ED SLOTT'S IRA ADVISOR

January 2020

Tax & Estate Planning For Your Retirement Savings

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2020 HAPPY NEW YEAR

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Join the Retirement Planning Conversation

The SECURE Act Becomes Law

With the clock ticking down on 2019, Congress enacted a $1.4 trillion year-end spending bill to keep the government running. Tucked away inside this mammoth piece of legislation is the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which includes ***significant changes to retirement accounts*** and easily became our "Top IRA Ruling" of 2019.

Age Limit Eliminated for Traditional IRA Contributions

Beginning in 2020, the SECURE Act eliminates the age limit for traditional IRA contributions. Now, those who are still working can continue to contribute to a traditional IRA, regardless of their age. This expands opportunities for back door Roth IRA contributions for older clients.

RMD Age Raised to 72

The SECURE Act raises the age for beginning required minimum distributions (RMDs) to 72 for all retirement accounts subject to RMDs. While 1½ years is not a big delay, this does remove the ½-year confusion for those in their 70½ year and also expands the "sweet spot" for planning (formerly between ages 59½ and 70½) to age 72. IRA owners reaching age 70½ in 2020 catch a break and will not have to take their first RMD in 2020 now that the RMD deadline has been extended to age 72.

The new proposed changes in the RMD life expectancy tables beginning in 2021 combined with the new RMD age will allow those who don't need the funds to keep them growing tax-deferred a little longer.

The qualified charitable distribution (QCD) age does not change, so QCDs can still be done at age 70½, even though no RMDs will be required until age 72. Even Congress admits this discrepancy will cause confusion.

New Exception to the 10% Penalty for Birth or Adoption

The SECURE Act adds a new 10% penalty exception for birth or adoption, but the distribution is still subject to tax. It is limited to $5,000 and applies to all contributory retirement plans. The exception applies to any distribution from the retirement account within one year from the date of birth or legal adoption. The birth or adoption distribution amount can be repaid at any future time (re-contributed back to any retirement account).

IRA Contributions for Fellowship and Stipend Payments

Additionally, the new law allows taxable non-tuition fellowship and stipend payments to be treated as compensation to qualify for an IRA (or Roth IRA) contribution.

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Employer Liability Protection for Annuities in Plans

The SECURE Act provides a safe harbor for employer liability protection for offering annuities in an employer plan. Any problems that employees have must be taken up with the insurance company.

The employer is required to complete its due diligence as a fiduciary when selecting the insurance company and the annuity option. The employer is not required to select the lowest cost contract. This is expected to open the door for more annuity products to be available as investment choices in employer plans.

Good Bye, Stretch IRA

Congress is forever searching for revenue sources. Thus, to pay for other law changes, it has broken the stretch IRA.

Beginning for deaths after December 31, 2019, the stretch IRA will be replaced with a 10-year rule for the vast majority of beneficiaries. The rule will require accounts to be emptied by the end of the tenth year following the year of death.

There will be no annual RMDs. Instead, the only RMD on an inherited IRA would be the balance at the end of the 10 years after death. For deaths in years 2019 or prior, the old rules remain.

There are five classes of "eligible designated beneficiaries" who are exempt from the 10-year post-death payout rule and can still stretch RMDs over life expectancy. These include surviving spouses, minor children, disabled individuals, the chronically ill, and beneficiaries not more than ten years younger than the IRA owner.

Clients with the biggest IRAs (over $1 million or multimillion dollar IRAs) will feel the most impact.

Why? A good chunk of these balances will be left to beneficiaries. Clients who named trusts as IRA beneficiaries will also be hit hard. Conduit trusts will no longer work. *Why?* There will no longer be annual RMDs. The only RMD will be at the end of the 10 years – *a 100% RMD at that point.* All inherited IRA funds will be released to the beneficiaries, nullifying any further trust protection – *exactly the opposite of what the IRA owner wanted.* Discretionary trusts will still work but at a potentially heavy tax cost.

Planning Opportunities

The new rules will mean a new landscape when it comes to retirement and estate planning. Advisors should act fast to contact clients and advise them on all the changes, including the elimination of the stretch IRA.

As 2020 begins, there are big opportunities for advisors ready to help clients navigate the myriad changes the SECURE Act has set in motion.

Beneficiary forms will need to be reevaluated. Clients who named a trust as their IRA beneficiary should be a priority. This decision must be reviewed and probably revised immediately!

Tax management strategies such as filling lower tax brackets and doing QCDs will be more valuable than ever, as will Roth conversions.

Life insurance moves to the top of the list as an estate and tax planning vehicle for the largest IRAs.

For clients with large IRAs who are charitably inclined, a charitable trust may work to simulate the stretch IRA.

As 2020 begins, there are big opportunities for advisors ready to help clients navigate the myriad changes the SECURE Act has set in motion. ■

Top IRA Rulings of 2019

In addition to the Setting Every Community Up for Retirement Enhancement (SECURE) Act, 2019 brought many other noteworthy IRA developments, from court decisions to IRS actions and private letter rulings. Here are more of 2019's top IRA rulings.

Trust Tactics

"For the vast majority of working Americans, an IRA or other retirement account will be the most valuable asset that can be passed upon death," says Michael J. Jones, partner in accounting firm Thompson Jones in Monterey, CA.

"It's a striking contrast that the value of wealth that can pass at death, free of estate, gift, and generation-skipping transfer taxes has been increased to over $11 million while the SECURE Act now decimates the value of inherited retirement funds."

"One possibility," says Jones, "is to consider naming a charitable remainder unitrust (CRUT) as the beneficiary of an IRA and the non-spouse heir as the income beneficiary of the CRUT."

"In the right situation," continues Jones, "the present value of the total payouts to the beneficiaries alone could be much greater than the value of the assets passing to them under a 10-year rule; charities will also benefit."

"Consider naming a charitable remainder unitrust (CRUT) as the beneficiary of an IRA, and the non-spouse heir as the income beneficiary of the CRUT."
-Michael J. Jones

In effect, stretching the CRUT distributions over the income beneficiary's life expectancy could offset some of the damage caused by enactment of a SECURE Act-type restriction, even after the expense of creating and administering a CRUT.

Robert Keebler, who heads Keebler & Associates, a tax advisory and CPA firm in Green Bay, WI, suggests using life insurance. "An IRA owner might create an irrevocable life insurance trust (ILIT)," he says. "The ILIT beneficiaries could be younger individuals, perhaps the IRA owner's children."

"An IRA owner might create an irrevocable life insurance trust."
-Bob Keebler

One approach is to have the IRA owner take lifetime required minimum distributions (RMDs) and pay the resulting income tax. The remaining cash can be contributed to an ILIT for premiums on a life insurance policy payable to younger loved ones.

"The insurance proceeds could be free of income and estate tax," says Keebler, "helping to make up for the loss of extended tax deferral under the new law. This might be especially appealing to clients who expect their assets to be subject to federal or state estate tax."

Roth IRAs to the Rescue

Bruce Steiner, an attorney with the law firm Kleinberg, Kaplan, Wolff & Cohen in New York, NY also believes that some sophisticated use of trusts may be useful under the new SECURE Act once the details can be studied. "The onset of reduced tax deferral," he says, "may encourage more Roth IRA conversions. A good idea would become even better."

To see why this new regime is favorable to Roth conversions, suppose that spouses A and B pass away, leaving a sizable traditional IRA to their children. Often, this wealth transfer would occur when the parents are in their 80s or 90s and the beneficiaries are in their 50s or 60s, at or near the peak of their careers – *and their peak earnings years.*

Under the SECURE Act, the next generation will have to empty these IRAs within 10 years. The beneficiaries likely would pay tax at steep rates on those distributions. "The key to a Roth conversion," says Steiner, "is the tax rate on the transaction.

The SECURE Act could push many non-spouse beneficiaries into higher brackets. Therefore, it might be better to convert some traditional IRA money to Roth IRAs now, taking advantage of current relatively low tax rates."

"The key to a Roth conversion, is the tax rate on the transaction."
-Bruce Steiner

Steiner adds, "we know we have a window when Roth conversions may be taxed efficiently, especially before age 72 – *the SECURE Act's new age to begin taking RMDs.*

The Tax Cuts and Jobs Act (TCJA) of 2017 widened the joint return tax brackets to double the width of the single brackets, through the 32% bracket. There's a big jump in rates from 24% to 32%, so many IRA owners convert up to the top of the 24% bracket, or to the top of the 12% bracket." Thus, many traditional IRA dollars now can be converted to possibly tax-free IRA dollars at only 24%, or even 12%. "If the tax on the conversion can be paid at today's rates, with outside money, clients may put more value into their IRAs," says Steiner. There are no required distributions for clients who move traditional IRA dollars to the Roth side, as well as the prospect of tax-free payouts for account owners and beneficiaries.

Even though the TCJA passed two years ago, it still qualifies as a key ruling, according to Steiner, especially the provision limiting the deduction for state and local taxes to $10,000. "That affects the timing of Roth conversions if someone might move to another state."

"Implementing the conversion (and paying the tax) should be done in the low-tax state, if possible. This $10,000 tax deduction limit also makes state income taxation of IRA distributions more important," Steiner adds, "because distributions from a traditional IRA are generally fully taxable, and state taxation of such distributions will be effectively increased, without full itemizing of deductions."

IRS Life Expectancy Tables

In November 2019, the IRS promulgated proposed regulations updating the life expectancy tables used for determining RMDs under IRAs and other retirement plans.

"The new tables, reflecting increased American longevity, add a small but measurable increase to everybody's life expectancy," says Natalie Choate, an attorney with the Boston, MA law firm Nutter McClennen & Fish.

"The effect will be a bit longer potential tax deferral for some retirees and beneficiaries."

"The effect will be a bit longer potential tax deferral for some retirees and beneficiaries."

-Natalie Choate

The IRS proposal revises three tables that have been used since 2003. They are the "Single Life Table," used for determing payouts to an eligible designated beneficiary under the SECURE Act as well as payouts from inherited retirement plans that are grandfathered under the new law;" the "Uniform Lifetime Table," used for determining lifetime RMDs to most plan participants over age 72; and the "Joint and Last Survivor Table," used for lifetime payouts to participants over 72 with a sole beneficiary who is a spouse more than 10 years younger than the participant.

Under today's Uniform Lifetime Table, the "distribution period" for an individual age 72 is currently 25.6 years. Under the new ULT, it will be 27.3 years. Under today's rules, an 85-year-old IRA owner's divisor is 14.8. "Under the new table," says Choate, "the divisor jumps to 16.0, a reduction of over $5,000 in the RMD from a $1 million IRA."

The best news of all will be for centenarians, Choate explains, as the IRS proposal recognizes the increased potential for an extended life span. "Under today's rules," she says, "the divisor drops below 2 at age 115, but the new tables never show a divisor below 2, which is the divisor for ages 120 and older."

Because these new tables will start applying in calendar year 2021, RMDs for 2020 will be computed under today's rules. "The switch to the new rules will be easy for situations where the life expectancy is recalculated annually," says Choate.

"For 2021 and subsequent years, the annual recalculation will simply track the new tables. This would be the case for all lifetime RMDs, and for post-death RMDs where the surviving spouse is (or is deemed to be) the sole beneficiary."

For a life expectancy being calculated under the fixed term method, there will be a one-time reset of the payout period, starting in 2021.

Choate gives the example of an IRA that's now being paid out to Junior, the designated beneficiary. The life expectancy payout started in 2015, the year after the participant's death, when Junior was 35, so his applicable distribution period was then 48.5 years. This is reduced by one each year, so under the old rules, the divisor for 2021 would have been 42.5 (48.5 - 6 years).

"Under the regulation's one-time reset," says Choate, "Junior would go back to 2015 and look up what his life expectancy would have been then, under the new table: 50.5 years. Deducting the 6 elapsed years from 50.5 would result in a 2021 divisor of 44.5 years. For future years, Junior will keep deducting one more year from 44.5 to get the divisor."

Separate Tables Switch

Keebler notes that the proposed regulations may apply to other taxpayers besides IRA owners or beneficiaries taking RMDs. "Younger people may be taking substantially equal periodic payments (SEPPs) from IRAs or company retirement plans," he says. Using SEPPs can allow a taxpayer to avoid the 10% penalty on distributions before age 59½; distributions must last for at least five years or until age 59½, whichever comes later.

The required SEPP amounts are calculated by various methods, as calculated by IRS life expectancy tables, so the proposed regulations will reduce the permitted penalty-free distributions. Under those regs, a taxpayer who began SEPPs before 2021 would apply the new rules, starting that year, without adverse consequences. Starting in 2021, new SEPP arrangements would use the revised tables, where applicable.

"Changing SEPP arrangements in mid-stream can be challenging," says Keebler, "but it must be done. If the rules aren't followed, retroactive penalties could apply, going back to the beginning of the SEPP distributions."

Beyond 60 Days

Jones also points out that the IRS has answered questions about waiving the 60-day limit on IRA rollovers. There are three ways to get such a waiver: qualifying for an automatic waiver, obtaining a favorable private letter ruling (PLR), or correctly self-certifying waiver qualification and justifying that assertion after an IRS income tax audit.

To qualify for an automatic waiver, a taxpayer must have sent the required funds to the relevant financial institution in time, but the company's error prevented timely deposit of funds.

To obtain a PLR, a taxpayer must submit a request for private letter ruling and pay a user fee of $10,000 to the IRS, as well as fees to the tax pro submitting the waiver request.

Self-certification can be accomplished by completing the Model Letter found in the appendix to IRS Revenue Procedure 2016-47 (there's no user fee). That model letter includes acceptable reasons

for missing the deadline (e.g., home damage, serious family illness). "If an IRA custodian won't honor a self-certification letter," says Jones, "the IRA may be moved to a more cooperative financial firm."

IRS information on this topic is available at irs.gov/retirement-plans/retirement-plans-faqs-relating-to-waivers-of-the-60-day-rollover-requirement.

Oversight for IRA Trusts

Seymour Goldberg, senior partner at Goldberg & Goldberg, a law firm in Melville, NY, has written two practitioner guides for the American Bar Association on IRA compliance issues. He is concerned about IRA trust violations under the IRS rules. An IRA trust is a trust that is the beneficiary of an IRA.

The issue involves timely delivery of certain paperwork to the institution that maintains the decedent's IRA account after the death of the IRA owner. According to Goldberg's conversations with the SEC, that issue is an IRS compliance issue, over which the SEC has no jurisdiction. "Therefore, it is up to the IRS and/or Congress to address this, in my opinion, systemic noncompliance issue," says Goldberg.

"I believe the IRS and/or Congress should provide for a reasonable IRS Voluntary Compliance IRA Correction Program to protect innocent IRA trustees who may have violated this compliance rule."

The key problem involves paperwork that the trustee must send to the IRA institution by October 31 of the year after the IRA owner's death. "Of the two permissible methods," says Goldberg, "I prefer the simpler one: sending a copy of the trust document to the IRA institution.

The other method is more complicated, requiring sending the IRA institution a list of all trust beneficiaries, along with additional specific required statements." Goldberg has found that most trustees, if not all, are "clueless" as to this rule. "Most trustees don't read IRS Publication 590-B or the IRS regulations to find out about this technical rule," he says.

What noncompliance issue will be raised, if such paperwork isn't delivered on time? If the IRA trust has a non-spouse beneficiary, RMDs won't be able to be stretched out over the life expectancy of the appropriate beneficiary. If RMDs have been stretched in this manner, without the paperwork being in place, back taxes and possible penalties may be assessed. There is no statute of limitations that protects the trustee.

Avoiding such problems by sending a copy of the trust document to the IRA institution might sound straightforward, but that's not always the case. "Some IRA institutions may not be interested in obtaining trust documentation," says Goldberg. "They may open a trust account without the required trust documentation."

Even if the IRA institution does not want to receive the IRA trust paperwork and perhaps analyze the terms of the trust, advisors should make sure that required documentation is sent to the IRA institution by the deadline. Goldberg asserts that the trustee should keep records of the timely submission of the required paperwork to the IRA institution.

"This should be done with a transmittal letter that is sent to the IRA institution by certified mail, return receipt requested," he says.

Advisors working with IRA trust non-spouse beneficiaries should explain the importance of meeting the October 31 deadline, if extended tax deferral is desired.

"One way to possibly mitigate the financial damage would be to close the IRA and pay the balance to the IRA trust."
-Seymour Goldberg

Take all necessary steps to see that the documentation is delivered on time and retain delivery records.

What's more, if an advisor discovers, for example, that a new client is the beneficiary of an IRA trust that has been taking life expectancy-based RMDs for years, even though the required paperwork was not filed on time, Goldberg believes that the advisor should notify the trustee about the noncompliance.

"One way to possibly mitigate the financial damage," he says, "would be to close the IRA and pay the balance to the IRA trust. The trustee should file Forms 5329, requesting that the 50% penalty for insufficient RMDs for the respective years be waived." These requests might be granted if it can be shown that the shortfalls resulted from reasonable error, and the mistake is being remedied.

New TSP Withdrawal Options

The TSP Modernization Act of 2017 was formally adopted on September 15, 2019. TSP stands for Thrift Savings Plan, which is the 401(k)-type plan offered to federal employees and members of the uniformed services.

Now that the new law has taken effect, federal workers have more flexibility in their distribution options. "The new TSP rules not only offer more choices to federal employees and retirees," says Heather Schreiber, founder of HLS Retirement Consulting in Holly Springs, GA, "but the new TSP rules also create more tax-efficient

drawdown strategies in retirement and provide some benefits that may extend to the IRA arena."

For example, employees were permitted only one in-service age-based withdrawal at age 59½ or older. Moreover, if an employee's balance consisted of both traditional and Roth balances, the partial in-service withdrawal would automatically be distributed on a pro-rata basis.

"The new law increases age-based in-service withdrawals from once in a lifetime to four in a calendar year," says Schreiber. "An employee may also take this distribution from the traditional balance, the Roth balance, or a combination of the two." According to Schreiber, some clients are unaware that the 5-year holding period that applies to the Roth portion of a TSP for purposes of a tax-free distribution of earnings does not also satisfy the 5-year holding period for the same person's Roth IRA.

"Therefore," she says, "it may make sense to roll over all or a portion of the Roth TSP balance to a newly established Roth IRA, in order to begin the 5-year holding period for qualified distributions there."

Another potential benefit to rolling the Roth portion of the TSP to a Roth IRA is the avoidance of lifetime RMDs. "The Roth portion of the TSP is subject to lifetime RMDs," says Schreiber, "which can cause a draw-down of monies that perhaps could have been avoided by employees who don't need the cash flow." Once money moves to a Roth IRA, there are no RMDs for those funds.

The new rules also offer greater flexibility in post-retirement distribution options, which now can be scheduled monthly, quarterly, or annually. "Partial withdrawals can now be taken once every 30 days," says Schreiber, "in addition to the life annuity options."

"The new TSP rules create more tax-efficient drawdown strategies in retirement and provide some benefits that may extend to the IRA arena."
-Heather Schreiber

Schreiber gives the example of an advisor working with a TSP account holder who retired at age 56 and now needs immediate income from the plan.

"Before the new law took effect," she says, "it was difficult to utilize the age-55 and separation-from-service exception to the 10% early distribution tax, particularly if the employee had previously used the one-time age-based withdrawal."

Under current law, the employee can request a partial distribution each month, effectively bridging the income gap before age 59½ with TSP funds while retaining the ability to roll the remainder to an IRA if desired for withdrawals after age 59½. "The age-55 exception does not extend to IRAs," says Schreiber, "so this kinder menu of post-retirement TSP withdrawal options allows an early retiree to effectively plan for and structure a more tax-efficient drawdown strategy."

Good News, Bad News

Unexpected events might derail a carefully designed retirement plan...*or they might not*, depending on how a court decides. Here are some examples:

Burack, TC Memo 2019-83, 07/08/19: On June 25, 2014, Nancy Burack received a $524,980 distribution from her IRA, which was held with Capital Guardian/Pershing. She used the money to purchase a home while waiting to close the sale of her former home, which occurred on August 21, 2014. Burack then overnighted a check for that amount to Capital Guardian, which received it on August 22 — *58 days after she had received the IRA distribution.*

"However," says Michelle Ward, partner with Keebler & Associates, "for undisclosed reasons the check wasn't deposited into Burack's IRA at Pershing until August 26, which was 62 days after her IRA payout."

"This might be the most important IRA-related case of the year," says Mary Kay Foss, a CPA in Walnut Creek, CA.

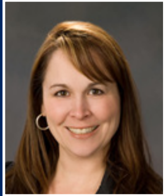
"This [Burack, TC Memo 2019-83] might be the most important IRA-related case of the year."
-Mary Kay Foss

"It's a situation to which both advisors and clients can relate. Burack knocked herself out to make her rollover work without any help from the custodian or the IRS, and she wound up with a taxable distribution. *Can you imagine someone's frustration if the custodian had the check on time but waited a few days to deposit it, after the deadline?*"

"The IRS held that Burack was required to include the $524,980 IRA distribution in her 2014 gross income," says Ward. Nevertheless, the Tax Court looked at the substance of the transaction — *the IRA was held with Capital Guardian and Pershing in a single account bearing both companies' names.*

"Consequently," Ward says, "the IRA custodian had accepted the deposit and held the assets subject to the IRA trust instrument, making its failure to record the transfer within 60 days a bookkeeping error." (The Tax Court also concluded that the petitioner was eligible for a hardship waiver.)

Legal niceties aside, Burack had to go through considerable effort and expense to prevail, so it makes sense to keep close tabs on any transaction where an IRA rollover crowds the 60-day deadline.



"Consequently, the IRA custodian had accepted the deposit and held the assets subject to the IRA trust instrument, making its failure to record the transfer within 60 days a bookkeeping error."
-Michelle Ward

Hoffman, (Bktcy Ct GA), 07/26/19: Timothy Hoffman guaranteed a loan to help his son-in-law open a restaurant. The restaurant failed so the loan came due. When the bank sought to collect a debt of over $450,000, Hoffman filed for bankruptcy and the matter was tried before the Bankruptcy Court of Georgia.

As part of the proceedings, Hoffman contended that his multiple retirement accounts, worth a total of over $1.8 million, should be exempt from his creditor.

"The bankruptcy court allowed Hoffman to exempt under Georgia law a traditional IRA account worth $1,477,000 and a small 401(k) account," says Ian Berger, IRA Analyst with Ed Slott & Co. "However, the court disallowed exemptions for Hoffman's Roth IRAs (worth a combined $276,000) and IRA distributions of $55,000." Thus, over $330,000 of the claimed retirement funds were vulnerable to collection.

"It is likely," says Berger, "that the debtor's traditional IRA account included rollovers from company plans, but he did not separately account for those rollovers in his bankruptcy filing." The federal Bankruptcy Code fully protects rollovers from creditors; contributory traditional and Roth IRA accounts are protected up to a cap ($1,362,800 for 2019 and 2020).

"By separating out the rollovers, Hoffman could have protected his Roth IRAs and his entire traditional IRA," says Berger. "That's because the sum of the Roth IRAs and the non-rollover part of his traditional IRA was likely less than $1,362,800." To get the benefit of the federal Bankruptcy Code exemption, Hoffman would have had to claim that exemption. But he did not – *he only claimed the state exemption.*

Individuals who file for bankruptcy should evaluate whether splitting out rollovers from their IRA accounts as well as claiming both federal and state exemptions will help them protect more of their retirement assets from creditors.

Richard L. Jones, U. S. Bankruptcy Court, Southern District of Illinois, 04/15/19: On or about April 16, 2018, Richard L. Jones withdrew $50,000 from his IRA and soon put nearly all of the cash into his non-IRA bank account. In the following weeks, Jones bought multiple lottery tickets, in hopes of paying off debts and avoiding bankruptcy.

As might have been expected, this "plan" was flawed. "Jones lost $30,000 and, within the 60-day rollover window, deposited the remaining $20,000 back into his IRA," says Andy Ives, IRA Analyst with Ed Slott & Co. The repayment occurred on June 15 of that year; on October 22 of that year, Jones filed a Chapter 7 petition and claimed that his $40,000 IRA was exempt from creditors. The bankruptcy trustee objected that the $20,000 redeposited in June shouldn't be exempt, and the matter wound up in bankruptcy court.

"Because the rollover money had been returned to a qualified retirement plan when Jones ultimately declared bankruptcy, those dollars remained protected from his creditors," says Ives. As the court's opinion pointed out, "The $20,000 was in the debtor's IRA on the date that he filed his bankruptcy case."

There was no indication of fraud; the court found no requirement that actual dollars be traced from withdrawal to redeposit, and the 60-day rollover deadline was met. "This case illustrates our mantra, *'what happens in the 60 days, stays in the 60 days,'*" says Ives. "Although it's not always understood, people can do whatever they want with their 60-day rollover dollars — *within the law.* As long as the money (or as in the Jones case, a portion of the money) is returned to an IRA or a qualified plan within the 60 days, no questions will be asked." The tax treatment and asset protection of IRAs will remain in force.

Berry, No. 4:17-cr-00385 (S.D. Tex. 2018), 12/17/18: Gwendolyn Berry was found guilty of embezzling over $1.8 million from a family's bank accounts; she was sent to jail and ordered to pay restitution, including 100% of her IRA. The court also ordered that 50% of her husband, Michael's, IRA be paid to the victims.

"A good discussion of community property and IRAs can be found in this case," says Foss. "The couple relied on precedents that found ERISA overrides community property law. However, the retirement benefits had been rolled to an IRA, which is not an ERISA plan, so Michael lost." Rolling an employer-sponsored plan to an IRA can often be a good decision, but participants with asset protection concerns should approach a rollover cautiously.

Rosenberg, TC Memo 2019-124, 09/19/19: Post divorce, a judgment ordered William Rosenberg's former spouse to pay him $10,000

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from her retirement account. "Instead of withdrawing the funds from her retirement account and making a cash payment, his ex-wife had the funds transferred from her retirement account to his IRA," says Ward. A few days later, Rosenberg, who was under age 59½, withdrew the funds and closed his IRA, triggering income tax and the 10% penalty.

Rosenberg took the issue to Tax Court, where he argued that the intermediate steps of the transaction (the transfers from his ex-spouse's retirement account to his IRA and his immediate withdrawal from that account) should be ignored. Instead, he asked the Court to treat the entire arrangement as a payment of cash from his former spouse to him as prescribed by the divorce order.

"The Court ruled that Rosenberg's understanding that his former spouse would withdraw the funds from her account and transfer them directly to him cannot overcome the fact that the funds were transferred to his IRA," says Ward, "and that Rosenberg withdrew them. The Court refused to use common law doctrines to fashion an equitable exception to the statutory scheme and found that withdrawal was includable in Rosenberg's gross income and subject to the 10% early distribution penalty." Substance may rule over form in some cases, but form still can have its days in court.

PLR 201930027: This request for a private ruling came from a taxpayer we'll call Ann, who had a substantial income for many years. Ann retained a CPA to prepare her tax returns, which reported Roth IRA contributions for multiple years. Ann's tax advisor never told her that her modified adjusted gross income (MAGI) was too high in each of the years that she made Roth IRA contributions.

"The CPA totally missed the Roth IRA eligibility rules," says Sarah Brenner, Director of Retirement Education with Ed Slott & Co. In addition, the advisor never told Ann that she could recharacterize the Roth IRA contributions to traditional IRA contributions. Ann reported that she had never taken distributions from her Roth IRAs.

"In this PLR," says Brenner, "the IRS allowed the IRA owner a 60-day extension, during which time she could recharacterize several years of ineligible Roth contributions as traditional IRA contributions, even though the deadline for recharacterization had long passed."

This PLR reinforces the fact that the TCJA eliminated recharacterizations of Roth conversions after December 31, 2017, but it did not eliminate recharacterizations of IRA contributions. "Recharacterization is often-overlooked for fixing ineligible contributions," says Brenner.

Another key point is that Roth IRA contributions have income limits; advisors should always check to make sure that a client has met the eligibility requirements for an IRA contribution. A double check, after the fact, can discover an ineligible contribution while there is still time for recharacterization. "The recharacterization deadline is October 15 of the year following the year for which an IRA contribution is made," says Brenner. In this PLR, Ann relayed that another advisor had discovered the previous errors, causing her to file this request. She asked for extra time to recharacterize the prior Roth contributions and pledged not to claim deductions for money moved to a traditional IRA, if her request was granted. (It's not clear whether Ann would have been able to deduct any or all of the recharacterized amounts, with her annual income.)

The IRS found that Ann had reasonably relied on a qualified tax professional who had misled her. By reporting the errors in a timely manner after she learned about them, Ann was deemed to have acted in good faith and thus qualified for the chance to set things right. ■

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