a deadline of December 31, 2010. Those individuals attaining age 70½ in 2010 still have April 1, 2011 as his or her required beginning date.

An inheriting IRA beneficiary will not be required to take a RMD for 2009. If an IRA accountholder died prior to 2009, the general rule is that the inheriting IRA beneficiary will be required to take a distribution using the life distribution rule unless the five-year rule applied. If the life distribution rules applies, there is no RMD due with respect to 2009. The deadline for the next RMD would be December 31, 2010. If the five-year rule applies because the beneficiary had elected it, the five-year rule is now applied without considering 2009. For example, if an IRA accountholder had died in 2006, so the beneficiary would have been required to close the inherited IRA by December 31, 2011, he or she will now have until December 31, 2012 to close the inherited IRA. An inheriting IRA beneficiary may certainly take a distribution during 2009 even though it is not a required distribution.

As we all know, the law prohibits the rolling over of any required distribution. It does not matter if the RMD is coming from an employer plan or from an IRA. But the fact is, there is no RMD for 2009.

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Even so, the law has been written so that a plan administrator is not required to directly roll over this amount at the request of the participant and the plan administrator is not required to withhold 20% of the amount not directly rolled over. The plan administrator may elect to treat this amount as being an eligible rollover distribution. The plan administrator may also choose to withhold 20% of the amount not directly rolled over if it so chooses.

An individual who receives a distribution of such amount can rollover such amount, since it is not a required distribution, within the 60 day period.

Law Change #2

Right of a Non-spouse Beneficiary To Directly Roll Over Inherited ERP Funds To an Inherited IRA.

It is highly questionable that this law change is even necessary. Code section 402(c)(11) had been added by Congress by the Pension Protection Act of 2006. However, Code section 402(f) (the section defining the contents of the notice to be given to a participant) had not been amended. Therefore, the IRS had adopted the position in Notice 2007-7 that a distributing plan was not required to do a direct rollover on behalf of the inheriting beneficiary and it was not required to withhold 20% of the distribution amount to the extent it was not directly rolled over. An employer could choose to amend its plan but it was not required. With respect to plan years beginning after December 31, 2009, an employer will be required to directly rollover an inheriting beneficiary's funds to an inherited IRA.

Law Change #3

Special "Conversion" or Rollover of Certain Amounts to Roth IRAs Received By A Qualified Airline Employee With Respect to the Bankruptcy of Certain Airline Carriers.

Financial planners have figured out the great value of Roth IRAs; the fact that the income earned by a Roth IRA will never be taxed if certain rules are met. These planners are working hard to get funds into Roth IRAs. To the extent they can, they are lobbying Congress to change the definition of what funds qualify to be converted or contributed to a Roth IRA.

Originally, only funds within a traditional IRA could

be converted to a Roth IRA. Then the law was changed to allow funds within certain employer retirement plans to be converted to a Roth IRA. In 2008, the Emergency Economic Stabilization Act of 2008 contained provisions authorizing certain plaintiffs of the Exxon Valdez Litigation to move litigation payments into either a traditional IRA (i.e. to prevent immediate taxation) or a Roth IRA (i.e. future tax free earnings).

The change made by this law is that a qualified airline employee is eligible to contribute any portion of an airline payment amount to a Roth IRA within 180 days of receipt of such amount (or, if later, within 180 days of the law's enactment). It does not matter if such payments occurred before, on or after such date.

An airline payment amount is the payment of any money or other property by a commercial passenger airline carrier to a qualified airline employee under the approval of an order of a Federal bankruptcy court in a case filed after September 11, 2001, and before January 1, 2007, and in respect of the employee's interest in a bankruptcy claim against the carrier, any note of the carrier, an amount paid in lieu of a note being issued, or any other fixed obligation of the carrier to pay a lump sum amount. The qualifying amount is the gross amount and it is not reduced by any requirement to deduct and withhold employment and social security taxes. However, any airline payment based on the carrier's future earnings or profits does not qualify.

A qualified airline employee is any employee or former employee of a commercial airline carrier who was a participant of a defined benefit plan maintained by the carrier which was qualified under Code section 401(a) and was terminated or became subject to the restrictions contained in paragraphs (2) and (3) of section 402(b) of the Pension Protection Act of 2006.

The commercial carrier will be required to report to the IRS the names of the payment recipients and to the IRS and the employees the years and the amounts of the payments. The IRS will create the necessary reporting forms.

RMD Notice Requirement For 2009

Whatever 2009 RMD Notice(s) you were planning to send to your 70½ and older clients will no longer work. We had written eight (8) various versions of a 2009 RMD Notice. These no longer can be used. We have created two new 2009 RMD Notices to make clear to RMD clients that because of the enactment of the "Worker, Retiree, and Employer Recovery Act of 2008," there is no required distribution for 2009. Version #9 of Form 62 is to be used for living accountholders and version #10 of Form 62 for inheriting IRA beneficiaries.

We expect the IRS will be giving guidance within the next 10-15 business days on how the new law impacts an IRA custodian's RMD Notice requirements. We will keep you informed. We realize that many of you like to send your RMD Notices out the first week of January. We strongly recommend postponing the furnishing of your 2009 RMD Notices until the IRS has issued its guidance. President Bush signed this bill into law on December 23, 2008.

Until the IRS issues its guidance, here is our recommended RMD administrative approach.

An IRA custodian should still plan to furnish a 2009 RMD notice by January 31, 2009. IRS rules require the RMD notice to cover three items of information.

Item #1 – was to state the required distribution amount for 2009. This will be \$0.00.

Item #2 – was to state the deadline for a person taking his or her RMD. With the waiver, there is no deadline.

Item #3 – was to inform the IRA accountholder that the IRA custodian would be completing the 2008 Form 5498 by checking box 11 to show that the accountholder was subject to the required distribution rules for 2009.

It will be interesting to see if the IRS rules that an IRA custodian may either check box 11 because most IRA custodians will have already programmed their software to check this box or the IRS may allow the box to be left unchecked because there is no RMD for 2009. We can see the IRS adopting either approach, but we tend to think the IRS will allow the box to be checked. Since the 5498 Forms are not filed until May, there is not the time pressure there is with respect to the RMD Notice, with a due date of January 31, 2009.

You will also want to review what form or forms your 70½ and older clients have completed and then decide what administrative steps are to be taken with respect to the periodic distribution schedules they have established. The majority of your clients will have instructed you that they were to be paid only their required distribution. In this situation, you will not make any 2009 distribution to an individual unless he or she instructs that he or she wants to take a non-required distribution. You will want to communicate this approach to your clients. CWF's version #9 of Form 62 will do this.

For those 70½ and older accountholders who have established a periodic distribution schedule exceeding the RMD amount, you should continue to follow such schedule unless the individual would instruct you that he or she wished to revise the periodic distribution schedule. You will want to communicate this policy or approach also. The same two approaches apply to an inheriting IRA beneficiary. Remember that the IRS does not require an IRA custodian to send an RMD Notice to an inheriting IRA beneficiary. You do it for customer service reasons and for limiting liability reasons. We certainly recommend sending RMD Notices to beneficiaries.

Please call us if you have any questions. We will be sending our FormSystem™ clients these new versions of the Form 62 very soon. We will also have these forms available in print format in the same time frame.

Required Distribution Notice for 2009

From: IRA Custodian/Trustee (Name & Address)

Date: January 2009

┌ _____ ┐

└ _____ ┘

Telephone Number: _____

To: IRA Accountholder (Name & Address)

┌ _____ ┐

└ _____ ┘

**Your Required Distribution
Amount for 2009**

\$0.00

Due to a new tax law, you do not have a required distribution for 2009. There are no required distributions for 2009. It does not matter if you attain age 70½ in 2009 or you did so in an earlier year. The "Worker, Retiree and Employer Recovery Act of 2008" waives required minimum distributions (RMDs) for 2009. Consequently, there is no deadline for taking 2009 required distributions. The deadline for an individual who attained age 70½ prior to 2009 would have been December 31, 2009. The deadline for an individual who would have attained age 70½ during 2009 would have been April 1, 2010.

If you previously instructed us to distribute only your required distribution amount pursuant to your normal schedule, then we will not be making any IRA distribution to you during 2009. You may, however, elect to take a non-required distribution at any time. Please contact us and we will provide the appropriate distribution forms.

If you previously instructed us to distribute to you an annual amount exceeding your required distribution amount, then we will continue to follow that schedule. You will be paid your annual amount during 2009 according to your previous instructions. You should contact us if you now wish to revise your previous instruction.

If you will be attaining age 70½ during 2009, we will need you to instruct us how and when you wish to take your required distributions in future years. We normally ask that you complete for us a form titled, "Periodic Payment Instruction for Accountholders 70½ and Older." We will provide this form upon request.

Your deadline for taking your 2010 RMD amount will be December 31, 2010. We will be furnishing you with your 2010 RMD Notice in January of 2010. The standard RMD rules will apply for 2010 and subsequent years unless there would be additional tax legislation extending the waiver of required distributions.

Special Notice. IRS rules require us to notify you that we will be informing the IRS that you are subject to the required distribution rules. We do this by checking a box on the Form 5498. We will follow IRS instructions as to what should be done for the 2009 year.

Additional Discussion – See Reverse Side

IRS Reporting For IRA Revocations and IRA Closures

The purpose of this article is to discuss the guidance the IRS provides with respect to IRA revocations and IRA closures as set forth on pages 2 and 3 of the 2008 Instructions for Forms 1099-R and 5498. Although the IRS guidance on an overall basis is helpful, there are a number of situations where the IRS guidance is not as thorough as it should be.

An individual establishing a new IRA has the general right to revoke his or her IRA within the first seven days for any reason. A revocation has the effect that the individual is treated as if he or she had never established the IRA. For some time the IRS has had rules requiring the IRA custodian to report the contribution(s) made to the IRA prior to its revocation and to report the amount(s) distributed. The reporting procedures differ depending on the type of the IRA contribution made and whether the contribution was to a traditional IRA or a Roth IRA.

The financial institution acting as the IRA custodian has the right to close the account holder's IRA if it must do so because the individual has not complied with the requirements under the Customer Identification Program. A closure, like a revocation, has the effect that the individual is treated as if he or she had never established the IRA. However, the IRA custodian must report the contribution(s) made to the IRA prior to its closure and to report the amount distributed. The reporting procedures differ depending on the type of the IRA contribution made and whether the contribution was to a traditional IRA or a Roth IRA.

The instructions for Forms 1099-R and 5498 have discussed for a long time the reporting to be done when the IRA account holder revokes his or her IRA. Since an individual only has seven days to revoke the account, the actual situations arising are quite limited. The amount of earnings, if any, will normally be quite minimal. Normally, the individual will have made only one contribution and normally the contribution and the distribution occur within the same tax year. The facts associated with a closure situation can be much more complicated. It is much more likely there will be multiple contributions and two tax years involved. The IRS needs

to provide additional guidance on the multiple contributions situations and the multiple tax year situations.

IRA Revoked by IRA Accountholder

If an individual makes a regular or annual contribution to a traditional IRA and then revokes it, the IRA custodian will need to prepare a Form 5498 with respect to this traditional IRA and report the contribution in Box 1. The distribution closing the IRA will be reported as follows. The total or gross distribution amount is reported in Box 1. Either the amount of earnings will be reported in box 2a or a zero will be reported if there were no earnings. An 8 is inserted in box 7 if there were no earnings included in the total distribution or there were earnings and the individual is over age 59½. An 81 is inserted in box 7 if there were earnings included in the total and the individual is under age 59½.

If an individual makes a regular or annual contribution to a Roth IRA and then revokes it, the Roth IRA custodian will need to prepare a Form 5498 with respect to this Roth IRA and report the contribution in Box 10. The distribution closing the Roth IRA will be reported as follows. The total or gross distribution amount is reported in Box 1. Either the amount of earnings will be reported in box 2a or a zero will be reported if there were no earnings. A J is inserted in box 7 if there were no earnings included in the total distribution. A J8 is inserted in box 7 if there were earnings included in the total distribution and the individual was under age 59½. A J8 is inserted in box 7 if there were earnings included in the total distribution and the individual was age 59½ or older. If an individual makes a rollover contribution to a traditional IRA and then revokes it, the IRA custodian will need to prepare a Form 5498 with respect to this traditional IRA and report the contribution in Box 2. The distribution closing the IRA will be reported as follows. The total or gross distribution amount is reported in Boxes 1 and 2a. A 1 is inserted in box 7 if the individual has not attained age 59½. A 7 is inserted in box 7 if the individual is age 59½ or older.

If an individual makes a transfer contribution to a traditional IRA and then revokes it, the IRA custodian will NOT report this contribution on the Form 5498. However, the distribution will be reported in the same

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manner discussed above with respect to revoking a rollover contribution and withdrawing it.

If an individual makes a rollover contribution to a Roth IRA and then revokes it, the Roth IRA custodian will need to prepare a Form 5498 with respect to this Roth IRA and report the contribution in Box 2. The distribution closing the Roth IRA will be reported as follows. The total or gross distribution amount is reported in Boxes 1 and 2a. The IRS instructions state to insert a Code J in box 7. This does not seem correct. The IRS has taken the position that the distribution is to be considered taxable. It seems Code T should be used, if applicable (i.e. the individual is age 59½ or older).

If an individual makes a transfer contribution to a Roth IRA and then revokes it, the IRA custodian will NOT report this contribution on the Form 5498. However, the distribution will be reported in the same manner discussed above with respect to revoking a rollover contribution and withdrawing it.

If a contribution has been made on behalf of an individual who participates in his or her employer's SEP-IRA plan or SIMPLE IRA plan, but the individual revokes the SEP IRA or SIMPLE IRA within the 7 day period, the IRA custodian will need to prepare a Form 5498 with respect to this IRA and report the contribution in Box 8 (SEP) or Box 9 (SIMPLE) as applicable. The IRS instructions state this distribution is fully taxable, but they do not discuss what Code(s) to use. If the distribution is from a SEP IRA, then we at CWF believe Code 1 is to be inserted in Box 7 if the individual is under age 59½ and Code 7 if the individual is age 59½ or older. If the distribution is from a SIMPLE IRA, then we at CWF believe Code S is to be inserted in Box 7 if the individual is under age 59½ and has not met the two year requirement, a Code 1 if the individual is under age 59½ and the two year requirement has been met and a Code 7 if the individual is age 59½ or older.

If an individual makes a Roth conversion contribution to a Roth IRA and then revokes it, the Roth IRA custodian will need to prepare a Form 5498 with respect to this Roth IRA and report the contribution in Box 3 (Conversion). The distribution closing the Roth IRA will be reported as follows. The total or gross distribution amount is reported in Box 1. If no earnings are distributed, the Roth IRA custodian enters zero (0) in box 2a

and Code J in box 7. If earnings are distributed, the Roth IRA custodian enters the earnings amount in box 2a and Code J in box 7. These earnings could be subject to the 10% early distribution tax under Code section 72(t).

**IRA Closed by IRA Custodian Because of CIP
Noncompliance Reasons**

The discussion above discusses the reporting to occur once the IRA accountholder revokes an IRA. The discussion now focuses on the reporting to occur if it is the IRA custodian who "closes" the account. There are two categories of "closures." The first category is the IRA custodian closes the IRA because the individual has failed to satisfy the Customer Identification Program (CIP) requirements described in section 326 of the U.S. Patriot Act. The second category covers all other reasons why an IRA custodian would choose to close an IRA.

The IRS instructions state that upon any closure of an IRA on account of CIP, the contributions and distributions must be reported in identical fashion to the revocation situations discussed above. Closure on account of CIP programs can occur at any time and the 7-day period is inapplicable.

If an individual makes a regular or annual contribution to a traditional IRA and the IRA is closed by the IRA custodian for CIP noncompliance reasons, then the IRA custodian will need to prepare a Form 5498 with respect to this traditional IRA and report the contribution in Box 1. The distribution closing the IRA will be reported as follows. The total or gross distribution amount is reported in Box 1. Either the amount of earnings will be reported in box 2a or a zero will be reported if there were no earnings. An 8 is inserted in box 7 if there were no earnings included in the total distribution or there were earnings and the individual is over age 59½. An 81 is inserted in box 7 if there were earnings included in the total and the individual is under age 59½.

If an individual makes a regular or annual contribution to a Roth IRA and the Roth IRA is closed by the Roth IRA custodian for CIP noncompliance reasons, the Roth IRA custodian will need to prepare a Form 5498 with respect to this Roth IRA and report the contribution

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in Box 10. The distribution closing the Roth IRA will be reported as follows. The total or gross distribution amount is reported in Box 1. Either the amount of earnings will be reported in box 2a or a zero will be reported if there were no earnings. A J is inserted in box 7 if there were no earnings included in the total distribution. A J is inserted in box 7 if there were earnings included in the total distribution and the individual was under age 59½. A J8 is inserted in box 7 if there were earnings included in the total distribution and the individual was age 59½ or older.

If an individual makes a rollover contribution to a traditional IRA and then the IRA is closed by the IRA custodian for CIP noncompliance reasons, the IRA custodian will need to prepare a Form 5498 with respect to this traditional IRA and report the contribution in Box 2. The distribution closing the IRA will be reported as follows. The total or gross distribution amount is reported in Boxes 1 and 2a. A 1 is inserted in box 7 if the individual has not attained age 59½. A 7 is inserted in box 7 if the individual is age 59½ or older.

If an individual makes a transfer contribution to a traditional IRA and then the IRA is closed by the IRA custodian for CIP noncompliance reasons, the IRA custodian will NOT report this contribution on the Form 5498. However, the distribution will be reported in the same manner discussed above with respect to revoking a rollover contribution and withdrawing it.

If an individual makes a rollover contribution to a Roth IRA and then the Roth IRA is closed by the Roth IRA custodian for CIP noncompliance reasons, the Roth IRA custodian will need to prepare a Form 5498 with respect to this traditional IRA and report the contribution in Box 2. The distribution closing the Roth IRA will be reported as follows. The total or gross distribution amount is reported in Boxes 1 and 2a. The IRS instructions state to insert a Code J in box 7. This does not seem correct. The IRS has taken the position that the distribution is to be considered taxable. It seems Code T should be used, if applicable (i.e. the individual is age 59½ or older).

If an individual makes a transfer contribution to a Roth IRA and then the Roth IRA is closed by the Roth IRA custodian for CIP noncompliance reasons, the Roth IRA custodian will NOT report this contribution on the

Form 5498. However, the distribution will be reported in the same manner discussed above with respect to revoking a rollover contribution and withdrawing it.

If a contribution has been made on behalf of an individual who participates in his or her employer's SEP-IRA plan or SIMPLE IRA plan, and then the IRA is closed by the IRA custodian for CIP noncompliance reasons, the IRA Custodian will need to prepare a Form 5498 with respect to this IRA and report the contribution in Box 8 (SEP) or Box 9 (SIMPLE) as applicable. The IRS instructions state this distribution is fully taxable, but they do not discuss what Code(s) to use. If the distribution is from a SEP IRA, then we at CWF believe Code 1 is to be inserted in Box 7 if the individual is under age 59½ and Code 7 if the individual is age 59½ or older. If the distribution is from a SIMPLE IRA, then we at CWF believe Code S is to be inserted in Box 7 if the individual is under age 59½ and has not met the two year requirement, a Code 1 if the individual is under age 59½ and the two year requirement has been met and a Code 7 if the individual is age 59½ or older.

If an individual makes a Roth conversion contribution to a Roth IRA and then the Roth IRA is closed by the Roth IRA custodian for CIP noncompliance reasons, the Roth IRA custodian will need to prepare a Form 5498 with respect to this Roth IRA and report the contribution in Box 3 (Conversion). The distribution closing the Roth IRA will be reported as follows. The total or gross distribution amount is reported in Box 1. If no earnings are distributed, the Roth IRA custodian enters zero (0) in box 2a and Code J in box 7. If earnings are distributed, the Roth IRA custodian enters the earnings amount in box 2a and Code J in box 7. These earnings could be subject to the 10% early distribution tax under Code section 72(t).

IRA Closed by IRA Custodian For Reasons Other Than CIP Noncompliance

The IRS instructions do not discuss the reporting procedures when the IRA custodian closes the IRA for reasons other than CIP noncompliance reasons. Most IRA plan agreements allow a financial institution to resign from being the IRA custodian by giving 30-days

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notice. Most IRA plan agreements also allow the IRA custodian to resign for any business reason.

The IRA custodian will be required to report all "reportable" contributions made prior to the closure. All contributions are reportable except for transfer contributions. The IRA custodian will also need to report each and every "reportable" distribution. A transfer distribution is non-reportable. The Codes for the distributions from a traditional IRA will generally be a "1" or a "7." The "8" code will not be used. The Codes for the distributions from a Roth IRA will be the standard codes, J, T and Q.

Understanding Direct Rollovers To a Traditional IRA Or Roth IRA

An IRA custodian is required to report the receipt of a direct rollover of an eligible rollover distribution on the Form 5498 in box 2, Rollovers. A separate form 5498 will be prepared for a traditional IRA receiving the direct rollover and a separate form 5498 will be prepared for a Roth IRA receiving the direct rollover.

A direct rollover of nondesignated Roth funds is the direct payment of a distribution from a qualified retirement plan, a governmental section 457 plan or a section 403(b) plan to a traditional IRA or other eligible retirement plan of designated Roth funds. This definition is found within the Tax Code. Note that a distribution from an IRA does not qualify as a direct rollover. The direct payment may be made on behalf of: (i) the plan participant; (ii) the surviving spouse of the plan participant; (iii) the spouse or former spouse of a plan participant who is an alternate payee under a qualified domestic relations order (QDRO) or (iv) a nonspouse beneficiary of a plan participant.

A direct rollover of nondesignated Roth funds for a nonspouse beneficiary may only be made to a traditional IRA. A direct rollover of designated Roth funds is the direct payment of a distribution from a qualified retirement plan, a governmental section 457 plan or a section 403(b) plan to a Roth IRA or other eligible retirement plan. This definition is found within the Tax Code. Note that a distribution

from a Roth IRA does not qualify as a direct rollover. The direct payment may be made on behalf of: (i) the plan participant; (ii) the surviving spouse of the plan participant; (iii) the spouse or former spouse of a plan participant who is an alternate payee under a qualified domestic relations order (QDRO) or (iv) a nonspouse beneficiary of a plan participant. A direct rollover of designated Roth funds for a nonspouse beneficiary may only be made to a Roth IRA.

The IRA custodian is to report "any" rollover contribution in Box 2 on the Form 5498 for a traditional IRA, including a direct rollover from a qualified plan, a governmental section 457 plan or a section 403(b) plan. This includes a direct rollover on behalf of a nonspouse beneficiary.

The IRA custodian is to report "any" rollover contribution in Box 2 on the Form 5498 for a Roth IRA, including a direct rollover from a designated Roth account within a qualified retirement plan, a governmental section 457 plan or a section 403(b) plan. This includes a direct rollover on behalf of a nonspouse beneficiary.

The IRS instructions are clear if there is a "rollover" of property, the IRA custodian is to determine and enter the fair market value as of the time it receives the contribution. This value may well be different from the value of the property at the time it was distributed to the plan participant or surviving spouse.

The IRS instructions do not expressly discuss the rule for a "direct rollover" of property. The same rules should apply since the value of the property at the time of the distribution (when it leaves the paying plan) and when received by the IRA custodian could well be different. Until the IRS gives additional guidance, the IRA custodian must determine and report the value of the property when it receives it.