ED SLOTT'S IRA ADVISOR

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Tax & Estate Planning For Your Retirement Savings

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2019 HAPPY NEW YEAR

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Join the Retirement Planning Conversation

Top IRA Rulings of 2018

The most important IRA "ruling" of 2018 actually arrived in the waning days of 2017, when the Tax Cuts and Jobs Act (TCJA) was passed. Throughout 2018, it became apparent how that far-reaching legislation has impacted IRAs and other retirement plans. Of course, 2018 also brought other noteworthy IRA developments, from further legislation to court decisions to IRS actions. Here are 2018's top IRA rulings.

Lower Tax Rates

"Among the TCJA's most important developments is the expansion of the joint return tax brackets to twice the width of the single brackets, through the 24% rate," says Bruce Steiner, an attorney with the law firm Kleinberg, Kaplan, Wolff & Cohen in New York, NY. "This allows many married couples to do Roth IRA conversions and contributions at tax rates of 24% or less," says Steiner.

"Among the TCJA's most important developments is the expansion of the joint return tax brackets to twice the width of the single brackets, through the 24% rate."
-Bruce Steiner

In 2019, the 24% tax bracket goes up to $321,450 of taxable income on a joint return, twice the $160,725 ceiling for single taxpayers. (These brackets, which are indexed for inflation, are now in place through 2025).

IRAs and Section 199A

Another provision of the TCJA, the creation of tax code Section 199A, which offers a 20% deduction for qualified business income (QBI) from certain sources, may impact retirement plan contributions.

"Depending on the situation," says Steiner, "the impact of the QBI deduction can make either traditional retirement plan and IRA contributions or Roth contributions more attractive."

Steiner gives an example of a hypothetical self-employed Bennet, whose only source of income merits a QBI deduction. (QBI may come from self-employment, an S corporation, an LLC, a partnership, an estate, or a trust.) Bennet files a joint return with his wife, reporting taxable income around $300,000.

"If it were not for the 20% QBI deduction," states Steiner, "the couple would be in the 24% (or lower) tax bracket, but instead are in the 19.2% (or lower) bracket." This tends to devalue a traditional, pre-tax retirement account.

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Summary of Key 2018 Rulings

Tax Cuts and Jobs Act of 2017 (Impact on 2018)

- Expanded tax brackets for couples filing joint returns will encourage Roth IRA conversions and contributions.
- New Section 199A of the tax code, which created a 20% deduction for qualified business income (QBI), adds another factor to consider when choosing between pre-tax and after-tax retirement accounts.
- Roth IRA conversions no longer can be recharacterized, but it remains possible to rectify some mishandling of IRAs through recharacterization.
- With the federal estate tax exemption now over $11 million, advisors may focus more on income tax issues, such as year-of-death required minimum distribution shortfalls.

Bipartisan Budget Act of 2018

- Victims of 2017 California wildfires are permitted some penalty-free retirement plan distributions, payment extensions on the income tax due, and extensions for tax-free rollovers of those distributions

Revised Uniform Fiduciary Income and Principal Act

- Non-spouse income beneficiaries of inherited IRAs held by trusts may benefit from more realistic income allocations.

Court Cases and Rulings

- An IRA and a 401(k) account acquired by an ex-spouse in a divorce were not exempt assets in bankruptcy, under federal law. (*Lerbakken*)
- The U.S. Supreme Court ruled that state revocation-upon-divorce laws, which can apply to IRAs, essentially void beneficiary designations of a spouse after a divorce, even if the beneficiary designation occurred before the state law was enacted. (*Sveen v. Melin*)
- Taking cash from an IRA and then writing a check to a former spouse, after a divorce settlement, was not a nontaxable transfer, according to the Tax Court. (*Kirkpatrick*)
- Escheatment — the transfer of unclaimed property to the state — will be reported as a taxable distribution. (*Rev. Rul. 2018-17*)
- After the taxpayer received a distribution from her qualified plan, she did not roll the funds to an IRA within 60 days because she mistakenly believed that she had more time, based on her husband's advice. The favorable IRS ruling, following a taxpayer error, may signal a new stance by the IRS. (*PLR 201822033)*
- The taxpayer, who admitted to a medical condition that impairs her ability to understand financial statements, was allowed to move the original amount to an IRA. *(PLR 201807010)*
- An IRA was left to a discretionary trust, with beneficiaries who had unlimited power to name their own remainder beneficiary, upon reaching age 30. Each original beneficiary executed a release that limited their choice of successor beneficiary to a natural person who was younger than the oldest primary beneficiary. The IRS confirmed their ability to take RMDs over the life expectancy of the oldest primary beneficiary. (*PLR 201840007*)

If Bennet contributes to a traditional retirement plan, the deduction would effectively be in a 19.2% bracket, but Bennet or his beneficiaries may take distributions in a higher bracket.

"In this situation," says Steiner, "Bennet may want to contribute after-tax money to a Roth account, where distributions can be untaxed."

On the other hand, some taxpayers will have income that's too high to get the full Section 199A deduction, or any Section 199A deduction. For those clients, contributing to a retirement plan may be able to reduce taxable income and increase the QBI deduction. "Any type of plan can help clients in this situation," says Bob Keebler, who heads Keebler & Associates, a tax advisory and CPA firm in Green Bay, WI. "Many clients will have a retirement plan already, but they may not have a defined benefit plan, which can be adopted." As Keebler notes, contributing more dollars to a retirement plan not only can provide a greater QBI deduction but also may result in more asset protection from creditors' claims.

"Contributing more dollars to a retirement plan not only can provide a greater QBI deduction but also may result in more asset protection from creditors' claims." -Bob Keebler

Another wrinkle in newly created Section 199A of the tax code relates indirectly to Roth IRAs, according to Keebler. "The QBI deduction is the lesser of 20% of QBI or 20% of taxable income," he says. "If someone has $300,000 of QBI but only $250,000 of taxable income, after deductions, the QBI deduction would be capped at $50,000 (20% of $250,000), not $60,000 (20% of $300,000)."

How does that involve Roth IRAs? "Converting some of a traditional IRA to a Roth IRA can increase taxable income," says Keebler, "so if QBI is lesser than taxable income, then a full QBI deduction might be available." The end result might be a very tax efficient Roth IRA conversion: for example, an effective 19.2% tax rate on the Roth IRA conversion, for a taxpayer in the 24% federal tax bracket.

IRA Recharacterization

One noteworthy IRA-related change made by the TCJA was to eliminate recharacterization of Roth conversions. "Starting in 2018, such conversions are permanent," says Natalie Choate, an attorney with the Boston, MA law firm Nutter McClennen & Fish. Individuals no longer have the option of a tax-efficient reversal, in whole or in part, until October 15 of the following year.

But... some recharacterizations are still viable. Drilling down, into Section 408A of the tax code, which is otherwise only about Roth IRAs, some valuable opportunities can be discovered. "Hidden away in 408A(d)(9), it's explained that only Roth conversions and valid tax-free rollover contributions are off-limits for recharacterization," says Choate. (The newly published 8th edition of her classic book, ***Life and Death Planning for Retirement Benefits,*** can be ordered at shop.btpubservices.com/Title/9780964944091.)

Therefore, some IRA missteps can be rectified. For example, suppose Julian, an aspiring actor who makes about $10,000 a year as a dog walker, contributes $6,000 to his Roth IRA in August 2019. In December, Julian marries a wealthy dog owner, which results in annual income well over $200,000 on their joint tax return for the year, which is in excess of the ceiling for Roth IRA contributions.

"Hidden away in 408A(d)(9), it's explained that only Roth conversions and valid tax-free rollover contributions are off-limits for recharacterization." -Natalie Choate

Using 408A(d)(9), Julian will be able to transfer that Roth IRA contribution (and any interim earnings) to a traditional IRA by the extended due date of his 2019 tax return: October 15, 2020. "Julian's regular Roth IRA contribution was not a conversion contribution, so it can still be recharacterized," says Choate.

A different scenario could involve Lacey, who requests a direct rollover of her 401(k) balance to her traditional IRA at Megabank. Suppose the bank erroneously puts the money into an IRA held by Larry, Lacey's husband. "When the mistake is discovered," says Choate, "Lacey should be able to move this contribution (plus any earnings) into the correct IRA, tax-free, by the extended tax return deadline, using recharacterization under 408A(d)(6)."

In this example, Lacey's initial rollover was not valid, because it went into Larry's IRA so it can be recharacterized." Choate adds that this possibility for Lacey is her opinion, because there are, as of yet, no published examples of this type of recharacterization. This portion of the TCJA was crafted very carefully, Choate concludes, to preserve recharacterization for valid purposes while removing chances for gaming the system.

Estate Tax Easing

The TCJA raised the federal estate tax exemption to over $11 million per decedent, which means that relatively few clients will be exposed to this tax. Many advisors, therefore, are placing more emphasis on income tax issues that heirs will face.

Seymour Goldberg, senior partner at Goldberg & Goldberg, a law firm in Melville, NY, says one area of possible concern is taking the required minimum distribution (RMD) for the year of death. "Recently," he says, "I've become aware of a number of cases where this RMD wasn't taken on time, and potential penalties could be significant."

"I've become aware of a number of cases where this RMD [for the year of death] wasn't taken on time, and the potential penalty could be significant." -Seymour Goldberg

Let's suppose Joe dies on October 15, 2019, with an IRA valued at

$1 million on December 31, 2018. "In most cases, he would not have taken his RMD, because IRA owners often maximize potential tax-deferred growth by waiting until late in the year to take their RMD, or else they receive RMD payments in monthly installments," says Goldberg, whose newly released book, ***Effective Use Of IRA Assets In Estate Planning*** *(includes IRS compliance issues and asset protection planning)*, is available at: trustestateprobate.com/publications-for-purchase-2018-2019/.

Joe would have been age 75 in 2019, his year of death. Thus, his life expectancy under the IRS Uniform Lifetime Table would have been 22.9 years. Dividing $1 million (year-end 2018 IRA balance) by 22.9 (life expectancy for year of death) equals $43,668, which would have been Joe's 2019 RMD.

Before he died, assume Joe had taken only one IRA distribution in 2019 for $10,000. The unpaid RMD balance of $33,668 would be payable to Joe's IRA beneficiary. Failure to timely pay this amount to Joe's beneficiary could generate a 50% penalty ($16,834) to Joe's beneficiary for the RMD shortfall.

According to Goldberg, this unpaid RMD for the deceased IRA owner's year of death should be paid to the beneficiary as soon as possible. The official deadline for this distribution is December 31 of the year of death, but that may not be possible.

If Joe had died on October 15, as stated, it may take longer than 2½ months to discover the shortfall and distribute the RMD balance. This is a real-world IRS significant noncompliance issue that may affect many people.

"Advisors who represent IRA beneficiaries should urge them to pay any RMD shortfall for the year of death, as soon as possible," says Goldberg. "If the deadline was missed, the beneficiary should file IRS Form 5329, indicating the shortfall and requesting a waiver of the 50% penalty."

Let's continue our example as if we are now in the year 2020. Assume that Joe's widow, Kat, was the sole IRA beneficiary. Kat did not take out the unpaid distribution before December 31, 2019.

On the Form 5329 waiver request – *filed shortly after Kat found out about the unpaid distribution in June 2020* – Kat should explain that Joe died on October 15, 2019, and she then withdrew the RMD shortfall of $33,668 as soon as she became aware of it. "Kat also should include information about when she became aware of the shortfall, who brought it to her attention, and that she will report the $33,668 as taxable income for 2020 – *the calendar year that she discovered the RMD shortfall and received the payout*," says Goldberg.

As the surviving spouse, Kat cannot roll over the unpaid RMD of $33,668. "According to IRS rules, an RMD is not eligible for a rollover," says Goldberg. "In addition, the first monies taken out during a given year from the traditional IRA are considered to be applied toward the RMD amount for that year."

Alimony Taxation, Plan Loans

Heather Schreiber, founder of HLS Retirement Consulting in Holly Springs, GA, reveals that the changes to alimony payments under the TCJA will have an impact on IRAs and other retirement plans. "Under prior law," she says, "an alimony payer received an above-the-line deduction and the recipient treated the alimony as income. However, for divorce agreements adopted on or after January 1, 2019, the tax rules are reversed – *now, there is no deduction for alimony payments and alimony payments are not treated as income*."

Schreiber points out that the payer under a divorce agreement is generally the higher earning spouse. "The old regime permitted the shift of income to the lower earning spouse and, in many cases, a lower overall tax liability on the alimony payments," she says. "The new rules favor the payee and may present a significant increase in tax liability for the payer."

In addition, alimony payments had historically been considered earned income for the recipient spouse, permitting a traditional or Roth IRA contribution. "For recipients under divorce or separation agreements that were adopted after 2018, IRA contributions are off the table," says Schreiber, "unless they have a source of earned income that meets the definition." Advisors representing such clients may have to find another way to build a retirement fund.

"For divorce agreements adopted on or after January 1, 2019, the tax rules are reversed – *now there is no deduction for alimony payments and alimony payments are not treated as income*." -Heather Schreiber

Schreiber also mentions the TCJA's changes to the plan loan offset rules. "Prior to 2018," she says, "a retirement plan participant who failed to pay back an outstanding loan at the time of separation from employment or plan termination was subject to rules regarding loan repayment." In order to avoid taxation and possibly a 10% premature withdrawal penalty, the employee had 60 days to replace

the amount of the outstanding loan and roll it to an IRA or another qualified plan. If the 60-day deadline was missed, participants were faced with a loan default and undesirable tax consequences.

The TCJA permanently relaxed these rules, as of January 1, 2018. “Participants now can complete a rollover of the outstanding loan amount by their tax filing deadline, plus extensions, following the year of their separation from employment or plan termination,” says Schreiber.

For example, Jane, age 45, has an outstanding loan balance of $25,000 at the time she leaves her employer in March 2019. She can roll $25,000 into an IRA or a new employer’s qualified plan up to April 15, 2020 (or October 15, 2020 by extension) to avoid taxation and possibly a 10% penalty on the outstanding loan balance.

"This welcome change allows a plan participant significantly more time to accumulate the funds to pay back the outstanding loan to an IRA or a qualified plan," says Schreiber, “which may allow the borrower to defer taxes and avoid potential penalties.”

Beyond TCJA: Disaster Relief

Another federal law, the Bipartisan Budget Act of 2018, included relief for victims of the 2017 California wildfires, reports Sarah Brenner, Chief IRA Analyst with Ed Slott and Company. “Among those provisions were penalty-fee retirement plan distributions for victims under age 59½, up to $100,000 per person,” she says. “The income tax on such distributions can be spread evenly over three years. Alternatively, repayments of those distributions to a retirement plan or an IRA within three years will be treated as tax-deferred rollovers.”

Currently, Congress is considering similar support for victims of last year’s wildfires. The IRS can grant some relief, such as an extension of tax-related deadlines and has done so for 2018 disaster victims, but changing the retirement account distribution rules is something only Congress can do.

Uniform Fiduciary Income and Principal Act

Michael J. Jones, partner in the accounting firm Thompson Jones in Monterey, CA, points to the importance of Section 408 of the 2018 Revised Uniform Principal and Income Act – *now the Uniform Fiduciary Income and Principal Act (UFIPA)*. “This update revises the allocation between income and principal of a trust’s receipts from an IRA as well as from a pension, profit-sharing, stock-bonus, or stock-ownership plan (a separate fund),” he says.

“The 2018 changes represent a dramatic shift from Section 409 of the 2009 UFIPA, which allocated those receipts 10% to income and 90% to principal, unless that 90/10 formula disqualified an estate tax marital deduction under an estate tax qualified terminable interest property (QTIP) election.”

Now, the 90/10 rule applies only as a last resort to trust receipts from a private or commercial annuity. According to Jones, the exception mentioned above, for separate funds that are subject to a federal estate tax marital deduction, still applies under the 2018 UFIPA, in either of two situations: one, where the decedent’s surviving spouse is entitled to all income for life and the surviving spouse is granted a general power of appointment; and two, where a QTIP election has been made for a trust as qualified terminable interest property.

“A new exception to the general rule has been added to the UFIPA,” says Jones. “This will be welcomed by practitioners and trust income beneficiaries. If the trustee can ascertain the amount of income realized within the separate fund, distributions received by the trust from the fund are allocated first to trust income, to the extent of the separate fund’s net income. To the extent the amount received by the trust exceeds the separate fund’s net income, that amount is required to be allocated to principal.”

Jones explains that this change opens up recognition by a trust of IRA accounting income, or recognition of income from an employer-sponsored defined contribution plan, provided that the amount of income is determinable. “In the vast majority of cases,” he says, “the trustee will have established an inherited IRA into which the decedent’s benefits are transferred directly from the decedent’s account. Accordingly, in those cases, this new rule applies.”

“In the vast majority of cases, the trustee will have established an inherited IRA into which the decedent’s benefits are transferred directly from the decedent’s account. Accordingly, in those cases, this new rule applies.”

-Michael J. Jones

Another change in the 2018 UFIPA would apply when income isn’t ascertainable by the receiving trustee. In that case, instead of applying the 90% principal/10% income rule, income would be the opening value multiplied by a unitrust percentage.

"The same unitrust percentages are recognized for purposes of defining trust income for income tax purposes under *Treasury regulations § 1.643(b)-1 Definition Of Income*, so UPIA Section 409’s

unitrust definition is identical to that of applicable trust income tax regulations, notes Jones.

Moreover, Jones reveals that UFIPA Article 6 provides suggested transition rules that could apply:

1. Beginning on the death of decedent for a trust funded after adoption, but only if the trust wasn't funded before death;
2. Beginning on the date of the decedent's death, if the trust was initially funded during the calendar year when UPIA Section 409 is adopted by the state where the decedent lived at death; and
3. For all other trusts, beginning on January 1 of the calendar year when Section 409 is adopted by the state where the decedent lived at death.

Another section, 605(3), of the 2018 UFIPA suggests that adopting states provide that trusts operating on amended Section 409 after operating under the previous version's 90%/10% rule will switch to the new rule going forward. That update will help non-spouse income beneficiaries of inherited IRAs held by trusts, by making income allocations more realistic.

"Hopefully," says Jones, "all states will adopt these portions of 2018 UFIPA and add a provision tailored to revocable living trusts."

Bankruptcy Verdicts

Several 2018 court decisions involved the treatment of IRAs in bankruptcy. For example, in the ***Brian A. Lerbakken (Bankruptcy 8th Cir., No. 18-6018)*** case, Lerbakken filed for bankruptcy, claiming an IRA and a 401(k) as exempt assets. He had obtained these in a divorce settlement.

"The United States Bankruptcy Appellate Panel for the 8th Circuit ruled that a 401(k) plan and an IRA acquired by an ex-spouse in a divorce were not exempt assets under federal law," says Michelle Ward, partner with Keebler & Associates.

As Ward explains, the federal bankruptcy code includes provisions that protect "retirement assets" from creditors if they meet two criteria: first, the money must be in a designated retirement account; second, the account is exempt from taxation under tax code sections 401, 403, 408, 408(A), 414, 457, or 501(a).

Here, the debtor claimed the retirement assets received in the divorce were exempt from the bankruptcy estate, because the accounts represent marital property that his ex-wife had saved for their joint retirement. "Lerbakken contended that his interest in the accounts satisfied the exemption statute because the proceeds are not taxable to his ex-wife, under the relevant tax code sections," says Ward.

However, the Bankruptcy Court disallowed the exemption on the basis that the relevant accounts were not retirement funds as defined by *Clark v. Rameker*, a 2014 U.S. Supreme Court ruling. In its *Clark* ruling, the Supreme Court had suggested that the exemption is limited to individuals who create and contribute funds into the retirement account.

Although the *Lerbakken* ruling is only applicable in the 8th Circuit, practitioners should take this case into consideration when advising clients in a divorce, Ward adds.

"The United States Bankruptcy Appellate Panel for the 8th Circuit ruled that a 401(k) plan and an IRA acquired by an ex-spouse in a divorce were not exempt assets under federal law." -Michelle Ward

"This case shows how important it is to avoid commingling retirement plan assets after a divorce," says Keebler. "That could expose otherwise exempt assets to creditors."

Let's go through an example: William and Wendy get divorced, and the settlement calls for William's 401(k) balance to pass to Wendy. She should not combine those dollars with her own retirement plan. "The *Lerbakken* case indicates that the commingled assets could be exposed to creditors if Wendy files for bankruptcy," says Keebler. "By keeping the assets separate, Wendy's own retirement plan can be exempt from creditors after a bankruptcy filing."

In re Chaudury, 2018 BL 34776, Bankr. M.D. Tenn., 16-05574 also involved the treatment of an IRA in bankruptcy. As Mary Kay Foss, a CPA in Walnut Creek, CA, explains, the debtor withdrew nearly $330,000 from one of his IRAs to buy a house with his spouse. Within 60 days, Chaudury got a bank loan and returned almost $250,000 to this IRA, paying tax on the net distribution.

Seeking the IRA in court, the bankruptcy trustee pointed out that Chaudury took that distribution to buy a house; the trustee claimed that this process had disqualified the IRA by essentially borrowing IRA money to purchase a home.

The Bankruptcy Court rejected this interpretation and held the IRA exempt from creditors. A legal distribution was followed by a timely redeposit, for a partial rollover. The fact that Chaudury was over age 59½, entitled to an IRA withdrawal without penalty, was another favorable point in the IRA owner's favor.

"In the past decade," says Foss, "bankruptcy trustees have searched for cases in which a debtor had disqualified an IRA,

exposing it to creditors. A 2009 ruling in *Willis*, a Florida case, has encouraged these efforts. In *Chaudury*, however, the IRA owner had complied with the law in how IRA money was handled."

"In the past decade, bankruptcy trustees have searched for cases in which a debtor had disqualified an IRA, exposing it to creditors."

-Mary Kay Foss

In re Xiao, case No. 13-51186, United States Bankruptcy Court, D. Connecticut, Hartford Division is cited by Jeremy Rodriguez, IRA Analyst with Ed Slott and Company. Jie Xiao was the owner of a business that grew to hire 13 other employees. Xiao adopted a prototype retirement plan from a major insurer.

After the initial paperwork was completed in 2007, this plan was covered by a favorable IRS Opinion Letter. "Within a few years," says Rodriguez, "Xiao had executed two discretionary amendments that prohibited otherwise eligible employees from participating in the plan, effectively limiting participation to Xiao and his wife."

Xiao later filed for bankruptcy and listed his interest in the retirement plan, worth over $400,000, as an exempt asset. The bankruptcy trustee challenged this asset's status as a qualified plan, which could have provided an exemption.

"The Court sided with the trustee, and the assets became available to the creditors" says Rodriguez, "holding that the discretionary amendments violated the nondiscrimination and minimum participation rules in the tax code and thus caused the plan to fall outside the scope of the original IRS Opinion Letter."

Other Court Decisions

In ***Sveen v. Melin, U.S. Supreme Court, No. 16-1432***, the Supreme Court held that life insurance proceeds would not go to an ex-spouse, even though her name remained on the ex-husband's beneficiary form after a divorce. "Although this is a life insurance case, IRA beneficiary forms are impacted too," Brenner points out.

"***Lazar v. Kroncke, Case No. 15-15078, 9th Cir. Court of Appeals, July 14, 2017, cert. denied June 18, 2018*** did involve an IRA. The Supreme Court declined to hear it after deciding *Sveen*." As Brenner points out, the Supreme Court has supported state revocation-upon-divorce laws, which can apply to IRAs. Such laws essentially void beneficiary designations of a spouse after a divorce. "The Supreme Court has clarified that these laws are in force," Brenner says, "even if the beneficiary designation occurred before the state law was enacted." About half of the U.S. states have such laws.

The issue in ***Kirkpatrick, TC Memo 2018-20*** was the taxability of the transfer of funds under a divorce agreement. Kirkpatrick was ordered to transfer $100,000 to an IRA titled in his wife's name. To comply, he moved the money from his IRA to his checking account and subsequently wrote her a $100,000 check.

In Tax Court, Kirkpatrick contended such a transfer of an individual's interest in an IRA to a spouse or former spouse under a divorce or separation instrument is not considered taxable by the tax code.

"The Tax Court disagreed," says Ward, "holding that Kirkpatrick's $100,000 IRA distribution was not a nontaxable transfer incident to divorce. There was no transfer to an IRA for Christiana Kirkpatrick, which was specifically mentioned in the divorce settlement." To avoid problems in such situations, Ward notes, advisors should have clients change the name of their IRA to the name of the former spouse or directly transfer the funds to the other spouse's own IRA. "As highlighted in this case," she says, "clients ordered to transfer IRA funds should not cash out a portion of their IRA and then write a check to their former spouse."

In ***Andrew Shank, T.C. Memo 2018-33,*** the taxpayer had made IRA contributions during the 1990s that he described as nondeductible. In 2006, the "cost" per a custodian's statement of his IRA investments was $4,760. "When he took a full $27,745 withdrawal from that IRA in 2014," Foss relates, "Shank did not report any taxable income from the distribution." The IRS found the entire distribution to be taxable income and imposed penalties for claiming basis without having filed Form 8606. "But," says Foss, "the Tax Court treated the $4,760 from the former custodian's report as basis in reducing the assessed tax."

The Court overturned the penalties. "I tell clients that Form 8606 should be attached to Form 1040 every year that they make a nondeductible IRA contribution or withdraw funds from any IRA after a nondeductible IRA contribution has been made," says Foss. Had Shank followed that procedure, he could have avoided a great deal of expense and aggravation.

IRS Rulings

Revenue Ruling 2018-17 gives guidance to custodians on how IRAs that are considered abandoned property must be handled, according to Brenner. "The ruling confirms that escheatment — *the transfer of unclaimed property to the state* — will be treated as a taxable distribution and reported as such," she says, "with the withholding rules in effect." In other words, the IRA owner gets a tax bill, even though the state gets the money.

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In **PLR 201822033**, the IRS waived the 60-day rollover requirement for a plan distribution. "The taxpayer retired and received a distribution from her qualified plan," says Ward. "She did not roll the funds to an IRA within 60 days because she mistakenly believed that she had until the end of the year to complete the rollover, based on her husband's advice."

Ward adds that the IRS generally has been unwilling to provide relief for failed rollovers that involve taxpayer error, rather than advisor or institution error. This favorable ruling may signal a softening of the agency's position.

When discussing **PLR 201807010,** Foss refers to it as an encore of "Wake Up Little Susie." In 2014, Susie claimed to have a medical condition that impairs her ability to understand financial statements, requested that her IRA annuity be terminated, and proceeds rolled to an IRA at a financial institution where she had a non-IRA account.

Late in the year, her investment advisor placed the cash in bonds, mutual funds and CDs, within a taxable account. "Susie should have received Form 1099-R for 2014 from the insurance company that held the annuity," says Foss. She also should have received 2014 Forms 1099-INT and 1099-DIV for the new investments; in 2015 Susie should have noticed that the taxable income from her investments in her taxable account had increased considerably.

In 2016, she received an IRS notice assessing tax on the 2014 rollover. "Then Susie woke up – *in trouble deep* – as the song goes," Foss says. "Despite the fact that she never opened an IRA account with the brokerage firm, the firm's error and her medical impairment led the IRS to allow a rollover of the original amount to an IRA," says Foss. "I wonder if the financial institution paid the $10,000 IRS user fee as well as the professional fees necessary to get this ruling."

In **PLR 201840007**, the taxpayer (we'll call him Fred) created an irrevocable discretionary trust and named it as the beneficiary of his 401(k) account. The trust listed Fred's five surviving children as beneficiaries. "Because this is a discretionary trust, the identity and ages of any remainder or successor beneficiaries must be taken into account for post-death RMD purposes," says Rodriguez. "The trust listed remainder beneficiaries for each of the five primary beneficiaries, but the trust granted them the unlimited power to name their own remainder beneficiary, upon reaching age 30."

The original version of the trust might have posed RMD problems, according to Rodriguez, so the five primary beneficiaries met before September 30 of the year after the original taxpayer died. "At this meeting," he says, "each original beneficiary executed a release that limited their choice of successor beneficiary to a natural person, who had to be younger than the oldest primary beneficiary."

Then the beneficiaries sought a PLR that confirmed their ability to take RMDs over the life expectancy of the oldest primary beneficiary. "They were worried," says Rodriguez, "of the mere possibility that a non-designated beneficiary (like an estate, charity, or creditor) could be named as a successor beneficiary and jeopardize the life expectancy payout. They were unsure if the releases cured this potential problem."

The IRS responded that the timing and limitations in the releases did preserve the life-expectancy-based RMD option. "Under the tax code," says Rodriguez, "a beneficiary group that can contract or expand is treated as identifiable (and thus entitled to stretch out distributions) only if it is possible to identify the class member with the shortest life expectancy. The releases signed by the beneficiaries not only removed potential non-designated beneficiaries but also prevented anyone with a shorter life expectancy than the oldest primary beneficiary from being named as a successor beneficiary."

This PLR, Rodriguez concludes, illustrates the interplay between the designated beneficiary and trust beneficiary rules, while serving as an important reminder to take appropriate, timely action. ■

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