IRA UPDATE: OCTOBER 2011

IRS allows partial disclaimer

A disclaimer is when a person who has rightfully inherited an asset basically states that they do not want the funds and if a qualified disclaimer is completed, the asset passes to the next person in line as if the original beneficiary had pre-deceased the asset owner.

In this recent IRS Private letter ruling, the owner of an IRA and 403(b) died leaving his accounts to his wife who subsequently died shortly after. She had taken required minimum distributions as a beneficiary and essentially the IRS allowed her executrix, her daughter, to initiate a partial disclaimer of the amounts not distributed. The amounts already distributed and the earnings attributable to those distributions were not allowed to be disclaimed. IRS stated that the acceptance of the required minimum distribution did not prevent a qualified disclaimer from being made with respect to the remaining IRA funds.

Without the disclaimer, the wife would have died without having the opportunity to name her own beneficiaries which means that the retirement accounts would likely have passed through her estate. The reason such a ruling in noteworthy is that without the ability to complete such a disclaimer, the children would have been forced to distribute the retirement funds over a much shorter period. By allowing the disclaimer, the children were allowed to stretch the distributions over their own life expectancies.

Beware when considering a disclaimer; it only works if a contingent beneficiary was named on the original account owner's beneficiary form. Or in other words, make sure you know where the funds are going if a disclaimer is executed.

10% Early Distribution Penalty Denied

In a Tax Court case that was ruled on July 25, 2011, Simeon Isaacs, a Podiatrist by trade (also an attorney) took distributions from retirement accounts prior to attaining age 59 ½ but did not pay the 10% early distribution penalty. IRS caught up with him and assessed him penalties that exceeded $100,000!

Mr. Isaacs took the distributions citing his disability due to depression that caused him to shut down his Podiatry practice at the insistence of his psychiatrist. IRS ruled against him for two reasons; a lack of credible evidence of disability, and IRS argued that he did not meet the strict definition of disability for purposes of avoiding the 10% early distribution penalty.

The definition for disability for purposes of avoiding the 10% early distribution penalty are quite strict and typically require the individual to be unable to engage in any substantially gainful activity and the disability to be long in duration or to be expected to result in death. Regulations do allow for the early distribution penalty waiver for persons with mental illness however such a disability must also be accompanied by institutionalization and/or continuous supervision of the individual by a qualified mental illness professional.

In Mr. Isaacs case, he was unable to meet this definition and thus the Tax Court held that he was liable for the penalties.

Extended deadline for Roth Recharacterizations and excess contributions for disaster relief

IRS has granted extension of Roth Recharacterization date from October 17th 2011 to October 31st 2011 for some areas affected by recent hurricanes Irene and Lee and the wildfires in Texas.

In New Jersey the following counties: Atlantic, Bergen, Burlington, Camden, Cape May, Cumberland, Essex, Gloucester, Hudson, Hunterdon, Mercer, Middlesex, Monmouth, Morris, Ocean, Passaic, Salem, Somerset, Sussex, Union and Warren;

In New York: Albany, Bronx, Clinton, Columbia, Delaware, Dutchess, Essex, Greene, Herkimer, Kings, Montgomery, Nassau, Orange, Otsego, Putnam, Queens, Rensselaer, Richmond, Rockland, Saratoga, Schenectady, Schoharie, Suffolk, Sullivan, Ulster, Warren, Washington and Westchester;

The 60 day IRA rollover and SEP IRA contribution deadlines have also been extended to October 31st.

Be sure to check the IRS website at www.irs.gov and click on "Disaster Relief" as well as consult with a qualified tax professional if you think this applies to you. Also check with the custodian to see if they are aware of the extension and if they will honor it.

As always, feel free to contact me to ask any questions you may have on these topics.

Sincerely,

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