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Latest Developments Affecting Distributions and Rollovers From Qualified Plans, 403(b) Arrangements and IRAs

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A. Minimum Distribution Rules Apply To Employer Sponsored Tax-Favored Retirement Plans And To Individual Retirement Arrangements.

1. General rule: distributions must begin no later than the required beginning date and a minimum amount must be distributed each year. For traditional IRAs, the required beginning date is April 1 following the calendar year in which the IRA owner attains age 70½. For employer-sponsored tax-favored retirement plans, the required beginning date for a participant who is not a 5 percent owner is April 1 after the later of the calendar year in which the participant attains age 70½ or retires.

B. Under a Defined Contribution Plan or IRA, the Minimum Amount Required to be Distributed is Based on the Joint Life Expectancy of the Participant Or Employee and a Designated Beneficiary (Who Is Generally Assumed To Be Ten Years Younger), Calculated At The End Of Each Year.

C. Minimum Distribution Rules Also Apply To Balances Remaining After A Plan Participant or IRA Owner Has Died.

1. The after-death rules vary depending on (1) whether a participant or IRA owner dies on or after the required beginning date or before the required beginning date, and (2) whether there is an individual designated as a beneficiary under the plan. The rules also vary depending on whether the participant's or IRA owner's spouse is the sole designated beneficiary.

2. Spouse beneficiary:

   a. Spouse receives distributions from the decedent's plan/IRA, based on the spouse's life expectancy, recalculated every year OR

   b. Spouse elect to treat the decedent's IRA as the spouse's IRA or spouse effects a transfer of the decedent's balance in the plan in which the decedent participated or the balance in the decedent's IRA to an IRA of the spouse. In either case, the spouse disregards the past history of the account.

3. Nonspouse beneficiary:

   a. Death on or after the required beginning date:

      i. If a plan participant or IRA owner dies on or after the required beginning date and there is a nonspouse individual designated as beneficiary, the distribution period is the beneficiary's life expectancy, calculated in the year after the year of death. The distribution period for later years is determined by subtracting one year from the initial distribution period for each year that elapses.

ii. If there is no individual designated as beneficiary, the distribution period is equal to the expected remaining years of the participant's or IRA owner's life, calculated as of the year of death.

b. Death before the required beginning date:

i. If a participant or IRA owner dies before the required beginning date and any portion of the benefit is payable to a non-spouse individual designated beneficiary, distributions must either begin within one year of the participant's or IRA owner's death and be paid over the life or life expectancy of the designated beneficiary or be paid entirely by the end of the fifth year after the year of death.

ii. If a participant or IRA owner dies before the required beginning date and there is no individual designated as beneficiary, then the entire remaining interest of the participant or IRA owner must generally be distributed by the end of the fifth year following the individual's death.

D. What Happens if the Designated Beneficiary Dies Before the IRA is Fully Distributed?

1. If the designated beneficiary dies during the distribution period, distributions continue to any subsequent beneficiaries over the remaining years in the distribution period.

E. Roth IRAs and Required Distributions

1. The minimum distribution rules do not apply to Roth IRAs during the life of the account owner, but do apply to balances remaining after the death of the owner.

F. Moving Assets From A Tax-Favored Employer Retirement Plan Or IRA To An IRA Or "Eligible Retirement Plan" Without Adverse Tax Consequences

1. A review of the meaning of key terms.

a. **"Eligible rollover distributions"** are the distributions which are capable of being transferred from one tax-favored investment vehicle to another without recognizing income.

i. This is a term defined in the Internal Revenue Code (IRC §402(c)(4):

Eligible rollover distribution. For purposes of this subsection, the term “eligible rollover distribution” means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include—

(A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made—

(i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

(ii) for a specified period of 10 years or more,

(B) any distribution to the extent such distribution is required under section 401(a)(9),

(C) any distribution which is made upon hardship of the employee.

b. “Eligible rollover distributions” come in two statutorily “defined” flavors: “direct transfers” of “eligible rollover distributions,” popularly known as (and so named in the Regulations as) “direct rollovers”; and eligible rollover distributions” that take the form of a distribution to the participant in the retirement plan or IRA and which are then transferred to an “eligible retirement plan” -- so-called “60-day rollovers.”

i. “Direct rollovers”

(a) Defined in IRC §401(a)(31)(participants in qualified plans must be given the option to have their eligible rollover distributions transferred directly from the qualified plan trust to the recipient eligible retirement plan.

(b) Reg. §1.403(b)-7(b): guidance concerning the “direct rollover” requirements for distributions from annuities described in section 403(b).

ii. “60-day rollovers”: a creature of Code §402(c)(1) and (c)(3) (for qualified plans) and Code §408(d)(3)(for IRAs): if a plan participant or IRA owner receives the distribution, then the special exclusion from gross income treatment applies if but only if (and, for qualified plans, to the extent) the amount received is transferred to an eligible retirement plan within 60 days.

c. **"Eligible retirement plan"**: the arrangement to which an "eligible rollover distribution" must be transferred in order to qualify for exclusion from gross income.

i. IRC §402(c): distributions from qualified plans can be excluded from gross income only if they are transferred to an "eligible retirement plan" (among other requirements).

(a) IRC §402(c)(8)(B) defines, "eligible retirement plan": an IRA, a qualified trust; an IRC §403(a) (annuity) or (b) (custodial account) arrangement; an IRC §457(b) deferred compensation arrangement.

ii. IRC §408(d)(3): distributions from IRAs can be excluded from gross income only if they are transferred to an "eligible retirement plan" (among other requirements).

(a) IRC §408(d)(3): cross-reference to all but one of the components of the definition in IRC §402(c)(8)(B) (individual retirement annuities in IRC §408(a) are ***not*** included).

2. General rule: direct rollover of a distribution, a 60-day rollover (these two are prescribed in the Internal Revenue Code), or an IRA trustee-to-IRA trustee transfer (this is a creature of IRS invention in Rev. Rul. 78-406, 1978-2 C.B. 157) do not result in income inclusion to the beneficiary.

a. IRC §408(d)(3)(A)(i): any amount distributed from an IRA will not be included in the gross income of the distributee to the extent the amount is paid into an IRA for the benefit of the distributee no later than 60 days after the distributee receives the distribution.

b. IRC §408(d)(3)(B): an individual is permitted to make only one rollover in any 1-year period.

i. Here is the actual text of the statute:

"This paragraph [the exclusion of the distribution from gross income] does not apply to any amount described in subparagraph (A)(i) received by an individual from an individual retirement account or individual retirement annuity if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in that subparagraph from an individual retirement account or an individual retirement annuity which was not includible in his gross income because of the application of this paragraph."

c. Watch out: this does not mean what you (and many IRA custodians and administrators -- and, for quite a while, the IRS --)

may think this means. See below for a discussion of the angst created by the U.S. Tax Court's decision in *Bobrow v. Commissioner* and the response crafted by the IRS for the future.

3. Exception to the general rule: not all of these methods are available with respect to assets of a plan or IRA inherited by a non-spouse beneficiary.

    a. When a participant in a tax-favored employer retirement plan dies before all assets in the plan have been distributed, a beneficiary who is a surviving spouse may roll over the assets, by either a "direct rollover" or by a 60-day rollover, into an IRA that is treated either as a spousal inherited IRA (i.e., an IRA in the name of the decedent in which distributions are made based on the surviving spouse's remaining life expectancy) or as the surviving spouse's own IRA.

        i. "Direct rollover": this term is a term of art. It means a direct transfer from a qualified plan, §403(b) arrangement, or a governmental §457 plan to the custodian/trustee of a traditional IRA, qualified plan, §403(b) arrangement, or a governmental §457 plan -- or a direct transfer from an IRA to the trustee/custodian of a qualified plan, §403(b) arrangement, or a governmental §457 plan. NB: a qualified plan, 403(b) arrangement or 457 plan must be on one of the two ends of the transaction. Not the case? Then it's not a "direct rollover."

        ii. 60-day rollover: the assets are distributed to the owner/beneficiary, rather than to the trustee/custodian of the receiving IRA, plan, or arrangement.

    b. A beneficiary who is not a surviving spouse may roll over the decedent's interest in a tax-favored employer retirement plan into an IRA that is a non-spousal inherited IRA only by means of a direct rollover: a 60-day rollover is not available to a surviving nonspouse beneficiary.[1]

    c. A surviving non-spouse beneficiary may treat the assets of the decedent's IRA as a non-spousal inherited IRA, and may move the assets to another non-spousal inherited IRA only by means of a direct trustee-to-trustee transfer; rollovers from the deceased

[1] IRC §402(c)(11), which sanctions the direct rollover, and IRC §408(d)(3)(C), which prohibits non-spouse beneficiaries from using the 60-day rollover method.

owner's IRA to another IRA are not available for a surviving non-spouse beneficiary.[2]

II. Special Rule to Remember: When Can a Surviving Spouse Elect to Treat the Deceased Spouse's IRA as the Surviving Spouse's IRA?

A. Reg. §1.408(a)-5, Q&A-5 Provides the General Rule

1. Which spouses are eligible to make the election and when the election must be made:

a. This election may be made at any time after the individual's date of death.

b. "In order to make this election, the spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts from the IRA. If a trust is named as beneficiary of the IRA, this requirement is not satisfied even if the spouse is the sole beneficiary of the trust." Reg. §1.408(a)-5, Q&A-5(a).

2. The two ways this election is effected:

a. An affirmative election by the eligible surviving spouse: the surviving spouse redesignates the deceased spouse's IRA as an IRA in the name of the surviving spouse as IRA owner rather than as beneficiary.

b. A deemed election: an eligible surviving spouse is deemed to have redesignated the deceased spouse's IRA as the surviving spouse's IRA in either of these two circumstances:

i. Distributions to the surviving spouse do not begin by the end of the year following the year of the deceased spouse's death; or

ii. The surviving spouse makes a contribution to the deceased spouse's IRA after the death of the deceased spouse.

B. The Preamble To The 2002 Final And Temporary Regulations Contains An Important Exception To The Limit On Which Surviving Spouses May Make This Election

1. What happens if the beneficiary of the IRA is the estate of the deceased spouse or a trust for which the deceased spouse is either the sole beneficiary or one of a number of beneficiaries? The surviving spouse

[2] IRC §408(d)(3)(C) contains the prohibition; Rev. Rul. 78-406 sanctions the trustee-to-trustee transfer methodology.

may **not** make the election to treat the deceased spouse's IRA as an IRA owned by the surviving spouse.

2. But, we don't care, for in these circumstances, the surviving spouse can end up in the same place by effecting an "eligible rollover distribution" of the 60-day rollover variety.

3. Example: PLR 201612001-Surviving spouse who is fiduciary and sole beneficiary of estate which is the beneficiary of deceased spouse's IRA may rollover IRA distribution within 60 days to surviving spouse's own IRA.

   a. "The preamble to the regulations provides, in relevant part, that a surviving spouse who actually receives a distribution from a deceased spouse's IRA is permitted to roll that distribution over into the spouse's own IRA even if the spouse is not the sole beneficiary of the decedent's IRA as long as the rollover is accomplished within the requisite 60-day period. A rollover may be accomplished even if IRA assets pass through either a trust and/or an estate.

   b. The preamble discusses the ability of a surviving spouse to treat an inherited ira as the surviving spouse's own IRA. The preamble notes that the election is deemed to have been made by a surviving spouse - but only if "the spouse is the sole beneficiary of the account and has an unlimited right to withdraw from the account. This requirement is not satisfied if a trust is named as beneficiary of the IRA, even if the spouse is the sole beneficiary of the trust." However, the preamble notes: "*If the spouse actually receives a distribution from the IRA, the spouse is permitted to roll that distribution over within 60 days into an IRA in the spouse's own name* to the extent that the distribution is not a required distribution, ***regardless of whether or not the spouse is the sole beneficiary of the IRA owner***. Further, if the distribution is received by the spouse before the year that the IRA owner would have been 70½, no portion of the distribution is a required minimum distribution for purposes of determining whether it is eligible to be rolled over by the surviving spouse."

4. NB: In the PLR, the surviving spouse was the sole executor of the estate and possessed the sole fiduciary power to cause a distribution from the deceased spouse's IRA to the estate; and the surviving spouse was the sole beneficiary of the estate. Were those two facts **required** in order to enable the surviving spouse to effect the rollover? **No!**

III. The Quick Overview: Roth IRAs, Designated Roth Accounts, and Distributions and Conversions of Traditional IRAs to Roth IRAs

A. Roth IRAs:

1. All contributions are after-tax.

a. Amounts held in a Roth IRA that are withdrawn as a ***qualified distribution*** are not includible in income or subject to the 10-percent early withdrawal tax.

b. ***Qualified distribution***: a distribution that (1) is made after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59-1⁄2, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

2. Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings.

a. Special ordering rules: after-tax contributions are recovered before earnings rather than being recovered pro rata with earnings.

b. The amount includible in income is also subject to the 10% early withdrawal tax unless an exception applies.

B. Roth IRA Conversions

1. Traditional IRA owners may convert amounts in a traditional IRA that are eligible for rollover. A conversion may be accomplished by means of a 60-day rollover, trustee-to-trustee transfer, or account redesignation.

2. Any amount converted from a traditional IRA to a Roth IRA is treated as distributed from the traditional IRA and rolled over to the Roth IRA. The amount converted is includible in income as if a withdrawal had been made, except that the 10% early withdrawal tax does not apply.

a. A special recapture rule applies for distributions made from a Roth IRA within a specified five-year period after a rollover.

C. Designated Roth Contributions, Designated Roth Accounts and Qualified Roth Contribution Programs (Code §402A)

1. Section 401(k) plans, section 403(b) plans, and governmental section 457(b) plans

   a. Qualified 401(k) plans and section 403(b) plans may include a qualified Roth contribution program: participants may choose to make pretax elective contributions or make elective contributions that are not excluded from income and are designated as Roth contributions.

   b. Similar to distributions from Roth IRAs (but not quite the same), if certain requirements are satisfied, distributions of designated Roth contributions and attributable earnings are excluded from gross income.

   c. Employer nonelective and matching contributions may not be designated as Roth contributions and generally are pretax contributions.

2. Designated Roth accounts

   a. All designated Roth contributions made under the plan must be maintained in a separate account (a "designated Roth account").

   b. A ***qualified distribution*** from a designated Roth account is excludable from gross income.

      i. A ***qualified distribution***: a distribution made after (1) an employee's completion of a specified five-year period and (2) the employee's attainment of age 59-1⁄2, death, or disability.

      ii. A distribution from a designated Roth account (other than a qualified distribution) is included in the distributee's gross income to the extent allocable to income under the contract and excluded from gross income to the extent allocable to investment in the contract (commonly referred to as basis), taking into account only the designated Roth contributions as basis. ***This rule differs from the rule for Roth IRAs and is not as favorable.***

   c. Eligible rollover distributions from designated Roth accounts may only be rolled over to another designated Roth account or a Roth IRA.

3. Rollovers from eligible employer plans (other than from designated Roth accounts)

   a. Rollover to eligible retirement plan that is not a Roth IRA or a designated Roth account

      i. An eligible rollover distribution from an eligible employer plan that is not from a designated Roth account may be rolled over to another such plan (other than to a designated Roth account) or to a traditional IRA.

      ii. An eligible employer plan is a qualified retirement plan, a section 403(b) plan, and a governmental section 457(b) plan.

      iii. An eligible rollover distribution is any distribution from an eligible employer plan with these exceptions: certain periodic payments; any distribution to the extent the distribution is a minimum required distribution; any distribution made on account of hardship of the employee.

      iv. Only an employee, a surviving spouse, or certain alternate payees are allowed to roll over an eligible rollover distribution from an eligible employer plan to another eligible employer plan.

   b. Rollover to a Roth IRA

      i. A distribution from an eligible employer plan that is not from a designated Roth account may be rolled over into a Roth IRA, subject to the rules that apply to conversions from a traditional IRA into a Roth IRA.

      ii. Result: a rollover from an eligible employer plan into a Roth IRA is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10% early distribution tax does not apply.

         (a) In the case of a distribution and rollover of property, the amount of the distribution for purposes of determining the amount includable in gross income is generally the fair market value of the property on the date of the distribution.

         (b) The special recapture rule relating to the 10% additional tax on early distributions applies for distributions made from the Roth IRA within a specified five-year period after the rollover.

c. In-Plan Roth Rollovers

i. If a section 401(k) plan, section 403(b) plan, or governmental section 457(b) plan has a qualified Roth contribution program, any amount eligible under the plan for distribution and rollover to another eligible employer plan may be rolled over from an account under the plan that is not a designated Roth account into a designated Roth account under the plan for the individual (an ‘‘in-plan Roth rollover’’).

ii. This rollover is treated in the same fashion as the conversion of a traditional IRA to a Roth IRA: the amount transferred is includible in gross income (except to the extent it represents a return of after-tax contributions), and the 10% early distribution tax does not apply.

iii. An in-plan Roth rollover may be accomplished at the election of the employee (or surviving spouse) through a direct rollover (operationally through a transfer of assets from the account that is not a designated Roth account to the designated Roth account) (an ‘‘in-plan Roth direct rollover’’), or by a distribution of funds to the individual who then rolls over the funds into his or her designated Roth account in the plan within 60 days (an ‘‘in-plan Roth 60-day rollover’’).

iv. A plan that does not otherwise have a qualified Roth contribution program may ***not*** establish designated Roth accounts solely to accept in-plan Roth rollover contributions.

v. A section 401(k) plan, a section 403(b) plan or a governmental section 457(b) plan that includes a qualified Roth contribution program may allow participants and beneficiaries to elect an in-plan transfer of any amount, **even though it is not otherwise distributable under the plan**, from an account that is not a designated Roth account under the plan to a designated Roth account maintained under the plan for the benefit of the individual. The transfer is treated as an in-plan Roth direct rollover, even though the plan may not otherwise permit a distribution from the plan of the amount transferred.

(a) An in-plan transfer is also permitted for an amount that is not distributable for any other reason.

i) Example: if an amount in a profit sharing plan may not be distributed because the plan requires that a specified number of years must elapse to be eligible for a distribution, the plan will not be treated as violating this distribution limitation solely by reason of an in-plan transfer.

vi. Warning: the basic character of the amounts as not being distributable under the plan remains untouched **even after the in-plan transfer to the designated Roth account occurs.**

(a) Example: an amount subject to a distribution restriction in a section 401(k), section 403(b) or governmental section 457(b) plan before an in-plan transfer must remain subject to the distribution restriction after the transfer.

(b) Example: an amount in a profit sharing retirement plan that is not distributable because the requisite number of years has not elapsed continues to be non-distributable out of the plan until the end of the term.

vii. A plan is not treated as violating the distribution restrictions applicable to section 401(k), 403(b) and governmental section 457(b) plans solely by reason of an in-plan transfer.

viii. Because an in-plan Roth direct rollover only changes the account in a plan under which an amount is held and the tax character of the amount, a distribution that is rolled over in an in-plan direct rollover is not treated as a distribution for certain purposes under the plan, including certain purposes related to participant or spousal consent, plan loans, and anti-cutback protections under the plan.

D. Removing the Mystery - and the Traps Involving - “Back Door” Roth IRA Contributions

1. Limits on direct contributions to a Roth IRA. IRC 408A(c)(2): the maximum amount that an individual may contribute during a year to a Roth IRA is equal to --

a. That year’s limit on deductible contributions to a traditional IRA as described in IRC §219(b) ($5,500 for 2016 plus a $1,000 catch up contribution for individuals age 50 or older); **minus**

b. the aggregate contributions -- deductible and non-deductible -- to all other individual retirement plans;

But in any event not more than --

c. IRC §408A(c)(3): the amount determined in "a" reduced by this fraction:

i. Joint return:

(a) Numerator: the amount by which the MAGI shown on the joint return exceeds $184,000 in 2016

(b) Denominator: $10,000.

ii. Single or head of household:

(a) Numerator: the amount by which the MAGI shown on the joint return exceeds $117,000 in 2016

(b) Denominator: $15,000.

iii. Married filing separately:

(a) Numerator: the MAGI shown on the return

(b) Denominator: $10,000

2. Result: as MAGI increases, the amount of the permitted contribution directly to a Roth IRA declines, and very quickly declines to zero:

a. Single filers: Up to $117,000 (to qualify for a full contribution); $117,000–$132,000 (to be eligible for a partial contribution)

b. Joint filers: Up to $184,000 (to qualify for a full contribution); $184,000–$194,000 (to be eligible for a partial contribution)

c. Married filing separately: $0 (to qualify for a full contribution); $0–$10,000 (to be eligible for a partial contribution).

3. But, the MAGI phase-out limit does NOT apply to Roth IRA conversions. IRC §408A(c)(6)(B): "A qualified rollover contribution [i.e., a compliant Roth IRA conversion described in IRC §408A(e)] shall not be taken into account for purposes of paragraph (2)."

a. Since the income phase-out described in IRC §408A(c)(3) only limits contributions described in and subject to the limit in IRC §408A(c)(2), and since a Roth conversion is not taken into account for purposes of §408A(c)(2), there is nothing to which the income phase-out can apply.

4. Here, therefore, are the resulting rules:

   a. Traditional IRA owners, and participants in a designated Roth account in a qualified plan, may convert all or any portion of those arrangements to a Roth IRA (assuming all of the rules that apply to conversions are satisfied), regardless of the amount of the owner-participant's income.

   b. If Client does not currently have a traditional IRA or a qualified plan designated Roth account:

      i. Step One: establish a traditional IRA and make a non-deductible contribution to the traditional IRA

      ii. Step Two: perform a Roth IRA conversion.

5. The First Warning: if Client cannot make a deductible contribution to a traditional IRA (Client is an active participant in a qualified plan, for example), and does possess a traditional IRA, instead of making a nondeductible contribution to the traditional IRA, establish a new IRA to receive the nondeductible contribution.

   a. Why? It avoids having to follow the IRC §72 rules and pro-rate any withdrawal between nondeductible and deductible amounts, thereby triggering an unnecessary taxable withdrawal. See "VI," below.

   b. But, **watch out: this special relief will only apply in the case of a an IRA trustee-to-IRA trustee transfer. It does NOT work if the Client receives cash/securities/anything else from the IRA**.

      i. If that occurs, then the IRC §72 rules **do apply**: we must aggregate **all IRAs** and then determine the percentage that the after-tax contributions bear to the total aggregate balance of all IRAs; the amount distributed to the IRA owner will consist of after-tax and pre-tax amounts in that proportion.

      ii. **Bad result.**

6. The Second Warning: Not Everyone Agrees With This Conclusion. Respectable advisors believe that a standard tax doctrine, the "step transaction" doctrine should apply - and thereby demolish the "backdoor Roth" stratagem.

a. What is the “step transaction” doctrine? It is a principle that the IRS uses (but which taxpayers have had virtually no luck asserting when that principle might help them): if a taxpayer breaks up a tax-unfavorable transaction into two or more separate steps, each of which in isolation might not produce “bad” tax results for the taxpayer, then ignore the separate steps, merge them back together, and look at the “true” end result.

b. "Backdoor Roths: Still the Standard of 'Can I Get Away With It'" (Harden and Upton, Tax Notes Today, 10-6-2016):

“The [backdoor Roth] strategy has become popular enough in practice and among taxpayers who believe they need it that they have rationalized that it is a proper procedure, even though at their income level, a direct contribution is clearly barred by the statute. The entire concept of the step transaction is to prevent taxpayers from doing an end run around something barred directly by the statute. To say that it does not apply is frankly a rationalization and brings us back to the premise that the focus in this area has slipped to a thought process of "Can we get away with doing it?" rather than "Should we be doing it?"

“There is also the practical issue of how long is long enough for the two steps in the transaction to be considered separate. In many areas, the IRS likes to see two years of items being treated a specific way. For example, the assumption that someone has acquired a profit interest with no immediate liquidation value in a partnership turns on a two-year presumption. In other areas, such as the stock wash sale rules, taxpayers must be out of the stock effectively for one month out of the two-month window surrounding the stock sale. So in the current case of the backdoor Roth contribution, is it a month, a quarter, a year, or at least one statement period for the broker? That is uncertain and clearly an area open to varying opinions.”

IV. Traps for the Unwary Trustee or Advisor When Dealing with In-Plan Roth Rollovers

A. Notice 2013-74

1. Notice 2013-74, 2013-52 IRA 819, Issued on December 11, 2013, contains a series of questions and answers. They reveal a number of potential traps --- areas where participants, beneficiaries and their advisors may be easily fooled.

B. Which Accounts Or Contribution Types Are Eligible For An In-Plan Roth Rollover?

1. Q&A-2: These contributions **(and earnings)** may now be rolled over to a designated Roth account in the same plan, without regard to whether the amounts satisfy the conditions for distribution: elective deferrals in §401(k) plans and §403(b) plans; matching contributions and nonelective contributions, including qualified matching contributions and qualified nonelective contributions described in §1.401(k)-6; and annual deferrals made to governmental §457(b) plans. (The federal government's Thrift Savings Plan is treated as a §401(k) plan for this purpose.)

2. Point to remember: it's not just the contributions -- earnings can also be rolled over.

3. Can an employer's nonelective contributions be rolled over? Yes.

C. Is An Amount Rolled Over To An Employee's Designated Roth Account Pursuant To §402A(C)(4)(e) Subject To Any Distribution Restrictions After The In-Plan Roth Rollover?

1. Q&A-3: **Yes.** If an amount is rolled over to a designated Roth account pursuant to §402A(c)(4)(E), then, notwithstanding Revenue Ruling 2004-12, **the amount rolled over and applicable earnings remain subject to the distribution restrictions that were applicable to the amount before the in-plan Roth rollover. Thus, for example, if a §401(k) plan participant who has not had a severance from employment makes an in-plan Roth rollover of an amount from the participant's pre-tax elective deferral account prior to age 59-1/2, that amount and applicable earnings may not be distributed from the plan prior to attainment of age 59-1/2 or the occurrence of another event described in §401(k)(2)(B).**

D. Is A Plan Permitted To Restrict The Type Of Contributions Eligible For An In-Plan Roth Rollover And The Frequency Of In-Plan Roth Rollovers (Q-6)?

1. A-6. Yes. Subject to the nondiscrimination requirements normally applicable to plan benefits, rights, and features (such as the right to make a rollover), **a plan may limit the type of contributions eligible for an in-plan Roth rollover and the frequency of in-plan Roth rollovers**. For example, to simplify recordkeeping in a designated Roth account, a plan could provide that only otherwise distributable amounts are eligible for an in-plan Roth rollover.

2. Moral: don't trust what the participant tells you.

V. A Handy Table (Direct From IRS Publication 590-A) That Shows Which Rollovers are Permitted Between Various Types of Plans or IRAs

		Roll To							
		Roth IRA	Traditional IRA	SIMPLE IRA	SEP IRA	Governmental 457(b) Plan	Qualified Plan[1] (pre-tax)	403(b) Plan (pre-tax)	Designated Roth Account (401(k), 403(b) or 457(b))
Roll From	Roth IRA	Yes[2]	No	No	No	No	No	No	No
	Traditional IRA	Yes[3]	Yes[2]	Yes[2,7], after 2 years	Yes[2]	Yes[4]	Yes	Yes	No
	SIMPLE IRA	Yes[3], after 2 years	Yes[2], after 2 years	Yes[2]	Yes[2], after 2 years	Yes[4], after 2 years	Yes, after 2 years	Yes, after 2 years	No
	SEP IRA	Yes[3]	Yes[2]	Yes[2,7], after 2 years	Yes[2]	Yes[4]	Yes	Yes	No
	Governmental 457(b) Plan	Yes[3]	Yes	Yes[7], after 2 years	Yes	Yes	Yes	Yes	Yes,[3,5]
	Qualified Plan[1] (pre-tax)	Yes[3]	Yes	Yes[7], after 2 years	Yes	Yes[4]	Yes	Yes	Yes,[3,5]
	403(b) Plan (pre-tax)	Yes[3]	Yes	Yes[7], after 2 years	Yes	Yes[4]	Yes	Yes	Yes,[3,5]
	Designated Roth Account (401(k), 403(b) or 457(b))	Yes	No	No	No	No	No	No	Yes[6]

[1]Qualified plans include, for example, profit-sharing, 401(k), money purchase, and defined benefit plans.
[2]Only one rollover in any 12-month period.
[3]Must include in income.
[4]Must have separate accounts.
[5]Must be an in-plan rollover.
[6]Any nontaxable amounts distributed must be rolled over by direct trustee-to-trustee transfer.
[7]Applies to rollover contributions after December 18, 2015:

(i) During the first 2 years of participation in a SIMPLE retirement account, the SIMPLE retirement account owner may roll over amounts from one SIMPLE retirement account into another SIMPLE retirement account; and

(ii) After the first 2 years of participation in a SIMPLE retirement account, the SIMPLE retirement account owner may roll over amounts from a qualified retirement plan or an IRA into the SIMPLE retirement account.

VI. Notice 2014-54[3] and Reg. §1.402A-1, as Amended on May 18, 2016[4] : New--and More Favorable--Guidance on Handling Simultaneous Distributions from Qualified Plans that Include Distributions from Designated Roth Accounts and Pre-Tax Accounts to Multiple Destinations[5]

1. Old principles that continue to apply:

   a. When a retirement plan makes a distribution (other than a distribution in the form of an annuity) from a participant's account that includes **both** pre-tax and after-tax amounts, each distribution includes a pro rata share of the pretax and after-tax amounts.

   b. A participant's after-tax voluntary employee contributions are treated as a separate account (Internal Revenue Code §72 calls these "separate contracts"), if the plan separately accounts for these funds and their earnings. A participant's designated Roth account (the participant's Roth deferrals, rollovers from other Roth plans, and in-plan Roth rollovers, and the earnings on these amounts) is also eligible for treatment as a separate contract. All plan accounts (other than after-tax employee contributions and the designated Roth account) jointly comprise one other separate contract.

   c. Distributions of after-tax funds are not taxable. Distributions of pre-tax funds are taxable, unless and to the extent the participant effects a "eligible rollover distribution"-- the participant receives the funds and rolls over the funds to an IRA within 60 days of the distribution, and the original distribution satisfies the once-per-year rule.

   d. If a participant receives a distribution which includes **both** pre-tax and after-tax amounts in the form of an eligible rollover distribution, the pre-tax amounts are rolled over first.

2. Prior guidance:

   a. What if the participant effects a "direct rollover"--a distribution directly from the qualified plan to one or more IRAs designated by the plan participant--and an eligible rollover distribution? Or, a direct rollover as well as a distribution to the participant?

   b. Final designated Roth account regulations: "any amount paid in a direct rollover is treated as a separate distribution from any amount paid directly to the employee."

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[3] Available at http://www.irs.gov/pub/irs-drop/n-14-54.pdf.
[4] 81 FR 31165
[5] Available at http://www.irs.gov/pub/irs-drop/n-14-54.pdf.

c. Result: a portion of the distribution received by the participant--even if that distribution came from sources that would otherwise constitute nontaxable after-tax amounts--will be characterized as having come from the taxable source.

3. New rules in Notice 2014-54 and Reg. §1.402A-1:

   a. All distributions that are made at the same time are treated as a single distribution for purposes of allocating between pretax and after-tax, even if the participant directs that the distributions go to different destinations.

   b. If the total amount of any direct rollovers exceeds the pretax funds distributed, then the entire pretax amount is allocated to the direct rollover. **If there is more than one direct rollover, the participant can select how to allocate the amount between them, but must inform the plan administrator of the allocation prior to the distribution.**

   c. If the pretax amount distributed equals or exceeds the total amount of direct rollovers, then the direct rollovers consist entirely of pretax funds. But if the participant also makes a 60-day rollover then:

      i. If the pretax funds are more than the sum of all the rollovers (direct and 60-day), then the rollover amounts consist of the pretax amounts.

      ii. If the pretax funds are less than the sum of all the rollovers (direct and 60-day), then the direct rollovers consist of pretax funds and the remaining pretax funds are allocated to the 60-day rollover. If there are multiple 60-day rollovers, then the participant may choose how to allocate the remaining pre-tax funds.

   d. Any remaining pretax funds distributed to the participant are subject to income tax, to withholding, and to any applicable premature distribution (before age 59-1/2) penalty tax.

4. The new guidance is effective for distributions after December 31, 2014. A plan can choose to operate under the new rules (or the old rules) for periods before that date, but the new rules cannot apply to distributions from a designated Roth account before September 18, 2014. The final regulation deletes from the Roth 401(k) regulations the sentence requiring separate distribution treatment.

5. Don’t forget: this special treatment applies only to distributions from qualified retirement plans.

   a. The rules for distributions from traditional IRAs are in IRC § 408(d).

   b. No pre-tax-first rule exists for traditional IRA distributions rolled over to IRAs. Result: the rules in Notice 2014-54 do not apply to distributions from traditional IRAs.

   c. If an individual’s traditional IRAs, when combined, contain both after-tax and pre-tax dollars, the rules treat any distribution as consisting of a proportionate share of each. Individuals can roll over (“convert”) any such distribution (except for any part that is a required minimum distribution because the IRA owner is 70-1/2 or older) to a Roth IRA, but the pre-tax dollars in the conversion must be included in gross income.

VII. A Quick Overview: Recharacterizations of Conversions of Non-Roth Amounts to Roth IRAs (IRC §408A(d)(6) and IRS Reg. §1.480A-5)

A. What Does A “Recharacterization” Accomplish?

1. A recharacterization allows a Roth IRA owner to “undo” or “reverse” a rollover or conversion to a Roth IRA.

B. Which Conversions Can Be Recharacterized?

1. A conversion of a traditional IRA into a Roth IRA can be recharacterized -- reversed -- by transferring the Roth IRA back to a traditional IRA.

2. Employer contributions (including elective deferrals) under a SIMPLE IRA or a SEP IRA **cannot be recharacterized as contributions to another IRA**. An amount converted from a SEP IRA or SIMPLE IRA to a Roth IRA may be recharacterized as a contribution to a SEP IRA or SIMPLE IRA, including the original SEP IRA or SIMPLE IRA.

3. A distribution from an employer-sponsored retirement plan that does not consist of designated Roth accounts to a Roth IRA can be recharacterized.

C. Mechanics For Effecting A Recharacterization

1. An individual makes the election to recharacterize by notifying, on or before the date of the transfer, both the trustee of the Roth IRA and the trustee of the non-Roth IRA to which the Roth IRA funds are going to be transferred that the individual has elected to treat the contribution as having been made to the non-Roth IRA, instead of the Roth IRA, for Federal tax purposes.

2. The notification of the election must include the following information:

   a. the type and amount of the contribution to the Roth IRA that is to be recharacterized;

   b. the date on which the contribution was made to the Roth IRA and the year for which it was made;

   c. a direction to the trustee of the Roth IRA to transfer, in a trustee-to-trustee transfer, the amount of the contribution and net income allocable to the contribution to the trustee of the non-Roth IRA;

   d. the name of the trustee of the Roth IRA and the trustee of the non-Roth IRA and any additional information needed to make the transfer.

D. Deadline For Making A Recharacterization

1. The election and the trustee-to-trustee transfer must occur on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the recharacterized contribution was made to the Roth IRA, and the election cannot be revoked after the transfer.

2. An individual who makes this election must report the recharacterization, and must treat the contribution as having been made to the non-Roth IRA, instead of the Roth IRA, on the individual's Federal income tax return for the taxable year for which the recharacterized contribution was made to the Roth IRA.

3. The election to recharacterize a contribution may be made on behalf of a deceased IRA owner by his or her executor, administrator, or other person responsible for filing the final Federal income tax return of the decedent under IRC §6012(b)(1).

E. Minimum Waiting Period To Reconvert The Money To A Roth IRA Following A Recharacterization

1. If an individual recharacterizes all or part of a rollover or conversion to a Roth IRA, the individual cannot reconvert the amount recharacterized to the same or another Roth IRA until the later of:

   a. 30 days after the recharacterization, or

   b. the year following the year of the rollover or conversion.

2. The waiting period to convert applies only to amounts that were recharacterized. Result: individual can convert amounts from a different traditional IRA to a Roth IRA immediately

VIII. Tips and Best Practices: Treatment by the Qualified Plan of the Ability of Former Participant to Remain a Participant and Willingness to Accept Direct Rollovers From Other Qualified Plans

A. May Former Plan Participants Maintain Their Accounts in Their Former Employer's Qualified Defined Contribution Plan?

1. General rule: Not only may participants maintain their accounts in their former employer's qualified defined contribution plan, but also the plan must permit participants to do so as long as the participant's account balance exceeds $5,000 (excluding any rollover contributions into the qualified plan).

2. Exception to the general rule: this right expires when the plan participant attains the plan's normal retirement age. From that point onward, the participant's ability to maintain their accounts in their former employer's plan depends upon the terms of the plan.

    a. Recent literature: plan sponsors are awakening to the desirability of allowing former plan participants to keep their plan balances in the plan: this boosts plan assets and generates lower fees for all participants.

    b. Plans increasing possess the ability (through their platform providers) to allocate plan costs to participant accounts. This increases the advantages of eliminating barriers to former participants' ability to continue to participate in their former employer's plan.

3. Drawbacks

    a. Former participants are limited to the distribution options prescribed by the plan document. That document may limit the distribution options to fixed and determinable installment payments or a lump sum, depriving the former participant of flexibility in determining the distributions the participant desires from time to time.

    b. Former participants are limited to the investment options provided by the plan.

4. Benefit

a. The plan may provide participants with the ability to invest in mutual funds through institutional pricing.

B. May Former Plan Participants Rollover Their Accounts From Their Former Employer's Qualified Plan to Their New Employer's Qualified Plan?

1. In theory, yes: the former plan participant defers distribution until securing employment by the new employer and then requesting a direct rollover from the former employer's plan to the new employer's plan or by distributing a check to the participant made payable the new plan.

2. In practice:

a. "401(k) plan processes for handling separating participants' accounts create barriers for participants to roll their savings to a new plan, making IRA rollovers an easier and faster choice for those who want to consolidate their savings in a new account after they separate from an employer. Currently, plans may include waiting periods before processing a new employee's rollover and have long and complex processes for verifying the tax-qualified status of the savings to be rolled over." *401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants,* Government Accountability Office, GAO 13-30, March 2013 (http://www.gao.gov/assets/660/652881.pdf).

IX. How Does the New, Final, Investment Advice Fiduciary Rule Affect Advice to Plan Participants and IRA Owners--Including Advice on Whether to Rollover or Not?

A. Background

1. ERISA §3(21): there are three different ways to become a fiduciary:

a. Have or exercise discretion as to the management of the plan or IRA

b. Have or exercise discretion as to the investment of plan/IRA assets

c. Give investment advice for a fee or other compensation

2. The DOL "Investment Advice Fiduciary" final regulation (issued on April 8, 2016 -- the "2016 Investment Advice Fiduciary Final Regulation" --, along with a new "Best Interest Contract Exemption) only addresses the third way to become a fiduciary.

a. The 2016 Investment Advice Fiduciary Final Regulation restates the prior version of the DOL Regulation that defined who is an investment advice fiduciary, DOL Reg. § 2510.3–21. The new incarnation of that regulation --

i. Expands its application to those who give advice to IRA owners (the "old" version of the regulation applied only to those who provided advice to plans subject to ERISA -- qualified retirement plans, primarily)

ii. Expands the circumstances that will trigger "investment advice fiduciary" status.

(a) The "old" regulation only applied if all five of these elements existed:

i) Making investment recommendations

ii) On regular basis

iii) Mutual understanding

iv) Primary basis for plan's decisions

v) Individualized to plan's needs

(b) The 2016 Investment Advice Fiduciary Final Regulation effectively eliminates "ii," "iv," and "v"

3. If we become a fiduciary, then we are forbidden from receiving compensation from third parties in connection with transactions or advice involving plan or IRA assets. Why? Because ERISA §406(b)(3) and IRC §4975(c)(1)(F) say so.

a. Result: if an investment advice fiduciary receives compensation from anyone other than the plan participant/IRA owner, the fiduciary needs an exemption.

b. The new "Best Interest Contract Exemption," issued together with the 2016 Investment Advice Final Regulation, rescinds the "Prohibited Transaction Exemptions" that formerly provided the necessary relief and introduces a new set of requirements that investment advice fiduciaries must satisfy in order to receive the exemption.

B. The 2016 Investment Advice Final Regulation's Matrix: What Conduct Will Trigger "Investment Advice Fiduciary Status" -- and What Conduct Will Not Trigger That Status

1. General Rule: A person renders fiduciary investment advice with respect to ERISA plan assets or IRA assets if **all three of these conditions exist**:

   a. Provide to a plan, plan fiduciary, plan participant or beneficiary, or IRA or IRA owner **for a fee or other compensation**

   b. a **recommendation** regarding:

      i. The advisability of acquiring, holding, disposing of, or exchanging securities or other investment property; ***or***

      ii. how to invest the securities or other investment property once they have been rolled over, transferred, or distributed from the plan or IRA; ***or***

      iii. the management of securities or other investment property, including:

         (a) investment policies or strategies;

         (b) portfolio composition;

         (c) selection of other persons to provide investment advice or management;

         (d) selection of investment account arrangements (such as a brokerage account when compared to an advisory account);

         (e) whether to engage in a rollover, transfer, or distribution from a plan or IRA, including the amount or form of any of these choices.

   c. And the person--

      i. represents or acknowledges that he or she is acting as a fiduciary within the meaning of ERISA or the Code regarding the advice; ***or***

      ii. renders investment advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is based on the particular investment needs of the advice recipient; ***or***

iii. directs the advice to a specific advice recipient regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

2. If we don't make a recommendation, then we avoid being characterized as an investment advice fiduciary. What is a recommendation?

a. DOL Reg. §2510.3-21(b)(1): " 'Recommendation' means a communication that, based on its content, context, and presentation would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action."

i. Determination whether a "recommendation" has been made is an objective -- not a subjective -- inquiry.

ii. "[T]he more individually tailored the communication is to a specific advice recipient or recipients about, for example, a security, investment property, or investment strategy, the more likely the communication will be viewed as a recommendation. Providing a selective list of securities to a particular advice recipient as appropriate for that investor would be a recommendation as to the advisability of acquiring securities even if no recommendation is made with respect to any one security."

iii. Result: a "recommendation" is advice that would reasonably be seen an encouragement to act. Generalized suggestions without enough specific detail for someone to execute a strategy should not constitute a recommendation.

3. What is guaranteed **not** to be a "recommendation"? DOL Reg. §2510.3-21(b)(2)(i)-(iv) list four activities which do **not** rise to the status of a "recommendation":

a. Platform Marketing: Marketing and making available investment platforms to plans without regard to individualized plan/participant needs, with appropriate disclosures.

i. NB: this special rule **does not apply to marketing to IRA owners.**

b. Selection and Monitoring Assistance: Identifying options meeting the plan fiduciary's specifications in connection with developing an investment platform, or responding to a plan RFP on a limited basis with respect to investments available on a platform, with appropriate disclosures

i. NB: this special rule **does not apply to marketing to IRA owners.**

c. General Marketing Communications: Furnishing information (to a plan or IRA owner) that a reasonable person would not view as an investment recommendation (for example, general circulation newsletters, broadcast commentary, widely attended speeches, general marketing data, or performance reports,).

d. Providing Investment Education: Making investment-related education available to a plan, plan fiduciary, participant, beneficiary, or IRA owner, provided that the information and materials do not include (standing alone or in combination with other materials) recommendations with respect to specific investment products or specific plan or IRA alternatives, or recommendations with respect to investment or management of a particular security or securities or other investment property, if the information does not include specific investment recommendations.

i. Exceptions that **do permit inclusion of specific products or alternatives:**

(a) Asset allocation models: With specified disclaimers listed in the 2016 Investment Advice Final Regulation, asset allocation models may be provided to plan participants and IRA owners as long as they do not include or identify any specific investment product or investment alternative available under the plan or IRA -- **except that, solely with respect to a qualified plan -- not an IRA -- , asset allocation models may identify a specific investment alternative available under the plan if the alternative is a designated investment alternative under the plan.**

(b) Interactive investment materials: they may include specific investment alternatives or distribution options as long either they are specified by the plan participant **or IRA owner** and meet a variety of disclosure requirements listed in the 2016 Investment Advice Final Regulation.

C. “I Will be an Investment Advice Fiduciary. What Do I Have to Do In Order to Continue to Provide Advice and Get Paid for That Advice?

1. Investment Advice Fiduciaries owe two sets of duties:

   a. If an investment advice fiduciary provides advice to a participant in a qualified plan or plan subject to ERISA (basically, arrangements **other than IRAs),** the investment advice fiduciary owes duties of --

      i. Loyalty: act for the exclusive benefit of the participants and beneficiaries, and to provide for plan benefits and defray plan expenses

      ii. Prudence: behave like a prudent person similarly situated would behave

      iii. Follow the plan document and ERISA.

   b. If an investment advice fiduciary provides advice to an ERISA plan participant **or an IRA owner**, then the investment advice fiduciary must not engage in a prohibited transaction: a fiduciary may not:

      i. Deal with the assets of the plan in her own interest or for her own account;

      ii. Act in any transaction involving the plan on behalf of a party, or represent a party, whose interests are adverse to the plan or IRA or its participants, beneficiaries, or owners; or

      iii. Receive any consideration for her own account from any party dealing with the plan or IRA in connection with a transaction involving the plan’s assets.

         (a) This last requirement effectively prohibits receiving money from anyone else for something related to the plan or IRA.

         (b) These prohibited third party payments include: gross dealer concessions; revenue sharing; 12b-1 fees; distribution, solicitation, or referral fees; volume-based fees; or fees for seminars and educational programs.

2. Before we explore the Best Interest Contract Exemption, which will permit receipt of third party payments, note that, if an advisor’s sole

compensation is on a level fee basis—either a flat fee or a percentage of plan assets--the advisor does not receive third party payments and does not need a prohibited transaction exemption.

a. Longstanding DOL guidance: receipt by the fiduciary of third party payments is not a problem if they are used to reduce the level fee, so that the total amount received by the fiduciary remains the same.

b. But, there is a problem.

i. A conflict of interest exists when a fee-level advisor makes a recommendation to a retirement plan participant to rollover her retirement plan accrued benefit to a fee-based IRA account.

(a) The advisor will generate future, ongoing fees that he or she would not otherwise receive if no rollover occurs, even if the future fees do not vary with the assets recommended or invested.

(b) Result: Prohibited transaction.

ii. A conflict of interest exists if an advisor recommends a change from a low activity commission-based account to an account that charges a fixed percentage of assets under management on an ongoing basis would result in a prohibited transaction.

(a) Result: Prohibited transaction.

D. The Best Interest Contract Exemption Comes in Two Flavors: Regular and, for Level-Fee Advisors, a Simplified Version

1. Terms of art

a. “Retirement Plan Investor” or “Investor”: a participant, beneficiary, or IRA holder.

b. “Advisor”: an individual who is a plan fiduciary because she is giving investment advice to a plan or IRA and who is also related to a financial institution and is registered or licensed to give the advice.

c. “Financial Institution”: an entity that employs or otherwise retains the advisor and is a registered investment advisor, bank or similar institution, an insurance company, broker-dealer, or an entity described as a financial institution in a DOL individual exemption.

d. “Affiliate”: a person or entity that controls, or is controlled by, the advisor or the financial institution; an officer, director, partner, employee, or relative of the advisor or financial institution; or is a company of which the advisor or financial institution is an officer, director, or partner.

e. “Related Entity”: an entity other than an Affiliate in which the advisor or financial institution has an interest that could affect the exercise of her best judgment.

2. The “Regular” Best Interest Contract Exemption

a. Contractual Requirement.

i. Advisors and Financial institutions that are fiduciaries with respect to plans subject to ERISA are subject to the ERISA fiduciary duties and ERISA gives plan participants specific rights to pursue claims against fiduciaries in federal district courts. But, IRAs are not subject to ERISA, and the prohibited transaction penalties that appear in the Internal Revenue Code that apply to both plans and IRAs do not provide IRA owners with private rights of action.

ii. Result: to take advantage of the Best Interest Contract Exemption, advisors and financial institutions that are investment advice fiduciaries to IRA owners must enter into written contracts with IRA owners in which the advisor and financial institution agree to comply with the terms necessary to qualify for the Best Interest Contract Exemption and must acknowledge that IRA owners may sue in court for breach of contract.

iii. The contract must be signed before or at the same time as the first recommended transaction to which the Best Interest Contract Exemption will apply.

iv. Any written agreement may not reduce or eliminate the advisor’s liability for violating the contract terms (or, for ERISA plans, the fiduciary requirements of ERISA).

v. The contract may not require the plan or investor to waive or qualify rights to participate in a class action, nor may it provide for liquidated damages for a breach of fiduciary duty or a Best Interest Contract Exemption violation. The contract may waive punitive damages or rescission rights, and can require mediation or arbitration of claims against the advisor, so long as the venue remains convenient and the rules for mediation or arbitration do not unreasonably limit the plan's or investor's ability to assert claims against the advisor.

b. Fiduciary Acknowledgement Requirement

i. The financial institution must affirmatively acknowledge in writing that the financial institution and the advisor are acting as fiduciaries.

c. Impartial Conduct Standards Requirement

i. The investment advice given must be in the "best interest" of the investor.

(a) The advice meets ERISA's prudence requirements: the advisor must act with the same care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with these matters would use in the conduct of an enterprise of like character and with like aims;

(b) The advice is based on the investment objectives, risk tolerance, financial circumstances, and needs of the investor; and

(c) The advice is without regard for the financial interests of the advisor, financial institution, affiliates, related entities or any other party.

ii. Compensation paid to the financial institution and advisor in relation to the advice must be reasonable.

iii. The advisor and the financial institution may not make misleading statements about the investments.

d. Policies and Procedures Requirement

i. The financial institution must provide the investor with a warranty that the financial institution has adopted policies and procedures reasonably and prudently designed to ensure that its advisors satisfy the Impartial Conduct Standards.

ii. The policies and procedures must include:

(a) A specific identification and documentation of the financial institution's material conflicts of interest.

(b) Measures reasonably and prudently designed to prevent material conflicts of interest from causing the advisor to violate the Impartial Conduct Standards.

(c) The designation of one or more persons (who can be identified by name, function, or title) charged with the responsibility of addressing material conflicts of interest and monitoring Impartial Conduct Standards adherence by advisors;

(d) Neither the financial institution nor any affiliate or related entity may use or rely upon quotas, appraisals, bonuses, contests, special awards, differential compensation, or other actions or incentives that are intended or reasonably expected to cause advisors to give financial advice that is not in the investor's best interest.

iii. That last requirement does not prohibit the use of commissions or varying compensation depending upon products sold. Advisors "may receive differential compensation … based on investment decisions by Plans, participant or beneficiary accounts, or IRAs, to the extent that the financial institution's policies and procedures and incentive practices, when viewed as a whole, are **reasonably and prudently designed to avoid misalignment of the interests of Advisors with the interests of the Retirement Investors they serve as fiduciaries**."

iv. Result: variable compensation is permitted - if the advisor can demonstrate that the possibility of variable compensation did not cause the advisor to act against the investor's best interest.

e. Disclosure Requirements

i. *Written disclosure*. A written disclosure, separate or part of the written contract, provided prior to the execution of the recommended transaction that clearly and prominently:

(a) States the Best Interest standard of care and describes whether the Investor will pay for the services of the financial institution and advisor directly or through third party payments.

(b) Describes material conflicts of interest, discloses fees or charges imposed by the financial institution or advisor, and states the type of compensation that the financial institution, advisor affiliates, and related entities expect to receive from third parties in relation to the recommended investments.

(c) Tells the investor that she may obtain copies of the financial institution's written description of those policies and procedures, as well as the specific costs, fees, and compensation (including third party payments) in relation to the recommended investments. The compensation may be described in dollar amounts, percentages, formulas, or any other means reasonably designed to present an accurate disclosure of their scope, magnitude, and nature in sufficient detail so as to permit the Investor to make an informed judgment about the transaction costs and the magnitude and severity of the material conflicts of interest. This part of the disclosure also should tell the investor that this information may be requested and provided before the transaction is entered into and that, if requested after the transaction, must be provided within 30 days.

(d) Includes a link to the financial institution's website. The disclosure must also advise the Investor that model contract disclosures that are on the website are updated as needed on a quarterly basis and that the description of the policies and procedures is available free of charge on the website.

(e) Discloses whether the financial institution offers proprietary products or receives third party payments with regard to the recommended investments. If the advisor's recommendations are limited, in whole or in part, to the proprietary products or those that generate third party payments, the Investor must be notified of those limitations. A mere statement that the advisor "may" limit investment recommendations to proprietary or third-party-generating investments is not sufficient for this purpose.

(f) Provides telephone and email contact information for a representative of the financial institution that may be contacted with any concerns about the advisor or service received and, if applicable, a statement explaining that the investor may research the financial institution and its advisors on financial institution NRA's BrokerCheck database or the Investment Advisor Registration Depository.

(g) Describes whether the financial institution and advisor will monitor the investor's investments and, if so, how often and reasons why the investor will be alerted.

ii. Website Disclosure. The financial institution must maintain a website that is freely accessible to the public and updated not less frequently than quarterly. The Best Interest Contract Exemption contains a laundry list of elements that the website must display.

iii. DOL Notification. The financial institution must also notify the DOL that it is using the Best Interest Contract Exemption before it receives any compensation for any recommended transactions for which it is relying on the Best Interest Contract Exemption. The financial institution need only accomplish this task once: the notification remains in effect until the financial institution revokes it in writing.

f. Record Retention Policies

i. The financial institution must retain the records needed to demonstrate that it has complied with the Best Interest Contract Exemption for at least six years, and must be reasonably accessible for examination by the DOL, investors and plan fiduciaries.

3. The Simplified Best Interest Contract Exemption for Level Fee Advisors

a. Fiduciary acknowledgement. Prior to, or at the time of the transaction on which the advice is being provided, the financial institution must provide the Investor with a written statement acknowledging that it is a fiduciary.

b. Impartial Conduct Standards. Same as those for the "regular" version of the Best Interest Contract Exemption. See above.

c. If the prohibited transaction involves a rollover from a plan in which the advisor is a fiduciary to an IRA, and the transaction will result in additional compensation to the advisor, the advisor document (and retain the documentation):

i. That the advisor considered:

(a) Other alternatives, including remaining in the plan;

(b) The fees and expenses associated with the plan and the IRA;

(c) the employer pays some or all of the expenses in the plan; and

(d) Differences in the levels of service being provided in the plan vs. the IRA;

ii. Why the new arrangement is in the Investor's best interest; and

iii. If the transaction involves a switch from a commission-based account to a level fee arrangement, why the arrangement is in the Investor's best interest.

E. Effective Date, Applicability Date; Transition Rules, and Grandfathering

1. The 2016 Investment Advice Fiduciary Final Regulation is effective as of June 7, 2016.

2. "Applicability Date": The Best Interest Contract Exemption applies to "transactions occurring on or after April 10, 2017.

a. Investments made on or after April 10, 2017, or under a systematic purchase program established before that date based on advice given before that date, are grandfathered.

i. Result: receipt of compensation related to the advice is not treated as a prohibited transaction.

b. Ongoing (advice to hold, for example) and new advice provided under a grandfathered arrangement is subject to the new requirements. Grandfather status also lapses prospectively with the expiration of the contract under which the grandfathered advice is being provided.

3. Additional relief between the Applicability Date (April 10, 2017) and January 1, 2018:

a. Financial institutions and advisors must adhere to the impartial conduct standards, provide notice to their retirement investors that, among other things, acknowledges their fiduciary status and describes their material conflicts of interest, and designate a person responsible for addressing material conflicts of interest and monitoring advisor adherence to the impartial conduct standards.

4. Full compliance with the Best Interest Contract Exemption is required as of January 1, 2018.

X. A Continuing Hot Topic: May a Surviving Spouse Effect a Tax Free Rollover if the Beneficiary of the Deceased Spouse's IRA is the Deceased Spouse's Estate or Trust?

A. Background

1. IRC Section 408(d)(1): Except as otherwise provided in Section 408(d), any amount paid or distributed out of an IRA is included in gross income by the payee or distributee, as the case may be, in the manner provided under section 72.

a. That's bad: the distribution must be included in gross income.

2. IRC Section 408(d)(3)(A): the bad general rule in IRC §408(d)(1) does not apply to any amount paid or distributed out of an IRA to the individual for whose benefit the IRA is maintained (**NB: this is not limited to spouse-beneficiaries)** if the entire amount received (including money or any other property) is paid into an IRA or another eligible retirement plan for the benefit of the individual not later than the 60th day after the day on which the individual receives the payment or distribution.

a. That's good: the distribution does not have to be included in gross income.

3. IRC Section 408(d)(3)(C)(i): the rollover rules of section 408(d)(3) do not apply to inherited IRAs. IRC Section 408(d)(3)(C)(ii): the term "inherited IRA" means an IRA obtained by an individual, other than IRA owner's spouse, as a result of the death of the IRA owner.

a. That's bad for non-spouse beneficiaries -- but don't worry: IRC §408(d)(3)(C)(ii) exempts non-spouse beneficiaries as long as the recipient vehicle is an IRA

b. This is good for spouse-beneficiaries.

4. Reg. §1.408-8, Q&A-5: a surviving spouse of an IRA owner may elect to treat the spouse's entire interest as a beneficiary of an individual's IRA as the spouse's own IRA. *In order to make this election, the spouse must be the sole beneficiary of the IRA and have an unlimited right to withdraw amounts from the IRA.* ***If a trust is named as beneficiary of the IRA, this requirement is not satisfied even if the spouse is the sole beneficiary of the trust.***

5. If we stop here:

a. Surviving spouses may NOT effect 60 day rollover distributions under IRC Section 408(d)(3)(C)(i) to an IRA for their benefit if their deceased spouse's IRA designated a trust or the deceased spouse's estate as the beneficiary of the deceased spouse's IRA - even if the surviving spouse is the sole beneficiary of the estate (directly or indirectly) and is the sole fiduciary possessing authority to effect distributions from the deceased spouse's IRA.

B. PLR 201606032-Beneficiary of IRA Was Estate; Estate Poured Over to Trust; Surviving Spouse Was Executor of Estate and Trust and Sole Beneficiary of Trust-IRS Says, Surviving Spouse is Eligible to Effect a 60 Day Rollover to an IRA for the Benefit of Surviving Spouse

1. After reciting the general rules in "A," the IRS then concludes:

"Generally, if the proceeds of a decedent's IRA are payable to a trust or estate (or both), and are paid to the trustee of the trust, who then pays them to the decedent's surviving spouse as the beneficiary of the trust, the surviving spouse is treated as having received the IRA proceeds from the trust and not from the decedent. Accordingly, such surviving spouse, in general, is not eligible to roll over the distributed IRA proceeds into her own IRA.

"However, the general rule will not apply where the surviving spouse is the sole trustee of the decedent's trust and has the sole authority and discretion under trust language to pay the IRA proceeds to herself. The surviving spouse may then receive the IRA proceeds and roll over the amounts into an IRA set up and maintained in her name.

2. Result:

"In this case, Decedent B designated his estate as the beneficiary of his IRA, and Taxpayer A was the executor of his estate, which passed through to Trust D. Taxpayer A was also the sole Trustee of Trust D and had the power to distribute the assets of IRA C from Trust D to herself. Thus, Taxpayer A could have taken a distribution from IRA C and rolled it over into an IRA in her name."

C. PLR 201612001-Surviving Spouse Who is Fiduciary and Sole Beneficiary of Estate Which is the Beneficiary of Deceased Spouse's IRA May Rollover IRA Distribution Within 60 Days to Surviving Spouse's Own IRA-Ruling Cites Regulations Preamble That Surviving Spouse May Roll Distribution Over Into The Spouse's Own IRA Even If Spouse Is Not The Sole Beneficiary Of Decedent's IRA And Even If IRA Assets Pass Through Either A Trust And/Or An Estate

1. Same basic fact pattern as PLR 201606032.

2. Important new lesson: the surviving spouse **does not have to be the sole executor and/or sole fiduciary of the trust in order to effect a 60 day rollover of an IRA whose beneficiary is an estate or trust.** PLR 201606032 says:

"Generally, if the proceeds of a decedent's IRA pass through a third party, e.g. a trust or an estate, and then are distributed to the decedent's surviving spouse, the surviving spouse will be treated as having received the IRA proceeds from the third party and not from the decedent's IRA. Thus, *generally a surviving spouse will not be eligible to roll over the distributed IRA proceeds into her own IRA. However, the general rule will not apply in a case where the IRA has not yet been distributed and the surviving spouse, as fiduciary of the decedent's estate, has the sole authority and discretion to pay the IRA proceeds to herself.* In such a case, when the surviving spouse actually receives the IRA proceeds, the surviving spouse may roll over the amounts into an IRA set up and maintained in her own name within 60 days.

The preamble to the regulations provides, in relevant part, that a surviving spouse who actually receives a distribution from a deceased spouse's IRA is permitted to roll that distribution over into the spouse's own IRA even if the spouse is not the sole beneficiary of the decedent's IRA as long as the rollover is accomplished within the requisite 60-day period. A rollover may be accomplished even if IRA assets pass through either a trust and/or an estate.

3. How did the IRS reach this conclusion? What does the preamble say?

   a. Preamble to the 2002 Final Regulations, 67 FR 18988, at 18992-18993: The preamble discusses the ability of a surviving spouse to treat an inherited ira as the surviving spouse's own IRA. The preamble notes that the election is deemed to have been made by a surviving spouse - but only if "the spouse is the sole beneficiary of the account and has an unlimited right to withdraw from the account. This requirement is not satisfied if a trust is named as beneficiary of the IRA, even if the spouse is the sole beneficiary of the trust."

   b. However, the preamble notes: "***If the spouse actually receives a distribution from the IRA, the spouse is permitted to roll that distribution over within 60 days into an IRA in the spouse's own name*** to the extent that the distribution is not a required distribution, ***regardless of whether or not the spouse is the sole beneficiary of the IRA owner***.

4. That's great news!

5. This PLR also contains another great rule:

> "Further, if the distribution is received by the spouse before the year that the IRA owner would have been 70-1⁄2, no portion of the distribution is a required minimum distribution for purposes of determining whether it is eligible to be rolled over by the surviving spouse."

   a. Result: the five year rule does not apply!.

XI. Errors Made in Effecting Rollovers From One Provider's IRA to Another Provider's IRA: Failure to Comply With the Statutory Limits on 60 Day Rollovers

A. Problems When the IRA Owner Receives the Distribution: Two Statutory Limits Must Be Followed; Failure Produces an Excess Contribution and Disqualifies the Rollover IRA

1. To avoid immediate taxation, the recipient must roll over the distribution to the new IRA not later than the 60th day after the day on which the recipient received the distribution. Code §408(d)(3)(A)(i).

2. The tax-free treatment granted by Code §408(d)(3)(A)(i) is subject to **two limits:**

   a. Limit on the number of times a 60 day rollover may be effected during the course of a single one-year period.

   b. Limit on the nature of the assets that may permissibly be transferred to the receiving IRA.

B. Limit on the Number of 60-Day Rollovers in a 12 Month Period

1. Section 408(d)(3)(B): an individual is permitted to make only one tax-free rollover (i.e., a distribution from an IRA to the distributee, who then deposits the distribution in a new IRA or redeposits the distribution in the original IRA) in any one-year period.

2. Prior to *Bobrow,* many taxpayers and the IRS thought the one-per-year rollover restriction applied separately to each IRA. Result: a taxpayer with more than one IRA could effect 60 day rollovers from multiple IRAs during the same 12 consecutive month period.

3. *Bobrow v. Commissioner*, T.C. Memo. 2014-21, Jan. 28, 2014: IRC §408(d)(3)(B)'s one rollover per year rule is applied on an aggregate basis not on IRA-by-IRA basis.

4. Result: Regardless of how many IRAs he or she maintains, a taxpayer may make only one nontaxable rollover contribution within each one-year

period. The one year period begins on the date of each IRA distribution to the IRA owner/beneficiary.

C. Limit on the Assets That May Be Rolled Over to the Recipient IRA as Part of a 60 Day Rollover

1. The limit appears in Code §408(d)(3)(B):

"This paragraph [§408(d)(3), which excludes IRA distributions from gross income if the distributee rolls over the distribution to an IRA within 60 days] does not apply to any amount described in subparagraph (A)(i) received by an individual from an individual retirement account or individual retirement annuity if at any time during the 1-year period ending on the day of such receipt such individual received any other amount described in that subparagraph from an individual retirement account or an individual retirement annuity which was not includible in his gross income because of the application of this paragraph."

2. Code §402(c) and 408(d) can be read to require that the assets deposited into the recipient IRA must be the same as the money or property the IRA owner received from the distributing IRA.[6]

3. IRS Publication 590: "The same property must be rolled over. If property is distributed to you from an IRA and you complete the rollover by contributing property to an IRA, **your rollover is tax free only if the property you contribute is the same property that was distributed to you**."

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[6] *402(c)(1)* "If—

" (A) any portion of the balance to the credit of an employee in a qualified trust is paid to the employee in an eligible rollover distribution,

"(B) the distributee transfers any portion of the property received in such distribution to an eligible retirement plan, and

"(C) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

"then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid."

408(d)(3) Rollover contribution. "An amount is described in this paragraph as a rollover contribution if it meets the requirements of subparagraphs (A) and (B) .

"(A) In general. Paragraph (1) [distributions are taxed on receipt] does not apply to any amount paid or distributed out of an individual retirement account or individual retirement annuity to the individual for whose benefit the account or annuity is maintained if—

"(i) the entire amount received (including money and any other property) is paid into an individual retirement account or individual retirement annuity (other than an endowment contract) for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution; or

"(ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received…"

4. The U.S. Tax Court has agreed with the IRS's interpretation. Lemishow v. Commissioner, 110 T.C. 110 (1998).

XII. Fixing a Failed Roth IRA Recharacterization

A. Typical Problems.

1. Failure to complete the required steps

2. Failure to complete the steps in the correct order

3. Failure to transfer the Roth IRA assets to the traditional IRA by the required time.

B. What Is The Statutory Authority For Seeking An Exception From the IRS?

1. Code §408A does not contain a provision granting the Secretary the authority to waive the requirements.

2. What to do? Use Reg. §§301.9100-1 through Treas. Reg. §301.9100-3.

a. General Rule: Reg. §§301.9100-1, 301.9100-2, and 301.9100-3 provide guidance concerning requests for relief submitted to the Internal Service on or after December 31, 1997.

b. Reg. §301.9100-1(c): the Commissioner of Internal Revenue, in his discretion, may grant a reasonable extension of the time **fixed by a regulation, a revenue ruling, a revenue procedure, a notice, or an announcement published in the Internal Revenue Bulletin for the making of an election or application for relief in respect of tax under, among others, Subtitle A of the Code.**

c. Reg. §301.9100-2 lists certain elections for which automatic extensions of time to file are granted.

d. Reg. §301.9100-3: provides guidance with respect to the granting of relief with respect to those elections not referenced in Reg. §301.9100-2. Applications for relief that fall within Reg. §301.9100-3 will be granted when the taxpayer provides sufficient evidence (including affidavits described in Reg. §301.9100-3(e)(2)) to establish that (1) the taxpayer acted reasonably and in good faith, and (2) granting relief would not prejudice the interests of the Government.

i. Reg. §301.9100-3(b)(1): a taxpayer will be deemed to have acted reasonably and in good faith (i) if its request for Reg. §301.9100-1 relief is filed before the failure to make a timely election is discovered by the Service; (ii) if the taxpayer inadvertently failed to make the election because of intervening events beyond the taxpayer's control; (iii) if the taxpayer failed to make the election because, after exercising reasonable diligence, the taxpayer was unaware of the necessity for the election; (iv) the taxpayer reasonably relied upon the written advice of the Service; or (v) the taxpayer reasonably relied on a qualified tax professional, including a tax professional employed by the taxpayer, and the tax professional failed to make, or advise the taxpayer to make, the election.

ii. Reg. §301.9100-3(c)(1)(ii): ordinarily, the interests of the Government will be treated as prejudiced and that ordinarily the Service will not grant relief when tax years that would have been affected by the election had it been timely made are closed by the statute of limitations before the taxpayer's receipt of a ruling granting relief under Reg. §301.9100-3.

3. Result:

a. Relief is available under Reg. §§301.9100-1, 301.9100-2, and 301.9100-3 only if the failure involves a missed deadline and then only if the deadline is prescribed in a regulation or subregulatory guidance. If the deadline is prescribed by the Code, then taxpayers cannot use Reg. §§301.9100-1, 301.9100-2, and 301.9100-3 to secure an exception from the IRS.

b. What is the deadline for completing a Roth IRA-to-traditional IRA recharacterization and where does it appear?

i. The deadline: the election and the trustee-to-trustee transfer must occur on or before the due date (including extensions) for filing the individual's Federal income tax return for the taxable year for which the recharacterized contribution was made to the Roth IRA.

ii. This appears in Reg. §1.408A-5, A-6(b).

iii. Does a deadline appear in IRC §408A?

(a) §408A(d)(6)(A):

(6) Taxpayer may make adjustments before due date

(A) In general. Except as provided by the Secretary, if, on or before the due date for any taxable year, a taxpayer transfers in a trustee-to-trustee transfer any contribution to an individual retirement plan made during such taxable year from such plan to any other individual retirement plan, then, for purposes of this chapter, such contribution shall be treated as having been made to the transferee plan (and not the transferor plan).

(b) §408A(d)(7):

(7) Due date. For purposes of this subsection, the due date for any taxable year is the date prescribed by law (including extensions of time) for filing the taxpayer's return for such taxable year.

c. Result: a deadline does appear in the statute -- but §408A(d)(6) says that the Secretary may provide an exception.

C. PLR 201320022 (released on May 17, 2013 and dated February 19, 2013): An Example of How the IRS May Choose to Exercise Its §301.9100 Authority When a Taxpayer Misses the Deadline for a Roth IRA Recharacterization

1. Facts:

a. May 26 of Year 1: Taxpayer, after discussions with Attorney, converts two traditional IRAs to Roth IRAs. That decision was based on Attorney's evaluation of Taxpayer's basis in the traditional IRAs and the resulting income Taxpayer would be required to recognize as the result of the conversion. Taxpayer was informed that, due to substantial basis, the conversion would generate very little taxable income.

b. In Year 2, during the tax preparation of Taxpayer's Year 1 income tax return, Attorney acquired the Taxpayer's basis in the traditional IRAs from Custodian. Custodian provided Attorney with information showing the total cost basis as Amount D. Attorney included this amount in the Year 1 tax return as the adjusted basis for the two traditional IRAs.

c. On June 1, Year 3, Attorney reviewed the Year 1 income tax return in preparation for the filing of the Year 2 income tax return and noticed that the adjusted basis reported on the Taxpayer's Form 8606 appeared to be unusually high. Attorney immediately contacted the Taxpayer about his concerns. Attorney contacted Custodian to discuss the irregularity in the basis amounts and it was ultimately determined that the cost basis information received by Custodian was the cost basis of the securities held by the traditional IRAs and not Taxpayer's adjusted basis in the traditional IRAs. All parties agreed that the adjusted basis was actually $0.

d. Attorney represented that he did not realize this and "mistakenly understood" that the unusually high figure received from Custodian was not Taxpayer's adjusted basis until after the deadline for re-characterizing Taxpayer's Roth IRA conversions.

e. Taxpayer averred to the IRS in the ruling request that, had Taxpayer been informed that his basis in the traditional IRAs was $0 rather than Amount D before making the Roth IRA conversions, Taxpayer would not have elected to make the conversions. Taxpayer also represented that he would have timely recharacterized his Roth IRA if he had been advised of the error prior to the deadline for recharacterizing his Roth IRA conversions.

f. The statute of limitations on Taxpayer's Year 1 Federal Income Tax Return was still open at the time of the issuance of the ruling.

   i. NB: We don't know how much time had elapsed between the date the request for the ruling was submitted and the date the ruling was issued. That time period must be factored into the decision-making process, for if not enough time is allotted, this crucial requirement will not be satisfied and the ruling request will be denied.

2. IRS ruling:

"The information presented and documentation submitted by Taxpayer, **including an affidavit by Attorney admitting his error,** is consistent with his assertion that after excising reasonable diligence, his failure to elect to recharacterize the Roth IRAs, (IRA Y and IRA Y) on or before the date prescribed by law, including extensions, for filing his Federal Income Tax Return for the year of contribution, was caused by his lack of awareness of the necessity of making an election as a result of relying upon incorrect information provided to him by Attorney.

"Based on the above, Taxpayer meets the requirements of section 301.91003(b)(1) of the Regulations, clauses (i) and (iii), for the Year 1 tax year. In addition, since the statute of limitations is still open, under section 301.9100-3(c)(1)(ii) of the Regulations, granting relief will not prejudice the interests of the Government.

"Accordingly, **Taxpayer is granted an extension of 60 days** as measured from the date of the issuance of this ruling letter to recharacterize Amount A and Amount B contributions to traditional IRAs."

3. Note: The attorney had to submit an affidavit assuming responsibility for providing erroneous tax advice.

XIII. Errors Made in Effecting Rollovers Between a Qualified Plan and an IRA: Not All Qualified Plans Are Created Equal--Unique Requirements For Transfers To The Federal Civil Service Retirement System

A. Background

1. Federal statutes that prescribe the operations of CSRS do not permit *pre-tax* employee contributions. An eligible employee contributes portions of his salary on an after-tax basis to CSRS; the employing agency withholds the contributions from the employee's salary; the employing agency also makes matching contributions to CSRS for the benefit of the employee. (5 USC §§8331-8351)

2. The CSRS permits participants to make additional contributions to the CSRS to purchase retirement benefits for periods of service in which otherwise required employee contributions were not withheld from the employee’s compensation.

B. Recent Case Illustrates the Problem--Bohner v. Commissioner

1. Bohner v. Commissioner (143 T.C. No. 11, 10-23-2014): the federal employee withdrew funds from a traditional IRA and then contributed cash to CSRS in an amount equal to the IRA distribution.

2. Was the IRA distribution an “eligible rollover distribution”? Tax Court: no, it was not:

a. 5 USC §8334(c) does not sanction civil service employees to remit the deposit by means of a tax-free rollover contribution from an IRA or another eligible retirement plan; regulations under 5 USC §8334(c) do not require CSRS to accept tax-free rollovers as a form of deposit.

b. Employee deposits are intended to mimic the result that would have occurred if the employee contribution had been effected through salary withholding: on an after-tax basis.

3. Result: CSRS accepted the cash as an after-tax deposit. No exclusion from gross income for the distribution from the IRA.

XIV. Errors Made in Effecting Rollovers From One Provider's IRA to Another Provider's IRA: Failure to Comply With the 60 Day Time Limit on 60 Day Rollovers

A. If This Failure Occurs, Is There a Way to Fix It? Yes, There Is: -- It's in Code §§402(c)(3)(B) and 408(d)(3)(I): The IRS May Waive the 60 Day Requirement

1. Code §§402(c)(3)(B) (exception for 60 day requirement failures that began with a distribution from a qualified plan) and 408(d)(3)(I) (exception for 60 day requirement failures that began with a distribution from an IRA):

    a. §402(c)(3)(B): "*Hardship exception*. The Secretary may waive the 60-day requirement …where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement."

    b. §408(d)(3)(I): "*Waiver of 60-day requirement*. The Secretary may waive the 60-day requirement under subparagraphs (A) and (D) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement."

2. Treas. Reg. §1.408A-4 Q&A 1(b) says that an owner of a traditional IRA who wishes to convert the traditional IRA to a Roth IRA may achieve this result by any of three methods. One of them: receive a distribution from the traditional IRA and transfer it to a Roth IRA within the 60-day period that applies under Section 408(d)(3) for traditional IRA rollover distributions**. What happens if the IRA owner fails to transfer the distribution within 60 days?** Treas. Reg. §1.408-4 Q&A 3 provides relief: pretend that the traditional IRA-to-Roth IRA conversion was completed within the 60 day period and then follow the rules for recharacterizing that conversion back to the status of a traditional IRA, as prescribed in Treas. Reg. §1.408-5 Q&A-6: transfer the funds to a traditional IRA before the due date (including extensions) for filing the IRA owner's Federal income tax return for the year in which the original distribution from the traditional IRA occurred.

3. The legislative history to P.L. 107-16, §644(b), which added §408(d)(3)(I) to the Code, instructed the IRS to issue guidance that would include objective standards to determine whether a waiver will be granted. The legislative history includes among its examples a waiver due to military service in a combat zone or during a Presidentially declared disaster, or for a period during which the participant has received payment in the form of a check, but has not cashed the check, or for errors committed by a financial institution, or in cases of inability to complete a rollover due to

death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error. H.R. Conf. Rep. No. 84, 107th Cong., 1st Sess. 155 (2001).

a. The IRS issued its guidance in Rev. Proc. 2003-16, 2003-4 I.R.B. 359. To request a waiver, a taxpayer must submit a request for a letter ruling under the procedures set forth in the annual revenue procedure on matters under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division (including submission of a user fee). §3.01 of Rev. Proc. 2003-16.

b. In determining whether to grant a waiver, Rev. Proc. 2003-16 states that the IRS will consider all relevant facts and circumstances, including: (1) errors committed by the financial institution; (2) the inability to complete the rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error; (3) the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and (4) the time elapsed since the distribution occurred. §3.02 of Rev. Proc. 2003-16.

c. §3.03 of Rev. Proc. 2003-16 contains an exception to the need to secure a letter ruling:

"3.03. **Automatic approval**. No application to the Service is required if a financial institution receives funds on behalf of a taxpayer prior to the expiration of the 60-day rollover period, the taxpayer follows all procedures required by the financial institution for depositing the funds into an eligible retirement plan within the 60-day period (including giving instructions to deposit the funds into an eligible retirement plan) and, solely due to an error on the part of the financial institution, the funds are not deposited into an eligible retirement plan within the 60-day rollover period. Automatic approval is granted only: (1) if the funds are deposited into an eligible retirement plan within 1 year from the beginning of the 60-day rollover period; and (2) if the financial institution had deposited the funds as instructed, it would have been a valid rollover."

B. Applying for a Private Letter Ruling May No Longer Be Cost Effective

1. Prior to 2016, the user fees for a failed 60-day rollover ranged from as little as $500 to no more than $3,000. And the user fee for a failed Roth IRA conversion was $4,000.

2. Beginning in 2016, the user fee for all of those requests is $10,000.

C. Good News: Rev. Proc. 2016-47 Now Provides a Free and Easy "Self-Certification" Procedure

1. Rev. Proc. 2016-47, published on August 24, 2016, creates a new taxpayer self-certification process that should eliminate the need to request a PLR in many circumstances when a taxpayer fails to complete a rollover of a distribution from a plan or IRA within the required 60 day period.

2. The laundry list of acceptable excuses which could result in relief if a taxpayer sought a PLR has been copied into Rev. Proc. 2016-47. If one of those events occurs, the taxpayer can now self-certify, provide a letter (the text appears as an appendix to Rev. Proc. 2016-47) to the administrator or IRA trustee, and the rollover can be completed on a tax free basis.

    a. Warning: Rev. Proc. 2016-47 says, the taxpayer must complete the failed rollover as soon as reasonably possible after the abatement of the cause that triggered the failure; a taxpayer will be treated as satisfying this request if the rollover is completed within 30 days of abatement.

3. The list of the reasons that are covered by the self-certification process:

    a. An error was committed by the financial institution making the distribution or receiving the contribution.

    b. The distribution was in the form of a check and the check was misplaced and never cashed.

    c. The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was a retirement plan or IRA.

    d. The taxpayer's principal residence was severely damaged.

    e. One of the taxpayer's family members died.

    f. The taxpayer or one of the taxpayer's family members was seriously ill.

    g. The taxpayer was incarcerated.

    h. Restrictions were imposed by a foreign country.

    i. A postal error occurred.

    j. The distribution was made on account of an IRS levy and the proceeds of the levy have been returned the taxpayer.

k. The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

4. How does this list compare to the list of factors the IRS has considered under Rev. Proc. 2003-16? Rev. Proc. 2003-16 says, the IRS will consider these factors:

a. errors committed by a financial institution, other than as described in Section 3.03 which permits self-certification under Rev. Proc. 2003-16

b. inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error

c. the use of the amount distributed (for example, in the case of payment by check, whether the check was cashed); and

d. the time elapsed since the distribution occurred.

5. As a practical matter, the factors that now appear in Rev. Proc. 2016-47 are a rehash of the factors the IRS has used since 2003.

6. **Good news**: **if we fit into a category for which the IRS would have issued a favorable PLR under Rev. Proc. 2003-16, we don't have to apply for a PLR**.

7. **Bad news**: self-certification is not a blessing from the IRS **–** the IRS can still challenge the validity of a failed rollover.

8. **Additional bad news**: IRS has not expanded the grounds for curing a failed rollover: the list of reasons doesn't expand the factors or conditions that the IRS has traditionally applied.

XV. Recent Examples That Show How the IRS Weighs the Relevant Facts When a Taxpayer Applies for a Letter Ruling Under Rev. Proc. 2003-16

A. Owner Wishes to Invest in Nontraditional Assets and Attempts to Rollover Assets from Unwilling IRA Provider to Willing IRA Provider -- and Then Discovers that the Willing IRA Provider Really is Not Interested

1. When are we most likely to encounter this scenario: for clients whose IRAs have invested in non-publicly traded securities.

a. Larger IRA custodians are increasingly reluctant to administer IRAs that contain these assets.

b. If that's the case, why not simply effect a trustee-to-trustee transfer to an IRA custodian or IRA trustee who is willing to hold the asset?

i. That would be the perfect solution: it eliminates reporting (IRA custodians that initiate trustee-to-trustee transfers do not issue Form 1099-R). And the recipient IRA would have been identified in advance.

ii. Don't count on this: those larger IRA custodians wish to keep their lives as simple as possible - and they inevitably distribute the hot asset to our client. That places the burden on the client to find a successor IRA trustee or custodian and do so quickly - within 60 days.

iii. The potential problem: client's financial advisor avers that the financial advisor's organization will accept the asset - and only learns on the 55th day that the Compliance officer has rejected the transfer.

c. Does this scenario qualify for Rev. Proc. 2003-16 Section 3.03 automatic approval? Let's hope so, because if we cannot reach that conclusion, the IRS may not be so generous.

2. PLR 201547010--IRA owner whose IRA custodian issued a check to acquire partnership interest but simultaneously issued a Form 1099-R to treat the purchase as a distribution to the IRA owner and who failed to complete a rollover within 60 days is **not** entitled to relief. Instead, the IRS treats the IRA owner as choosing to use the proceeds from the IRA To fund a business venture rather than attempt to roll the proceeds over into an IRA for retirement purposes.

a. Facts:

i. Taxpayer maintained IRA #1 with Custodian D. Taxpayer wanted to purchase a partnership interest in Partnership C. Financial Advisor prepared the paperwork for Taxpayer to sign and on November 21, 2012, Custodian D issued a check in Amount 1 *payable to Partnership C.*

ii. Taxpayer: "I intended to have IRA #1 purchase the partnership interest and hold the partnership interest.

iii. And that's what the Partnership's records said: the partnership agreement indicated that the interest was held by "Taxpayer A IRA".

iv. Unfortunately, the IRA #1 Custodian decided that it was unable to hold the partnership interest and as a result, issued a Form 1099-R treating the distribution on November 21, 2012, as a taxable distribution.

v. Taxpayer's position in taxpayer's request for a private letter ruling to the IRS: Financial Advisor should have prepared paperwork to transfer cash from IRA #1 to Financial Institution F, which would have held the partnership interest on behalf of an IRA for Taxpayer.

b. The mistake was discovered in October, 2013, during the preparation of Taxpayer A's 2012 tax return.

c. The IRS was not to have been impressed with the taxpayer's position. After citing the general requirements in Rev. Proc. 2003-16 for relief, which include errors committed by a financial institution, death, hospitalization, postal error, incarceration, and/or disability, the IRS concluded:

"In this instance, Taxpayer A chose to use the proceeds from IRA B to fund a business venture rather than attempt to roll the proceeds over into an IRA account for retirement purposes.

"Therefore, pursuant to section 408(d)(3)(I) of the Code, Taxpayer A's request that the Service waive the 60-day rollover requirement with respect to the distribution of Amount 1 is declined, and Amount 1 and any earnings thereon are therefore includible in Taxpayer A's gross income for the 2012 taxable year."

3. You May Do Better in Court: McGaugh v. Commissioner (T.C. Memo. 2016-28, 2-24-2016): IRA Owner Whose IRA Issued a Wire Transfer From IRA to Corporation-Issuer and Whose IRA Received the Stock From the Issuer More Than 60 Days After the Check Distribution Was a Conduit and Did Not Receive a Taxable Distribution

a. Raymond McGaugh maintained a self-directed IRA with custodian Merrill Lynch, and the IRA held 10,000 shares of stock in First Personal Financial Corp. ("FPFC"). Summer of 2011, Mr. McGaugh requested that Merrill Lynch use funds from his IRA to purchase an additional 7,500 shares of FPFC stock.

i. However, for reasons the record does not show, Merrill Lynch would not purchase the shares directly on Mr. McGaugh's behalf.

ii. Consequently, Mr. McGaugh requested that Merrill Lynch initiate a wire transfer of $50,000 directly to FPFC. On October 7, 2011, Merrill Lynch initiated and FPFC received the wire transfer. (There is no evidence that Mr. McGaugh requested an IRA distribution to himself.) On November 28, 2011, FPFC issued the stock certificate not in Mr. McGaugh's name but instead in the name of "Raymond McGaugh IRA FBO Raymond McGaugh", as Mr. McGaugh had requested. FPFC claims that the stock certificate was mailed to Merrill Lynch on or about the same day as the November 28, 2011, issuance date on the certificate; but because Merrill Lynch states that the stock certificate was not received until "early 2012", the Tax Court treated the timing of the transmittal of the stock certificate to Merrill Lynch as being in dispute and assume it was in 2012--more than 60 days after the wire transfer.

iii. Believing the transaction to be subject to the rollover rules, and believing the transfer to be outside the 60-day limit, Merrill Lynch reported the $50,000 transaction as a taxable distribution on Form 1099-R, "Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc." and refuses to treat the FPFC stock as an asset of the IRA. Mr. McGaugh continues to object to the refusal.

b. IRS assesses a deficiency. McGaugh argues: I never received anything - the IRA made the investment; the check was made payable to FPFC, not me; the share certificates were issued in the name of the IRA, not me. No distribution therefore occurred and the 60 day time period therefore does not apply, either.

c. Tax Court:

i. There was no literal distribution of IRA funds to Mr. McGaugh.

ii. McGaugh was, at most, a conduit of the IRA funds.

iii. The Commissioner emphasizes that "[i]t appears that petitioner is in possession of the purported stock certificate." Even if Mr. McGaugh had physical possession of the stock certificate, he was not in constructive receipt of the asset. The "essence [of constructive receipt] is that funds which are subject to a taxpayer's unfettered command and which he is free to enjoy at his option are constructively received by him whether he sees fit to enjoy them or not." Ancira v. Commissioner, 119 T.C. at 138 (quoting Estate of Brooks v. Commissioner, 50 T.C. 585, 592 (1968)). Here, the stock was issued not in Mr. McGaugh's name but in the name "Raymond McGaugh IRA FBO Raymond McGaugh". Even with physical possession of the stock certificate, Mr. McGaugh could not have realized any practical utility or benefit from the certificate in the name of the IRA."

4. Lesson to be learned:

   a. Stick to the facts - facts which show an error on the part of the financial institution.

   b. Don't create an inventive, hypothetical, unsubstantiated alternate world.

B. PLR 201606032-Spouse IRA Beneficiary's Failure to Effect Timely 60 Day IRA Distribution Rollover Waived-Beneficiary of IRA Was Estate; Estate Poured Over to Trust; Spouse Was Executor of Estate and Trust and Sole Beneficiary of Trust-Spouse was Therefore Eligible to Rollover the Distribution and Failure Was due to Emotional Stress

1. "The information and documentation submitted by Taxpayer A are consistent with her assertion that the failure to accomplish a rollover of Amount 1 from IRA C into her own IRA within the 60-day period prescribed by 408(d)(3)(A) of the Code was due to the emotional distress following her husband's death and the stress of administering his estate."

2. Good news for the surviving spouse.

C. PLR 201542010-IRS Declines to Waive IRC §408(d)(3) 60-Day Rollover Requirement-Executor Failed to Produce Evidence That Decedent Withdrew Funds from IRA Prior to Death With the Intent to Rollover the Distribution to a New IRA-Death Prior to End of 60 Day Period Was Not Sufficient Without Evidence of Intent to Roll Over

1. Decedent A was not happy with the rate of return on IRA X and requested a distribution of Amount D from IRA X to be wired to his Bank C checking account. That took place; however, before Decedent could take any further action, Decedent died.

2. Time passes; surviving spouse -- Taxpayer B -- is appointed executor of Decedent's estate; the checking account is transferred to an account in the name of the estate.

3. The following year, surviving spouse receives a Form 1099-R from the custodian of IRA X - and realizes that no action was taken with respect to the withdrawal from IRA X.

4. IRS response:

   "Taxpayer B has not presented adequate evidence to the Service that shows Decedent A's intent to roll over Amount D from IRA X into a rollover IRA. The information presented and the documentation Taxpayer B has submitted is consistent with her assertion that Decedent A took a distribution totaling Amount D from IRA X, but no rollover IRA was established and there was no documentation signed by Decedent A showing his intent to establish a rollover IRA.

   "Therefore, pursuant to section 408(d)(3)(I) of the Code, the Service hereby declines to waive the 60-day rollover requirement with respect to the distribution of Amount D from IRA X."

D. Lessons to be Learned

1. Do ***not*** make IRA distributions to IRA owners or IRA beneficiaries.

2. Instead, IRA owners and beneficiaries who have more than one IRA may make multiple direct transfers from the trustee or custodian of one IRA to the trustee or custodian of another IRA without triggering the IRC §408(d)(3)(B) limitation. Rev. Rul. 78-406, 1978-2 C.B. 157: trustee/custodian to trustee/custodian transfers Transferring does not result in a "distribution" within the meaning of IRC §408(d)(3)(A).

XVI. Watch Out for Unexpected Failures If a Client Has Engaged in a Prohibited Transaction Involving the Client's IRA

A. The issue

1. IRC §4975 imposes an initial tax and an additional tax on each "disqualified person" who participates in a "prohibited transaction.

   a. What is a "prohibited transaction"? IRC §4975(c)(1): "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 interests 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."

b. Who is a "disqualified person"? IRC §4975(e)(2): a person who is--

(A) a fiduciary;

(B) a person providing services to the plan;

(C) an employer any of whose employees are covered by the plan;

(D) an employee organization any of whose members are covered by the plan;

(E) an owner, direct or indirect, of 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of a corporation,

(ii) the capital interest or the profits interest of a partnership, or

(iii) the beneficial interest of a trust or unincorporated enterprise, which is an employer or an employee organization described in subparagraph (C) or (D);

(F) a member of the family (as defined in paragraph (6)) of any individual described in subparagraph (A), (B), (C), or (E);

(G) a corporation, partnership, or trust or estate of which (or in which) 50 percent or more of—

(i) the combined voting power of all classes of stock entitled to vote or the total value of shares of all classes of stock of such corporation,

(ii) the capital interest or profits interest of such partnership, or

(iii) the beneficial interest of such trust or estate,

is owned directly or indirectly, or held by persons described in subparagraph (A), (B), (C), (D), or (E);

(H) an officer, director (or an individual having powers or responsibilities similar to those of officers or directors), a 10 percent or more shareholder, or a highly compensated employee (earning 10 percent or more of the yearly wages of an employer) of a person described in subparagraph (C), (D), (E), or (G); or

(I) a 10 percent or more (in capital or profits) partner or joint venturer of a person described in subparagraph (C), (D), (E), or (G).

c. IRC §4975(d) contains a laundry list of exemptions.

d. IRC §4975(a) imposes an initial tax equal to 15% of the amount involved on each disqualified person who participated in a prohibited transaction which does not qualify for an exemption. If the prohibited transaction is not corrected before the IRS issues a notice of deficiency or assesses the initial tax, then IRC §4975(b) imposes an additional tax on each disqualified person, equal to 100% of the amount involved.

2. There is one circumstance in which a prohibited transaction will ***not*** trigger the initial or the additional tax. It triggers something worse.

a. Under Code Sec. 408(e)(1), an IRA is exempt from income tax. However, Code Sec. 408(e)(2)(A) provides that if, during any tax year an individual or his beneficiary engages in any transaction prohibited by Code Sec. 4975 with respect to his IRA, the IRA will cease to be an IRA as of the first day of the tax year. Code Sec. 408(e)(2)(B) provides that in any case in which an IRA ceases to be an IRA because of this rule, Code Sec. 408(d)(1) applies as if there were a distribution on the first day of the tax year in an amount equal to the fair market value (on that day) of all assets in the account.

b. Result: if an IRA owner or beneficiary engages in a non-exempted prohibited transaction, the entire value of the IRA immediately becomes includible in gross income - and the assets in the IRA will not be eligible for the “federal” bankruptcy protection for “retirement assets” (see below).

B. How Might an IRA Owner Run Afoul of These Rules?

1. Code Sec. 4975(c)(1) lists transactions that constitute prohibited transactions, such as a transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan. Specifically, Code Sec. 4975(c)(1)(B) prohibits "any direct or indirect...lending of money or other extension of credit between a [retirement] plan and a disqualified person."

2. Under Code Sec. 4975(e)(2)(A), a "disqualified person" is defined as a fiduciary, i.e., any person who exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets.

3. Result: IRA owners are fiduciaries and, therefore disqualified persons. If an IRA owner engages in a transaction that results in any indirect loan from the IRA to the IRA owner, or if the transaction involving the IRA has the effect of making more valuable other assets owned by the IRA owner, a prohibited transaction will occur for which there is no exemption.

C. Rollover as Business Startup" (ROBS)

1. What is a ROBS?

a. Step #1: Aspiring Entrepreneur recently terminated her employment with Public Corporation and possesses a meaningful balance in the Public Corporation Retirement Plan. Aspiring Entrepreneur effects a direct rollover of her balance in the Public Corporation Retirement Plan to a traditional IRA while she scouts for a new business opportunity.

b. Step #2: Aspiring Entrepreneur creates a C corporation (NewCorp), but does not immediately issue any C corporation stock.

c. Step #3: NewCorp-- which has no assets or liabilities -- adopts a retirement plan that sanctions up to 100% of the plan assets attributable to rollover contributions to be invested in C corporation employer securities (the "NewCorp Profit Sharing Plan").

d. Step #4: Aspiring Entrepreneur transfers the balance in her traditional IRA to the NewCorp Profit Sharing Plan by a direct rollover (custodian to plan trustee transfer) or by a not-more-than once-per-year compliant 60 day limit rollover. The distribution is allocated to Aspiring Entrepreneur's account in the NewCorp Profit Sharing Plan.

e. Step #5: Aspiring Entrepreneur causes NewCorp to issue all of its stock to its first shareholder, NewCorp Profit Sharing Plan, and in exchange for the proceeds held in Aspiring Entrepreneur's account in the NewCorp Profit Sharing Plan. The NewCorp stock is allocated to allocated to Aspiring Entrepreneur's account in the NewCorp Profit Sharing Plan.

f. Step #6: NewCorp now possesses liquid capital to create the 9th investment wonder of the world that Aspiring Entrepreneur has envisioned. Because all of NewCorp's stock has been allocated to Aspiring Entrepreneur's account in the NewCorp Profit Sharing Plan, future participants in the NewCorp Profit Sharing Plan will not be able to invest in NewCorp stock.

g. Result: Aspiring Entrepreneur has used rollover proceeds to start up or acquire a business and avoid tax on the original distribution of Aspiring Entrepreneur's interest in the Public Corporation Retirement Plan.

h. IRS has expressed concern about potential abuses surrounding ROBS arrangements, and has completed a compliance project that investigated ROBS arrangements. http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-(EPCU)---Completed-Projects---Project-with-Summary-Reports-%E2%80%93-Rollovers-as-Business-Start-Ups-(ROBS). IRS had previously issued examination guidelines for its employee plan specialists when reviewing ROBS arrangements. http://www.irs.gov/pub/irs-tege/robs_guidelines.pdf

2. If a ROBS arrangement results in a prohibited transaction, then bad things will happen--Peek and Fleck v. Commissioner, 140 T.C. No. 12 (May 9, 2013) --individuals' guarantees of loan to company owned by their IRAs were prohibited transactions

a. In this case, the aspiring entrepreneur taxpayers deployed a variant of the prototypical ROBS arrangement upon which the IRS has frowned. Instead of causing NewCorp to create a qualified retirement plan to which Aspiring Entrepreneur transfers the proceeds of what began as the distribution from the Public Corporation Retirement Plan, Aspiring Entrepreneur simply caused Aspiring Entrepreneur's traditional IRA to purchase NewCorp's stock.

b. The rub: the distribution wasn't sufficient to satisfy NewCorp's cash needs. NewCorp borrowed money - and the aspiring entrepreneur taxpayers guaranteed the loan.

c. Result: a prohibited transaction: the fiduciaries engaged in an extension of credit to or for the benefit of the IRA.

D. Ellis v. Commissioner (8th Cir. June 5, 2015)-A Variant on the ROBS Produces the Same Bad Result

1. Ellis rolls over a distribution from his now-former employer's 401(k) plan to a "self-directed IRA." Ellis directs the IRA to invest in a newly created limited liability company, CST Investments, LLC ("CST"); in exchange for investing the entire $319,500 balance in the IRA, the IRA received a 98% interest in the limited liability company. Limited liability company purchases a used car business and pays a salary to Ellis for his services as the general manager.

2. Court: "By directing CST to pay him wages from funds that the company received almost exclusively from his IRA, Mr. Ellis engaged in the indirect transfer of the income and assets of the IRA for his own benefit and indirectly dealt with such income and assets for his own interest or his own account." That's a prohibited transaction.

3. Ellis argued, there is an exemption: §4975(d)(10) excludes from the list of prohibited transactions the "receipt by a disqualified person of any reasonable compensation for services rendered, or for the reimbursement of expenses properly and actually incurred, in the performance of his duties with the plan." The 8th Circuit rejected this argument: this exemption applies only to compensation for services rendered in the performance of plan duties. CST compensated Ellis for his services as general manager of the company, not for any services related to his IRA. Result: IRC § 4975(d)(10) does not apply.

E. A Prohibited Transaction Involving an IRA Owner That Results in the Loss of Exempt Status for the IRA Also Exposes the IRA to Claims of Creditors in Bankruptcy

1. The Bankruptcy Abuse and Consumer Protection Act of 2005, signed into law on April 20, 2005 and effective as of October 20, 2005 ("BACPA") added a new provision to §522(b)(3), which lists assets of a debtor in bankruptcy that are exempt from claims of creditors if the debtor elects to use the federal exemptions rather than state exemptions. The new federal exemption appears in §522(b)(3)(C).

   "(C) Retirement funds, **to the extent that those funds are in a fund or account that is exempt from taxation under section** 401, 403, **408**, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986."

2. In Re: Kellerman, (Bk Ct., E. AK, May 26, 2015)

   a. IRA owner caused the IRA owner's self-directed IRA to purchase four acres of land adjacent to property owned by an LLC in which the IRA owner and his wife were the sole equal members. The LLC owned 120 acres. The IRA then contributed the land to a partnership with the LLC to facilitate development of the LLC's property.

b. Result: the transaction enabled the IRA owner -- a fiduciary -- to use the IRA's assets for the personal benefit of the IRA owner (the ability to develop the 120 acres owned by the LLC that the IRA owner possessed that 50% membership interest).

c. That constituted a prohibited transaction that immediately terminated the exempt status of the IRA. When the IRA owner subsequently filed for bankruptcy protection, the IRA assets failed to qualify for the federal exemption.

F. Thiessen v. Commissioner (U.S. Tax Court, 146 T.C. No. 7, 3-29-2016)-- IRA Owners' Personal Guarantees of Loans to a Company Owned by Their IRA Constitute Prohibited Transactions

1. June, 2003: James and Judith Thiessen, who had just terminated their employment with Dillon Cos. Inc. (an affiliate of Kroger Co.) wished to purchase the assets of a metal fabrication business. To generate the funds necessary for the acquisition, they rolled over their Dillon Cos. Inc. qualified retirement plan account balances (a total of $432,076.41) into newly established IRAs. The Thiessens then incorporated Elsara, and the new IRAs purchased stock in Elsara for a total of $431,500. Armed with this cash, Elsara entered into an asset purchase agreement with the owner of the metal fabrication business to acquire the assets for $601,977.50. Since that cash was not sufficient to satisfy the entire purchase price, the seller agreed to provide seller financing: Elsara issued a promissory note to the seller for $200,000. The Thiessens personally guaranteed that loan.

2. The Thiessens excluded the rollover contribution from their gross income on their 2003 income and did not disclose the loan guarantee on their 2003 return.

3. Tax Court:

a. The Thiessens' IRAs constituted "plans," as that term is used in IRC §4975. The Thiessens were "disqualified persons": they exercised discretionary authority or discretionary control over the management of their IRAs, as well as over the management and disposition of the assets of their IRAs.

b. The loan guarantee constituted an indirect extension of credit to the IRAs and therefore constituted a prohibited transaction.

c. Result: The Thiessens' IRAs ceased to qualify as IRAs on account of the guarantees as of the first day of the taxable year in which the prohibited transaction occurred and the Thiessens are treated as having received distributions as of that date equal to the fair market value of the assets in their IRAs.

d. Because the unreported gross income from the deemed distributions exceeded 25 percent of gross income for tax year 2003, the three year statute of limitations of assessment and collections was extended by statute to six years. The Tax Court found that the Thiessens' return disclosure of the rollovers as tax-free wasn't sufficient to put IRS on notice that petitioners had engaged in the prohibited transactions.

XVII. Does the BACPA Federal Exemption Shield Inherited IRAs When the Beneficiary Seeks (or is Involuntarily Forced into) Bankruptcy?

A. The Split in the Circuits

1. *Chilton v. Moser (In re Chilton)*, 674 F.3d 486 (5th Cir. 2012): inherited IRAs are exempt from taxation under tax code Section 408(e) and therefore satisfy the "retirement funds" bankruptcy federal exemption requirement.

2. *In re Clark*, 714 F.3d 559, 55 EBC 1756 (7th Cir. 2013): the 7th Circuit came to the opposite conclusion.

B. The Dispute Among The Circuits Is Resolved: U.S. Supreme Court Rules That Inherited IRAs Are Not "Retirement Funds" and are Not Entitled to a Federal Exemption from a Debtor's Bankruptcy Estate

1. Clark v. Rameker, 134 S.Ct. 2242 (2014): Funds held in inherited IRAs are not "retirement funds" within the meaning of §522(b)(3)(C).

C. State Exemptions May Still Be Available to Shield Inherited IRAs from Claims of Creditors of the Owner of the Inherited IRA

1. The Supreme Court's decision was based solely on the federal exemptions in the Bankruptcy Code. Debtors may elect to use state law exemptions; a number of states provide more generous exemptions and exclude inherited IRAs from claims of creditors.

2. States with more generous exemptions include Alaska, Arizona, Florida, Missouri, North Carolina, Ohio, and Texas.

D. May a Plan Sponsor Use the Voluntary Corrections Program to Retroactively Fix a Retirement Plan So as to Qualify for the Federal Exemption?

1. Issue: if a debtor participates in a qualified retirement plan that had lost its qualified status as of the date of the debtor's Bankruptcy Court petition, then the qualified plan benefit does not meet the definition of "retirement funds" in 522(b)(3)(C)-- the arrangement must be exempt from tax.

2. In re: James Gilbraith (U.S. Bankruptcy Ct AZ 12-24-14): although plan failed to qualify due to a document failure, the debtors adopted a new prototype plan document and obtained retroactive relief through EPCRS. The relief re-qualified the plan, as of a date prior to the date of the Bankruptcy Court petition.

3. Held: as long as the correction is retroactive to a date prior to the petition date, the qualified plan benefits do meet the definition of "retirement funds."

E. Distribution From a Traditional IRA to Purchase a Section 408(b) Individual Retirement Annuity: Does the Individual Retirement Annuity Qualify for the 522(b)(3)(C) "Retirement Funds" Exemption?

1. Issue: Although 522(b)(3)(C) specifically includes IRC §408(b) individual retirement annuities as vehicles that can constitute "retirement funds," the IRC definition of an "individual retirement annuity" places a limit on the size of the premiums that may be paid: (1) the premiums may not be fixed; and (2) the annual premium on behalf of any individual may not exceed the IRC §219(b)(1)(A) annual deductible contribution limit for an IRA, or (ii) the individual's includible compensation for the year. IRC §408(b)(2)(A) and (B).

2. Running v. Miller (8th Cir. 2-13-2015): prior to filing for bankruptcy, the debtor withdrew $267,300 from a traditional IRA and used the distribution to purchase an individual retirement annuity.

3. Issue: was that transfer a "premium" that exceeded the IRC §408(b) limits and thereby disqualified the arrangement? That's what the bankruptcy trustee argued.

4. 8th Circuit: No, eligible rollover distributions do not constitute "premiums" as that term is used in IRC §408(b)(2).

XVIII. How Do We Avoid the 50% Excise Tax for Failure to Have Received Minimum Required Distributions?

A. Background.

1. Code §4974(a) imposes a 50% excise tax on the amount by which the minimum required distribution exceeds the actual amount distributed during the taxable year.

2. Code §4974(d) provides that the IRS may waive any or part of the excise tax if the taxpayer can show that the shortfall in the distribution amount was due to reasonable error and that appropriate steps are being taken to remedy the shortfall.

3. Use Form 5329 to report the tax on excess accumulations.

B. Can We Avoid Paying the Excise Tax “Up Front”?

1. Yes. Here is an excerpt from IRS Publication 590, “Individual Retirement Arrangements (IRAs)’:

“If the excess accumulation is due to reasonable error, and you have taken, or are taking, steps to remedy the insufficient distribution, you can request that the tax be waived. If you believe you qualify for this relief, attach a statement of explanation and complete Form 5329 as instructed under Waiver of tax in the Instructions for Form 5329. (Page 59.)

2. Here is the text of the relevant portion of Form 5329:

Part VIII **Additional Tax on Excess Accumulation in Qualified Retirement Plans (Including IRAs)**
Complete this part if you did not receive the minimum required distribution from your qualified retirement plan.

50	Minimum required distribution for 2013 (see instructions)	50	
51	Amount actually distributed to you in 2013	51	
52	Subtract line 51 from line 50. If zero or less, enter -0-	52	
53	**Additional tax.** Enter 50% (.50) of line 52. Include this amount on Form 1040, line 58, or Form 1040NR, line 56	53	

1. The instructions to Form 5329 say:

Waiver of tax. The IRS can waive part or all of this tax if you can show that any shortfall in the amount of distributions was due to reasonable error and you are taking reasonable steps to remedy the shortfall. If you believe you qualify for this relief, attach a statement of explanation and file Form 5329 as follows.

1. Complete lines 50 and 51 as instructed.

2. Enter “RC” and the amount you want waived in parentheses on the dotted line next to line 52. Subtract this amount from the total shortfall you figured without regard to the waiver, and enter the result on line 52.

3. Complete line 53 as instructed.

You must pay any tax due that is reported on line 53. The IRS will review the information you provide and decide whether to grant your request for a waiver.

XIX. Commonly Encountered Minimum Distribution Issues May Lack Clear Answers

A. A Frequently Encountered Issue: If a Trust is the Beneficiary of an IRA, and the Trust Has More Than One Beneficiary, How Do We Determine the Required Distribution for Each Trust Beneficiary

1. The Problem

   a. The "separate accounts" rule in Reg. §1.401(a)(9)-8, Q&A-2(a)(2) (which also applies to distributions from IRAs) says:

"If the employee's benefit in a defined contribution plan is divided into separate accounts and the beneficiaries with respect to one separate account differ from the beneficiaries with respect to the other separate accounts of the employee under the plan, for years subsequent to the calendar year containing the date on which the separate accounts were established, or date of death if later, such separate account under the plan is not aggregated with the other separate accounts under the plan in order to determine whether the distributions from such separate account under the plan satisfy section 401(a)(9). ***Instead, the rules in section 401(a)(9) separately apply to such separate account under the plan.*** However, the applicable distribution period for each such separate account is determined disregarding the other beneficiaries of the employee's benefit only if the separate account is established on a date no later than the last day of the year following the calendar year of the employee's death." (Emphasis added.)

   b. If this rule applies, then each beneficiary of each separate account may use his or her life expectancy to determine his or her applicable distribution period, and do so without affecting any other beneficiary of another separate account.

   c. What, then is the problem? The separate account rule does not apply to trusts. Reg. §§1.401(a)(9)-4, Q&A-5(c) and 1.401(a)(9)-5, Q&A-7 provide that we must use the age of the oldest "designated beneficiary – i.e., the beneficiary with the shortest life expectancy.

2. How Does This Affect Trusts

   a. IRA owners frequently designate a revocable trust as the beneficiary of the IRA. The trust provides that the assets of the trust will be divided into separate funds for each beneficiary, in the proportions specified in the trust, and then paid -- usually over an extended period of time, which may vary with the degree of generational separation from the IRA owner (the further removed, the longer the period of time assets are held in trust).

b. Result: a trust can have beneficiaries who vary wildly in age: a surviving spouse; an aged relative; children; and grandchildren.

c. If the required distribution must be calculated for all beneficiaries based on the age of the oldest beneficiary--rather than separately for each beneficiary--, then distributions for the youngest beneficiaries will be dramatically accelerated.

3. Pre-Mortem Planning Considerations

a. The IRA owner and trust grantor may wish to consider designating the "old" beneficiaries of the trust as direct beneficiaries of the IRA instead of the trust.

i. Problem: they may not be competent to handle those assets.

ii. Solution: an individually designed IRA that contains language identical to that in the trust to regulate how and when those IRA assets will be distributed.

b. Another solution: instead of designating the "Trust" as the beneficiary of the IRA, designate each sub-trust created under the terms of the Trust for each of the individual beneficiaries.

i. We circumvent the prohibition on the use of the separate account rule.

ii. See PLR 200528031: IRS agrees that designating separate sub-trusts established under the terms of trust permits the use of the "separate account" rule, but designating the trust does not, even if trust assets are subsequently divided into sub-trusts.

iii. Problem: we lose flexibility in determining how much goes to each share.

4. Post-Mortem Solutions

a. The trustee of the Trust can effect IRA-to-IRA transfers of each Trust beneficiary's interest in the Decedent's IRA, in the same fashion as described for pre-mortem planning.

b. Accomplish this prior to September 30 of the calendar year following Decedent IRA Owner's death.

c. Result? Arguably, use each trust beneficiary's life expectancy to determine the annual minimum required distributions from his or her transferee IRA.

d. **The problem**: the Final Regulations do not address this issue. In the Private Letter Rulings issued to date, the requestors asked for a more conservative ruling from the IRS: use the age of the oldest Trust beneficiary, regardless of when the transfers to the IRAs occurred.

i. Point to consider: requestors may have acceded to this request only after requesting the more aggressive position and being told by the IRS that it would not issue a favorable ruling unless the requestors changed their request to the more conservative position.

B. Who is a "Contingent Beneficiary" And Why Do We Care? And Is the Term as Broad as It Might Seem (and as Many of Us Thought)? PLR 201633025 Provides Surprisingly Favorable Guidance

1. The issue

a. Reg. §1.401(a)(9)-4, Q& A-3: only individuals may be designated beneficiaries for purposes of §401(a)(9).

i. A person who is not an individual, such as the employee's/IRA owner's estate, or a charity, may not be a designated beneficiary.

ii. If a person other than an individual is designated as a beneficiary of plan/IRA, the participant/IRA owner will be treated as having no designated beneficiary for purposes of section 401(a)(9), even if there are also individuals designated as beneficiaries.

iii. If this happens, then we must use the age of the deceased participant/IRA owner to determine the applicable distribution period over which required minimum distributions must be made. That could be a very short period of time -- a lot shorter than if we could use the age of the individuals who are also designated beneficiaries.

b. If a trust is the designated beneficiary of a plan or IRA, Reg. §1.401(a)(9)-4, Q& A-5 provides that beneficiaries of a trust with respect to the trust's interest in an employee's benefit (and not the trust itself) will be treated as having been designated as beneficiaries for purposes of determining the applicable distribution period if certain requirements are met. Reg.

§1.401(a)(9)-5, Q& A-7(a): if plan participant/IRA owner has more than one individual that is a designated beneficiary, the designated beneficiary with the shortest life expectancy will be the designated beneficiary for purposes of determining the applicable distribution period.

i. Result: one older beneficiary among a gaggle of younger beneficiaries accelerates the distribution period for everyone.

c. Reg. §1.401(a)(9)-5, Q& A-7(b): a **contingent beneficiary** (one whose entitlement to an employee's benefit after the participant/IRA owner's death is a contingent right) is considered a beneficiary for purposes of determining the designated beneficiary with the shortest life expectancy and whether a person other than an individual is a beneficiary, except as provided in Reg. §1.401(a)(9)-5, Q& A-7(c)(1).

d. Reg. §1.401(a)(9)-5, Q& A-7(c)(1): for purposes of determining the beneficiary with the shortest life expectancy or whether a person other than an individual is a beneficiary, a person will **not** be considered a beneficiary merely because that person could become the successor to the interest of one of the employee's beneficiaries after that beneficiary's death. **However, this exception does not apply** (that's bad news) to a person who has any right (including a contingent right) to a plan participant's/IRA owner's benefit beyond being a mere potential successor to the interest of one of the employee's beneficiaries upon that beneficiary's death.

i. Example: if the first beneficiary has a right to all income with respect to an employee's individual account during that beneficiary's life and a second beneficiary has a right to the principal but only after the death of the first income beneficiary (any portion of the principal distributed during the life of the first income beneficiary to be held in trust until that first beneficiary's death), **both beneficiaries must be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries.**

e. Now for the conundrum: we frequently encounter trusts in which assets are held for a period of time, if not for the life of, the primary beneficiaries of a trust, and, if a primary beneficiary dies before his or her trust assets are exhausted, those assets go to others. What if the others include an older generation individual or a charity? If we have to count those individuals/charities among the class of “designated beneficiaries,” have we just dramatically shortened the applicable distribution period and dramatically accelerated the period of time over which IRA/plan distributions must be made to the primary beneficiaries?

2. PLR 201633025 Provides Surprisingly favorable guidance

a. Terms of trust: pay net income to Child, plus, at trustee’s discretion, distribute principal for health, education, welfare and general maintenance, until Child reaches age 50. If Child is alive at age 50, distribute remaining trust assets to Child. If Child dies prior to attaining age 50, trust will terminate and will be distributed to the Child’s children (hold in trust until a grandchild reaches age 21). If a child of Child dies before attaining age 21, beneficiary's share is paid to the beneficiary's personal representatives. If Child and all her issue die prior to final distribution of assets from Trust, distribute the remaining assets to Child’s brother and sister; if they are not alive at that time, distribute the remaining assets to various charitable organizations.

b. Must the brother and sister and/or the charities be taken into account in determining the beneficiary with the shortest life expectancy and whether only individuals are beneficiaries? The general rule on contingent beneficiaries, and the exception which forces us to include them, is not a model of clarity.

c. PLR 201633025: No, we do not have to include the brother or the sister or the charities. We do have to include Child and Child’s children - but not the more remote beneficiaries. Why?

“Individual E [Child] is taken into account as a designated beneficiary because she is entitled to all net income of Trust while she is alive and is entitled to a distribution of the entire trust if she attains age 50. Individual F and Individual G [the children of Child] are also taken into account as designated beneficiaries because the trustee has the discretion to make distributions of principal to them during Individual E's lifetime for their health, education, support, or maintenance, in addition to their contingent interest in the remainder of the Trust if Individual E dies before receiving full distribution of the Trust at age 50. ***All other potential recipients of the funds in the Trust are mere successor beneficiaries within the meaning of the regulations.***”

d. Can you articulate the distinction?

C. To Whom Should a Qualified Plan Distribution be Paid: Dueling Beneficiary Scenarios

1. Mays-Williams v. Asa Williams, Jr. (9th Cir. 1-28-15): the decedent plan participant notified the qualified plan administrator of the participant's wish to change beneficiaries (to remove an ex-spouse and substitute a child from a previous marriage) and gave the administrator all of the information to effect the change -- but never completed the beneficiary designation form that the administrator sent to the plan participant. The decedent was not married at the time of the decedent's death.

   a. Since the governing qualified plan documents did not formally incorporate a requirement to submit a form specified by the plan as a condition to effecting a beneficiary designation, or changing a beneficiary designation, state law will govern whether the actions taken by the plan participant constituted a valid beneficiary designation.

   b. Xerox plan document: unmarried participants "shall designate" a beneficiary, and "may change [the] designation of beneficiary from time to time." Summary plan description: a participant "may visit the Your Benefits Resources web site . . . or call the Xerox Benefits Center . . . to complete or change [his] beneficiary designation at any time." SPD says that, upon the death of an unmarried participant, "a valid beneficiary designation must be on file with the Xerox Benefits Center prior to . . . death," or Xerox will disburse benefits to the participant's estate.

   c. ERISA §404(a)(1)(D): ERISA fiduciaries must distribute benefits "in accordance with the documents and instruments governing the plan." *Issue: did the Xerox plan administrator's beneficiary designation form rise to the level of "documents and instruments governing the plan"?*

   d. 9th Circuit: No, the forms do not constitute "documents and instruments," since neither the plan document nor the summary plan description formally incorporate them or require submission of a form to effect a beneficiary designation for an unmarried participant.

      i. The 9th Circuit noted that the phrase, "documents and instruments governing the plan" also appears in ERISA §404(a)(1)(D)'s prudent person standard of care.[7] In Kennedy v. Plan Administrator for DuPont Savings &

[7] "[A] fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and…in accordance with the documents and instruments governing the plan…"

Investment Plan, 555 U.S. 285 (2009), the U.S. Supreme Court declined to decide whether the category of "documents and instruments governing the plan" described in ERISA sec. 404(a)(1)(D) included beneficiary designation forms in circumstances similar to those facing the Xerox plan.

ii. Only those documents that provide information as to "where [the participant] stands with respect to the plan," such as an SPD or trust agreement, could qualify as governing documents with which a plan administrator must comply in awarding benefits under ERISA §404(a)(1)(D).

iii. Because the beneficiary designation forms in the present case don't provide that information -- in this case, the forms only confirm the participant's attempt to change his designated beneficiary – the forms are not "plan documents" governing the administrator's award of plan benefits.

e. The 9th Circuit concludes that, since nothing in the plan documents prohibits unmarried plan participants from telephonically designating or changing beneficiaries, the trial court must determine whether the decedent strictly or substantially complied with the governing plan documents -- which revolves around state law.

2. Lesson to be learned:

a. Avoid this problem: make sure that beneficiary designations on forms completed in a manner acceptable to the IRA custodian have been filed in the manner specified in the IRA documents.

b. Don't count on using this case: ERISA §§401 et. seq. only apply to employer-sponsored employee benefit plans -- individual traditional IRAs are not subject to ERISA Title I, Part 4. State law will apply.

c. Example: LeBlanc v. Wells Fargo, 134 Ohio St. 3d 250, 2010-Ohio-5458 (November 28, 2012)

i. The IRA custodian's beneficiary and change of beneficiary procedures must be followed in order to effectively designate a beneficiary or change a beneficiary.

ii. However, the IRA custodian's procedures are intended to protect the IRA custodian. Therefore, the custodian may waive its procedures if it chooses to do so. If the custodian elects to file an interpleader action to enable a court to determine who is the beneficiary when two or more persons allege that the IRA owner designated one of them as the beneficiary, the IRA custodian waives its procedures.

iii. If the custodian waives its procedures, then Ohio law involving disputes among putative beneficiaries of life insurance policies will apply to disputes among putative beneficiaries of IRAs: the "clearly expressed intent" test. If the IRA owner's intent to change beneficiaries was clearly communicated to the custodian, the proceeds will be paid to the newly designated beneficiary rather than to the original beneficiary.

XX. It's OK to Be a Pig, But Don't Be a Hog-Pigs Get Fat; Hogs Get Slaughtered.

A. How to be a Hog: Claim Losses Incurred by an IRA on Your Individual Income Tax Return -- Fish v. Commissioner, T.C., No. 10691-13, T.C. Memo 2015-176, 9-10-2015

1. Ronald Craig Fish, a semi-retired California patent attorney, caused his IRA to invest in interests in two pipeline and storage master limited partnerships. For 2009, each MLP provided the IRA with a K-1; one reported a $66,000 loss and the other reported a $23,000 loss. During that same year, Fish received a $40,585 distribution from his IRA and a Form 1099-R from the IRA custodian reporting that distribution.

2. Fish reported the distribution as ordinary income on his 2009 Form 1040. He also attached a Schedule E in which he reported the losses on the two K-1s.

3. IRS issued a notice of deficiency: only the IRA may claim the loss. Fish's argument: that's not fair! The loss isn't worth anything to a tax-exempt entity such as the IRA. The IRS also assessed the IRC §6662(a) 20% accuracy-related penalty

4. Tax Court: too bad: "While petitioner may not agree with the way the law is written and may have reasons he believes support changing the law, we cannot do that for him." Both the addition to tax (and interest) and the assessment of the 20% accuracy related penalty were sustained.

B. Powell v. U.S. (Ct. Fed. Claims 3-15-16)-A Tax-Free Rollover Requires a Rollover to a Plan or IRA Expressed in the Form of a Written Document-Taxpayers Never Formalized or Signed a Written IRA or Plan Instrument

1. James Clement Powell and Lucy Hamrick Powell withdrew $78,000 from their IRAs in 2004 and excluded the distribution from income, reporting the $78,000 as having been rolled over to another IRA.

2. An audit occurs (this is what can happen when the distributing IRA issues a Form 1099-R, but no Form 5498 is filed by any financial institution for that year to show a corresponding receipt by an IRA). The agent - and later the IRS District Counsel before the U.S. Tax Court, requested a copy of the IRA document to which the funds were rolled over.

3. The Powells argued that their IRA distributions were used "in something called a BORSA, or "Business Owners Retirement Savings Account," which they claimed need not be reported until the plan terminates due to the small size of the rollover, under IRS Form 5500." According to the Tax Court opinion, "[a]pparently, BORSA is a trade name for a type of vehicle the IRS calls "ROBS" or a "rollover as business startup."

4. "[T]he Powells did not have a written plan. And while it may be true that one participant plans with less than $250,000 worth of assets are not required to file annual reports until their final year of existence, see 29 U.S.C. § 1365, Pensions and Welfare Plans Required to File Annual Report / Return, IRS, https://www.irs.gov/instructions/i5500sflch01.html (last visited March 15, 2016), to be plans in the first place such entities need trust instruments, see 26 U.S.C. § 401(a), and "a definite written program and arrangement," 26 C.F.R. § 1.401-1(a)(2). With no written plan in existence under which the IRA distributions were reinvested, the arrangement could not have employed a qualified trust under 26 U.S.C. §401.

5. An interesting side note: the Powells did not creating the entity that would operate the business they acquired (real estate) until they commenced their Tax Court proceeding, some eight years after the initial distribution.

C. Vandenbosch v. Commissioner, (T.C. Memo. 2016-29, 2/24/16)-SEP-IRA Owner Who Received Distribution and Loaned Money in His Own Name to Individual Who was an Officer of a Company That Was the Intended Ultimate Recipient Received a Taxable Distribution-IRA Owner Had a Claim of Right, Was Not a Conduit and Cannot Ignore the Form of the Transaction-Economic Substance Doctrine Cannot be Used

1. Dr. Vandenbosch is an anesthesiologist. His professional corporation adopted a SEP.

2. Dr. Vandenbosch met John R. Carver in the operating room in 1998 when Mr. Carver was working as a licensed radiology technologist. Before becoming a radiology technologist, Mr. Carver spent time working as a stockbroker. They became friends; Carver shared investment tips with Dr. Vandenbosch, who "believed that Mr. Carver was always correct in his investment advice."

3. Carver becomes vice president of marketing and sales for Altenesol, which publicly traded as IAHL, and acquires an ownership interest in

IAHL. IAHL was formed to develop a liquefied natural gas plant in Colombia. Mr. Carver told Dr. Vandenbosch that IAHL needed capital for its expenses and that any loan would be repaid quickly because IAHL expected to receive funding from a large Colombian company. Dr. Vandenbosch explained that he had $125,000 available in his SEP-IRA that Mr. Carver could use for developing IAHL.

4. March 1, 2011, Dr. Vandenbosch and Mr. Carver executed a contract memorializing an agreement to lend money to IAHL. The note was titled “Corporate Loan Agreement/Promissory Note”, and it recited that it was between “IAHL or John Carver” as the borrower and “Mark J. Vandenbosch, SEP IRA” as the lender. Under the heading titled “Loan Amount” the parties agreed to “$125,000.”

5. On the signature page Dr. Vandenbosch and Mr. Carver signed the note in their personal capacities. Dr. Vandenbosch signed his name above the line that read “Mark J. Vandenbosch” and that denominated him as lender. He did not indicate that he was signing on behalf of his SEP-IRA. Likewise, Mr. Carver signed his name on the line that read “John R. Carver” and that denominated him as borrower. Mr. Carver did not indicate that he was signing on behalf of IAHL.

6. “Although the note stated that IAHL or Mr. Carver was the borrower, Dr. Vandenbosch and Mr. Carver believed that Mr. Carver was the true borrower. Mr. Carver testified that he included IAHL in the borrower's name because he wanted Dr. Vandenbosch to know that the loan was for IAHL's expenses and advancing the project but that he would be responsible for repaying the loan. Likewise, Dr. Vandenbosch was (and still is) looking to Mr. Carver for repayment.”

7. To fund the loan:

    a. Dr. Vandenbosch signed a form titled “Retirement Distribution or Internal Transfer”. He requested that Edward Jones distribute $125,000 from his SEP-IRA into his joint account with Mrs. Vandenbosch at Edward Jones. He did not elect to have Federal and State income tax withheld. He checked a box indicating “I am under the age of 59 1/2. (IRS premature distribution TAX APPLIES * * *)”.

    b. Edward Jones distributed $125,000 from Dr. Vandenbosch's SEP-IRA into the Vandenbosches' joint account at Edward Jones.

    c. Dr. Vandenbosch wired $125,000 from the joint account to his personal account at BankFirst.

d. Dr. Vandenbosch wired $125,000 from the BankFirst account to "John R. Carver" at a JPMorgan Chase Bank, N.A. (Chase) account.

8. In a separate transaction, Dr. Vandenbosch rolled over funds from his SEP-IRA to an IRA account with E*Trade Financial Corp. (E*Trade) and caused that IRA (a Roth IRA) to purchase shares of stock of IAHL.

9. The $125,000 loan was reported on a Form 1099-R (and was never repaid); the Vandenboshes instructed their accountant to report the distribution as a rollover. "With their return, the Vandenbosches included a copy of a letter from Maizel & Maizel Accountants which stated that the return preparer believed that the funds were directly rolled over from the SEP-IRA to IAHL's account or John R. Carver's account."

10. The inevitable audit occurs and IRS assesses a deficiency.

11. Vandenboshes argument and the Tax Court's response:

a. "We never possessed a claim of right: Because Dr. Vandenbosch had a prior obligation to provide funds to Mr. Carver, he was acting as a conduit or an agent in arranging the transfer.

i. Vandenboshes cite Ancira v. Commissioner, 119 T.C. 135 (2002): the taxpayer requested the custodian of his self-directed IRA to invest in stock that was not publicly traded but was available directly from the issuer. The custodian drew a check on the taxpayer's IRA account, and at all times the check was payable to the issuing company. The custodian sent the check to the taxpayer, who in turn delivered it to the issuing company. After considerable delay, the company issued a stock certificate stating that the taxpayer's IRA purchased the shares of stock. That certificate was delivered to the taxpayer who, in turn, delivered it to the custodian

ii. *Tax Court*: *Ancira* is distinguishable. "Dr. Vandenbosch had unfettered control over the funds…Dr. Vandenbosch had access to the funds. He directed his SEP-IRA to distribute the funds into his account. Afterwards, he transferred the funds between his accounts and eventually to Mr. Carver. These actions show that he had unfettered control over the funds. Accordingly, he was not acting as a mere conduit or an agent when the funds were distributed to him."

b. Substance over form: disregard the actual paperwork. Treat the transaction as one in which Dr. Vandenbosch received the

$125,000; treat the SEP-IRA as having signed the promissory note; treat Dr. Vandenbosch has having returned the $125,000 to the original SEP-IRA within 60 days together with the promissory note; then treat the SEP-IRA as having disbursed the $125,000 to IAHL.

i. What law applies to determine whether a taxpayer can invoke substance over form?

(a) One possibility: Commissioner v. Danielson, 378 F.2d 771, 775 (3d Cir. 1967): a party may challenge the tax consequences flowing from a written agreement as construed by the Commissioner "only by adducing proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc.", vacating and remanding 44 T.C. 549 (1965).

(b) A second possibility: the "strong proof rule," in Schulz v. Commissioner, 294 F.2d 52, 55 (9th Cir. 1961), among other 9th Circuit decisions, which requires more than a preponderance of the evidence that the terms of the written instrument do not reflect the actual intentions of the contracting party. Major v. Commissioner, 76 T.C. 239, 247 (1981).

(c) Tax Court: the 9th Circuit, to which appeal lies in this case, has not adopted the Danielson standard, but has adopted the "strong proof" rule.

ii. Result: "The Vandenbosches argue that because the SEP-IRA was funding its obligation under the note, the distribution should be considered paid directly to Mr. Carver. However, the substance of what occurred is entirely consistent with the form. Dr. Vandenbosch received a distribution, exercised control over the funds, eventually lent funds to IAHL, and personally has a right to repayment on the note. We will not disregard the various agreements. We hold that Dr. Vandenbosch received a taxable distribution because he had a claim of right to the withdrawal and the distribution was not a nontaxable rollover."

XXI. The PATH Act Permanently Enshrines Qualified Charitable Distributions from IRAs in IRC §408(d)(8)

A. Background

1. First included in the Pension Protection Act of 2006, which added IRC §408(d)(8) to the Code on a temporary basis.

2. The Health, Retirement, and Fringe Benefits Provisions in H.R. 2029, which includes the Consolidated Appropriations Act, 2016 and the Protecting Americans from Tax Hikes Act of 2015: signed into law on December 18, 2015 -- IRC §408(d)(8) is now permanent, and retroactive to January 1, 2015.

3. Qualified charitable distributions are excluded from gross income.

B. Statutory Requirements for a Qualified Charitable Distribution from an IRA

1. IRA Accounts Only. The qualified charitable distribution must be made from an IRA. Simplified Employee Plans (SEPs), Savings Incentive Match Plans for Employees (SIMPLE plans), IRC §§403(b) and 401(k) plans, profit-sharing plans, and pension plans, do **not** satisfy this requirement.

2. Eligible Recipients. The recipient must be described in IRC §170(b)(1)(A),"public charities," which includes churches, hospitals, museums, and educational organizations. Donor-advised funds operated by public charities, and supporting organizations, although included in IRC §170(b)(1)(A), are specifically excluded as eligible recipients of IRA qualified charitable distributions.

3. IRA Account Owner Must Be at Least Age 70-1/2. The distribution must be made on or after the date that the IRA account holder attains age 70-1/2. **Note: This is more restrictive than the rules for required minimum distributions during the first distribution calendar year.**

4. Distributions Must Be Made Directly to Charity

a. The distribution from the IRA to the charity must be made "directly by the trustee": the distribution must be made payable directly from the IRA to the charity. If a check is made payable to the IRA account owner and then endorsed over to the charity, it does not qualify. If a check from an IRA is made payable to a qualified charitable organization and delivered by the IRA owner to the charity, the payment to the charitable organization will be treated as a direct payment by the IRA trustee to the charity.

5. The Distribution to Charity Must Otherwise Be Fully Deductible As a Charitable Contribution. A distribution from an IRA to a charity will constitute a qualified charitable distributions only if the "entire distribution would be allowable under section 170" as a charitable deduction.

   a. Any quid pro quo benefit received by the IRA owner in exchange for the distribution, such as the FMV of a dinner or other benefit that is cannot be disregarded under IRC §170, disqualifies the entire distribution, not just the quid quo pro portion.

   b. Cannot use the IRA distribution to fund a pooled income fund or a charitable gift annuity.

   c. IRC §170(f)(8): no charitable deduction is allowed for any contribution of $250 or more, unless the donor obtains a contemporaneous written acknowledgement, which must disclose the value of any goods or services provided by the charity in return for the contribution. Result: the IRA owner must obtain a written acknowledgement that says that no goods or services were received in return for the contribution.

6. Distribution Must Otherwise Be Includible in Gross Income.

   a. A distribution from an IRA to a qualifying charity constitutes a qualified charitable distribution to the extent the distribution would have otherwise been included in the IRA owner's gross income if the distribution had been received by the IRA owner.

      i. Result: only the taxable portion of an IRA can qualify as a qualified charitable distribution.

      ii. Further result: A distribution from a Roth IRA that would have been taxable because it is made within the five-taxable-year period can constitute a qualified charitable distribution.