IRA Masterclass
Session 4: Filling in the Gaps: Common IRA Questions from advisors

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Denise Appleby is a nationally recognized author, expert, trainer, speaker, and consultant on IRAs and employer plans for small businesses. She helps financial, tax, and legal professionals avoid mistakes with their clients' retirement accounts and, where possible, fix mistakes.

Due to her knack for helping even the most resistant IRA custodians correct IRA mistakes and resolve other complex IRA-related issues, Denise has earned the reputation of being "The IRA Whisperer".

Denise graduated from John Marshall Law School, where she obtained a Master of Jurisprudence in Employee Benefits and has earned several professional designations for IRAs and employer plans.

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This information is for general information purposes only and is not intended to be used as tax or legal advice. You may need additional material to answer some questions related to the course topic.

For legal and compliance reasons, we are unable to answer questions about specific cases, unless we are separately retained for such a consultation.

What We Covered So Far

- Rollovers, Transfers, Roth Conversions
- Early Distributions, RMDs
- Beneficiary Options

Learning Objectives for Today's Session

At the end of the session, participants should be able to:

- Demystify Back-Door Roth Conversion Strategies
- Navigate the SECURE Act
- Identify and Address Key Gaps in IRA Savings
- Create IRA Planning Strategies for the Current Year

•Describe the tax impacts of rollovers from employer plans to Roth IRAs

Learning Objective

- Demystify Back-Door Roth Conversion Strategies

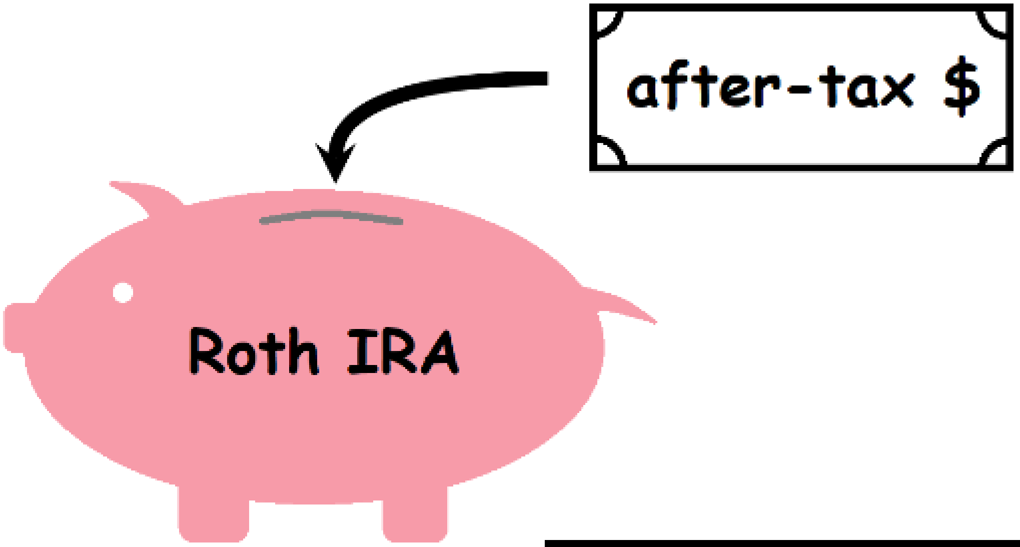
Backdoor Roth IRA Contribution Strategies

ISSUE: MAGI is too High

MAGI limits for contributing to a Roth IRA		
Tax Filing Status	**MAGI**	**Allowed contribution**
a. All taxpayers other than b. or c. below	$146,000 or less	100%
	$146,000 to $161,000	Partial
	$161,000 or more	None
b. Married taxpayers filing a joint return or taxpayers filing as a qualifying widow(er)	$230,000 or less	100%
	$230,000 to $240,000	Partial
	$240,000 or more	None
c. Married individual filing a separate return	Less than $10,000	Partial
	$10,000 or more	None

How does the backdoor Roth IRA work?

- **Issue:** MAGI too high to make a regular Roth IRA Contribution
- **Step 1**: Make a regular IRA contribution to a traditional IRA
- **Step 2:** Convert the contribution to a Roth IRA.
- Considerations:
  - Convert immediately to ensure growth accrues in the Roth IRA
  - File Form 8606: If no deduction is claimed for the IRA contribution



Is the Conversion Taxable?

- It depends
- Conversion includes a pro-rated amount of pre-tax and after-tax balance. All traditional, SEP, and SIMPLE IRAs aggregated.
- **Conversion is tax-free if** no other traditional, SEP, and SIMPLE IRA assets, and no deduction is claimed for the contribution
  - **Tip**: Convert immediately so earnings accrue in Roth IRA

- Charles has a traditional IRA balance of $95,000, all of which is pretax.
- Charles made a nondeductible traditional IRA contribution of $5,000 in 2024. Total now $100,000.
- Charles immediately converted the $5,000 to his Roth IRA.
- Charles did not take any other distributions or perform any other Roth conversion in 2024.
- The $5,000 is nondeductible. A partial (less than $100,000) conversion would include only a portion of the $5,000 because of the pro rata rule.
- Charles' conversion of $5,000 would include:
  - $4,750 taxable amount.
  - $250 nontaxable amount.

- The remaining $4,750 of the $5,000 nondeductible contribution would remain in Charles' traditional IRA and eventually come out in the wash for future distributions/Roth conversions.
- The pretax and after-tax ratio is calculated on IRS Form 8606. Factors in after-tax accrued in previous years.

Mega Roth | Employer Plans with Designated Roth Accounts

Available only if plan has a Designated Roth Account feature

How does the Mega backdoor Roth work?

- **Step 1**: Make after-tax contribution to traditional account (e.g.401(k))
- **Step 2:** Convert the contribution to a Roth 401(k).
- Considerations:
  - Plan must have Roth feature
  - Total contributions call exceed annual addition limit.
  - **Caution**: After-tax contribution is subject to nondiscrimination testing

Roth: Employer Matching & Nonelective

- **Pre-SECURE Act 2.0:** All employer contributions to 401(k), 403(b), and governmental 457(b) plans could be made only to pretax accounts
- **Effective the date of enactment of Secure Act 2.0:** Employers may allow participants to elect to have employer matching and nonelective contributions deposited to their designated Roth accounts.
  - Optional provision. 604 of the SECURE 2.0 Act
  - Nonforfeitable
  - For vested contribitions

Roth Contribution Treatment

- Roth designation must be made before contribution is made to account
- Irrevocable
- Included in income for the year the contribution is made to the employee's account . Even if for the previous year
- Designation can be changed at least once per year
- Excluded from wages for purposes of withholding, FICA, FUTA
- Employee may need to increase withholding to meet estimated tax withholding requirements

Tax Reporting

- 1099-R as an in-plan conversion
- Amount in Box 1 and 2a
- Code G in Box 7

country, ZIP or foreign postal code, and telephone no.

$ 100,000

2a Taxable amount

$ 100,000

2024

Form **1099-R**

Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

2b Taxable amount not determined ☐ Total distribution ☐

Copy A For Internal Revenue Service Center

File with Form 1096.

PAYER'S TIN	RECIPIENT'S TIN	3 Capital gain (included in box 2a)	4 Federal income tax withheld
		$	$

RECIPIENT'S name	5 Employee contributions/ Designated Roth contributions or insurance premiums	6 Net unrealized appreciation in employer's securities
	$	$

Street address (including apt. no.)	7 Distribution code(s)	IRA/ SEP/ SIMPLE	8 Other	
	G	☐	$	%

City or town, state or province, country, and ZIP or foreign postal code	9a Your percentage of total distribution	9b Total employee contributions
	%	$

For Privacy Act and Paperwork Reduction Act Notice, see the **2024 General Instructions for Certain Information Returns.**

10 Amount allocable to IRR within 5 years	11 1st year of desig. Roth contrib.	12 FATCA filing requirement	14 State tax withheld	15 State/Payer's state no.	16 State distribution
$		☐	$		$
			$		$

Account number (see instructions)	13 Date of payment	17 Local tax withheld	18 Name of locality	19 Local distribution
		$		$
		$		$

Example : Mega Roth

- 55-year-old Jane has a SBOK Plan for her S-Corporation (she is the only employee).
- Her W-2 Wages is $150,000. Jane's 2024 Contributions are:
  - $69,000 | $23,000 to her Roth 401(k) **+** $39,000 employer contributions to her Roth 401(k)
  - $7,500 catch-up to her Roth 401(k)

  T: $69,000 + $7,500 catchup: Roth 401(k) contribution **(Mega Roth-** No backdoor needed)

DRA Roth Only Catch-up & $145,000 Income

- Employees can choose to make their salary deferral contribution to their traditional account or designated Roth account or split it between the two.
- **Effective 2024 (extended to 2026):** The employee's compensation the employee from their employer during the preceding year is more than $145,000 (indexed for inflation)-
  - then the catch-up contribution must be made to a designated Roth account.

No RMDs for DRA Participants : Effective 2024

- No RMDs for designated Roth account owners (Roth 401(k), 403(b), 457(b)
- RMDs still apply to beneficiary accounts
- Now on par with Roth IRAs

Caution: This does not apply to any RMDs due for 2023 and earlier, including DRA participant who reaches their applicable RMD age in 2023 and who can, therefore, take that 2023 RMD in 2024 by April 1.

Roth SEP/ Roth SIMPLE

SEP and SIMPLE Roth IRAs: New Rules

Pre-SECURE Act 2.0:

- All contributions to SEP IRAs and SIMPLE IRAs had to be made to pre-tax accounts
- a SEP or SIMPLE IRA account could not be designated as a Roth IRA

Effective 2023:

- Employers may allow participants to elect to have employer and nonelective contributions made to Roth IRAs. Optional feature.

SEP and SIMPLE Roth IRAs

Pre-SECURE Act 2.0:

SECURE Act 2.0 Effective 2023:

- contributions to any such SEP or SIMPLE IRA account would not be taken into account for purposes of the Roth IRA contribution limit of section
- a Roth IRA will not be treated as a SEP/SIMPLE unless the employee elects for the Roth IRA to be so treated

SEP and SIMPLE Roth IRAs| Tax Treatment

- Excluded from income
- Reported as Roth Conversion.
- Not subject to pro-rata rule

Can You Give Detailed Explanation of the 529 to Roth provision?

New: 529 Plans To Roth IRAs

Excess (unused) 529 plan amounts

- Lifetime limit of $35,000
- 529 plan that has been maintained for 15 years
- Amount must ‘bake’ 5 years in the 529 plan before rollover
- 529 rollover + IRA/Roth IRA contribution cannot exceed limit for the year
- Roth rules apply to distributions

Effective 2024

New: 529 Plans To Roth IRAs Cont'd

- Counts as regular Roth IRA contribution
- Must have eligible compensation
- Roth MAGI limit does not apply
- IRA custodian must be notified that amounts represents a 529 to Roth
- If done January 1 to April 15: Custodian must be informed whether the contribution is for the previous or current year

•Describe the tax impacts of rollovers from employer plans to Roth IRAs

Learning Objective

Navigate the SECURE Act: RMD aggregation

RMD Aggregation

Multiple Traditional IRAs

- RMDs must be calculated separately. Can be totaled and taken from one or more IRAs.

Multiple 403(b)s

- RMDs must be calculated separately. Can be totaled and taken from one or more 403(b)s.

Multiple Employer Plans [pension, 401(k), etc.]

- RMDs must be calculated separately. Must be taken from each plan

RMD Aggregation Now Includes Annuities

- **Pre-SECURE Act 2.0:** RMDs could not be aggregated with annuitized accounts
- **Effective Date of Enactment:** SECURE Act 2.0 permits aggregation of RMD for an annuity and the rest of the account

RMD Aggregation: Beneficiary IRAs

- Aggregated by type (Traditional with traditional. Roth with Roth)
- Aggregated only if from the same decedent

My client named his trust as beneficiary for his 401(k). Can the trustee rollover the inherited 401(k) to an IRA?

It Depends!

- Only a designated beneficiary can roll over inherited 401(k)s and other qualified plans, 403(b)s, and governmental 457(b)s
- Non-designated beneficiaries (estates, non-qualified trusts, and other non-persons) do not qualify
- A see-through trust is a designated beneficiary

See-through Trusts May Roll Over Inherited 401(k)

A trust is a see-through trust if:

1. The trust is valid under state law or would be valid but for the fact that there is no corpus;
2. The trust is irrevocable or will, by its terms, become irrevocable upon the death of the employee;
3. The beneficiaries of the trust who are beneficiaries with respect to the trust's interest in the employee's benefit are identifiable; and
4. The specified documentation requirements are satisfied

•Describe the tax impacts of rollovers from employer plans to Roth IRAs

Learning Objective

- Planning strategies for the current year

Can My Client Still Do a QCD Since He Already Took His RMD?

- Yes. But, in future, if he wants his QCD to cover his RMD, he should do the QCD before satisfying his RMD.

My Client Is Age 84 and His Wife Is 55. Can He Use the Joint and Last Survivor Table To Calculate His RMD? The IRA Custodian Says No.

Answer ->

- It depends
- He can, only if his wife is the sole primary beneficiary
- The custodian has the right to use the Uniform Lifetime Table if they want to
  - However, if they do, your client can ignore that and have their tax advisor perform the calculation using the Uniform Lifetime Table if your client qualifies

My client has two Traditional IRAs. She is age 73 this year.
Can you do a case study for her IRAs? What if she waits until 2025?

Case Study: First Applicable Year for RMD

Calculating Minimum Distributions for Susan's Traditional IRAs	
Current Year:	2024
Year of First Required Distribution:	2024
12/31/2023 Plan Balance: IRA Number 1	$400,000
12/31/2023 Plan Balance: IRA Number 1	$100,000
Total	**$500,000**
Expected Plan Growth:	7.0000%
Is there a Designated Beneficiary?	Yes: Beneficiary
Owner's Birth Date:	1/1/1951
Beneficiary's Birth Date:	1/1/1968
Beneficiary is Spouse?	No

Key Considerations: Timing- Slide 1 of 2

- Susan can take her first RMD at any point during 2024 but must ensure the total RMD is withdrawn by April 1, 2025.
- Susan’s RMD for the applicable year is the only RMD that can be deferred past December 31 of the year for which it is due.
- If Susan defers her 2024 RMD to 2025, she will need to take two RMDs in 2025

Key Considerations: Timing- Slide 2 of 2

The tax impact of either option must be considered.

a) If Susan expects to be in a lower tax bracket for 2025, she may defer her 2024 RMD until 2025.

b) If Susan does not expect to be in a lower tax bracket for 2025, her accountant must analyze the tax impact of including her 2024 RMD in 2024 vs 2025.

Key Considerations: RMD Calculation

Susan's RMD for a year is calculated as follows:

- The Fair Market Value (FMV) for the previous-year-end (12/31/2023 / the life expectancy for the calculation year (year for which the RMD is being calculated).
  - These factors do not change even if the RMD is taken in a later year
- Susan's life expectancy factor is determined using the Uniform Life Table, using her age of year end

Key Considerations: Multiple Accounts

- Susan has multiple Traditional IRAs.
- The RMD amounts must be calculated for each account separately.
- She can withdraw the total RMD from any one or a combination of her IRAs.

Key Considerations: Missing the RMD deadline

- If Susan fails to take the full RMD by the deadline, she may incur a penalty of 25% on the amount that was not withdrawn.
- The 25% excise tax is reduced to 10% if the RMD shortfall is corrected during the RMD correction window.
- If the deadline is missed due to 'reasonable error', Susan's tax preparer may file IRS Form 5329 and request a waiver of the excise tax.

RMD Deadline: Reminder

- RMD for the applicable year may be taken as late as April 1 of the following year- the required beginning date
- All other RMDs must be taken by December 31 of the year for which they are due

Can you explain the NUA strategy- who qualifies? How does it work?

Net Unrealized Appreciation

- NUA is the growth on employer stocks, while being held in a qualified retirement plan
- NUA eligible for special tax treatment if part of a lump-sum distribution
  - When employer stock is distributed, basis is taxed as ordinary income
  - NUA is taxed at long-term capital gains rate
  - NUA taxed when stock is sold
- Special tax treatment is lost if stocks are rolled over

Cost of missing out

- Missed opportunity for tax reduction strategy

Lump Sum Distribution

A distribution or payment from a qualified plan

- within one taxable year of the recipient of the balance to the credit of the employee
- which becomes payable to the recipient on account of
  - the employee's death,
  - after the employee attains age 59 1/2,
  - on account of the employee's separation from service, or
  - after the employee has become disabled

If a lump-sum distribution includes employer securities & the payer reported an amount in box 6 of Form 1099-R for NUA, the NUA is generally not subject to tax until the securities are sold. But taxpayer may elect to include the NUA in income in the year the securities are distributed

$

2a Taxable amount

$

2024

Form **1099-R**

Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

2b Taxable amount not determined ☐

Total distribution ☐

Copy A

For Internal Revenue Service Center

File with Form 1096.

PAYER'S TIN

RECIPIENT'S TIN

3 Capital gain (included in box 2a)

$

4 Federal income tax withheld

$

RECIPIENT'S name

5 Employee contributions/ Designated Roth contributions or insurance premiums

6 Net unrealized appreciation in employer's securities

$

For Privacy Act and Paperwork Reduction Act Notice, see the **2024 General Instructions for Certain Information Returns.**

Street address (including apt. no.)

7 Distribution code(s)

IRA/ SEP/ SIMPLE ☐

8 Other

$ %

City or town, state or province, country, and ZIP or foreign postal code

9a Your percentage of total distribution %

9b Total employee contributions

$

10 Amount allocable to IRR within 5 years

$

11 1st year of desig. Roth contrib.

12 FATCA filing requirement ☐

14 State tax withheld

$

$

15 State/Payer's state no.

16 State distribution

$

$

Account number (see instructions)

13 Date of payment

17 Local tax withheld

$

$

18 Name of locality

19 Local distribution

$

$

Check for Net Unrealized Appreciation

- Review client's statement <u>before</u> distribution is requested
- Check for employer securities
- Is the NUA significant?
  - Ensure lump-sum distribution *if* NUA is desired
- Reminder: NUA is not an 'all or none' solution. Choose NUA for 'affordable' amount
- Caution: Start lump-sum early in the year
- Caution: rollover invalidates option for NUA
- Caution: Liquidation in plan disqualifies from NUA

•Describe the tax impacts of rollovers from employer plans to Roth IRAs

Learning Objective

- Identify and Address Key Gaps in IRA Savings

Maximizing contributions for the year

Cautionary Tip: Multiple Plans

- About 13 million U.S Workers have more than one job

Using Administrative Data, Census Bureau Can Now Track the
Rise in Multiple Jobholders / Keith A. Bailey and James R. Spletzer
February 03, 2021

- Multiple jobs could mean multiple retirement plans
- Clients with multiple jobs cannot always double up on contributions

Reminder: Multiple Plans- Employee Contributions

- IRA contribution is a per-person limit: Deadline April 15/tax filing due date. Audit IRAs not for eligibility. Especially Roth IRAs.
- Salary deferral is a per-person limit:
  - Cannot exceed \$23,000 + \$7,500 catch-up. 457 plans are separate
  - Check for excess.
  - Notify plan administrator before March 15, to allow correction by April 15, to avoid double taxation.

Reminder: Multiple Plans- 415(c)limit

- Annual contribution for 2024 is $69,000
- This is a 'per employer' limit
- John works for Bif Corporation.
- His total contribution to the Bif 401(k) is $69,000 (salary deferral, plus employer contributions)
- John does consulting on the side.

Special Rule for 403(b) Plans

- Participant is treated as ‘employer’ for 403(b) plans
- For $69,000 limit, individual must combine contributions made to 403(b) account with contributions to qualified plan/ SEP IRA of all corporations, partnerships, and sole proprietorships in which he has had more than 50% control to determine the total annual additions

Plan for spouses

Funding Spouse's IRA 

Benefits

- Same as those that apply to regular IRA contributions.
- Helps to double up on couples' retirement savings.

Spousal IRA Contribution

Kay Bailey Hutchison Spousal IRA

- Made by a working spouse on behalf of a spouse that has little or no income
- Subject to the same rules as regular and catch-up contributions
- Spouses must file joint tax return
- IRA contribution limits apply to each spouse separately

Spousal IRA Contribution: Who Is or Isn't 'Spouse' ?

- Not married: An individual legally separated from their spouse under a decree of divorce or of separate maintenance
- Married but living apart: the mere fact that spouses have not lived together during the course of the taxable year shall not prohibit them from making a joint return

Case Study

Case Study: Spousal IRA Contribution Rules

Spousal IRA Contribution

- 45-year-old Tim is a stay-at-home dad. He makes $1,500 for the year, from his new baking business.
- His wife's W-2 wages is $200,000.
- They file a joint tax return

How much can Tim contribute to a traditional IRA?

Spousal IRA Contribution

- **Answer**: Since his wife has sufficient income and they file a joint tax return, Tim can use her income to meet the eligible income requirement, for IRA contribution purposes.
- He can contribute the maximum amount in effect for the year (no catch-up because he us under age 50)

Adding a spouse to a SBO(k)

What’s Mine is Yours and Ours

Doubling up on plan contributions means:

- More tax benefits
- More for a couple's retirement

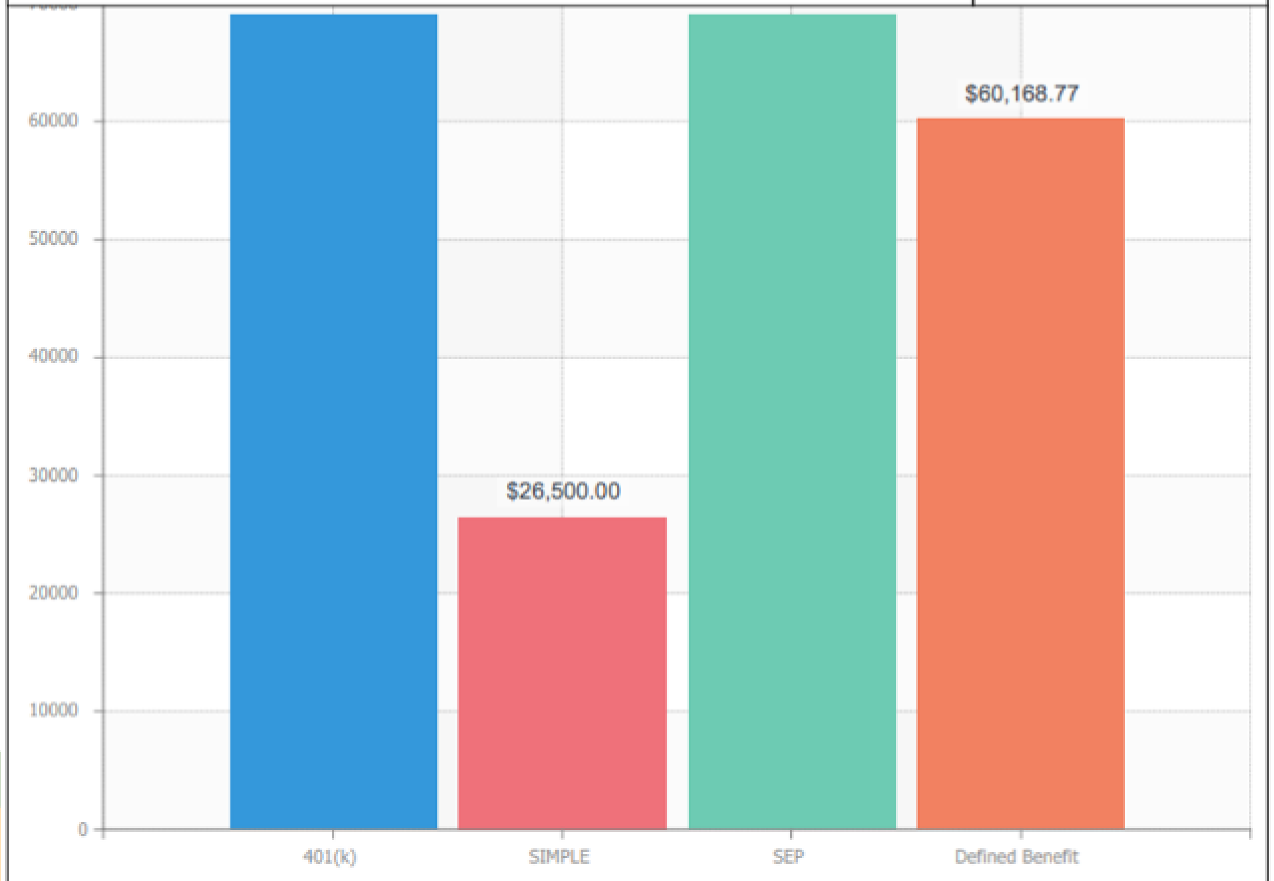
Case Study: Junelle and Noah

- Junelle and Noah are married. Both under age 50 (no catch-up)
- Junelle runs a consulting firm and Noah is an employee.
- Junelle has no other employees (Controlled and affiliated service group rules apply).
- The business is an S Corporation.
- Junelle’s salary is $350,000
- Noah’s salary is $100,000

Junelle	28	$350,000	Corporation

The maximum contribution into an Individual 401k plan is comprised of 2 elements, the profit sharing contribution and the 401(k) deferral. The maximum allowable contribution calculation simply takes the profit sharing contribution and adds the maximum 401(k) contribution amount to it and that is the total allowable contribution.

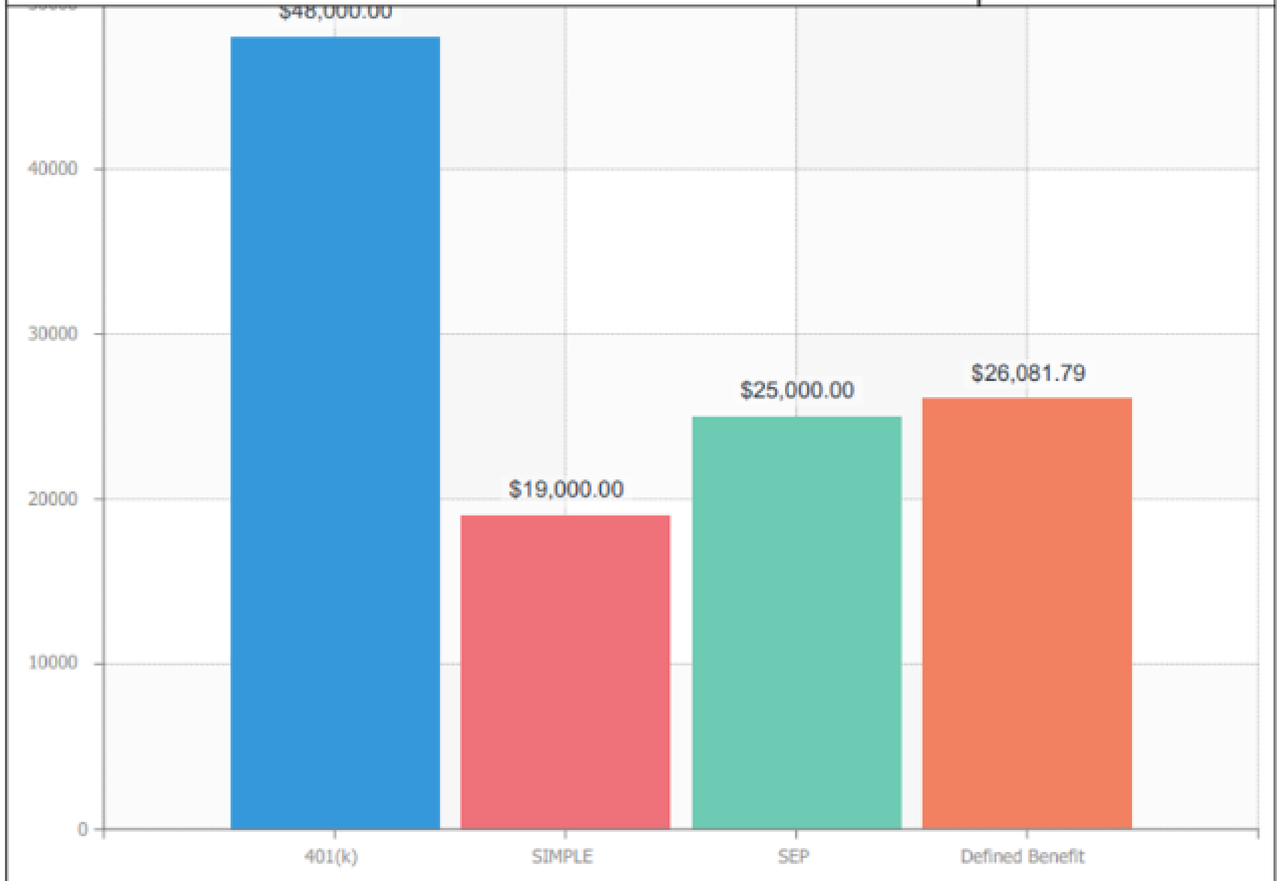
Maximum Profit Sharing Contribution	$69,000.00
Maximum 401(k) Deferral	$23,000.00
401(k) Catchup	$0.00
Total SBOK Calculator Contribution	$69,000.00
Maximum SIMPLE IRA Contribution	$26,500.00
Maximum SIMPLE IRA Catchup	$0.00
Total SIMPLE IRA Contribution	$26,500.00
Maximum SEP Contribution	$69,000.00
Maximum DB Contribution	$60,168.77



Noah	32	$100,000	Corporation

The maximum contribution into an Individual 401k plan is comprised of 2 elements, the profit sharing contribution and the 401(k) deferral. The maximum allowable contribution calculation simply takes the profit sharing contribution and adds the maximum 401(k) contribution amount to it and that is the total allowable contribution.

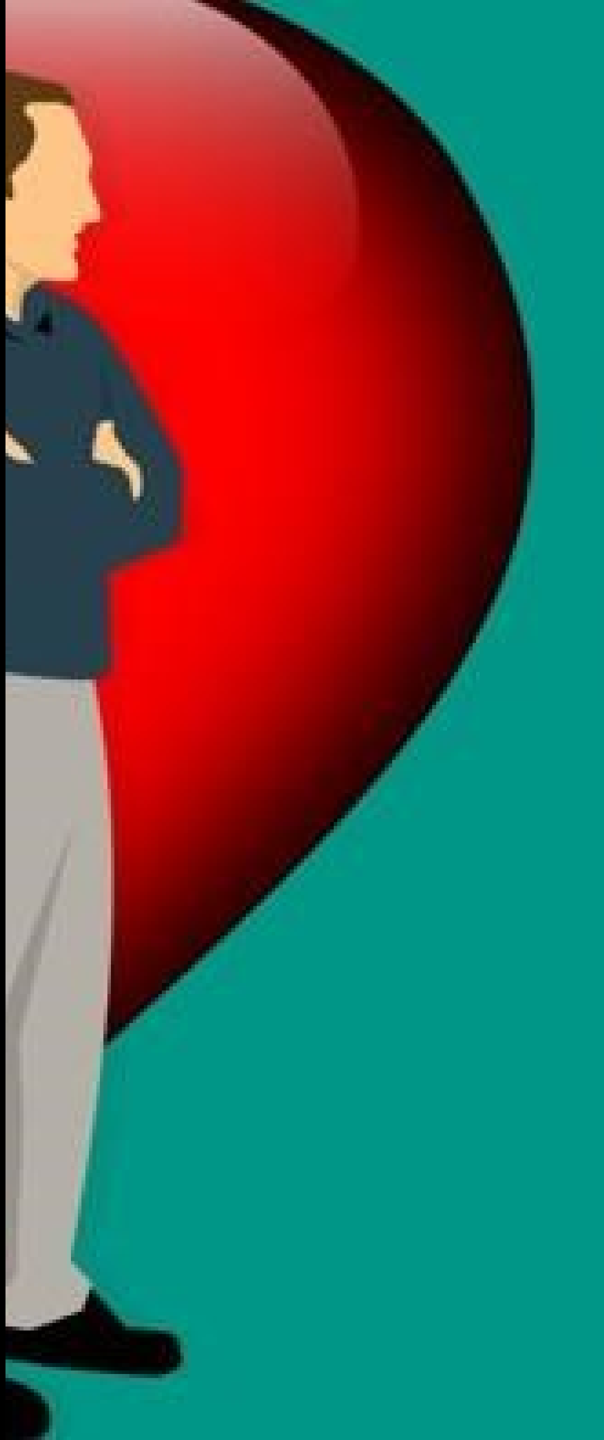
Maximum Profit Sharing Contribution	$25,000.00
Maximum 401(k) Deferral	$23,000.00
401(k) Catchup	$0.00
Total SBOK Calculator Contribution	$48,000.00
Maximum SIMPLE IRA Contribution	$19,000.00
Maximum SIMPLE IRA Catchup	$0.00
Total SIMPLE IRA Contribution	$19,000.00
Maximum SEP Contribution	$25,000.00
Maximum DB Contribution	$26,081.79



Comparing Plan Options

Participants	W-2 Wages	SBO(k) Plan	Profit Sharing Plan	SEP Plan	SIMPLE IRA Plan
Junelle	$350,000	$69,000	$69,000	$69,000	$26,500
Noah	$100,000	$48,000	$25,000	$25,000	$19,000
		$118,000			

Splitting an IRA Due to Divorce



Divorce and Retirement

- About 40 percent of marriages end in divorce.
- Divorce is expected to adversely affect retirement readiness
- Households with a past divorce are much more likely to be at risk for maintaining their standard of living in retirement
- Even those who remarry are likely hurt financially by divorce

Source: How Does Divorce Affect Retirement Security? by Alicia H. Munnell , Wenliang Hou , and Geoffrey T. Sanzenbacher , IB#18-12-Trustees of Boston College, Center for Retirement Research

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When Is One ‘Divorced’

- An individual legally separated under a decree of divorce or of separate maintenance is not to be considered as married
- Living separately does not constitute divorce
- Married couples separated under an interlocutory decree of divorce retain the relationship of husband and wife until the decree becomes final
- Marital status is determined at the end of the year

§ 1.6013-4

Marriage and Beneficiary Designation

- Beneficiary form must be updated for each lifechanging event
- Marriage, divorce, remarriage, birth, death

IRAs Divorce and Beneficiary Designation

- Divorce results in revocation of beneficiary designation under (Some) state law. e.g. *Minnesota Statute §524.2-804, subd. 1*.
- In some states, divorce does not result in a revocation [*See, e.g.*, *In re* Declaration of Death of Santos, Jr., 282 N.J. Super. 509, 660 A.2d 1206 (Super. Ct. App. Div. 1995)]
- Revocation under some IRA agreements
- Court order can specify whether revocation occurs
- Participant should reaffirm/update beneficiary form after divorce, even if intent is for (former) spouse to remain beneficiary

Divorce and Beneficiary Designation

- ERISA preempts state laws [ERISA §514(a)]. Terms of the plan document govern whether a divorce affects beneficiary designation
- Plan can include language stating whether divorce has effect on plan
- Even after QDROs, participant can still allow spouse/former spouse to remain as beneficiary (Parsonese v. Midland Nat'l Ins. Co., 550 Pa. 423, 706 A.2d 814 (Pa. 1998)

IRAs Require a Divorce Decree to Split

- Divorce decree or legal separation agreement required
- Private agreement is not sufficient
- Should specify that assets must be transferred to spouse
  - Can be all or portion of IRA
- Should specify percentage or dollar amount

IRA and Divorce Tax Responsibility

- Must be moved nonreportably to receiving spouse
- Receiving spouse responsible for any income tax from subsequent distributions
- Unlike QDROs: Amount to former spouse not eligible for exception to 10% early distributions penalty because of transfer due to divorce

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Operational Procedures

- IRA custodian transfers assets to receiving spouse's (former spouse's) IRA
- Must be IRA of the same type (Traditional to Traditional or Roth to Roth)
- Any distribution would be reported to receiving spouse (former spouse), who must include amount in income
- Age 59 ½ rule applies to receiving spouse (former spouse) as owner

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IRA and Divorce – Private Agreement

- IRA owner can use IRA to settle other obligation
- Would be distribution to owner
- Owner responsible for any income tax
- Not eligible for transfer to spouse

IRA and Divorce – Case

Summers v. Commissioner of Internal Revenue, T.C. Memo 2017-125 (2017)

- IRA owner owed the IRS a 10% early distribution penalty of $1,738. Distribution was not a 'transfer-due-to-divorce'
- Husband wanted to help wife pay off her debt
- Took distribution and gave wife money
- Divorce decree entered after distribution
- IRA owner did not pay penalty and claimed QDRO exception in petition to court
- Tax Court denied petition: QDRO exception does not apply to IRA

Sympathy is not sufficient to rule in favor

“We have considerable sympathy for petitioner's position: In effect, his willingness to help minimize stress on his soon-to-be ex-wife disabled him from satisfying the statutory requirements. But we are not at liberty to add equitable exceptions to the statutory scheme that Congress enacted, and we thus have no alternative but to sustain the 10% additional tax that respondent has determined.” Tax Court

Divorce and Spousal IRA Contribution

- Before divorce, spousal contribution rules apply
- After divorce: Ineligible to use spouse’s income. Therefore, no Spousal IRA contribution

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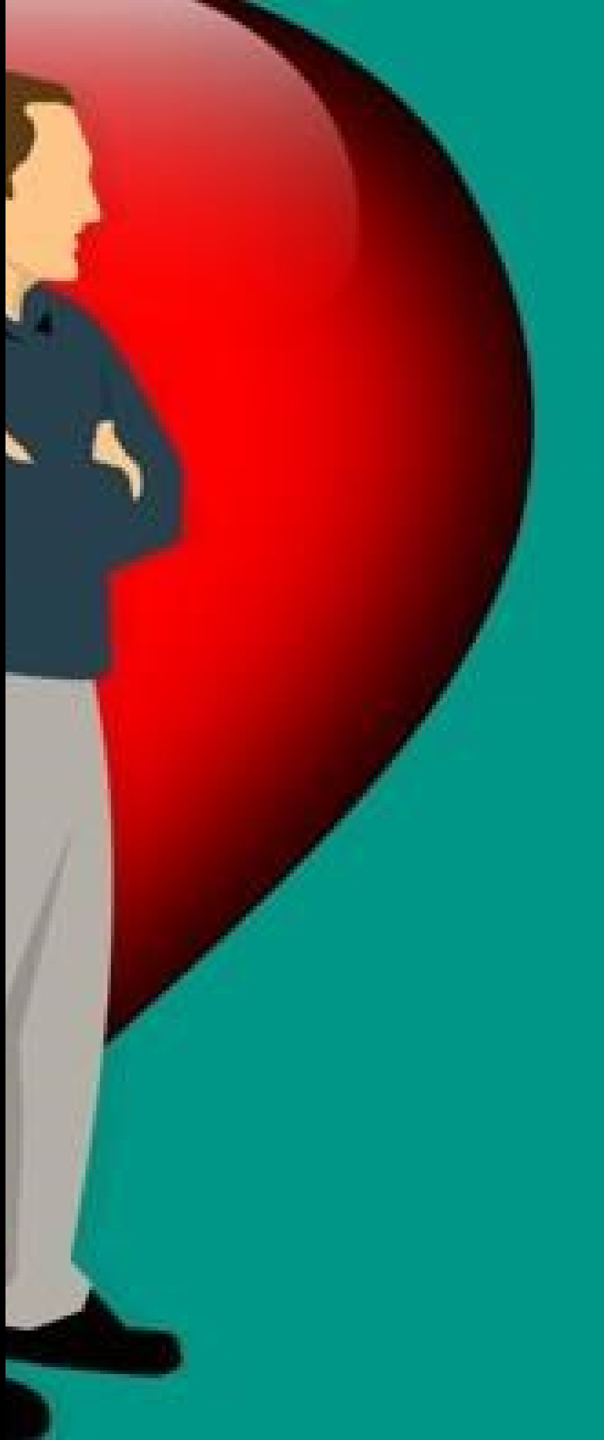
Splitting an Employer Plan Account Due to Divorce



Divorce – Employer-Sponsored Retirement Plan

- Qualified Domestics Relations Order (QDRO)
  QDRO is an exception to the anti-assignment rule
  - For QRPlan, 403(b), and Gov't 457(b)
  - Paid to spouse, former spouse, or dependent under a QDRO
  - Not a QDRO if paid under a settlement, but outside of a QDRO *[Mills v. Comm'r, T.C. Summary Opinion 2003-41 (U.S.T.C. 2003)]*

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DRO Court Issued

- DRO must be issued by court. Court would have jurisdiction over proceedings of divorce/separation
- DRO requirements include:
  - Language assigning benefits to alternate payee and indicating how much is assigned. DOL provides sample language in Notice 97-11.
  - How payments should be made and when

DRO

The Tax Code defines a DRO as:

- "…any judgment, decree, or order (including approval of a property settlement agreement) which —
  i. Relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of a participant, and
  ii. Is made pursuant to a State domestic relations law (including a community property law)".

Cite: [IRC § 414(p)(1)(B)]

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DRO-Qualified Determination

- Plan documents generally include guidelines
- Plan administrator determines if DRO is qualified (QDRO)
  - Will reject if not qualified
  - Plan administrator must notify the participant and alternate payee(s) about the approval status of the QDRO
  - Explanation must be provided if not approved
- Attorney should be consulted on qualified status of QDRO

QDRO Notification

- Plan administrator should notify participant and alternate payee of receipt of DRO and include copy of plan's qualification requirements for DRO and sample QDRO
- QDRO should include:
  - name and last known mailing address of participant and alternate payee;
  - amount or percentage of participant's benefit to be paid to the alternate payee;
  - number of payments or period of time over which payments are to be made to the alternate payee; and
  - the name of the plan

QDRO – Operational Procedures

- Notify participant and alternate payee
- Follow QDRO procedures of plan
- Segregate assets for alternate payee
- Follow distribution procedures of plan

QDRO Exception to Penalty: Plans Only

- Exception to 10% early distribution penalty
- Does not apply to IRAs
- Exception lost if rolled over to IRA
- Divorce exception does not apply to IRAs even under transfer due to divorce

Key Takeaways

- Perform and comprehensive over of client's retirement profile
- Fill in any gaps.
- Drill down on pertinent and tax saving areas.

Questions?

Send them to Training@DeniseAppleby.com

Thank you for your attention and your time!