IRA UPDATE: DECEMBER 2012

Avoid Hurricane Damage to your IRA

Many people are still dealing with the aftermath of Hurricane Sandy which hit the Northeast in October. When such natural disasters hit, many are unprepared not only for the event itself, but specifically for the financial ramifications that come later. When an emergency such as this occurs, it can be tempting or possibly necessary to tap retirement funds to get by.

There is a hardship exemption for employer plans that allows a participant to access the money however such access still subjects the distribution to taxes and the 10% penalty if under age 59 ½. In is important to know that there is no such hardship exemption from IRAs. The hardship exemption from plans is an optional feature for the plan. In other words, if the plan does not allow a hardship distribution then you are probably going to have to find other funds to use. If you live in a specific area which the IRS identifies as a "covered area," there may be some relief. In IRS announcement 2012-44, any person or their spouse who lives or works in a covered area can qualify for a hardship distribution from their plan if taken no later than February 1, 2013. A list of covered areas can be found at http://www.irs.gov/uac/Newsroom/Help-for-Victims-of-Hurricane-Sandy. Even if you qualify for a hardship distribution, you will still have to pay taxes and the 10% early distribution penalty if under 59 ½, so if this applies to you, ideally you should look to avoid taking retirement money and instead look for other viable sources such as other assets or a plan loan if available.

Sometimes people will try to access IRA funds via a "60-day IRA loan." It is critical to understand that there is no such thing as a loan from an IRA. In fact you cannot loan money to or from your IRA and if you do, it is a prohibited transaction that will deem the entire IRA distributed and taxable with the 10% penalty if applicable. The way the "60-day IRA loan" works is that you have 60 days to return any funds taken from your IRA so in the case of emergency, some will take money needed with the intention of rolling it over within 60 days. Caution should be used because if the funds are not returned in time the distribution is taxable and a 10% early distribution penalty may apply if you are under age 59 ½. IRS has granted extensions to the 60 day rule in some cases however there must be true intent to do a rollover and the above scenario would not qualify. Furthermore you are only allowed one 60-day rollover per IRA per 365 days (not once per calendar year) causing a secondary distribution to be ineligible for rollover.

Roth IRAs are a potential source because you can always access your contributions at any time free of tax or penalty. Be aware of taking any funds that were converted from an IRA less than 5 years ago as special rules apply.

IRA Legal Update

- Better to name an Irrevocable IRA trust because naming a revocable living trust may allow creditors to access the inherited IRA even if the trust becomes irrevocable at death. Creditors accessing an inherited IRA that was from a revocable trust is now precedent from a 2007 decision for states that have adopted the uniform trust code.

- Florida passed a law in 2011 that gives the beneficiary of an inherited IRA the same creditor rights as the original IRA owner. This law applies retroactively to any inherited IRA regardless of when it was created. Other states have made similar efforts to apply the same creditor protection to inherited IRAs either through laws or in many cases, a court ruling.
- In a 2012 case in a Texas federal district court, an executor and trustee were found to be personally liable for unpaid taxes that were due because they made distributions to beneficiaries before gift taxes owed by the decedent were paid. The implications for IRAs are such that if the executor has any reason to believe there may be any problems with an IRA such as excess contributions or failure to take a required minimum distribution where taxes and/or penalty may be due should wait to pay beneficiaries until the issue is resolved.
- The IRS will soon begin implementing a "compliance initiative" in response to a 2010 report from the Treasury Inspector General for Tax Administration which cites growing non-compliance with IRA contribution and distribution requirements. For 2006 and 2007, over 250,000 taxpayers fell short of their required minimum distributions by nearly $350,000,000 and about 300,000 taxpayers made excess contributions to IRAs totaling over $800,000,000! Clearly there is incentive to crackdown on this non-compliance and IRS will begin to do so therefore you should be diligently aware of following proper contribution, distribution, and any other IRA related rules to avoid an unpleasant visit from the IRS.

As always if any of this applies to you, give me a call to discuss your situation.

Sincerely,

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