Life and Death Planning for Retirement Benefits, 7th edition, 2011

Post-Publication Updates

September 23, 2016

This document contains <u>all</u> post-publication updates to the 7th edition of *Life and Death Planning for Retirement Benefits* by Natalie B. Choate, Esq. These updates have already been incorporated into the electronic edition of the book (www.retirementbenefitsplanning.com).

Overview

Three significant changes have made parts of Chapter 2 OBSOLETE. These are:

✓ Rules for getting a **hardship waiver of the 60-day rollover deadline** changed significantly in 2016. For some situations it will be possible to "self-certify" that you qualify for a hardship waiver. See ¶ 2.7.05, ¶ 2.7.06, and ¶ 2.7.07 below.

✓ IRS **rule changes in 2014 made it easier to do a separate tax-free Roth conversion** of after-tax money in qualified plans and IRAs. See ¶ 2.2.04, ¶ 2.2.05, and ¶ 2.2.09(A) below.

✓ A **2014 change in the once-per-12-months IRA-to-IRA rollover limit**, as a result of the *Bobrow* case, has made the rule MUCH STRICTER. See ¶ 2.6.05(A) below.

Also, "qualified charitable contributions" (QCDs) from IRAs have become a permanent part of the Tax Code since the 2011 edition was published. This update contains complete detail on QCDs. See ¶ 7.6.07 below.

Several rounds of tax legislation since 2011, though making few direct changes in the retirement plan rules, have changed income tax rates as well as transfer tax rates and exemptions. Keep these changes in mind as they affect some discussions in the book and clearly have an impact on planning for retirement benefits, especially:

✓ Increase in the federal estate tax and GST tax exemptions to $5 million (plus inflation) and "portability of the estate tax exemption between spouses. See ¶ 6.4.06A below.

✓ Income tax increases—the top income tax rate is now 39.6%, and a new 3.8% additional income tax applies to both earned income and investment income above certain thresholds. Retirement plan distributions are not subject to this tax.

Contents

★ Indicates significant new material.

Chapter 1: THE MINIMUM DISTRIBUTION RULES

*1.1.05 **MRDs under defined plans, "annuitized" DC plans***

The title of this section should be "MRDs under defined *benefit* plans, annuitized DC plans." For discussion of how a defined contribution plan can morph into an "annuitized" plan by virtue of offering investment contracts with guaranteed income options, see PLR 2010-48044 (12/3/2010). Though this ruling dealt with spousal rights (see ¶ 3.2.04) and did not purport to decide minimum distribution aspects, it may be a preview of things to come, as "variable annuities" with guaranteed income features become more popular.

Chapter 2: INCOME TAX ISSUES

Three **significant changes** need to be made in this chapter.

One has to do with **rolling after-tax money out of a qualified retirement plan or IRA**: A flip-flop in IRS rules now makes such rollovers easier and more tax-efficient. Accordingly ¶ 2.2.04, ¶ 2.2.05, and ¶ 2.2.09(A) of the book need to be replaced; see restated versions below.

Another change, triggered by the *Bobrow* case, imposing **stricter rules on IRA-to-IRA rollovers**, makes ¶ 2.6.05(A) obsolete, and accordingly that section is also restated below.

Rev. Proc. 2016-47 (August 2016) now allows some taxpayers to "self-certify" and obtain a **do-it-yourself hardship waiver of the 60-day rollover deadline**. Accordingly existing ¶ 2.7 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011) has been replaced with an entirely NEW ¶ 2.7 dealing with the 60-day deadline. See relevant portions below.

*2.1.08 **Excess IRA contributions; corrective distributions***

H. (p. 136): At the end of the first paragraph, delete "See" and insert "§ 219(f)(6); § 4973(b);".

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As a result of IRS Notice 2014-54, 2014-41 IRB 670 (10/6/14) ("Guidance on the Allocation of After-tax and Pretax Amounts"), ¶ 2.2.04 and ¶ 2.2.05, pages 141-150 of the book, are now obsolete.

If a participant has after-tax money in his qualified plan account or in his IRA, the "holy grail" would be to do a separate "Roth conversion" of just that after-tax money. Since the participant has already paid tax on this money, the transfer of after-tax funds to a Roth IRA would be tax-free.

Roth conversion of *pre-tax money* in a plan or IRA (including any earnings accrued on the after-tax money while it was inside the plan or IRA) would be a taxable event (because a Roth conversion is taxed as if the converted money had been distributed to the participant). And normally, plan and IRA distributions are deemed to consist of proportionate amounts of the pre- and after-tax money, so under the "usual rules" you cannot do a separate Roth conversion of only the after-tax money. So when you find an exception to this "cream-in-the-coffee" rule, i.e., a way to separate the pre-tax and after-tax money for purposes of converting only the latter to a Roth IRA, it's worth its weight in gold!

Prior to 2014, it appeared that such separation was possible for some people, but only through a convoluted series of transfers and rollovers (involving unusually cooperative plan administrators). As a result of two developments in 2014, however, the IRS has cleared the path for safe, legal, easy Roth conversions (for some people—not everyone will be able to take advantage of this change) of just the after-tax money in a plan or IRA.

This major change has obsoleted ¶ 2.2.04 and ¶ 2.2.05 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011). The IRS has in effect "repealed" the rule it stated in Notice 2009-68, discussed in those sections. Accordingly, **cross out the old ¶ 2.2.04 and ¶ 2.2.05 and replace them with the following new versions:**

*2.2.04 **QRP distributions from account that contains after-tax money***

Under the "cream-in-the-coffee" rule of § 72 (¶ 2.2.02), a distribution from a QRP generally carries out a pro rata share of the participant's pre- and after-tax money in the plan. § 72(e)(8)(A), (B), (5)(D). Thus, for example, the employee cannot tell the plan administrator, "Send me a check for all my after-tax money, and keep the pretax money inside the plan for now"; the plan administrator generally cannot distribute the after-tax money separately from the pretax money or vice versa.

(As a reminder, this ¶ 2.2.04 matters only if there is after-tax money in the plan. If the participant doesn't have any after-tax money in his retirement plan, you can skip this section: All distributions from his account(s) will consist entirely of pretax money...there is no after-tax money to be prorated or allocated. Most participants do not have after-tax money in their qualified plan accounts; for how and why some people do have after-tax money in their plan accounts, see ¶ 2.2.03.)

On the bright side, unlike with IRAs (see ¶ 2.2.08), there is no "aggregation rule" requiring multiple nonIRA plans to be considered as "one plan" for purposes of determining how much of any distribution constitutes after-tax money. Thus, for example, a solo practitioner lawyer who has both a 401(k) plan and a defined benefit plan does not aggregate his two plans for purposes of determining the taxable proportion of a distribution from one or the other.

Now we know the general rule: Distributions from the plan carry out pre- and after-tax money pro-rata. There are two exceptions to the general rule, one for separate accounts maintained by the plan (see "A") and one for pre-1987 after-tax contributions (see "B").

While that general rule is still true, and IRA change in 2014 rules that the pre- and after-tax portions of a single distribution may be sent to different "destinations"; see "C."

A. **Separate employee contribution accounts may be distributed separately.** In a defined contribution plan that accepts employee contributions, the employer typically maintains a separate accounting for the employ*ee* contribution account (i.e., the employee's after-tax contributions and the earnings thereon) and the employ*er* contribution account (i.e., the employer's contributions and the earnings thereon). § 72 is applied separately to these separate accounts. § 72(d)(2). In the lingo of § 72, the employee contribution account is treated as a "separate contract" for purposes of § 72. This rule is favorable to the employee, because typically he has a higher proportion of after-tax money in the employee-contribution account, so a distribution from that account (or direct Roth conversion of that account; see ¶ 5.4.08) might be largely tax-free if it is treated separately from the rest of his plan benefits. Since issuance of Notice 2014-54 (see "C"), enabling pre- and after-tax money in a single plan account to be rolled or distributed to separate "destinations" (see ¶ 2.2.05) this advantage has become less significant.

Some employees are confused by this exception and think it means they can withdraw their after-tax contributions separately from any pretax money in the plan. That is not correct. The "employee contribution account" includes not only the employee's own contributions (which are indeed after-tax money) but *also* the earnings that have accrued on those contributions. The earnings are pretax money. A distribution from the employee contribution account is subject to the same rules of § 72 (though applied only to that separate account) as usual, meaning that a partial distribution from the employee contribution account would carry out proportionate amounts of the pre- and after-tax money *in that account* (unless some other exception applies; see "B").

Under some plans that allow the employee to make after-tax contributions to purchase "past service credits," the employee's after-tax contributions are not kept in a "separate account." Rather, the plan pays a single benefit based on both employer and employee contributions. A distribution from such a plan is generally treated as a pro rata distribution of pretax and after-tax money, based on the value of the employee's entire account, rather than as a distribution from a separate employee contribution account. However, there are exceptions and grandfather rules, so § 72 must be carefully studied in these cases; see § 72(e)(8)(D) and PLRs 2001-15040, 2004-11051, and 2004-19036.

B. "Cream" rule exception for pre-1987 balances. Some pre-1987 balances are not subject to the general rule applicable to other balances. The Code provides that: "In the case of a plan which on May 5, 1986, permitted withdrawal of any employee contributions before separation from service, subparagraph (A) [of § 72(e)(8)] shall apply only to the extent that amounts received before the annuity starting date (when increased by amounts previously received under the contract after December 31, 1986) exceed the investment in the contract as of December 31, 1986." § 72(e)(8)(D).

In other words, to the extent the money in the employee's account consists of the employee's pre-1987 nondeductible contributions (and this can be documented in the plan's accounting for such funds), the employee can withdraw that money separately from other money in the account. The employee can indeed say with respect to these funds, "Send me a check for an amount equal to my pre-1987 contributions, and keep all the earnings thereon (and other pretax money) inside the plan for now."

In the form of notice the IRS provides to plan administrators (to give to a retiring employee receiving a distribution from his account), the IRS suggests telling the employee "If a payment is only part of your benefit, an allocable portion of your after-tax contributions is generally included in the payment. If you have pre-1987 after-tax contributions maintained in a separate account, a special rule may apply to determine whether the after-tax contributions are included in a payment"—but there's no statement of what that "special rule" is. Notice 2009-68 (9/28/09), 2009-39 IRB 423, p. 428.

C. **One "distribution" may be sent to multiple destinations; Notice 2009-68 reversed.** When an employee is entitled to a distribution from the employer's qualified retirement plan, the employee can request that the employer divide the distribution and send varying amounts of it to different "destinations." The potential destinations are: outright to the participant; direct rollover to one or more traditional IRAs; direct rollover to one or more Roth IRAs; and direct rollover to another qualified plan. If the multiple checks or transfers sent to multiple destinations are all part of a single distribution event, the multiple checks and transfers will be considered a single distribution for purposes of the cream-in-the-coffee rule. The pre- and after-tax portions of that distribution can then go separately to the different "destinations" to the extent explained in ¶ 2.2.05.

From the Notice: "For purposes of determining the portion of a disbursement of benefits from a plan to a participant, beneficiary, or alternate payee that is not includible in gross income under the rules of § 72, all disbursements of benefits from the plan to the recipient that are scheduled to be made at the same time (disregarding differences due to reasonable delays to facilitate plan administration) are treated as a single distribution without regard to whether the recipient has directed that the disbursements be made to a single destination or multiple destinations." Notice 2014-54, 2014-41 IRB 670 (10/6/14) ("Guidance on the Allocation of After-tax and Pretax Amounts").

Darcy Example: Darcy works for Omega Widget Co. Darcy has $250,000 in his account in the Omega Profit-Sharing Plan, of which $50,000 (20%) is after-tax money and $200,000 (80%) is pretax money. The funds are all in a single plan account [see "A" for why this matters] and none of his account is attributable to pre-1987 contributions [see "B" for why this matters]. None of the money is in a designated Roth account (¶ 5.7). Darcy leaves the employment of Omega and requests a distribution of $100,000 from his plan account. Under the cream-in-the-coffee rule of § 72, this distribution carries out proportionate amounts of the pre- and after-tax money in his account, so the pretax portion of the distribution is $80,000 (80%) and the tax-free after-tax portion is $20,000 (20%). See Notice 2014-54, Example 1. This is considered a single distribution even if Darcy directs that part of the money be sent directly to a traditional IRA and part to a Roth IRA (see ¶ 2.2.05(B)), or directs that part of the money be rolled directly into a traditional IRA and part be paid to him personally (see ¶ 2.2.05(C)).

Note that Darcy still cannot simply request a separate distribution of his after-tax money. He can request a partial distribution from his account, but the partial distribution will contain pro rata amounts of the pre- and after-tax money in that account. What's changed is that he can now separate the pre- and after-tax portions of any particular distribution and have them sent to different destinations (see ¶ 2.2.05).

Prior to issuance of Notice 2014-54, the IRS's position was that a distribution that was sent to multiple different "destinations" would be treated as *multiple* distributions, one separate distribution to each "destination." See Notice 2009-68, 2009-39 IRB 423 (9/28/09), providing a "safe harbor" form of notice that plan administrators could use to tell employees about their distribution options; Reg. § 1.402A-1, A-5(a), third sentence (discussed at ¶ 5.7.06); and the Instructions for IRS Form 1099-R (2014), p. 4 ("If part of the distribution is a direct rollover and part of it is distributed to the participant, prepare two Forms 1099-R").

If the money sent to each separate destination is treated as a separate distribution, then each "destination" will receive a pro rata share of the pre- and after-tax money in the employee's account, with no ability to send the pre- and after-tax money to different "destinations." This IRS rule was controversial—for one thing, it contradicted other IRS pronouncements. For example, the IRS's own regulation dealing with income tax withholding treats the direct rollover and outright payment as *two portions of a single eligible rollover distribution*, when the "distributee elects to have a portion of an eligible rollover distribution paid to an eligible retirement plan in a direct rollover and to receive the remainder of the distribution…." Reg. § 31.3405(c)-1, Q-6. See also PLR 2009-26041, in which the IRS blessed a "direct rollover of the [participant's] entire account balance from Plan X into Plan Y, except the after-tax contributions…which were to be distributed directly to" the participant; such a split-up of the pre- and after-tax money is not possible if the direct rollover and outright distribution must be treated as two separate distributions as was stated in Notice 2009-68.

According to anecdotal evidence, some plan administrators simply ignored the Notice 2009-68 rule on this point (they have been well rewarded; see ¶ 2.2.05(G)). Now Notice 2014-54 formally reverses the rule; contains a proposed amendment to Reg. § 1.402A-1, A-5(a); and states that the IRS "intends to revise the safe harbor explanations that may be provided to recipients of eligible rollover distributions from an employer plan."

Although the new rule is formally effective January 1, 2015, plan administrators can use it for pre-2015 distributions as well. For the effect this has on distributions that occurred between Notices 2009-68 and 2014-54, see ¶ 2.2.05(G).

2.2.05 ***Partial and split rollovers, conversions: QRP distributions***

This ¶ 2.2.05 explains what happens to the pre- and after-tax portions of a distribution made from a "traditional" QRP account to the participant if the distribution is sent via direct rollover to both a traditional and a Roth IRA, or if only *part* of the distribution is rolled over to an IRA. Most of these rules come from IRS Notice 2014-54, 2014-41 IRB 670 (10/6/14) ("Notice 2014-54").

A. Introduction: Please read this first

This ¶ 2.2.05 does not tell you what constitutes a "distribution" (see ¶ 2.1.03). Nor does it tell you how much of a particular distribution constitutes after-tax or pretax money; for that, see ¶ 2.2.04 instead.

Once you have identified a particular "distribution" made from the participant's account, *and* you have determined how much of that distribution is after-tax money, this ¶ 2.2.05 tells you what happens to the pre- and after-tax money included in that distribution when the distribution is paid to different "destinations," or (following the distribution) is partly rolled over:

"B" explains what happens when a single distribution is sent, via direct rollover, partly to a Roth IRA and partly to a traditional IRA.

"C" explains the tax treatment of a QRP distribution that is partly paid outright to the participant and partly sent via direct rollover to an IRA.

"D" explains the tax treatment of a QRP distribution that is paid outright to the participant then partly rolled over by the participant, within 60 days, to one or more IRA(s).

"E" explains the effect of having a distribution sent, via direct rollover, entirely into multiple traditional IRAs or multiple Roth IRAs.

"F" explains how this section applies to beneficiaries who have inherited QRPs.

"G" discusses the effective date of Notice 2014-54 and the options for participants who took QRP distributions between 9/28/09 (issuance of Notice 2009-68) and 10/6/14 (issuance of Notice 2014-54).

This book does not cover direct rollovers from one QRP to another. See instead Notice 2014-54, Examples 2 and 3.

The rules discussed in this ¶ 2.2.05 also apply to distributions and rollovers from 403(b) plan accounts and governmental 457(b) plan accounts that contain after-tax money. Notice 2014-54, "Purpose," "Background."

However, these rules do not apply to:

- ♦ Partial rollovers and split distributions from a Designated Roth Account (DRAC); see ¶ 5.7.06 instead of this section.

- ♦ Distributions that are in the form of annuities. If the participant's plan account has been "annuitized," that is, converted from an individual account plan (also called a defined contribution plan) into a true annuity (stream of fixed payments for the life or lives of one or more individual(s) or for a term of years), different rules apply. Notice 2014-54, "Background."

B. Part direct rollover to Roth IRA, part direct rollover to traditional IRA

If the participant instructs the plan administrator to transmit part of his distribution to a Roth IRA and part to a traditional IRA, the participant should also instruct the plan administrator which IRA should receive the after-tax money. The participant should tell the plan administrator to transfer the after-tax money to a Roth IRA. The pretax money should be directed to a traditional IRA (assuming the participant wants to continue deferring tax on it). This enables a participant who is retiring (or for some other reason receiving a distribution from a QRP) to do a "tax-free Roth conversion" of the after-tax money in his QRP account, while continuing to defer tax on the pretax money in his account. See Notice 2014-54, Examples 1 and 4.

This option to "separate the cream from the coffee" when taking a QRP (or 403(b), or governmental 457) distribution that includes after-tax money, by doing a tax-free Roth conversion of just the after-tax money, is an extremely valuable option. EVERY QRP PARTICIPANT WHO

IS RECEIVING A DISTRIBUTION THAT INCLUDES AFTER-TAX MONEY SHOULD USE THIS APPROACH, BLESSED BY THE IRS IN NOTICE 2014-54, IN ORDER TO ACHIEVE A TAX-FREE ROTH CONVERSION OF THE AFTER-TAX MONEY IN HIS ACCOUNT. The only exception would be someone who has an immediate need for all of the after-tax cash; he or she would instead use the option for cash distribution of the after-tax money (see "C"), rather than bothering to have it first transferred into a Roth IRA.

Darcy Example, cont: See the Darcy Example at ¶ 2.2.04(C). Darcy directs the plan administrator to transfer $20,000 of his $100,000 distribution via direct rollover to Darcy's Roth IRA and $80,000 via direct rollover to Darcy's traditional IRA. Before the transfers occur, Darcy instructs the plan administrator to treat the $20,000 Roth conversion as consisting entirely of after-tax money and to allocate all the pretax money in the distribution to the traditional IRA rollover. The plan administrator honors this request. Darcy has achieved a tax-free Roth conversion of the $20,000 of after-tax money included in his distribution and a tax-free (tax-deferred) rollover to a traditional IRA of the $80,000 of pretax money included in the distribution. Only if Darcy knows he needs the $20,000 of cash for spending or investment in the near future would it make sense for him to NOT request a direct rollover of the after-tax money to a rollover, and to request a cash distribution of that instead (see "C").

C. Part outright distribution, part direct rollover into any IRA(s)

If a participant requests a distribution from his account, and asks that part of the distribution be paid directly to himself and part be sent via direct rollover to an IRA, the two separate checks or transfers will be considered a single distribution; and if this "single distribution" contains both pre- and after-tax money, the pretax money will be allocated first to the direct rollover. Pretax money will be allocated to the part paid outright to the participant only to the extent the amount he receives outright exceeds the total after-tax amount included in the single distribution. Notice 2014-54, Example 1.

The tax result is identical to an outright distribution to the participant of the entire amount, followed by a partial 60-day rollover (see "D"), except that using the direct rollover avoids the 20 percent mandatory income tax withholding that would be applicable to an outright distribution of pretax money. Note:

♦ This strategy would be appropriate for someone who wants to get some assets out of his retirement plan account upon retirement (or other distribution occasion) tax-free while continuing to defer tax on as much of the plan as possible. Requesting that the after-tax portion be distributed to him gives him some spending (or investing) money outside the plan, with no tax impact, and sending the rest of the account via direct rollover to a traditional IRA allows continued deferral on the rest of the funds.

♦ Another advantage of this strategy is that it becomes much easier, in retirement, to report distributions taken from the traditional IRA if such distributions are 100 percent taxable. If an IRA contains any after-tax money, each distribution carries out proportionate amounts of the pre- and after-tax money in the participant's aggregated IRA accounts, and that proportion must be recalculated every year; see ¶ 2.2.08. Avoiding this complication makes retirement living much easier!

♦ This strategy would not be appropriate for someone who wants to do a Roth conversion in connection with his distribution. If the portion of the distribution that is transferred directly to an IRA is transferred to a *Roth* IRA, that portion will be taxable to the extent pretax money is included in it. For how to do a Roth conversion weighted towards the after-tax money see "B." The partial-cash-distribution/partial-direct-rollover strategy is appropriate ONLY if the direct rollover is to a traditional IRA.

D. Distribution outright to participant followed by one or more 60-day rollover(s)

Note: the sequences described here (outright distribution followed by partial rollover, or two successive rollovers) will presumably never be used again. The purpose of this two- or three-step dance was to accomplish the goal of cashing out after-tax money while continuing to defer tax on the pretax money, or the goal of sending after-tax money to a Roth IRA and pretax money to a traditional IRA. Since Notice 2014-54 has made this two- or three-step dance unnecessary to accomplish those goals (see "B" and "C"), this subsection "D" will presumably be of interest only with respect to employees who used the "dance" when they took distributions prior to September 2014.

Myron Example. Myron is retiring. His \$150,000 profit-sharing plan account at Acme Widget consists of \$50,000 of after-tax money and \$100,000 of pretax money. He does not have "separate accounts" for employer and employee contributions (¶ 2.2.04(A)); all this money is in one "account." None of the money is "pre-1987 contributions" (¶ 2.2.04(B)). None of the money is in a DRAC (¶ 5.7). Myron directs the plan to distribute the entire \$150,000 to him. Within 60 days after that distribution, Myron "rolls" \$100,000 to a traditional IRA. He keeps the rest of the distribution (\$50,000) in his taxable account.

The Code has a specific rule, in § 402(c)(2), dealing with the partial rollover of a QRP distribution that contains both pre- and after-tax money. The pretax money is deemed to be rolled over "first." Here is how we reach that conclusion. § 402(a) tells us that distributions from QRPs are includible in gross income. ¶ 2.1.01. § 402(c)(1) then tells us that § 402(a)'s general rule of income-inclusion does *not* apply to the "portion" of any eligible rollover distribution that is transferred to another retirement plan. In other words, amounts properly "rolled over" to another plan are excluded from gross income despite § 402(a).

Then comes the mysterious § 402(c)(2). This section seems to say that, notwithstanding § 402(c)(1), the participant cannot roll over any after-tax money that was included in his plan distribution; except that (A) he *can* transfer after-tax money to a nonIRA plan *if* such transfer is accomplished via direct rollover, and (B) he *can* roll over after-tax money to an IRA. The last sentence of § 402(c)(2) then says that "in the case of a transfer described in subparagraph (A) or (B)" (i.e., *any* rollover to an IRA, or a *direct rollover* to another QRP), the amount transferred into the plan or IRA that receives the rollover "shall be treated as consisting first of the portion of the distribution that" would have been includible in gross income if it were not rolled over.

This last sentence of § 402(c)(2) clearly says that, if the employee receives a distribution from the plan, then rolls over only *part* of the distribution, the part rolled over is deemed to come first from the pretax money included in the distribution. This rule enables the employee to isolate the after-tax money *outside* the plan, while rolling over the pretax money to keep it tax-sheltered in an IRA. The IRS agrees with this conclusion; see Regs. § 1.402A-1, A-5(b), and § 1.402(c)-2, A-8; PLR 9840041; and IRS Publication 575, *Pension and Annuity Income* (2015), p. 28, which says: "If you roll over only part of a distribution that includes both taxable and nontaxable amounts, the amount you roll is treated as coming first from the taxable part of the distribution."

The taxable portion of Myron's distribution is $100,000. A plan distribution that could have been rolled over by direct rollover but which the employee chooses to, instead, take as an outright distribution to himself, is subject to mandatory 20 percent income tax withholding on the taxable portion, so the withheld income tax on Myron's distribution would be $20,000, leaving Myron with $130,000 of cash. He then could roll $100,000 of this into a traditional IRA. If that is all he does, he would be deemed to have rolled the pretax money entirely into the traditional IRA. He will then be left with zero tax on the distribution, plus $30,000 of cash in his taxable account, and a $20,000 credit for the withheld tax on his income tax return for the year of the distribution.

Prior to Notice 2014-54, this circuitous route was the only way (according to Notice 2009-68) that a participant could "cash out" his after-tax QRP money while continuing to defer tax on the pretax money. Thanks to Notice 2014-54 it is no longer necessary to engage in this two-step dance. Myron can instead request, upon retirement, that the after-tax money be distributed to him outright and the pretax money be sent via direct rollover to an IRA. See "C."

Suppose Myron, after receiving the $150,000 cash distribution of his entire account from the plan (minus $20,000 mandatory income tax withholding), and after rolling $100,000 over into a traditional IRA within 60 days, later (but still within 60 days after the original distribution) rolls the final $50,000 of the distribution into a Roth IRA. (Because $20,000 of his distribution was sent to the IRS as withheld income taxes he will have to make up that $20,000 using "substituted funds" in order to complete a rollover of the entire distribution; see Reg. § 1.402(c)-2, A-11.)

Now his entire $150,000 distribution has been rolled over. Did he succeed in rolling the pretax money to a traditional IRA and the after-tax money into a Roth IRA? Or has he simply rolled proportionate amounts of each into each IRA?

Experts disagreed on the answer to this question. Fortunately, it is no longer necessary to wonder about the answer; thanks to Notice 2014-54, Myron can now split his distribution into a direct rollover to a Roth IRA (for the after-tax money) and a direct rollover into a traditional IRA (for the pretax money). That approach is far preferable to using successive 60-day rollovers. But for participants who took distributions between 2009 and 2014 and thus (under the regime of Notice 2009-68) saw a need to use the circuitous route, it is nice to know the IRS has answered the question. In Notice 2014-54, in making this entire three-step dance unnecessary, the IRS gave as one of its justifications the fact that IRA owners could accomplish the desired tax result by taking an outright distribution and rolling over the pretax portion to a traditional IRA within 60 days. Then "The remaining amount of the distribution would be after-tax, which the participant could *either roll over* *into a Roth IRA* or retain without incurring any tax liability." Notice 2014-54, "Background." emphasis added.

E. Direct rollover into multiple traditional (or Roth) IRAs

If the participant requests that his entire distribution be sent, via direct rollover, to multiple traditional IRAs, but does not request any outright distribution or direct rollover to a Roth IRA as part of the transaction, the allocation of his after-tax money among the multiple "destinations" (i.e., the multiple traditional IRAs into which the money is transferred) does not matter. All his IRAs will be aggregated (treated as a single account) for purposes of determining how much of any later distribution from any one of his IRAs constitutes after-tax money. See ¶ 2.2.08.

Similarly, If the participant requests that his entire distribution be sent, via direct rollover, to multiple Roth IRAs, but does not request any outright distribution or direct rollover to a traditional IRA as part of the transaction, the allocation of his after-tax money among the multiple Roth IRAs into which the money is transferred does not matter. All his Roth IRAs will be aggregated (treated as a single account) for purposes of determining the income tax treatment of any later distribution from any one of his Roth IRAs. See ¶ 5.2.03(B).

F. How these options apply to QRP beneficiaries

A designated beneficiary is entitled to request a direct rollover of inherited QRP benefits into a traditional or Roth IRA. See ¶ 4.2.04 for explanation of the requirements of such "beneficiary rollovers," including the definition of "designated beneficiary." A designated beneficiary has the same options as a living participant to request partial outright distribution combined with partial direct rollover to traditional IRA (see "B"), or to request partial direct rollover to a Roth IRA combined with partial direct rollover to a traditional IRA (see "C"). However, a designated beneficiary who is not the surviving spouse does not have the option to use a distribution followed by rollover(s) (see "D"); nonspouse beneficiaries are not permitted to do "60-day rollovers." ¶ 4.2.02(A).

G. Effective date and retroactivity of Notice 2014-54

The transition rules of Notice 2014-54 are generous to people who totally ignored Notice 2009-68, but offer no relief to people who "obeyed" it.

According to the Notice's "Proposed Regulation and Transition Rules," Notice 2014-54 applies to distributions made on or after January 1, 2015. However, for distributions prior to that date any "reasonable interpretation" of the allocation rules of § 402(c)(2) will be accepted, and "reasonable interpretations" would include *either* the old "separate distribution" rule of Notice 2009-68 *or* the new allocation rules blessed in Notice 2014-54. (Note: This ability to use the new rules retroactively does not apply to distributions from Designated Roth Accounts; see ¶ 5.7.06).

A person who, between 9/28/09 and 10/6/14, took a retirement plan distribution that included after-tax money will therefore have very different results depending on whether his plan administrator and tax preparer were sticklers for the rules or defiant free spirits.

1. Partial Direct Rollover/Partial Distribution Examples

Lanny Example: Lanny retired in 2010 and took a total distribution of her $100,000 account at the Newco Profit-Sharing Plan of which $20,000 was post-1986 after-tax money. She requested a cash distribution to herself of $20,000 and a direct rollover of $80,000 to a traditional IRA. Her plan administrator and tax preparer reported this as a tax-free distribution of the after-tax money combined with a tax-free (tax-deferred) rollover of the pretax money to the traditional IRA, in defiance of the "separate distributions" rule of Notice 2009-68. This tax treatment is retroactively blessed by Notice 2014-54. By "violating" Notice 2009-68, Lanny and her advisors got the tax treatment she wanted and are all set now—they do not need to do anything further, or worry about the IRS attacking what they did in 2010.

Fanny Example: Fanny retired in 2010 and took a total distribution of her $100,000 account at the Bigco Profit-Sharing Plan of which $20,000 (20%) was post-1986 after-tax money. She requested a cash distribution to herself of the $20,000 of after-tax money and a direct rollover of the $80,000 of pretax money to a traditional IRA. The funds were sent out as she had directed, but her plan administrator and tax preparer did not report this they way she wanted. Instead they reported this as two distributions, a cash distribution to Fanny of $20,000 of which 80 percent ($16,000) was taxable (and subject to mandatory 20% income tax withholding, i.e., $3,200 sent directly to the IRS; see ¶ 2.3.02(C)), combined with a tax-free direct rollover to a traditional IRA of $80,000, of which 20 percent ($16,000) was after-tax money. Fanny missed out on the ability to cash out her after-tax money tax-free at retirement because her plan administrator and tax preparer followed the rules of Notice 2009-68.

Even under the now-obsolete Notice 2009-68 regime, she *could* have achieved the tax-free distribution of her after-tax money by taking a total distribution of $100,000 and rolling over the $80,000 taxable part tax-free to an IRA within 60 days (see "Myron Example" at "D" above). However to do that she would have had to absorb the 20 percent mandatory withholding of $16,000 (20% X $80,000) on the total distribution: See Notice 2014-54, "Background," 11th paragraph, last sentence: "The option to roll over all after-tax amounts into a Roth IRA, however, would [under the Notice 2009-68 regime] only be available to taxpayers with sufficient funds available outside of the plan to be able to roll over the entire amount distributed, including the 20 percent of the taxable portion of the distribution paid to the IRS as withholding pursuant to § 3405(c)." Fanny did not use this option.

Can Fanny retroactively change the 2010 tax treatment of her distribution, and claim the favorable treatment now allowed by Notice 2014-54? The Notice does not discuss this point. If it's not too late, perhaps the plan administrator could file an amended 1099-R for the year of Fanny's distribution, reporting the $20,000 cash distribution as a tax-free return of after-tax contributions as now allowed by Notice 2014-54, allowing Fanny to file for a refund of any income tax she paid on the $16,000 distribution (if it's not too late for her to do that). She would then have to revise her Forms 8606 to show a zero basis (investment in the contract) for the rollover traditional IRA. But how many plan administrators would be willing to engage in all this extra paperwork to help retired employees like Fanny, and how many Fannies and their advisors will even be aware enough to think of requesting that they do so?

Danny Example: Danny retired in 2010 and took a total distribution of his $100,000 account at the Oldco Profit-Sharing Plan of which $20,000 (20%) was post-1986 after-tax money. He wanted to take a tax-free distribution of the after-tax money and have the pretax money sent by direct rollover to an IRA. However, his plan administrator and tax preparer told him that (according to Notice 2009-68) the only way he could safely do this was to take a total cash distribution of the entire sum ($100,000), from which 20 percent ($16,000) of the taxable portion ($80,000) would be sent to the IRS as withheld income taxes, then, within 60 days after the distribution, roll $80,000 into a traditional IRA to "erase" the taxable income, and wait until early 2011 to get a refund of the withheld income taxes. Rather than incur these risks, costs, and complications, he directed the plan administrator to roll his entire $100,000 distribution directly into a traditional IRA. So he now has an IRA with $20,000 of after-tax money in it, and each distribution he takes during retirement will contain a proportionate amount of nontaxable after-tax money (see ¶ 2.2.08 for how to compute that). There would not appear to be any way for him to retroactively take advantage of the Notice 2014-54 rule. The only hope for him is if (despite being retired from Oldco) he still participates in a qualified plan that accepts rollovers; see ¶ 2.2.09(A).

2. Direct Rollover Split Between Roth and Traditional IRAs: Examples

Mary Example: Mary retired in 2010 and took a total distribution of her $100,000 account at the Newco Profit-Sharing Plan of which $20,000 was post-1986 after-tax money. She requested a direct rollover of the $20,000 of after-tax money to her Roth IRA and a direct rollover of the $80,000 of pretax money to her traditional IRA. Her plan administrator and tax preparer reported this as a tax-free "conversion" rollover of the after-tax money to the Roth IRA combined with a tax-free (tax-deferred) rollover of the pretax money to the traditional IRA, in defiance of the "separate distributions" rule of Notice 2009-68. This tax treatment is retroactively blessed by Notice 2014-54. By "violating" Notice 2009-68, Mary and her advisors got the tax treatment she wanted and are all set now—they do not need to do anything further, or worry about the IRS attacking what they did in 2010.

Sarah Example: Sarah retired in 2010 and took a total distribution of her $100,000 account at the Bigco Profit-Sharing Plan of which $20,000 (20%) was post-1986 after-tax money. She requested a direct rollover of the $20,000 of after-tax money to her Roth IRA and a direct rollover of the $80,000 of pretax money to her traditional IRA. The plan administrator duly sent $20,000 to the Roth IRA and $80,000 to the traditional IRA, but the plan administrator and Sarah's tax preparer told her she could not report the transfers the way she wanted to, accordingly to Notice 2009-68. Instead, they reported the two direct transfers as two distributions, a "Roth conversion" distribution of $20,000 to the Roth IRA of which 80 percent ($16,000) was taxable, combined with a tax-free direct rollover to a traditional IRA of $80,000, of which 20 percent ($16,000) was after-tax money. Sarah paid income tax on the $16,000 "taxable portion" of her Roth conversion.

Can Sarah retroactively change this and claim the favorable treatment now allowed by Notice 2014-54? The Notice does not discuss this point. If it's not too late, perhaps the plan administrator could file an amended 1099-R for the year of Sarah's distribution, reporting the $20,000 direct rollover to the Roth IRA as a tax-free Roth conversion of Sarah's after-tax contributions as now allowed by Notice 2014-54, allowing Sarah to file for a refund of any income tax she paid on the $16,000 portion of such distribution that she previously reported as taxable (if it's not too late for her to do that). She would then have to revise her Forms 8606 for the traditional IRA to show a zero basis (investment in the contract) for the traditional IRA. But how many plan administrators would be willing to engage in all this extra paperwork to help retired employees like Sarah, and how many Sarahs and their advisors will even be aware enough to think of requesting that they do so?

Harry Example: Harry retired in 2010 and took a total distribution of his $100,000 account at the Oldco Profit-Sharing Plan of which $20,000 (20%) was post-1986 after-tax money. He asked the plan administrator to send the $20,000 of after-tax money via direct rollover to a Roth IRA and to send the $80,000 of pretax money via direct rollover to a traditional IRA. However, the plan administrator and Harry's tax preparer told him that (according to Notice 2009-68) it was not possible to "split" the pre- and after-tax money in this fashion, and if $20,000 was transferred to a Roth IRA that would have to be reported as a taxable Roth conversion to the extent of the $16,000 of pretax money included in the $20,000 transferred to the Roth. Harry could not afford to or did not want to pay tax on $16,000, so he capitulated and directed the plan administrator to transfer his entire $100,000 tax-free (tax-deferred) via direct rollover to a traditional IRA. He has lost out on the ability to do a tax-free conversion of the after-tax money in his Oldco plan account. So he now has an IRA with $20,000 of after-tax money in it, and each distribution he takes during retirement will contain a proportionate amount of nontaxable after-tax money (see ¶ 2.2.08 for how to compute that). There would not appear to be any way for him to retroactively take advantage of the Notice 2014-54 rule. The only hope for him is if (despite being retired from Oldco) he still participates in a qualified plan that accepts rollovers; see ¶ 2.2.09(A).

[END OF REVISED VERSIONS OF ¶ 2.2.04 AND ¶ 2.2.05]

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In Rev. Rul. 2014-9, 2014-17 IRB 975 (4/3/14), the IRS set out procedures for a direct rollover from a traditional IRA to a qualified plan. With a clear path for such rollovers now set out in this Rev. Rul., plan administrators should become more willing to accept direct transfers from IRAs–thus opening the way for some employees to achieve a tax-free Roth conversion of the after-tax money in their IRAs. Accordingly, ¶ 2.2.09(A) on page 158 of the book is now obsolete, and is hereby replaced with the following new version:

2.2.09 ***Partial rollovers and conversions: IRA distributions***

This section explains how basis is apportioned in the case of a partial rollover or partial Roth conversion of an IRA distribution.

A. **IRA-to-nonIRA plan rollovers.** When a distribution from a traditional IRA is rolled over to a QRP or 403(b) plan, the rolled-over money is deemed to come entirely out of the *taxable* portion of the traditional IRA distribution. § 408(d)(3)(H) (applicable to years after 2001).

This rule is necessary because the *nontaxable* portion of an IRA cannot legally be rolled into a QRP or 403(b) plan. ¶ 2.6.02(H). See IRS Publication 590-A (*Contributions to IRAs*) (2015 edition, p. 21).

This exception creates the opportunity for a tax-free distribution (or tax-free Roth conversion) of the after-tax money in a traditional IRA. In the Gibbs Example (¶ 2.2.08(G)), if Gibbs participates in a QRP that accepts rollovers, Gibbs could follow the road map in Rev. Rul. 2014-9, 2014-17 IRB 975: First, he has his IRA provider send a check for all or almost all of the pretax money in his IRA to the qualified plan, along with a certification from Gibbs to the plan administrator that this is a rollover and is coming entirely from pretax money. Once the pretax money is safely transferred to the QRP, Gibbs is left with a "stub" traditional IRA that is all or mostly after-tax money. He then converts this "stub" account to a Roth IRA totally tax-free (or very nearly tax-free if he didn't quite transfer all of the pretax money to the 401(k) plan); or if he needs money he can simply cash it out tax-free.

Note: Eventually, Gibbs may want to roll the pretax money back from the QRP to his traditional IRA, but he must be very careful NOT to do this before the end of the calendar year in which he did the Roth conversion: Doing so would reactivate the cream-in-the-coffee problem, because the taxable proportion of IRA conversions is partly based on the amounts in the IRA as of the *end* of the year, not at the time of the conversion itself.

[END OF REVISED VERSION OF ¶ 2.2.09]

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As a result of the *Bobrow* case, ¶ 2.6.05(A) on pages 188-189 of the book is now obsolete. You can NOT rely on the IRS rule stated in that subsection (or as stated in pre-2015 editions of IRS Publication 590). The IRS has "repealed" that rule in order to follow the court's decision in *Bobrow v. Comm'r*, TC Memo 2014-21 (1/28/14). Accordingly, ¶ 2.6.05(A) should be crossed out and replaced with the following:

2.6.05 ***60-day rollovers: Only one IRA-to-IRA rollover in 12 months***

A participant or surviving spouse may not roll over an IRA distribution to the same or another IRA "if at any time during the 1-year period ending on the day of…[the receipt of the distribution] such individual received any other amount...from an individual retirement account...which was not includible in his gross income because" it was a tax-free rollover to an IRA. § 408(d)(3)(B).

A. **How rule applies to multiple IRAs.** Under the statute, it appears that the tax-free rollover of a distribution from *any* IRA into the same or any other IRA prevents the tax-free rollover into an IRA of any *other* IRA distribution that is received less than 12 months after the first distribution—*regardless* of which IRA the second distribution came from. The Tax Court has affirmed that interpretation. *Bobrow v. Comm'r*, TC Memo 2014-21 (1/28/14).

However, for rollovers prior to 2015, the IRS did not apply the rule in this strict fashion. Rather, the IRS applied the rule on an account-by-account basis: Once an IRA owner had rolled over tax-free a distribution from one IRA into the same or another IRA, he could not, within 12 months after the date of the distribution that was rolled over, do an IRA-to-IRA rollover of any *other* distribution *from the IRA (or either of the two IRAs) involved in the first rollover*. See, *e.g.*, *IRS Publication 590 (2013)*, p. 25, and Prop. Reg. § 1.408-4(b)(4)(ii). Under the IRS's (now defunct) liberal interpretation of the rule, the participant could nevertheless roll over, to an IRA, a later distribution received within 12 months after the earlier distribution, provided that the later distribution came from an IRA that was *not* involved in the prior rollover.

When Mr. Bobrow took advantage of that rule, however, to do a series of IRA-to-IRA rollovers using three separate IRA accounts owned by him and his wife, the Tax Court threw out the IRS's easy-going interpretation of the once-per-12-months rule. The Court held that there could be no IRA-to-IRA rollover of a second (or later) IRA distribution received by the same recipient within 12 months after any earlier IRA distribution that was rolled over to an IRA, *regardless* of whether the distributions came from different IRAs.

The IRS has agreed to follow the Tax Court's holding in *Bobrow*. However, because the *Bobrow* holding represented a radical change from long-standing IRS policy, the IRS decided to apply the "new" rule prospectively only–specifically, only to distributions received after 2014.

Accordingly, effective January 1, 2015, an IRA distribution ("Distribution #2") can NOT be rolled over to any IRA if, within 12 months prior to the date of Distribution #2, the recipient received another IRA distribution ("Distribution #1") that was tax-free by virtue of being rolled over to an IRA (with one exception; see item #2 in the following list). IRS Announcement 2014-15, 2014-16 IRB 973, and the "follow up" announcement, IRS Announcement 2014-32.

Note the following in applying this new stricter rule:

1. It has always been, and still is, extremely easy to avoid getting caught by this rule: **Direct transfers from one IRA to another are not "rollovers" and accordingly are not subject to the once-per-12-months limitation.** If you wish to move money from one IRA to another, it has long been considered preferable to use direct IRA-to-IRA transfers rather than 60-day rollovers (see ¶ 2.6.01 for the difference): A direct transfer avoids not only the once-per-12-months limit but also the 60-day deadline. It is now even more important and desirable than ever to use direct transfers rather than rollovers!

2. The new rule applies to IRA distributions received after 2014. However, if the earlier distribution occurred in 2014, and the later distribution that occurs in 2015 is from a different account (one that was not involved in the first rollover) the second rollover is permitted. Effectively the new rule applies only if *both* distributions are received in 2015 or later; if the earlier distribution was received in 2014, the old rule applies (i.e., the second rollover is permitted if the distribution came from an IRA not involved in the 2014 rollover). IRS Announcement 2014-32.

3. The new rule would appear to apply to a surviving spouse who takes a distribution from an IRA inherited from her deceased spouse: She cannot roll that distribution over to an IRA if, within 12 months prior to receiving such distribution, she received another IRA distribution that she rolled over to an IRA (regardless of whether that earlier distribution came from "her own" IRA or from an IRA inherited from the deceased spouse) (subject to the exception noted in #2). However, she presumably can avoid this fate by not taking a distribution from the deceased spouse's IRA–rather, she can simply "elect" to treat the deceased spouse's IRA as her own IRA (see ¶ 3.2.03), or use a direct transfer.

. 4. Converting a traditional IRA to a Roth IRA does not "count" for purposes of the once-per-12-months rule, even if it is technically an IRA-to-IRA rollover. However, if an individual takes a distribution from his Roth IRA and rolls it into another Roth IRA, he has done his "once-per-12-months" IRA-to-IRA rollover: He cannot roll any Roth IRA distribution received in the next 12 months over to a Roth IRA—and he also cannot roll any traditional IRA distribution received in the next 12 months over to a traditional IRA. IRS Announcement 2014-32.

The once-per-12-months rule has always been a trap for the unwary, and will now trap even more of the unwary under the new stricter post-*Bobrow* interpretation:

Granny Example: Granny has two IRAs, IRA A with Florida Bank A and IRA B with Florida Bank B. In 2015 she moves from Florida to Minnesota. She opens IRA C with Minnesota Bank C. She cashes out her IRA with Bank A and mails the money to Bank C. A week later she cashes out her IRA at Bank B. She cannot roll this second distribution over to any IRA because she already did one IRA-to-IRA rollover of an IRA distribution received within the preceding 12 months. Under the IRS's now-defunct more sensible approach that expired 12/31/14, she *could have* rolled the second distribution to IRA C because the second distribution came from an account that was not involved in the first rollover (as the IRS so ruled on similar facts in PLR 2013-48017).

Of course Granny does not *have* to move her funds simply because she is moving to a new state; most IRA providers can do business nationally. And she does not need to do 60-day rollovers—she could (and should) have used direct transfers instead. But this "harmless error" has trapped her in a taxable distribution and unfortunately the IRS can not grant waivers or exceptions to this rule.

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In August 2016 the IRS created a significant new method for obtaining a "hardship waiver" of the 60-day rollover deadline, called "self-certification." To accommodate this change, ¶ 2.7 of the existing book will be renumbered ¶ 2.8, a new ¶ 2.7 will collect all material on the 60-day deadline from elsewhere in the book, and the following new and/or revised sections ¶ 2.7.05, ¶ 2.7.06, and ¶ 2.7.07 will explain the new self-certification procedure (as well as the existing private letter ruling procedure for hardship waivers, which continues to exist for situations not entitled to use self-certification).

2.7 The 60-day Rollover Deadline: Details, Exceptions

As explained at ¶ 2.6.01(D), one way to get assets from one retirement plan to another (or out of one plan and back in to the same plan) is the indirect or 60-day rollover. This ¶ 2.7 explains how to compute the 60-day period, how it applies to direct rollovers and lost checks, when a longer deadline may apply, and how to get a "hardship waiver" of the deadline....

2.7.05 ***Hardship waivers of 60-day rollover deadline: General***

The IRS "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." § 402(c)(3)(B); § 408(d)(3)(I) (effective for distributions after 2001).

There are two ways to obtain such a waiver. If your fact situation fits into the guidelines of Rev. Proc. 2016-47, 2016-37 IRB 346, you can "self-certify" that you are entitled to the waiver; the administrator of the plan or IRA you are rolling into can rely on your certification. This is the simplest, fastest, and cheapest way to a waiver—for those who qualify for it. Self-certification is explained in ¶ 2.7.06.

If you don't meet the requirements for self-certification, you may still be able to obtain a waiver, but you will have to apply to the IRS for a private letter ruling to get it. ¶ 2.7.07 explains the private letter ruling approach, as set out in Rev. Proc. 2003-16, 2003-1 C.B. 359.

The legislative history of EGTRRA indicates that Congress wanted the IRS to issue "objective standards" for granting hardship waivers of the 60-day deadline. The IRS finally did that in the self-certification procedure (August 2016); see ¶ 2.7.06. Prior to that date, the only IRA pronouncement (which still applies to cases not qualifying for the self-certification procedure) was Rev. Proc. 2003-16, which says only that the IRS will consider "all relevant facts and circumstances," such as "death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error;...the use of the amount distributed (for example...whether the check was cashed); and...the time elapsed since the distribution occurred." These are more "guidelines" than "objective standards."

Getting a hardship waiver does not solve all the problems caused by a late rollover:

- ✓ See the problem of designating a beneficiary for an IRA established by the participant's executor to receive a late rollover of a distribution made during the participant's life, ¶ 4.1.04(B).

- ✓ All that can be rolled over is the amount of the distribution, not any income earned on that distribution during the period of time the money was outside the IRA—regardless of how long that was, and regardless of what hardship prevented the participant from completing the rollover on a timely basis. Rev. Proc. 2003-16, § 3.04.

- ✓ Another problem with long-delayed rollovers is what to do about required minimum distributions (RMDs; see Chapter 1) that would otherwise have accrued in the meantime. The waiver rulings typically specify that interim RMDs cannot be rolled over despite the extension but do not specify how that nonrollable amount is to be determined.

Polly Example: Polly suffered from a mental disability in 2007, when she was age 69, and she cashed out her entire $500,000 IRA. She did not have the mental capacity to know what she was doing. In 2008, the year she reached age 70½, she was placed under guardianship and the guardian applied for a waiver of the 60-day deadline to allow the $500,000 distribution to be recontributed to the IRA. The waiver is granted by the IRS in 2009; the waiver specifies that any RMD cannot be rolled over. But there was no RMD for the year that the distribution came out of the IRA, in 2007, because Polly was only 69 years old. An RMD *would have accrued* in 2008 and 2009 if the money had still been in the IRA, but there was no "prior year-end balance" for either year because the account didn't exist. Accordingly it would appear that the guardian can roll over the entire $500,000 in 2009 and start taking RMDs in 2010; however, there is no guidance from the IRS on this point. This does not "cheat" the IRS too much because Polly was taxable in 2008 and 2009 on the income earned by the $500,000 distribution outside the IRA (and she is not allowed to roll over that income "as if" it had been earned inside an IRA; see Rev. Proc. 2003-16, § 3.04).

2.7.06 ***Hardship waiver, method #1: Self-certification***

Rev. Proc. 2016-47, 2016-37 IRB 346, created a new "self-certification" procedure for obtaining a hardship waiver of the 60-day rollover deadline: If you have received a plan distribution, but you have not completed the rollover of that distribution within 60 days, you can make the rollover late, provided you can "certify" to the administrator of the plan you are rolling over to that you qualify for a waiver of the 60-day deadline. The plan administrator can rely on your self certification and accept the rollover. The IRS has conveniently included a sample letter form in the Rev. Proc. that can be used (as is or modified) to self-certify qualification for the 60-day waiver.

To qualify for self-certification, you must meet three requirements. First, you must not have been previously denied a waiver by the IRS for this particular distribution (see ¶ 2.7.07). Second, you must have been unable to complete the rollover due to one or more of the 11 reasons in the following list. Third, you must complete the rollover as soon as practicable after the reason(s) that prevented you from completing it no longer prevent you. Completing the rollover within 30 days after the "reasons no longer prevent you" will automatically be deemed to comply with condition #3.

Here is the menu of reasons justifying the waiver based on the self-certification procedure:

1. An error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates.

2. The distribution was made in the form of a check which was misplaced and never cashed.

3. The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan.

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

5. A member of the taxpayer's family died.

6. The taxpayer or a member of the taxpayer's family was seriously ill.

7. The taxpayer was incarcerated.

8. Restrictions imposed by a foreign country.

9. Postal error.

10. The distribution was made on account of an IRS levy under § 6331 and the proceeds of the levy have been returned to the taxpayer.

11. 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.

The self-certification procedure is not invulnerable. If the IRS audits your return, and finds that (for example) you made a material misstatement in your certification, or the reason(s) you claimed did not in fact prevent you from completing the rollover, or you did not complete the rollover as soon as practicable once the reasons were removed, the IRS can take away the waiver of the 60-day deadline. In that case you will of course be in big trouble: You will owe income taxes on the late-rolled distribution, plus penalties for an excess contribution to the receiving plan, plus interest and penalties on the foregoing.

How will the IRS ever know that you used the self-certification procedure? Don't count on "audit roulette" to protect you from IRS scrutiny on this issue. The IRS intends to revise Form 5498 to include a box for the IRA provider to check if any rollover contribution came into the account after the 60-day deadline.

Of the 11 reasons, #1 is the most common reason people are forced to seek waivers of the 60-day deadline—financial institution error. Since 2001, more waivers have been issued (under the private letter ruling procedure—see ¶ 2.7.07) for that reason than for all the others combined. Reason #11 appears to be just another example of reason #1—financial institution error.

There have also been many waivers issued where the rollover delay was due to the taxpayer's illness, or illness or death of his family members (#5, #6). There have been a few waivers for postal error (#9), and also for cases where the taxpayer thought he had rolled the money into a retirement plan but it wasn't actually a retirement plan (#3).

As for the distribution check's being lost and never cashed (#2), that's pretty rare. Also rare (nonexistent?) are waivers issued due to damage to the principal residence (#4), the taxpayer's being incarcerated (#7), restrictions imposed by a foreign country (#9), or a returned IRS levy (#10).

The list leaves out some significant reasons that have regularly led to waiver requests in the past:

✓ Error by a financial advisor who is not part of the distributing or receiving financial institution.

✓ The taxpayer's death.

✓ Mental or emotional state of the taxpayer.

✓ Funds were stolen from the account; taxpayer was unaware of the theft for some period of time (unless fraud and theft count as "financial institution error").

This does not mean that waivers cannot be granted for those causes. It just means you must use the apply-for-a-private-letter-ruling approach (¶ 2.7.07) rather than self-certification.

Perhaps the IRS wants to personally review the facts in those situations. For example, the mental or emotional state of the taxpayer can be rather subjective and has a wide range. The IRS will normally grant the waiver if the taxpayer suffered from such mental impairment that he didn't understand the nature of the IRA distribution he took (documented by a doctor's opinion), but will not grant the waiver if the failure was due to the taxpayer's alleged extreme stress caused by getting ready to go on vacation.

2.7.07 ***Hardship waiver, method #2: Apply to the IRS***

A participant or surviving spouse who does not qualify for self-certification (¶ 2.7.06) can request a hardship waiver of the rollover deadline from the IRS by following the procedure for obtaining a private letter ruling, as outlined in Rev. Proc. 2003-16.

Obtaining an IRS letter ruling requires payment of a "user fee" (filing fee). Prior to 2016, requests for waiver of the 60-day deadline had their own special reduced user fee schedule, but effective in 2016 and later the user fee is the same as for any other PLR—$10,000 (possibly less for low-income taxpayers).

The waiver can be granted long after the original distribution. See PLRs 2003-27064 (rollover allowed more than a year after funds were stolen from IRA; loss had not been discovered immediately) and 2007-05031 (rollover allowed in 2005 of a "restorative payment" replacing losses incurred due to defalcations by the advisor in the years 2000–2004; see ¶ 8.1.03).

Since the issuance of Rev. Proc. 2003-16, the IRS has issued hundreds of private letter rulings dealing with these deadline waiver requests. Here is a recap of some of the most common reasons waivers have been granted (or denied). Note that some of these situations would now qualify to use the self-certification procedure (¶ 2.6.06).

The tragedy is that, in most of these hardship waiver-seeking cases, if the participant had just read his account statements when they came in, he would have discovered the mistake immediately and been able to fix it within 60 days.

A. Waiver granted for error by financial institution (FI) or advisor (FA).

This is by far the most common reason for obtaining a deadline waiver. The "good" news is that the IRS *always* grants the waiver when the participant missed the deadline due to a processing error by an FI or FA. Generally the IRS seems to require the FI or FA to admit the mistake in writing. Typical are rulings in which the participant's new financial advisor or institution inadvertently established a regular taxable account instead of an IRA with funds transferred from prior advisor or institution, such as PLRs 2004-02028, 2004-04053, 2004-01023, 2004-20035, 2009-51040, 2010-14073. If the professional error involved *erroneous tax advice* rather than a straight processing error, the standards are tougher. If the advisor gave erroneous advice *about the rollover requirements* (such as telling the participant that the deadline is 90 days not 60 days), the IRS will generally grant the waiver; regarding other erroneous tax advice, see "F" below.

Here are three examples out of the hundreds of financial institution blunders that have justified IRS waivers:

Financial institution informed taxpayer and her advisor (twice) that her account was not an IRA. The account statement did not reveal it was an IRA. So when taxpayer withdrew the money and transferred it to another institution, she did not put it into an IRA. Two years later the first institution informed her—actually it *was* an IRA! Late rollover allowed. PLR 201416013.

With the assistance of a representative of the bank, in 2008, taxpayer completed the form for creating a rollover traditional IRA and deposited her rollover check. The form "clearly indicated" the intent to roll into a traditional IRA. Instead, the bank put the money into a Roth IRA, a mistake that was not discovered until 2013, when the certificate of deposit matured. Late rollover allowed (for the original rollover amount, not the five years' worth of earnings). PLR 201524027.

Financial institution was supposed to transfer taxpayer's required minimum distribution from her IRA to her taxable account. Which it did. In fact they did it twice, due to a coding mistake. Taxpayer didn't notice the mistaken double distribution until the following year. Late rollover of second distribution allowed. PLR 201429032.

If your facts sound like the facts in those three PLRs, then you qualify for the self-certification procedure. However, it's not enough just to assert "financial institution error;" you have to prove it. In the above examples, there were big obvious financial institution goofs, and the institutions admitted their mistakes. If you don't have that kind of evidence you may not be entitled to the self-certification waiver. Consider:

In PLR 201432020, taxpayer closed out her IRAs at Financial Institution D but did not deposit the proceeds into new rollover IRAs until after expiration of the 60-day period. She said she was late because she relied on Financial Institution D "to provide guidance regarding the rules associated with her IRA investments, specifically the 60-day rollover period." The IRS refused to give her a waiver, because there was no documentation that the financial institution was her financial advisor: "...the Code imposes no...obligation on IRA custodians [to explain the 60-day rule]. Absent actions on the part of a financial institution undertaking such an obligation we do not recognize this failure as financial institution error."

B. Waiver granted: Distribution was not requested by taxpayer.

In many successful waiver requests, the original distribution was "involuntary," in that the participant hadn't requested it and often did not even realize it had occurred, or the participant was mentally incompetent to understand the consequences of withdrawing the funds. See PLRs 2004-21009, 2004-21008, 2004-27027, 2004-35017, 2004-36014, 2010-15040, 2010-16093.

C. Waiver granted: Health problems, trauma.

Many successful waiver requests have involved participants who were hampered from initiating and/or completing the rollover by significant mental or physical health problems (of themselves or family members), a death in the immediate family, or other catastrophes. See PLRs 2004-30039, 2004-30040, 2004-36021, 2004-04051, 2004-12002, 2004-26020, 2004-30037, 2004-30038, 2004-36021, 2009-36048, 2010-15042, 2010-05059.

D. Waiver denied: "Short term loan" (Participant spent funds, etc.)

The IRS normally refuses a waiver when the taxpayer deliberately took the distribution with the intent to spend it or invest it elsewhere (e.g., to qualify for Medicaid, PLR 2005-47024, or to pay medical expenses, PLR 2005-49023, or to complete a house closing, PLR 2005-44025); and/or showed no evidence of intent to roll it over until after the 60-day deadline (typically, when he discovers it is taxable; PLR 2005-46047, 2005-48030, 2005-49017, 2004-33029, 2004-22058); or he deliberately took it, intending to spend it and then replace the funds with other funds, but he did not receive the replacement funds in time to meet the 60-day deadline (PLRs 2004-17033, 2004-22053, 2004-23038, 2004-33022, 2004-36018, 2005-44025).

However, even if the participant did deliberately use his IRA as a "source of short-term financing," the IRS will grant the waiver if the participant had the replacement funds, and sent them in to the IRA provider, within the 60-day time limit, if the deadline was then missed due to financial institution error or other cause beyond the participant's control. See, *e.g.,* PLR 2010-16092.

E. Evolving and inconsistent IRS standards.

The IRS has grown more restrictive over the years when it comes to granting hardship waivers. In the early days some waiver requests were granted where the taxpayer really didn't have much of an excuse (e.g., taxpayer waited until the 58th day, then found the bank was closed for a long holiday weekend so she couldn't deposit the check; PLR 2004-11052).

More recently, the IRS has denied waivers for such "flimsy" excuses as: participant was busy getting ready to go on vacation (2007-30024); minor surgery (2007-51032); participant's father's cancer and death (2008-29030); participant's sibling's financial crisis (2010-02049); and participant's lack of a college education and lack of knowledge of legal, accounting, or tax matters (2010-03030).

The worst thing about the IRS's "evolving" standards is that the IRS is not consistent. The IRS has taken to reciting a mantra in the PLRs where it denies the waiver: A waiver will be granted *only* if the deadline was missed because of one of the factors listed in Rev. Proc. 2003-16. See, *e.g.*, PLRs 2007-27023, 2007-30023, 2010-15039. Yet this pious recital is absent in many PLRs which *do* grant a waiver, because the IRS regularly grants waivers when the ability to meet the rollover deadline was completely within the participant's control at all times and no factor listed in the Rev. Proc. existed; see, *e.g.*, PLRs 2006-06055, 2009-30052, 2009-51044, and 2009-52066 (waiver granted because the final day of the 60-day period fell on a bank holiday); PLRs 2007-15016 (participant received two distributions when he had requested one; he was granted a waiver despite no mention of any illness or other problem that prevented him from noticing the double distribution or rolling it over); and 2007-08085, 2007-26031.

F. Erroneous tax advice.

Another inconsistency has to do with reliance on tax advice of a professional advisor. Sometimes erroneous tax advice is grounds for granting a waiver…and sometimes it isn't. In PLR 2006-17039, the IRS *refused* a waiver where a participant took a distribution of employer stock from his company plan, not intending to roll it over because his advisor told him the distribution qualified for NUA treatment (see ¶ 2.5). After the 60-day rollover deadline had passed, he found out the distribution did *not* qualify for NUA treatment. Says the IRS "We do not believe that Congress intended to permit the Service to retroactively correct tax treatment choices which do not produce the expected benefits even though…these choices were the result of erroneous advice" by the financial consultant. But in PLRs 2006-09019 and 2009-25047 the IRS *granted* waivers to widows who were told (incorrectly) by their advisors that distributions from their deceased husband's retirement plans were tax-free. What's the difference? The IRS mentions the widow's depression in PLR 2009-25047; is the IRS saying that it is reasonable to rely on professional tax advice only if you are mentally ill?

G. Waiver denied: Taxpayer's own mistake

The most insidious trend in IRS waivers is that they will not grant the waiver if the *taxpayer himself* made a mistake that caused the rollover deadline to be missed (and the taxpayer was not incapacitated). For example, an individual who clearly requested a direct rollover to an IRA, but wrote the wrong account number on his form, so the money went into a taxable account by mistake, and nobody noticed the mistake until after the deadline had passed—the IRS did not grant a waiver, because they said the ability to complete the rollover was within his control at all times.

Similarly, a taxpayer who thought she had 60 *business* days rather than 60 *calendar* days to complete the rollover did not get a waiver. PLR 201449009. The taxpayer who gave her IRA distribution check to her husband to reinvest without telling him it was an IRA did not get a waiver. PLR 201418063. The taxpayer who requested a distribution to himself of his entire qualified plan balance, rather than a direct rollover to an IRA, thereby triggering mandatory income tax withholding (which he was informed about) was not granted a waiver to allow him to wait until he got the taxes refunded to complete rollover of the withheld portion. PLR 201419026.

See PLRs 2010-02049, 2010-03030, 2010-06035, 2010-07080, 2010-15039, and 2010-37038 for other examples of this IRS position.

Chapter 3: MARITAL MATTERS

3.4.03 ***REA requirements for "exempt" profit-sharing plans***

An "exempt" profit-sharing plan of the type discussed in this section could become subject to the QJSA/QPSA requirements if it offers participants, as an investment option, the type of deferred variable annuity contract that contains a lifetime income guarantee option. For discussion of how the QJSA/QPSA requirements apply to such a contract, see PLR 2010-48044 (12/3/2010).

Chapter 4: INHERITED BENEFITS: ADVISING EXECUTORS AND BENEFICIARIES

4.6.08 ***IRD deduction on the income tax return***

Delete the last paragraph of this section and substitute the following:

"On the negative side, the § 691(c) deduction is subject to § 68, under which an individual's itemized deductions are reduced by an amount equal to as much as three percent of the individual's AGI in excess of an annually-adjusted threshold amount, or (if less) 80 percent of total itemized deductions. § 68(a), (b). Although this section (called the "Pease" limitation) was "repealed" for the years 2010–2012, it has been reinstated and applies for 2013 and later years. The § 68 reduction of itemized deductions does not apply to trusts or estates; see ¶ 6.5.04."

Chapter 5: ROTH RETIREMENT PLANS

No updates at this time.

Chapter 6: LEAVING RETIREMENT BENEFITS IN TRUST

The 7th edition contains little material on federal estate tax planning for a married couple, though the subject is mentioned in ¶ 6.4.06 ("Planning choices: Trust for spouse"). The following comments could be inserted after ¶ 6.4.06:

6.4.06A ***Portability: Major impact on estate planning for retirement benefits***

An estate tax provision that most particularly impacts *retirement benefits* is a concept called **portability of the estate tax exemption**. The Code doesn't use that phrase, but that's what everyone calls it. A surviving spouse can add to his or her own federal estate tax "basic exclusion amount" ($5 million adjusted for inflation) the unused estate tax exemption amount (the deceased spousal unused exclusion amount, or "DSUEA") of her or his "last deceased spouse," *provided* that the executor of such last deceased spouse timely filed an estate tax return for the estate of such last deceased spouse, computing (and irrevocably elected to allow the surviving spouse to use) the DSUEA. § 2010(c)(2)(B), (4), (5)(A). Note that, unlike with the basic exclusion amount, the DSUEA amount is frozen at the first death—it does not increase with inflation. Compare § 2010(c)(3) with § 2010(c)(4). Also, the GST tax exemption is equal only to the individual's basic estate tax exclusion amount ($5 million adjusted for inflation); there is no ability to add on any unused GST exemption of a predeceased spouse. See § 2631(c).

A. Portability vs. "use it or lose it." This revolutionary addition to the Code means that the first spouse to die can in effect leave his $5 million exemption to the surviving spouse, so the surviving spouse will have a $10 million exemption.

Under the bad old system, which might be called "use it or lose it," the estate tax exemption of the first spouse to die was "wasted" unless he or she (1) owned assets equal to the exemption amount and (2) left such assets to a beneficiary other than the surviving spouse or charity—such as the couple's children, or a "credit shelter" (bypass) trust for the life benefit of the surviving spouse.

Thanks to portability, couples no longer have to create "credit shelter trust" estate plans to make full use of both spouses' exemptions. No longer do they have to carefully rearrange their assets to make sure that, regardless of which spouse dies first, the deceased spouse will have assets at least equal to the exemption amount, to avoid "wasting" his or her exemption.

This will make estate planning easier for many couples, *especially* when one or both spouses have most of their assets in the form of retirement plans and IRAs.

B. Advantage of portability for benefits-heavy estates. Joe and Lucia are married to each other, with three children. Their only asset is Joe's $10 million IRA. With $10 million of assets they obviously want to make sure they take full advantage of their estate tax exemptions, so the full $10 million can eventually pass to their three children with no federal estate tax.

Without portability, the only way they could have taken advantage of their exemptions was for Joe to cash out half his IRA, pay the income tax on it, and give the net to Lucia (so she would have assets in her name in case she died first—assets she would leave either directly to the children or to a "bypass trust" for Joe's life benefit), then (if Lucia survives him) leave what was left of his IRA either directly to the children or to a "credit shelter" or "bypass" trust for the life benefit of Lucia. Leaving the IRA direct to the children could be a good tax move, but most clients don't like it because it takes money away from the surviving spouse.

Leaving an IRA to a bypass or credit shelter trust for the surviving spouse SEEMS to protect the surviving spouse financially, and it definitely saves estate taxes for the children by keeping the IRA out of the surviving spouse's estate, but it causes a huge loss of income tax benefits. There is no spousal rollover for retirement benefits left to a trust, and no stretch payout over the children's life expectancy even after the spouse's later death. Instead, the entire IRA gets dumped out into the credit shelter trust over the single life expectancy of the surviving spouse, a relatively short period of time.

So (before portability) clients in Joe's and Lucia's situation had to make a hard choice: Do we go for the income tax benefits of the spousal rollover by leaving the entire IRA outright to the surviving spouse, even though that costs extra estate taxes by wasting the first spouse's estate tax exemption? Or do we save estate taxes by leaving the benefits to a credit shelter trust but give up on the long term deferral that would otherwise be available via the spousal rollover?

Thanks to portability clients will no longer have to make that particular hard choice. Instead, Joe can leave his \$10 million IRA outright to Lucia and Joe's executor can *also* elect to leave her Joe's \$5 million estate tax exemption. Joe and Lucia can now get the income tax savings of long-term deferral of distributions via the spousal rollover, *without* having to waste one spouse's estate tax exemption to get it. When Lucia later dies, she will have a \$10 million IRA and a \$10 million estate tax exemption.

Of course, as with all estate tax planning, there are many factors to consider besides federal taxes. There are other reasons couples might leave assets in trust for each other rather than outright to each other, such as: desire to preserve assets for the couple's children in case the surviving spouse remarries; concern about the surviving spouse's vulnerability to creditors, disability, or poor investing/spending choices; state estate tax issues; concern about future changes in the estate tax law; etc. And for couples whose assets are *not* primarily in the form of retirement benefits, leaving assets in trust for the surviving spouse is usually a neutral choice income tax-wise compared with leaving assets outright to the spouse, so that if these other factors apply they can ignore portability and leave assets in trust with no income tax loss.

But for couples where a substantial portion of the assets are in retirement benefits, leaving such retirement benefits to a trust for the spouse versus outright to the spouse is *not* an income tax-neutral choice. Leaving benefits to a trust for the spouse is extremely unfavorable compared to leaving such benefits outright to the spouse who rolls them over to her own IRA. See ¶ 3.3.02. "Portability" has a major favorable impact on these couples, enabling them to get *both* the income tax benefits of the spousal rollover (by allowing all retirement benefits to belong outright to the surviving spouse) *and* the estate tax benefits of using both spouses' estate tax exemptions. .

Chapter 7: CHARITABLE GIVING

When Life and Death Planning for Retirement Benefits (7th ed. 2011) went to press, "Qualified Charitable Distributions" had expired at the end of 2009, so the book includes no material on that subject. Subsequent rounds of legislation reinstated and/or extended the QCD device several times, always on a temporary basis, until, finally, QCDs were re-authorized and made permanent for 2015 and later years by the "Protecting Americans from Tax Hikes (PATH) Act of 2015" enacted December 18, 2015. To accommodate this change, the existing ¶ 7.6 of the book ("Lifetime Gifts of Retirement Benefits") has been renumbered ¶ 7.7, and the following completely new ¶ 7.6 is inserted to cover the important topic of Qualified Charitable Distributions:

7.6 Qualified Charitable Distributions

The preceding sections have discussed leaving retirement benefits to charity *at death*. This and the following section discuss ways to transfer retirement benefits to charity *during life*.

Generally, lifetime gifts of retirement benefits are not a tax-favored way to deal with such benefits; see discussion at ¶ 7.7.01. One minor but very popular exception is the "qualified charitable distribution" (QCD)—the ability of *some people* to transfer *a limited amount* of funds directly from *certain types of IRA* to *certain types of charities*. Specifically, an over-age-70½ IRA owner or beneficiary (see ¶ 7.6.02) can instruct the administrator of the IRA (see ¶ 7.6.03) to transfer up to $100,000 in any calendar year (see ¶ 7.6.04) to one or more eligible charities (see ¶ 7.6.05). The amount(s) so transferred is not includible in the gross income of the IRA owner-donor (see ¶ 7.6.06), even though it is a distribution from his or her IRA, and even though it may be used to satisfy the required minimum distribution (see ¶ 7.6.08(A)).

This ¶ 7.6 explains QCDs—the requirements, mechanics, limitations, and benefits.

7.6.01 ***Where to find the law***

The QCD is created by § 408(d)(8), which has in effect been part of the Tax Code since 2006—"in effect" because it was enacted several times on a temporary and often retroactive basis before being made a permanent part of the Code in December 2015.

Originally enacted as a temporary measure (good for IRA distributions in 2006 and 2007 only), § 408(d)(8) was extended in late 2008 for two more taxable years (2008 and 2009). In December 2010, § 408(d)(8) was extended for two more years (2010–2011). The American Taxpayer Relief Act of 2012 (ATRA) extended them *again*, but only through 2013. (All the rest of ATRA's provisions were permanent). They were again allowed by late-in-the-year legislation for 2014, but again as a temporary provision: Subsection (F) of § 408(d)(8) stated that the section would not apply to distributions after 2014. Finally, QCDs were re-authorized *and made permanent* for 2015 and later years by the "Protecting Americans from Tax Hikes (PATH) Act of 2015" enacted December 18, 2015, which struck subsection (F). See PATH, section 112.

The Treasury's only authoritative pronouncement on QCDs to date is IRS Notice 2007-7 (Part IX), 2007-5 I.R.B. 395, Q & A 34 through 44.

The QCD is a watered down version of the "charitable IRA rollover" that the philanthropic community has sought to get enacted since at least the late 1990s. Under the "real" charitable IRA rollover, which does not yet exist and may never exist, unlimited transfers would be allowed from any retirement plan by any participant to any tax-exempt charitable entity including charitable remainder trusts. The QCD is a distant relation to this "dream" charitable rollover.

7.6.02 ***Who can make QCDs: Individuals over age 70½***

Only individuals who are age 70½ or older can make QCDs. § 408(d)(8)(B)(ii).

The QCD donor can be either an IRA participant donating from his own IRA or a beneficiary donating from an inherited IRA. IRS Notice 2007-7, A-37. The only requirement is that the donor (whether owner or beneficiary) must be age 70½ or older.

This is the only tax code provision to make the age 70½ "birthday" itself a significant event. Required minimum distributions are based on the YEAR the participant reaches age 70½, not the DAY he reaches that age. Someone who reaches age 70½ on (say) December 30 could have a tough time getting his IRA provider to make the QCD on the last day of the year. It would have been easier for all concerned to allow QCDs to occur anytime during or after the calendar year the individual reaches age 70½—but that's not what the law says.

Example: In 2014, Jonathan inherited an IRA from his mother. He also has an IRA of his own. Jonathan's 70th birthday was April 1, 2015. He turned 70½ on October 1, 2015. He can make QCDs from either his own IRA or the inherited IRA he holds as beneficiary of his mother (or both) any time on or after October 1, 2015.

7.6.03 ***From IRAs only (but not ongoing SEPs or SIMPLEs)***

QCDs may be made *only* from IRAs. § 408(d)(8)B). So, a QCD can not be made from a "qualified retirement plan," i.e., a plan qualified under § 401(a) of the Code, such as a pension, profit-sharing, Keogh, or 401(k) plan); or from a 403(b) plan; or from a 457 plan.

A QCD can be made from *any type of IRA* (including a Roth IRA) subject to the following exceptions/limitations:

✓ A QCD may **not** be made from an "ongoing" SEP-IRA or SIMPLE IRA. SEPs and SIMPLEs are IRAs funded directly by contributions from the individual's employer. See § 408(k) and § 408(p). An "ongoing" SEP or SIMPLE in any particular year is one that receives an employer contribution in such year. IRS Notice 2007-7, A-36.

✓ A QCD can come from a Roth IRA (to the extent the amount distributed would be included in the owner's gross income if distributed to him or her; see ¶ 7.6.06). § 408(d)(8)(B). But generally a person would not make a QCD from a Roth IRA. For one thing, most Roth IRA distributions are income tax-free, and so not eligible to be the subject of a QCD; see ¶ 5.2.03 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011). Even if an over-age 70½ person holds a Roth IRA distributions from which could be partly includible in his/her income (because he/she had not held a Roth IRA for the required 5-year holding period of § 408A(d)(2)(B); see ¶ 5.2.05 of *Life and Death Planning for Retirement Benefits*), the Roth IRA owner can expect that these funds eventually will qualify for income-tax free treatment and it would not be advantageous to throw away that future tax benefit just to make a QCD.

Example: Carl is age 76 and still working at Acme Widget. In 2016, he holds an IRA he inherited from his father, a Roth IRA he had owned for 10 years, a SEP-IRA to which Acme Widget is contributing in 2016, and a 401(k) plan account in the plan of his prior employer, Bacchus Detective Agency. He can make a QCD in 2016 from the inherited IRA. He cannot make a QCD from the Roth IRA because anything distributable to him from that account would be excludible from his income and thus not QCD-eligible. He cannot make a QCD from the SEP-IRA this year because it is "ongoing" (receiving an employer contribution) in 2016. He cannot make a contribution from the 401(k) plan because it is not an IRA.

7.6.04 ***How much? $100,000 per year per IRA owner***

The QCD income exclusion is limited to $100,000 per year. § 408(d)(8)(A). The limit is per IRA owner, not per IRA. "For married individuals filing a joint return, the limit is $100,000 per individual IRA owner." IRS Notice 2007-7, A-34. So, a husband and wife who are both over age 70½ and who both have IRAs can each transfer up to $100,000 to charity from their respective IRAs in the same year. But if (for example) wife has an IRA and husband does not, wife cannot "borrow" husband's limit and give $200,000 from her IRA.

The donor does not have to give that much. $100,000 per IRA owner per year is the maximum and there is no minimum (other than what the IRA provider may impose administratively).

Example: Jody, age 83, gives $5,000 per year to her church and does not make any other charitable gifts. Since 2006 she has made these annual gifts directly from her IRA as QCDs. Her sister Agatha, age 81, gives $200,000 a year to charity. She makes half her annual gift in the form of a QCD and the rest using appreciated stock held in her taxable account.

7.6.05 ***Requirements applicable to charity and donation***

A QCD can be made to any charity EXCEPT a donor-advised fund (§ 4966(d)(2)) or a supporting organization (§ 509(a)(3)). § 408(d)(8)(B)(I).

Also, the QCD must be a contribution that would be 100 percent deductible if paid from the owner's nonIRA assets, so a split-interest gift will NOT qualify. Thus, QCDs can NOT be made to a charitable remainder trust (¶ 7.5.04), pooled income fund (¶ 7.5.10), or charitable gift annuity (¶ 7.5.08), or in exchange for any consideration. Note however that in determining whether the gift would be 100 percent deductible if made with nonIRA assets the percentage-of-income limits in § 170(b) are ignored. § 408(d)(8)(C).

The gift must meet all other requirements applicable to the income tax charitable deduction under § 170, such as the substantiation requirement. IRS Notice 2007-7, A-39.

7.6.06 ***Income tax aspects; effect on basis***

The QCD is excluded from the individual's gross income for all purposes. § 408(d)(8)(A). Thus it cannot be counted as part of the individual's gross income for purposes of applying the percentage-of-income limits in § 170(b) with respect to his other charitable gifts. Of course, there is no income tax charitable deduction for the QCD. IRS Notice 2007-7, A-39.

The QCD must be a distribution that would otherwise be includible in the donor's gross income. § 408(d)(8)(B). Here is the effect of this rule on:

✓ Distributions from Roth IRAs: A qualified distribution from a Roth IRA (see ¶ 5.2.01 of *Life and Death Planning for Retirement Benefits*) cannot be a QCD because a qualified Roth IRA distribution is nontaxable. Thus, QCDs could be made from a Roth IRA only if the Roth IRA had not yet met the requirements for a "qualified distribution." But even then it would normally not be good planning to make a QCD from a Roth IRA; see ¶ 7.6.03.

✓ IRAs where the IRA owner has no after-tax money in any IRA: If the traditional-IRA owner does not have any after-tax money in any of this IRAs, this rule is "no problem" since all distributions from any of his IRAs will consist 100 percent of pretax money (includible in gross income).

✓ If the IRA owner has any "basis" (after-tax money; also called "investment in the contract") in any of his IRA accounts, then the requirement that QCDs must be all pretax money would pose a problem. Under the rule nicknamed the "cream-in-the-coffee rule" of § 72 (explained at ¶ 2.2.08 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011)), any distribution from an IRA normally carries out proportionate amounts of the "pretax" and "after-tax" money in the individual's IRAs (with all of his traditional IRAs being treated as single account for purposes of determining the proportions).

To accommodate the includible-in-income requirement, there is a special "basis recovery rule" in the Tax Code for QCDs: QCDs are deemed to come out of the IRA's pretax money first. § 408(d)(8)(D).

Burton Example. Burton is a charitably-inclined individual age 71 who does not like to pay taxes. He owns a $70,000 IRA with a $20,000 basis resulting from nondeductible contributions in prior years. He owns no other IRAs. He directs the IRA provider to transfer $50,000 from his IRA directly to the Red Cross. This is a QCD, so the $50,000 is deemed to come from the IRA's pretax money "first." Now he is left with a $20,000 IRA which is 100 percent after-tax money. He can then convert this small "stub" IRA to a Roth IRA tax-free, or cash it out tax-free.

Note that this federal rule does not necessarily have any effect on state tax treatment of the distribution. For example, a particular state's "basis recovery rule" for IRA distributions may or may not accommodate this special federal rule for QCDs. The client and preparer must determine the client's income tax basis (investment in the contract) both before and after the QCD occurs, for both federal and (if applicable) state purposes.

7.6.07 ***How to do it; how to report it***

To effect a QCD, the IRA owner directs the IRA provider/administrator to transfer funds from the IRA to the charity. The donor-IRA owner should communicate with her IRA provider regarding its policies and preferred procedures for carrying out these transfers. One acceptable procedure is for the IRA provider to cut a check payable to the charity and have the donor physically deliver the check to the charity. IRS Notice 2007-7, A-41.

The IRA custodian is supposed to report the QCD on Form 1099-R, just as if it had paid the distribution to the individual donor rather than to a charity. There is no special code or other indication on Form 1099-R signaling that the distribution is a QCD. Thus, nothing in the 1099-R will reveal that the distribution is nontaxable! As the IRS put it in the instructions for Form 1099-R (2016), p. 1, "There's no special reporting" that IRA providers have to do for qualified charitable distributions.

Instead, it's up to the IRA owner-donor to report the nontaxable status, in the following manner: First, he enters the total distribution (as shown on Form 1099-R) on Line 15a of his personal income tax return, Form 1040. Then he enters the taxable portion of the distribution (zero, if the QCD was the only distribution for the year) on Line 15b. See instructions for IRS Form 1040, 2014, p. 24, Lines 15a and 15b, Exception 3. Then the donor is supposed to "Enter 'QCD' next to line 15b," apparently by hand in the margin of the tax form.

This method of reporting QCDs presumably means that some QCD-donors will not get the benefit of the income tax exclusion. This will happen if the IRA owner-donor simply turns over all his 1099-Rs to his tax preparer without alerting the preparer to the fact that there was a QCD. The preparer will then presumably simply report the entire distribution as taxable, and if the client doesn't notice that discrepancy but simply signs and files the return, the U.S. Treasury will collect a bit more money than it's entitled to.

7.6.08 ***Using QCDs for the RMD; other planning uses and pitfalls***

The QCD will not save anyone millions of dollars of taxes, but it is nevertheless a safe legal tax-favored way for an over-age-70½ client to use his IRA to benefit charity. Despite a few kinks and pitfalls, the QCD is a low-tax way to fulfill the minimum distribution requirement for the charitably inclined client.

A. **Use QCD to fulfill RMD.** A QCD will count as a distribution for purposes of determining whether an individual has fulfilled the RMD requirement. IRS Notice 2007-7, A-42. This is consistent with Regs. § 1.401(a)(9)-5, A-9(a), and § 1.408-8, A-11(a), which state that, except as otherwise provided in A-9(b) or A-11(b) of such regulations, or as may later be otherwise provided by other IRS pronouncements, "all amounts distributed" from a plan or IRA "are taken into account in determining whether section 401(a)(9) is satisfied…." The charitable IRA rollover is an ideal way for a charitably-inclined individual over age 70½ to fulfill the RMD requirement.

B. **Mixing up QCDs and RMDs.** Someone who has already taken his RMD for a particular year cannot use a QCD later in the year to fulfill his RMD requirement for that year; he cannot roll the already-taken RMD back into the IRA (to enable him to use a QCD instead) because RMDs are not eligible rollover distributions. See ¶ 2.6.03 of *Life and Death Planning for Retirement Benefits*. He can still make a QCD from his IRA; it just will not be his RMD. People will get confused about the RMD/QCD relationship. The two things have nothing to do with each other (other than the fact that a QCD counts towards the RMD, to the extent the RMD has not already been taken). A person can make QCDs of up to but not more than $100,000 (in any year QCDS are permitted), *regardless* of: whether his RMD for the year is more or less than $100,000; *regardless* of whether he has already taken the RMD; and *regardless* of what other distributions he has taken or later takes from the IRA.

C. **Advantages of the QCD.** The QCD eliminates *some* of the problems that arise when making lifetime charitable gifts from an IRA (see ¶ 7.7.01). A QCD does not increase AGI and therefore does not: increase the individual's adjusted gross income for purposes of determining the extent to which his "net investment income" will be taxed (§ 1411); decrease the deductibility of medical expenses (§ 213(a)) or miscellaneous itemized deductions (§ 67(a)); increase the reduction of itemized deductions (§ 68(a)); increase the taxability of Social Security benefits (§ 86); increase Medicare premiums (42 U.S. Code §1395r(I)); or increase state income taxes (in a state that uses federal AGI as the basis for computing state income tax but does not allow a charitable deduction). Since there is no itemized charitable deduction for the QCD gift, the gift does not "count" for purposes of the percentage-of-income limits on charitable deductions in § 170(b); does not get reduced by § 68(a); and is in effect "deductible" even for someone who does not itemize deductions.

D. **Fulfilment of pledge.** A QCD is considered a payment "to" the participant for purposes of the prohibited transaction rules. Thus, it is not a prohibited transaction even if it is used to fulfill a pledge to the charity. IRS Notice 2007-7, A-44.

E. **Drawbacks, problems, and what will go wrong.** QCDs are allowed only for direct transfers from the IRA to one of the permitted types of charitable recipients. If the money is first distributed to the individual, then donated to charity, it is not a QCD, and all the usual limits and drawbacks described at ¶ 7.7.01 will apply (there was an exception to this for certain charitable transfers in January 2013). While it might appear desirable for an over-age 70½ individual to use QCDs to fund all of his charitable contributions, there will be practical limits on this: Presumably, IRA providers will start charging "distribution fees" or setting minimum distribution amounts if they are asked to issue dozens of tiny QCDs. Finally, for an IRA owner who wants to give more to charity than just the amount of his/her RMD, the donor-owner should determine whether another form of charitable gift would be more advantageous for such additional gifting (such as gifts of appreciated stock from a taxable account).

Chapter 8: INVESTMENT ISSUES; PLAN TYPES

8.1.02 ***Investment losses and IRAs***, p. 517

To reflect legislative changes, in the last line of paragraph (C) of this section change "through 2009 and after 2010" to "through 2009 and after 2012."

8.1.04 ***Paying, deducting, IRA investment expenses***, p. 522

To reflect legislative changes, in paragraph (B) of this section change "(through 2009 and after 2010)" to "(before 2010 and after 2012)."

Chapter 9: DISTRIBUTIONS BEFORE AGE 59½

No updates at this time.

[end of 9/23/16 Update to *Life and Death Planning for Retirement Benefits*, 7th ed. 2011]