

Advanced IRA Planning

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Rollovers and Transfers

Rollovers

- Since 2002–
 - After tax money can now be rolled into an IRA, or possibly a defined contribution plan
 - Basis must be tracked
 - Use Form 8606 for IRAs
 - Rollovers must be completed within 60 days
 - Greater portability among plans
 - IRAs can now be rolled into company plans
 - Just because you can doesn't mean you should
 - Plans do NOT have to accept rollovers
 - **Non spouse beneficiaries still cannot do rollovers!**
 - Governmental 457s can now be rolled over to IRAs or other plans

After Tax Money in IRA

- Can only be transferred to another IRA
- When rolling from an IRA to a qualified plan, pre tax money comes out first
 - Basis stays in IRA
 - All IRA accounts considered as one IRA, so it does not matter which IRA has basis
 - PLANNING POINT - Roll all taxable money into plan, leaving basis in IRA - Basis can then be removed tax and penalty free, or rolled to Roth tax free

After Tax Money in IRA

Example

- 2 IRAs
- IRA #1- \$50,000 w/\$30,000 basis
- IRA #2- \$100,000, all before tax
- Can roll IRA #1 into employer plan
- Better – Roll \$120,000 into plan, leaving \$30,000 IRA, all non taxable
 - Convert to Roth

Rollovers

- Generally, any distribution to an account participant, or the **spouse beneficiary** of a deceased account participant, can be rolled over
- Exceptions are –
 - Any payment that is part of a series of substantially equal periodic payments, i.e. annuity
 - Any required minimum distribution
 - Any hardship distribution from a qualified plan

You Can, But Should You?

Advantages of IRA

- Possible greater control over investment decisions
- Greater flexibility with beneficiary designation
 - No federal requirement to name spouse as beneficiary of IRA
- Ability to stretch IRA after death
 - Most plans are more restrictive than 401(a)(9) rules, but as of 2007 inherited plan assets can be transferred into an inherited IRA

You Can, But Should You?

Disadvantages of IRA

- Loss of ERISA creditor protection
- Loss of ability to hold life insurance
- Loss of certain tax benefits
 - Ten year averaging if born prior to 1/1/36
 - Net unrealized appreciation on employer stock
- Loss of ability to borrow from plan
- Loss of ability to postpone minimum distributions

60 Day Rollover Rule

- You have 60 days to redeposit a withdrawal in order to avoid taxation
 - You can only rollover the same funds once in a 12 month period starting the date of the first withdrawal
- Metcalf v. Commissioner, T.C. Memo 2002-123
 - Taxpayer claimed he had 3 years, to effect a rollover, the time in which he could file an amended return

One rollover per year rule

- Rule applies on a per account basis
- A rollover taints the account that the money came from, and the account that the money went to

One rollover per year rule

- EXAMPLE:
 - Jim has two IRA accounts, IRA1 and IRA2
 - Jim takes a distribution from IRA1 and redeposits it into IRA2
 - Result: Jim cannot do any more rollovers of amounts distributed from either IRA1 or IRA2 for 12 months from the date of the first distribution

One rollover per year rule

- EXAMPLE:
 - Jim has two IRA accounts, IRA1 and IRA2
 - Jim takes a distribution from IRA1 and redeposits it into IRA3
 - Jim could still do another rollover from IRA2 at any time, since he has not touched that IRA

Rules for Rollovers

- In the case of an IRA distribution, the SAME ASSETS must be put into the new account
 - CANNOT purchase assets and deposit
 - PLR 2006-47028
 - CANNOT sell assets and deposit cash

60 Day Rollover Rule

Dirks v. Commissioner, T.C. Memo 2004-38

- 2001 distribution
- Equitable Doctrine of Substantial Compliance
 - Not a “requirement”, just a “suggestion”
- 76 days should be “good enough”
- The Court was not amused. Not only did Dirks lose on the rollover issue, but \$8,819 substantial underpayment penalty was upheld

60 Day Rollover Rule

- Prior to EGTRRA, basically no relief for failure to complete a rollover within 60 days
- EGTRRA amended Sec 402(c)(3) and added Sec 408(d)(3)(I) to permit the IRS to waive the 60 day rollover requirement “where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the control of the individual subject to such requirement”

60 Day Rollover Rule

Rev. Proc. 2003-16

- The background statement of the Rev. Proc. acknowledges the EGTRRA committee reports list of examples
 - Distribution in the form of a check that was not cashed
 - Errors committed by financial institution
 - Inability to complete rollover due to death, disability, hospitalization, incarceration, foreign govt restrictions, or postal error

60 Day Rollover Rule

Rev. Proc. 2003-16

- Automatic waiver of 60 day rule if **ALL** conditions are met
 - Distribution after 12/31/2001
 - Financial institution received funds prior to expiration of 60 day rollover period
 - Taxpayer followed all institution's procedures for depositing funds into eligible retirement account within the 60 day period
 - Solely due to error by institution, rollover not deposited in eligible retirement account
 - If funds had been deposited, it would have been a valid rollover
 - The funds are in fact deposited within one year of the beginning of rollover period (305 day extension)

60 Day Rollover Rule

Rev. Proc. 2003-16

- If taxpayer does not qualify for automatic waiver under the Rev. Proc., taxpayer can apply for a private letter ruling to request relief
- New user fee schedule; was \$95
 - Rollover under \$50K, \$500
 - Rollover \$50K to under \$100K, \$1,500
 - Rollover \$100K or over, \$3,000

60 Day Rollover Rule

- PLR 2004-46030
 - Taxpayer was attempting to obtain a mortgage to purchase real estate
 - Because she owned 4 parcels free and clear, bank assured her that “the time needed to process her mortgage loan application would not exceed 60 days”
 - TP took IRA distribution to purchase real estate
 - Delay in closing loan
 - TP could not restore funds to IRA

60 Day Rollover Rule

- PLR 2011-18025
 - Taxpayer acknowledged he used money
 - Needed funds to help buy suitable residence for aging mom
 - Mom would then ‘reverse mortgage’ residence and pay back taxpayer
 - Bank assured that all this would be done within 60 days
 - Taxpayer claimed ‘bank error’

60 Day Rollover Rule

- PLR 2005-47024
 - Wife in nursing home; advised to ‘pay down assets’
 - Husband withdraws wife’s IRA – had no authority to do so
 - Wife dies 11 days later
 - Custodian won’t take back IRA money, 60 days expires

60 Day Rollover Rule

- PLR 2004-28031
 - Taxpayer feared IRS levy

PLR 2004-28031

- “Actions by a taxpayer to deliberately avoid a Service levy do not represent the type of circumstances upon which a waiver of the 60 day rollover requirement should be based under Rev. Proc. 2003-16.”

Lawsuit proceeds

- Numerous rulings permit settlement proceeds to be rolled back into IRA

PLR 2011-19040

- Taxpayer withdrew IRA money
- Gave to financial advisor who opened new IRA account
- Taxpayer received IRA statements
- All a fraud
- Financial advisor doing time
- TP can complete the rollover

60 Day Rollover Rule

- PLRs 2006-34017, 2006-34018, 2006-34019, 2006-34020, 2006-34021, 2006-34022
- Not eligible for NUA
- Cannot roll back

60 Day Rollover Rule

CAVEAT

- There is still a "one rollover per year" rule, that was not part of EGTRRA relief
- Better to stick with Trustee-to-Trustee transfers
- NO 60 day rollover rule for non-spouse beneficiaries, in any event
- On PLR requests, IRS wants proof that money was not used, but stayed in an account the entire time
- IRS NO LONGER AS LENIENT
- IRS wants to see that a rollover was intended

Chances of getting permission for late rollover

- Good shot
 - Intended rollover all along
 - Did not use money after withdrawal
 - Did not intend to withdraw
 - Intended trustee to trustee transfer but funds were erroneously transferred to taxable account
- No shot
 - Did not intend to do rollover
 - Used money
 - Rollover rules not intended to permit short term loans
 - NON SPOUSE BENEFICIARY

Rev. Rul. 2007-24

- NON-QUALIFIED ANNUITY – **NOT AN IRA**
- TP wants to move to new annuity
- Company won't transfer, issues check
- TP endorses check to new company
- TAXABLE - NOT a 1035 exchange

Spousal Rollovers and transfers

- Spouses are the only beneficiaries who can take a deceased spouse's interest in a retirement plan and make it her own
- They are also the only one who can get a (former) spouse's interest in a retirement plan in a tax free transaction

Retirement Plans and Divorce

- Planning pointer
 - Clients with retirement plans need financial advice when divorcing
 - Attorneys are not usually aware of tax implications of dividing retirement plans
 - You probably will have to take sides
 - People in the middle of the road tend to get run over!

Retirement Plans and Divorce

Company Plans

- QDRO - Qualified Domestic Relations Order
 - Participant's (ex-)spouse becomes an alternate payee under the plan

Retirement Plans and Divorce

IRAs

- IRAs are NOT subject to QDRO's
- Sec. 408(d)(6) controls the division of an IRA in divorce
 - If an individual's interest in an IRA is transferred to a (former) spouse under a divorce or separation agreement, the transfer is not considered a distribution
 - Subsequent to the transfer, the IRA will then be considered as the IRA of the spouse

Bunney v. Commissioner

114 T.C. 17

- Taxpayer lived in a community property state. As part of his divorce, he had to give spouse 1/2 of IRA.
- TP withdrew \$125K from IRA and gave \$111K to ex
- TP argued that IRA should be taxed to spouse
- Court held taxable to TP and subject to 10% penalty

QDRO v 408(d)(6)

- QDRO
 - Applies to company plans
 - Ex becomes alternate payee under plan
 - Not subject to 10% early withdrawal penalty
- 408(d)(6) IRA split in divorce
 - Applies to IRAs
 - Ex becomes owner of her/his share of IRA
 - All IRA rules apply including the 10% early withdrawal penalty

Ten Year Averaging

ONLY AVAILABLE IF BORN ON OR BEFORE 1/1/36

- Must take Lump Sum Distribution
 - IRAs do NOT qualify
 - Triggering event
 - Death
 - Separation of service
 - Age 59½
 - Disability under 72(m)(7)
 - Must take entire balance in one taxable year
 - 5 Year rule - had to have been in plan for 5 years
 - Cannot roll over any part of distribution
- Tax computed based upon 1986 tax rates
- Use Form 4972

Ten Year Averaging

- Figured separately from regular tax
- Figured separately for each spouse
 - No marriage penalty
- Is not included in AGI
 - Will not affect deductions, credits or other benefits based upon AGI
- Is not included in AMT

Net Unrealized Appreciation

Applicable to employer securities

- Must take lump sum distribution
 - Cannot use ten year averaging
 - **CAN** rollover part to IRA
 - Five year in plan rule not applicable
- Employer securities taxed at plan cost
- Difference between cost and FMV at distribution taxed as LTCG - When sold
- Holding period starts on date of distribution for future appreciation

Net Unrealized Appreciation

Example

- Age 50
- Employer security cost to plan = \$20,000
- FMV on date of distribution = \$80,000
- Sold six months later for \$85,000
- Results:
 - Pension income of \$20,000
 - LTCG of \$60,000
 - STCG of \$5,000
 - 10% early withdrawal penalty of \$2,000

NUA and Rollovers

- Clients can roll over non NUA assets to IRA to avoid current taxation on that portion of distribution
- Client can even roll part of employer stock to IRA, and only pay tax on non rolled over portion

NUA and Rollovers

Example

- Mike's retirement plan is worth \$1.25million including employer stock worth \$600K that has a basis of \$200K, and other assets worth \$650K
 - If Mike does no rollover, he will be currently taxed on \$850K
 - Alternatively, Mike can roll the other assets worth \$650K into an IRA (or other plan) and only pay current tax on \$200K
 - Mike can further reduced current tax by rolling some employer stock into the IRA, but he will lose the NUA benefit on the stock so rolled over

NUA and Rollovers

- Planning pointer
 - Is it better to pay current tax on cost of stock to plan, and pay capital gains later, or roll the entire amount to an IRA, diversify portfolio, and continue tax deferral?

NUA and Rollovers

PLR 2004-34022

- Taxpayer had Employer stock and other assets in plan
- He wanted to roll over other assets to IRA and take stock personally to use NUA
- Took stock personally but rollover to IRA got screwed up and not completed until following year
- Therefore there was no lump sum distribution
- If no lump sum distribution, no NUA benefit - stock taxed as ordinary income on full market value
- Lesson: Follow up, follow up, follow up

PLR 2004-34022

- Most likely no chance for 60 day relief
– See PLR 2006-17039

NUA and Rollovers

PLR 2004-42032

- Taxpayer's entire interest in company plan was in Employer stock
- He wanted to utilize NUA
- Financial Advisor told him to direct stock to an IRA account
- By the time advisor realized error, it was too late to stop transfer
- TP asked IRS to rule that transfer was null and void
- IRS said transfer was "irrevocable"
- NUA advantage irretrievably lost
- Lesson: Make sure financial advisor knows what they're talking about

IMPORTANT CONSIDERATION

- Both NUA and 10 Year Averaging are available to beneficiaries, on the same basis as if the decedent received the plan proceeds
 - ▶ 10 Year averaging available based upon age of decedent, not beneficiary
 - ▶ No step in basis for NUA – Rev. Rul. 75-125

Death of Account Holder

FIRST THING YOU NEED TO
KNOW WHEN A CLIENT DIES

- Don't let anyone do anything

- Jacob Jankelovits et ux. v. Commissioner;
T.C. Memo. 2008-285; No. 24615-06
– Bank failure to give proper information is no
excuse

After Death Distributions

Beneficiary Determination Date

- Beneficiary is determined on September 30th of year following year of death
- Can use this time to “eliminate” a “bad” beneficiary
 - CANNOT (it is clear!) distribute through estate
 - CANNOT add a beneficiary!!!!
- Beneficiary can disclaim
 - Beneficiary designation form takes on added importance

Inherited Accounts

- Death in “gap” period
 - Use dead beneficiary’s life expectancy
- Potential 3 month extension if “bad” beneficiary on 9/30
 - Split account

“Good” Beneficiary Designation Form

- Names beneficiary
- Names contingent beneficiary
- May name contingent contingent beneficiary
- Disclaimer planning may be in play

Rev Rul 2005-36

- Revenue Ruling, not a Private Letter Ruling
 - Applies to all IRA beneficiaries
 - CAN be cited as precedent
- Question: Can IRA beneficiary who takes a year-of-account-holder’s-death required minimum distribution, do a subsequent disclaimer?
- Holding: They can

Rev Rul 2005-36

- Background:
 - Once an account holder has reached their required beginning date (April 1st of year after year they attain age 70½), a required minimum distribution must be taken in each year. Year the account holder dies is no exception
 - Penalty is 50% of required minimum distribution that is not taken in any year

Rev Rul 2005-36

- Year of death required minimum distribution
 - Who takes it
 - The named beneficiary on the account, NOT the estate of the decedent

Rev Rul 2005-36

- 3 Examples in Rev Rul
 - A pecuniary disclaimer (\$)
 - A fractional disclaimer (%)
 - A complete disclaimer
- In each case, the disclaimant must keep income attributable to their share of the account, including on the minimum distribution that was taken

Rev Rul 2005-36

- IF complete disclaimer AND attributable income is withdrawn before 9/30 of year after year of account holder's death, the disclaimant is no longer a beneficiary, and is no longer a measuring life for post-death required minimum distributions

Rev Rul 2005-36

- IF there is a partial disclaimer, either fractional or pecuniary, AND the accounts are split no later than 12/31 of the year after the year of the account holder's death, THEN each beneficiary can use their own life expectancy to compute post-death required minimum distributions

Rev Rul 2005-36

- Rules for disclaimers
 - 1. Must be in writing
 - 2. Must be made no more than 9 months after the later of date of death or beneficiary attaining age 21
 - 3. Beneficiary cannot have accepted any benefits
 - 4. Account will pass WITHOUT any direction on the part of the disclaimant to either the account holder's spouse, or to a person other than the disclaimant

Disclaimers

- Special rule for deaths in 2010
 - Disclaimer deadline no earlier than 8/17/2011
 - Nine months from date of 2010 Tax Act

Rev Rul 2005-36

- 3. Not accept benefits
 - Cannot trade securities within the account
 - A spouse beneficiary cannot put the IRA in her/his own name
 - A NON-SPOUSE BENEFICIARY CAN NEVER PUT AN INHERITED IRA IN HIS/HER OWN NAME!
 - A beneficiary CAN retitle account AS A BENEFICIARY account, e.g. Mary Smith, beneficiary of John Smith, dec'd, IRA

Rev Rul 2005-36

- 4. Account will pass WITHOUT any direction on the part of the disclaimant to either the account holder's spouse, or to a person other than the disclaimant
 - Follows the beneficiary designation form NOT the will!
 - Beneficiary designation form should be completed with the same care that a client would have a will prepared
 - Importance of contingent beneficiary

Rev Rul 2005-36

- Importance of contingent beneficiary:
- PLR 2003-27059
 - ▶ Wife named designated beneficiary
 - ▶ No contingent beneficiary named
 - ▶ Wife disclaims, IRA goes through estate
 - ▶ Will provides that assets go to trust for spouse
 - ▶ Because account passed through the estate, no stretch
 - Account must be paid out in five years
 - ▶ Had trust been named the contingent beneficiary, the account could have been paid over spouse's life expectancy

Rev Rul 2005-36

- Beneficiary designations:
 - Beware of –
 - Estate as the beneficiary
 - Lack of contingent beneficiary
 - Beneficiary designations not updated for change in life events such as marriage, children or divorce
 - Prior spouse as beneficiary rather than the incumbent
 - » Divorce does not necessarily negate a beneficiary designation form

Beneficiary Designation Forms

- Periodically review them to be sure that
 - They still exist
 - They are up to date
 - They are in concert with the overall financial plan and estate plan

Rev Rul 2005-36

- Planning pointers:
 - Apparently, the Revenue Ruling result is not limited to IRAs in pay status
 - Not limited to cases where only the RMD is taken
 - Even in pay status, disclaimer can be made before the RMD is taken, so that contingent beneficiary gets the RMD

Rev Rul 2005-36

- Planning situations:
- Spouse is beneficiary, credit shelter trust is contingent beneficiary
 - Spouse can disclaim all or part to make sure credit shelter trust is fully funded
 - Spouse is still measuring life on all of IRA

Rev Rul 2005-36

- DON'T DO THIS---
- Child as beneficiary, credit shelter or marital trust as contingent beneficiary
 - Disclaimer will not work unless child also disclaims interest in trust (two disclaimers are needed)

Rev Rul 2005-36

- This should work—
- Child as beneficiary, spouse as contingent beneficiary
 - Child disclaims, spouse rolls IRA over into her own name and names child as beneficiary of her IRA

Rev Rul 2005-36

- Spouse as beneficiary, child as contingent beneficiary, grandchild as contingent contingent beneficiary
 - Spouse disclaims all or part and it goes to child
 - Child disclaims all or part and it goes to grandchild
 - Can fund GST
 - If accounts timely split, each beneficiary gets own life expectancy
 - S T R E T C H IRA!

Rev Rul 2005-36

- Planning pointer
 - If beneficiary dies within 9 months of the account holder, consider having the beneficiary's estate do a disclaimer
 - Death of beneficiary during "gap" period results in having to use the beneficiary's life expectancy
 - Disclaimer would permit account to be paid out over contingent beneficiary's life expectancy

Rev Rul 2005-36

- Example:
 - H is 80, W is 79 and child is 55
 - H dies. W takes YOD RMD
 - W dies 6 months after H. W never took any action to “accept” account
 - If no disclaimer, account needs to be paid out over 10.2 years (Single life of 80 year old)
 - If estate of W disclaims, and takes the required income from account, child becomes beneficiary and account can be paid out over 28.7 years (Single life of 56 year old)

Rev Rul 2005-36

- Recap:
 - Interaction between disclaimer rules and IRA rules – need to be aware of both rules
 - IRA beneficiary designation date is 9/30 of year after year of IRA holder’s death, but disclaimer deadline is nine months from date of death
 - Disclaimer deadline will always come first
 - Beneficiary designation forms are key!

“Bad” Beneficiary Designations

- Wrong person named
- No contingent beneficiary
- Estate is beneficiary
- Multiple beneficiaries including charity or estate
 - Watch for RLT as beneficiary
- Disclaimers still may useful

PLR 2010-21038

- Trust included a charity as a potential beneficiary
- Local Court allowed trust to be restated to have only daughters as trust beneficiaries
- IRS did not accept restated trust: "In this instance, the efforts undertaken to modify the terms of the Restated Trust will not be given retroactive effect for federal tax purposes and the designated beneficiary of IRA X must be determined under the terms of the Restated Trust as it existed at the time of Taxpayer B's death."

Revocable Living Trust as Beneficiary

- Unless conduit trust, have to count all potential beneficiaries
 - PLR 200228025
- Stuck with beneficiary with shortest life expectancy
 - Cannot split to get all individual life expectancies
 - Is estate a beneficiary?

RLT as Beneficiary

- Ways to solve estate as potential beneficiary
 - Draft trust correctly in first place
 - Pay off bad beneficiaries before 9/30 designation date
 - Prove to IRS that only individuals could get IRA money
 - Need PLR
 - Costs \$\$\$

After Death Distributions

Spousal Options

- Spouse can treat decedent's IRA as her own if SOLE beneficiary
- Spouse can rollover her share of account into her own IRA even if not sole beneficiary
 - Any year of death required distribution must be taken first prior to rollover or treating as own
 - Spouse becomes owner and all rules apply, e.g. distributions prior to age 59½
 - PLR 2001-10033
 - Distributions as beneficiary, then rollover after 59½

PLR 2004-50057

- Under 59½ spouse beneficiary permitted to roll husband's plan benefits into IRA in husband's name with wife as beneficiary
- Avoid 10% penalty as beneficiary
- She should be able to roll over IRA into her own name after 59½.

Spousal Rollovers when Spouse not Named Beneficiary

- There are numerous rulings where the estate, or a trust, was the named beneficiary
- Spouse had unrestricted right to estate/trust property
- IRS permits spouse to take distribution and roll distribution into own IRA
- Rulings have permitted surviving spouse to roll over pre death distributions taken by decedent
- In some rulings, spouse has also gotten extension of 60 day rollover period, e.g. PLR 2004-28032

Private Letter Rulings

- They are EXPENSIVE
 - IRS fee \$10,000
 - We might want to get paid also
- They are NOT part of planning, but are useful to fix after the fact

PLR 2001-26038

- Father died with multiple IRAs
- Some IRAs named estate as beneficiary
- IRAs paid to estate, then paid from estate to wife. Wife intended to roll these over to her own IRA
- Wife died prior to rollover
 - -Daughters run for PLR
 - -Wife sitting with all IRA taxable income
 - -No way to return it to IRA

PLR 2001-26038

- On IRAs that the wife was named beneficiary, she was deemed to be the owner
- She did not name new beneficiaries
- Daughter, as executrix, wanted to name new beneficiaries

After Death Distribution

Spouse Beneficiary

- Spouse takes beneficiary distributions based on her recalculated life expectancy if sole beneficiary
 - Spouse can wait to start distributions until year decedent would have turned 70½
 - If SHE dies prior to starting beneficiary distributions, she is considered to be the OWNER
 - Should name beneficiary, otherwise five year rule will be in effect

PLR 2006-44022

- Trust beneficiary of IRA
- Wife beneficiary of Trust
 - Enough powers to allow remainder beneficiary to be ignored
 - Similar to “conduit trust”
- Husband had died prior to age 70½
- Wife died prior to year Husband would have attained age 70½
- Son is beneficiary after Wife

PLR 2006-44022

- Trust beneficiary of IRA
- Wife beneficiary of Trust
 - Enough powers to allow remainder beneficiary to be ignored
 - Similar to “conduit trust”
- Husband had died prior to age 70½
- Wife died prior to year Husband would have attained age 70½
- Son is beneficiary after Wife
- What is the distribution period for the IRA after Wife’s death?

PLR 2006-44022

•Five Years!

Beware of using trusts with similar provisions!

After Death Distributions

Non-spouse beneficiary

- Multiple beneficiaries - spouse and non-spouse - rules apply as non-spouse beneficiary
- ▶ Trusts usually have multiple beneficiaries
- ▶ "Conduit trust" only counts current beneficiaries
- ▶ Do you want to "conduit" a QTIP?
– *It depends*
- Non-spouse beneficiary CANNOT do a rollover!!

After Death Distributions

Non-spouse designated beneficiary

- Distributions over life expectancy of beneficiary, starting in year after year of account holder's death
- If death after RBD, and beneficiary is older, you can use the longer life expectancy of the account holder

Example

- Beneficiary is 45 years old in year account holder dies
- First distribution is based upon the divisor for a 46 year old – 37.9 years
- The second year's divisor is 36.9, the third year's is 35.9, the fourth year's is 34.9, etc.

- If the decedent was past his RBD, and younger than the beneficiary, you would use the decedent's age rather than the beneficiary's age
- EXAMPLE: Decedent was 75 when he died, beneficiary is 80
 - First year's divisor would be based upon the age of a 76 year old – 12.7 years

- If death was before RBD, you must use the beneficiary's life expectancy, unless you use the five year rule
- EXAMPLE: Decedent was 50 in year of death, beneficiary was 80
 - The first year's divisor is based upon the life expectancy of an 81 year old – 9.7 years
 - Subsequent years will reduce the divisor by one each year

After Death Distributions
Non-spouse designated beneficiary

- Decrease divisor by one each subsequent year, until account exhausted
- Death of beneficiary (after determination date) has no effect on post-death distribution schedule
 - But check to see if custodian's rules are more restrictive
- Beneficiary can name a beneficiary to avoid probate in beneficiary's estate
 - Contingent beneficiary has no rights to account once primary beneficiary has accepted account

After Death Distributions
NO designated beneficiary

- Account holder died before the RBD
 - The five year is applicable
- Account holder died on or after the RBD
 - Post death MRDs are based upon the single life expectancy of decedent in year of death
- No five year rule if death is on or after the RBD

Post-Mortem Non-Spousal Rollovers

- Non-spousal beneficiaries (e.g. children, nieces, friends, etc.) are permitted to roll over a qualified retirement plan (e.g. 401(k) plan), via trustee-to-trustee transfer, into an inherited IRA.
- “Designated beneficiary” trusts are also permitted to roll over qualified retirement plans into inherited IRAs.
- Effective for tax years beginning after December 31, 2006

CAUTION: The inherited IRA must be set up under the decedent qualified plan owner's name (e.g. “John Smith, Deceased, IRA f/b/o Jane Smith (beneficiary))

Rolling from Company Plan to Inherited IRA

- Client's will need a LOT of hand holding
 - Apparently no provision for IRS relief if it gets screwed up
 - NO 60 day rollover, so NO 60 day rollover relief
- Open inherited IRA account FIRST
 - Title it CORRECTLY
 - Make sure it is an INHERITED IRA account
- Then arrange for the TRUSTEE TO TRUSTEE TRANSFER

Rolling from Company Plan to Inherited IRA

- Rollover of inherited company plan assets into inherited IRA by non-spouse beneficiary
 - No longer advantageous if death occurred prior to 2010 and company plan mandated five year payout
 - IRS said that plan did not have to permit the direct rollover by the beneficiary
 - Must be DIRECT ROLLOVER
 - IRA must be properly titled
 - As of 2010 plan must permit direct rollover

Rolling from Company Plan to Inherited IRA

- Rollover of inherited company plan assets into inherited IRA by non-spouse beneficiary
 - Hope that technical corrections act on PPA 2006 would require that employer plan permit beneficiary transfer to inherited IRA
 - IT DID NOT
 - But 2008 bill did, effective 2010

Rolling from Company Plan to Inherited IRA

- IRS has ruled that the direct rollover to an inherited IRA can be an inherited **Roth** IRA, if beneficiary meets income and filing requirements (IRS Notice 2008-30)
- Inherited IRA CANNOT be converted to an inherited Roth IRA

Inherited Accounts

- Don't Forget the IRD Deduction! (HERO!)
- ▶ Income tax deduction for the estate tax attributable to items that are Income in Respect of a Decedent, e.g. retirement plans, accrued interest, accrued dividends, etc.
- ▶ Determined by computing estate tax with and without IRD items. Difference is deduction.
- ▶ Deduction allocated on pro-rata basis
- ▶ Schedule A, NOT subject to 2% AGI floor, or AMT.

Don't Forget the IRD Deduction

- IRD deduction is based upon the difference in the net federal estate tax.
- Result is that there is no IRD deduction for the state estate tax

Planning Pointer

- When doing deathbed planning for a client with a retirement account, consider whether it would be advantageous for client to take required minimum distribution before death
 - Value of durable power of attorney
- In some cases it may be advantageous to take more than the minimum
- Consider Roth conversion

Investing with Retirement Plans

Rev. Rul. 2008-5

- If individual sells security at a loss, and repurchases substantially identical security within 30 days before or after, the loss is disallowed under Sec. 1091
- No basis adjustment in IRA
 - Even in Roth IRA or non deductible IRA
- Worse result than selling security and repurchasing in taxable account
 - Then, at least, you would get benefit of loss on ultimate disposition

Investing with Retirement Plan

- Prohibited Investments
- Prohibited Transactions

Investing with an IRA

- Prohibited Investments
 - Life insurance
 - Artwork
 - Rugs
 - Antiques
 - Metal or gem
 - Alcoholic beverage
 - Stamp or coin
 - Except gold, silver and platinum coins minted by US, and state issued coins

Investing with an IRA

- The “Budweiser” Rule
 - Your IRA CAN own the company
 - Your IRA CANNOT own the beer
 - Your IRA CANNOT cash in the empties

Prohibited Investment

- Any amount in an IRA invested in a prohibited investment is treated as a distribution
 - So IRA will never own a prohibited investment

Investing with an IRA

- Permitted Investments
 - Everything except prohibited investments
 - Stocks, bonds, mutual funds
 - Bank CDs and accounts
 - Real estate
 - Mortgages
 - Private placements
 - Businesses, including farms

Investing with an IRA

- Investing in Real Estate, or other “non traditional” investments with an IRA will usually require that the account be moved to a custodian who accepts such investments in an IRA
 - Pensco Trust Company www.pensco.com
 - Next Generation

Investing with an IRA

- One issue to keep in mind with ‘non traditional investments’ is valuation
- While technically required each year, the valuation of an IRA is crucial once there are mandatory distributions
- This will require appraisals of the ‘non traditional assets’ at least annually; more often if that asset is used to make the distribution

Unrelated Business Income Tax (UBIT)

- If a not for profit entity engages in a business not related to its tax exempt function, it will be subject to UBIT
- Income derived from such business is called Unrelated Business Taxable Income (UBTI)
- IRAs are subject to UBIT if they are engaged in a business

Unrelated Business Income Tax (UBIT)

- Debt financed income is also subject to UBIT
- Check K-1s on partnership investments, especially hedge funds
- Form 990T, due 4/15
- K-1s on extension, so how do you know?

Prohibited Transactions

- A prohibited transaction is a transaction between the IRA or retirement plan, and a disqualified person

Prohibited Transactions

- 4975(c) Prohibited transaction
- (1) General rule
- For purposes of this section, the term "prohibited transaction" means any direct or indirect--
- (A) sale or exchange, or leasing, of any property between a plan and a disqualified person;
- (B) lending of money or other extension of credit between a plan and a disqualified person;
- (C) furnishing of goods, services, or facilities between a plan and a disqualified person;

- (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
- (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
- (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan

Disqualified Person in an IRA

- IRA
 - IRA owner
 - Spouse
 - Ancestors
 - Descendents or their spouse
 - Controlled entities
 - Anyone providing an indirect benefit

Disqualified Person in an IRA

- Siblings are NOT included in the list of disqualified persons
 - But remember “Anyone providing an indirect benefit”

Prohibited Transactions

- GENERAL RULE:
 - There is a 15% excise tax on the value of a prohibited transaction, for each year or part year that the prohibited transaction exists
 - The penalty can jump to 100% if not corrected
 - Form 5330 to compute and pay penalty
 - Statute of limitations

Prohibited Transactions

- Correction of prohibited transaction
 - Undoing the prohibited transaction to the extent possible, but without putting the plan in a financial position worse than it would be without the prohibited transaction

Prohibited Transactions

- IRA RULE:
 - If the prohibited transaction is between the IRA and the IRA holder, or beneficiary, there is no penalty on the prohibited transaction
 - Instead, the entire IRA account is deemed distributed on the first day of the year
 - Taxable distribution
 - 10% early distribution if no exception applies
 - Entire account is only account with the prohibited transaction, not all IRA accounts
 - If unsure, use separate IRA account

Investing with an IRA

- Prohibited transactions
 - Any transaction between an IRA and a disqualified person
 - Any transaction that directly benefits an IRA owner or disqualified person
 - Any transaction where the IRA owner has a conflict of interest

Investing with an IRA

- Prohibited transactions
 - Individual who sells annuities decides to buy an annuity in his IRA
 - Annuity company sends individual, or individual's closely held agency, a commission check for the annuity sale
 - Is this a problem?
 - How about if you're managing your dad's IRA for a fee?

Rollins Case

- Joseph Rollins v. Commissioner, T.C. Memo 2004-260
- Rollins was a CPA
- Rollins owned 100% of Rollins & Associates, P.C., a CPA firm
- The firm had a 401(k) plan
- Rollins was the plan trustee and the plan administrator

Rollins Case

- Rollins made the decision to lend a portion of the Plan's money to three entities, J&J Charlotte, Eagle Bluff, and Jocks and Jills
- All loans were fully secured
- All loans had a 12% interest rate
- All loans were repaid
- Rollins was a minority shareholder in each of these entities, but he owned the biggest piece

Rollins Case

- IRS contended that Rollins was a 'disqualified person'
- Rollins agreed, but argued
 - None of the borrowers were disqualified persons
 - None of the loans were between Rollins and the plan
 - He did not personally benefit from the loans

Rollins Case

- Rollins pointed out that on each of the loans
 - The interest rate was above market interest and was paid
 - The collateral was safe and secure and the loans were repaid
 - The plan assets were thus diversified and the portfolio's risk level was lowered

Rollins Case

- IRS' Position
 - Loans were prohibited transactions because they benefited Rollins
 - Entities did not have to go to outside sources to get loans
 - Loans were dealings with the Plan's assets in Rollin's own interest

Rollins Case

- Court's conclusions
 - No arm's length standard exceptions
 - It's possible that Rollins derived a benefit
 - Burden of Proof on Rollins that he did not derive a benefit
 - "Good intentions and a pure heart are no defense"
 - 4975(c)(1)(D) transfer to, or use by or **for the benefit of**, a disqualified person of the income or assets of a plan;

Rollins Case

- Insult to Injury
 - Rollins faced additional penalties for failure to file Form 5330
 - Form is filed when Plan owes excise tax
 - Rollins penalized for not filing form he believed he didn't need to file
 - Opposite conclusion on Form 5330 penalty in Morrissey v. Commissioner, T.C. Memo 1998-443

Investing with an IRA

- Investing in Real Estate in an IRA
 - It is NOT a prohibited investment
 - But beware of prohibited transactions
 - Debt financing is not a prohibited transaction
 - But it may give rise to Unrelated Business Taxable Income
 - Cannot rent to IRA owner or disqualified person
 - Contribution limitations if repairs needed
 - No "sweat equity" or other personal services

Investing with an IRA

- IRA cannot invest in existing venture with disqualified person
- However, IRA can be a original investor with a disqualified person who is also an original investor.
 - Swanson v. Commissioner, 106 T.C. 76 (2/15/96)

Investing in Real Estate in an IRA

- Real estate is a valid IRA investment and can be part of a diversified IRA portfolio
- However, many clients will be unable to avoid the risk of IRA disqualification due to their failure to respect the IRA as a separate entity that is prohibited from engaging in any transaction either with OR WILL BENEFIT any disqualified person

Investing in Real Estate in an IRA

- The IRA owner cannot
 - Collect the rent, pay the bills and deposit the excess into an IRA account
 - Pay the bills personally
 - Pay the bills personally and get reimbursed by the IRA
 - Provide personal services to do repairs
 - Personally make up any shortfall should the IRA be unable to pay the real estate bill, or for major repairs

Investing in Real Estate in an IRA

- The property should have a professional managing agent to run the property, collect the rents, pay the bills, and remit the excess to the IRA custodian
- This managing agent CANNOT be a disqualified person

In re: Ernest W. Willis, Debtor.
Case No.: 07-11010-BKC-PGH

- Debtor Willis claimed exemption in bankruptcy for \$1.5 Million of IRA assets
- Creditors claimed that Willis had engaged in prohibited transactions FIFTEEN years before bankruptcy proceeding and again TEN years before.

In re: Ernest W. Willis, Debtor.
Case No.: 07-11010-BKC-PGH

- Judge agreed that Willis had engaged in a number of prohibited transactions
- Ruling held that IRA ceased to exist, RETROACTIVE back to date of prohibited transaction
- As a result, not exempt in bankruptcy, and creditors able to get at IRA assets

Invest in Small Business?

- "Can my IRA purchase shares of stock in a small business that I own?"

Invest in Small Business?

- “Can my IRA purchase shares of stock in a small business that I own?”
- No, UNLESS IRA owner, along with all disqualified persons, own less than 50%
 - But be aware that activity between IRA and IRA owner may be prohibited transaction
 - Should not be done in case where business needs additional capital for survival

Invest in Notes?

- “If my IRA owns a note receivable, can I change the terms of the note?”

Invest in Notes?

- “If my IRA owns a note receivable, can I change the terms of the note?”
- Yes
 - Make sure we’re talking about a loan to an outside person


