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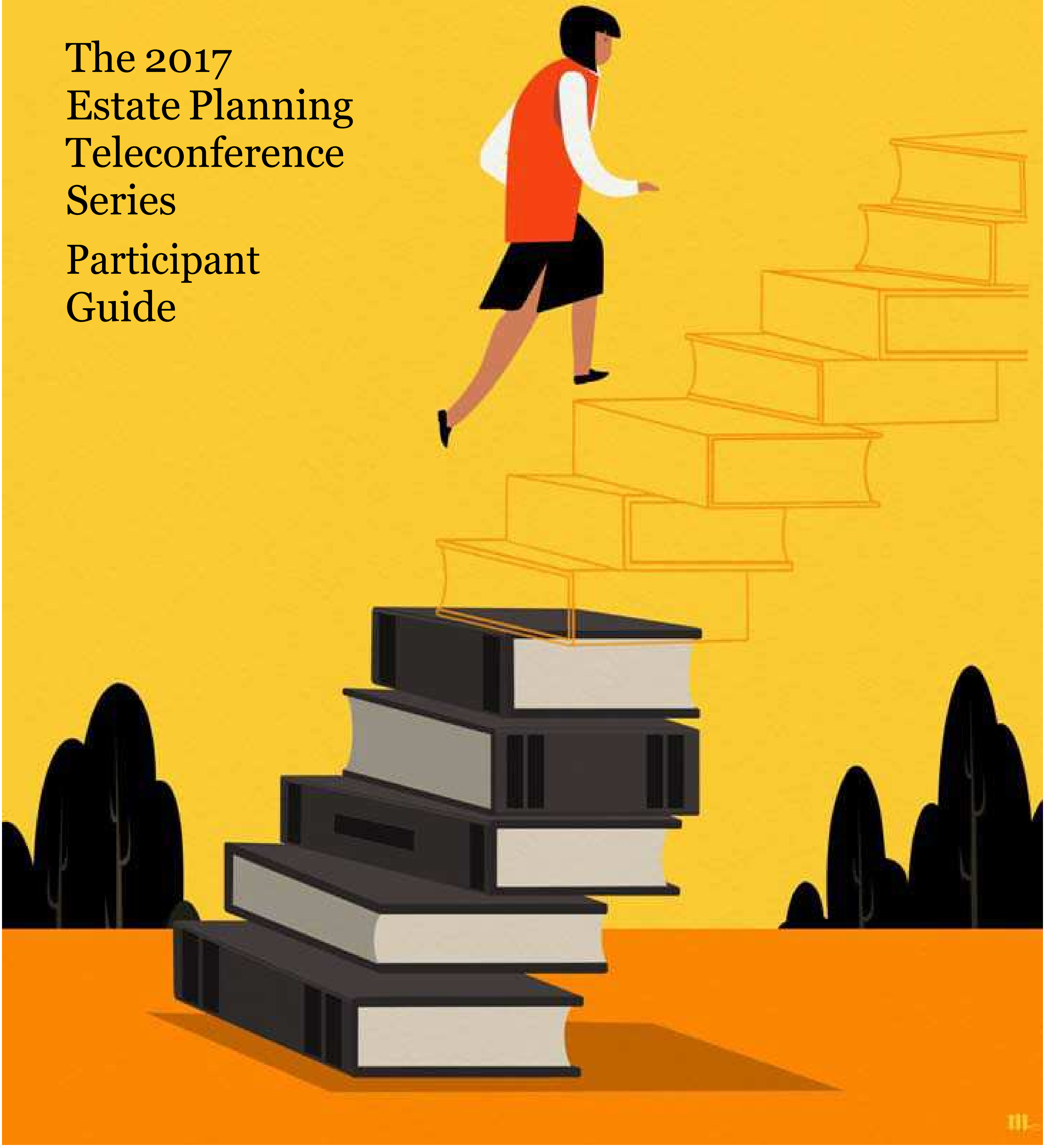

Elephant in the Room: Disposition of Qualified Plans and IRAs

Cannon Financial Institute, Inc.

Presents

The 2017 Estate Planning Teleconference Series

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By

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CHARLES A. REDD

CHARLES A. REDD is a partner in the St. Louis, Missouri, office of the law firm of STINSON LEONARD STREET LLP. Mr. Redd concentrates his practice in estate planning, estate and trust administration and estate and trust-related litigation. Prior to joining Stinson, Mr. Redd was a partner in and Vice Chairman of the Trusts & Estates Practice Group at the law firm of SNR Denton US LLP (now Dentons US LLP). Mr. Redd was also previously a partner in the law firm of Armstrong, Teasdale, Schlafly & Davis (now Armstrong Teasdale LLP) and was Chairman of that firm's Trusts & Estates Department. He was previously employed as a Trust Administrator by First Wisconsin Trust Company (now U.S. Bank, N.A.), Milwaukee, Wisconsin, and as an Assistant Counsel by Centerre Trust Company of St. Louis (now U.S. Trust, Bank of America Private Wealth Management).

Mr. Redd has extensive experience and expertise in: (a) the drafting of wills, trust instruments, durable powers of attorney, marital agreements and other estate planning documents; (b) pre- and post-death tax planning for individuals, trusts and estates; (c) preparation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (d) representation and filing of estate tax returns, gift tax returns and fiduciary income tax returns; (e) representation of individual and corporate fiduciaries and (f) litigation in the Probate Division and other equity divisions of the Circuit Court. Mr. Redd has worked on estates and estate planning projects, some involving assets valued at over a billion dollars, and has successfully handled numerous estate tax, gift tax and generation-skipping transfer tax matters, will and trust construction cases, will contests, contests of trust agreements, alleged breach of fiduciary duty cases and other types of cases involving estates and trusts.

Mr. Redd is a member of the State Bar of Wisconsin, The Missouri Bar (Probate and Trust Committee), the Illinois State Bar Association (Section on Trusts and Estates), The Bar Association of Metropolitan St. Louis (Probate and Trust Section, member and past chairman) and the Estate Planning Council of St. Louis.

Mr. Redd was Chairman of the Missouri Bar's Health Care Durable Power of Attorney Subcommittee, and he played a significant role in the drafting and enactment of the Missouri Durable Power of Attorney for Health Care Act. In 1991, Mr. Redd received The Missouri Bar President's Award.

Mr. Redd is an elected member of The American Law Institute, a Fellow of The American College of Trust and Estate Counsel (Missouri State Chair; Past Regent; Communications Committee (Chair); Estate and Gift Tax Committee; and Fiduciary Litigation Committee) and an Adjunct Professor of Law (Estate Planning) at Northwestern University School of Law. He also serves as Co-Chair of the Editorial Advisory Board of, and writes a regular column in, TRUSTS & ESTATES magazine. Mr. Redd is listed in The Best Lawyers in America and is nationally ranked by Chambers USA in its "Wealth Management" category. He frequently writes and lectures nationally on topics in the trusts and estates field.

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By Charles A. Redd
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1. See-Through Trusts

If a see-through trust (referred to as a "qualified trust" in the Treasury Regulations under Section 401(a)(9) of the Internal Revenue Code of 1986, as amended, (the "Code")) is named as a qualified plan or IRA beneficiary, the trust beneficiaries (not the trust itself) will be treated as having been designated as beneficiaries of the plan or IRA for purposes of IRC § 401(a)(9). Treas. Reg. § 1.401(a)(9)-4, Q&A-5. Only individuals may be designated beneficiaries. Treas. Reg. § 1.401(a)(9)-4, Q&A-3. If any trust beneficiary is not an individual, the qualified plan or IRA will be treated as having no designated beneficiary with the result that the entire plan or IRA balance must be distributed within five years of the employee's death (if death occurred before the employee's required beginning date; Treas. Reg. § 1.401(a)(9)-3, Q&A-1) or within the employee's remaining life expectancy (if death occurred on or after the employee's required beginning date ("RBD"); Treas. Reg. § 1.401(a)(9)-5, Q&A-5). *Id*.

The benefit of naming as beneficiary of a qualified plan or IRA a see-through trust whose only beneficiaries are individuals, as opposed to a trust with one or more beneficiaries who are not individuals and/or one that fails to satisfy the see-through trust requirements, is that the life expectancy of a trust beneficiary (albeit the one with the shortest life expectancy, *i.e.*, the oldest) is used to determine minimum required distributions ("MRDs") from the plan or IRA. Treas. Reg. § 1.401(a)(9)-4, Q&A-5. Thus, a see-through trust may reduce both the size of MRDs and, because of graduated income tax rates, the income tax imposed on them.

A "see-through trust" is a trust that meets the following requirements:

- The trust must be valid under local law.
- The trust must have identifiable beneficiaries. A class, such as descendants, may identify the beneficiaries; they do not need to be identified by name.
- The trust must be, or by its terms become, irrevocable on or before the participant's death.
- A copy of the trust instrument (and all subsequent amendments), or a list of all beneficiaries and a statement as to the circumstances under which they will take, must be provided to the plan administrator or Trustee by October 31 of the year after the year of the participant's death.

Which beneficiaries are considered for purposes of determining whether a trust has identifiable beneficiaries is not always clear. *Cf*. PLR 201320021 (disregarding certain remote beneficiaries) and PLR 200228025 (remainder beneficiary of trusts for grandchildren terminating on their 30th birthdays included). Steiner, "IRA Trust Takers After Beneficiaries Run Out Disregarded," *LISI Employee Benefits and Retirement Planning Newsletter* #625 (August 8, 2013), http://www.leimbergservices.com.

2. Conduit Trusts

A conduit trust is a see-through trust whose governing instrument provides that all MRDs and any other distributions from a qualified plan or IRA are to be distributed immediately to the current beneficiary of the trust. No subsequent beneficiaries are considered in calculating MRDs. *See* Treas. Reg. § 1.401(a)(9)-5, A-7(c)(3), Ex. 2. This is because no subsequent beneficiaries will ever receive MRDs. Thus, a conduit trust may reduce both the size of the required distributions (when compared to situations in which a trust is considered not to have any designated beneficiary) and the income tax rate imposed on them. A conduit trust, however, eliminates the Trustee's "control" over retirement plan distributions.

3. Accumulation Trusts

An accumulation trust is a trust that permits or directs the Trustee to accumulate distributions from an IRA or qualified plan. One main advantage of naming an accumulation trust as a beneficiary of an IRA or qualified plan is that some or all of the distributions from the plan may be retained inside the trust, and all of the funds from the plan not distributed out of the trust may pass to the next generation (potentially estate tax-free). This result may be especially desirable if the current trust beneficiary is not expected to consume all the MRDs that would be made to him or her during his or her life if an accumulation trust were not used.

An accumulation trust must be designed with care if income tax deferral is a primary objective. The practitioner must make sure that all of the trust beneficiaries (including any contingent beneficiaries) are eligible designated beneficiaries, Treas. Reg. § 1.401(a)(9)-4, Q&A-3, Q&A-5(c), so that the trust will qualify as a see-through trust. Treas. Reg. § 1.401(a)(9)-4, Q&A-5(b). Retained plan distributions are taxed at the trust's income tax rates.

This is a particularly difficult issue when designating a dynasty trust (or multi-generation-skipping transfer tax exempt trust) as the beneficiary of a qualified plan or IRA and aiming to qualify for a stretch distribution. Treas. Reg. § 1.401(a)(9)-4, Q&A-1, provides that the designated beneficiary need not be specified by name in the qualified plan or IRA or by the employee to qualify as a designated beneficiary so long as the individual who is to be the beneficiary is identifiable under the plan.

In determining the oldest living beneficiary to use as the measuring life, certain contingent beneficiaries are considered, but a successor beneficiary who merely takes as the successor of a prior beneficiary is not considered. Treas. Reg. § 1.401(a)(9)-5, Q&A 7(b)&(c).

The regulations do not indicate how many levels of contingent beneficiaries need to be considered in this context.

PLRs 200235038-41 offer one way of dealing with this problem. In these rulings, the participant designated his revocable trust as the beneficiary of his IRA and died after his RBD. The trust provided that a non-relative was to receive outright 25% of the trust property upon the participant's death. This distribution was satisfied by distributing 25% of the IRA to a separate IRA for the benefit of that non-relative. The remaining 75% of the trust was divided into equal trusts for the benefit of the participant's surviving children. Daughter A was the oldest.

Each child's trust provided that the child had a mandatory income interest and could receive discretionary principal distributions. Each child also had a broad special testamentary power of appointment. In addition, the child was prohibited from exercising that power in favor of a "Disqualified Appointee," which was defined as any person older than Daughter A, any person other than a trust or an individual or any trust that has or may have a beneficiary who is older than Daughter A. The IRS did not state what would happen to the property subject to the power of appointment if a child failed to exercise the power. The IRS ruled that the MRDs to each child's trust could be taken from the IRA based on the life expectancy of Daughter A, the oldest child of the participant.

B. Funding Marital Trusts

An owner of an IRA or a participant in a qualified plan may name a QTIP trust for the benefit of his or her spouse as the beneficiary of the IRA or qualified plan interest so as to gain more control over the ultimate disposition of the asset while still securing the estate tax marital deduction. The disadvantage of this approach is forfeiture of maximum income tax deferral. As discussed below, when a spouse is the direct or outright beneficiary of an IRA or qualified plan, he or she can often substantially delay the beginning of MRDs and reduce the amounts of such MRDs. A disposition to a trust for the spouse, on the other hand, does not have these advantages. The spousal rollover rules (discussed below) ordinarily do not apply. As discussed below, the Trustee would be required to distribute to the surviving spouse, at least annually, all of the net income of the trust, including any and all internally generated income inside the qualified plan or IRA.

In qualifying a qualified plan or IRA for the marital deduction, the primary concerns are meeting the "all income" requirement for QTIP trusts and avoiding the 50% tax on the failure fully to distribute a MRD. IRC § 4974(a). The IRS views the IRA or qualified plan itself as a trust that must separately qualify for the marital deduction. Thus, when preparing the United States Estate (and Generation-Skipping Transfer) Tax Return (Form 706), there must be an election to treat both the assets to be held directly in the QTIP trust and the separate retirement assets as QTIP. *See* Rev. Rul. 2006-26, 2006-22 I.R.B. 939.

It is, therefore, not enough simply to give the Trustee of the trust the ability to withdraw distributions from the qualified plan or IRA in excess of the MRD. Either the Trustee must be required to exercise that power so that all of the trust accounting income of the underlying plan is distributed to the trust, at least annually, or the spouse has to be given the right to do so, or to compel the Trustee to do so. Rev. Rul. 2000-2, 2000-1 C.B. 305. In addition, there must be a mechanism, either under the Will or trust instrument itself, under state law rules, or both, to guarantee that all of the trust accounting income that is distributed to the trust from the underlying qualified plan or IRA (or that the spouse can compel to be distributed) will be allocated to the income account and distributed to the spouse as income. If distributions to the trust from the qualified plan or IRA of income earned in the qualified plan or IRA are allocated to principal, marital deduction qualification is jeopardized. Finally, the surviving spouse must be able to compel the trustee to make the qualified plan or IRA assets income producing. *See* Rev. Rul. 2006-26, 2006-22 I.R.B. 939.

For qualified plans, the governing documents of the plan must be reviewed to ensure that there are no restrictions that would prevent qualification for the marital deduction. If there is an unavoidable restriction, the client may want to rollover the plan to an IRA.

C. Taking Maximum Advantage of Special Rules Only for Spouses

The surviving spouse has the right, under IRC § 402(c)(9), to rollover an eligible retirement plan of the predeceased spouse (such as qualified retirement plans, IRC § 403 annuities, simplified employee pension plans (also known as “SEPs”), governmental IRC § 457 plans and IRAs) to another eligible retirement plan or may treat an IRA of the predeceased spouse as the surviving spouse’s own IRA. Treas. Reg. § 1.408-2(b)(7)(II); -8, Q&A-5(a). Under either situation, distributions can be deferred until the surviving spouse reaches age 70½. IRC § 401(a)(9)(B)(iv)(I); Treas. Reg. § 1.401(a)(9)-3, Q&A-3(b). An IRA may receive a rollover distribution even if the surviving spouse is ineligible to make contributions to an IRA. Furthermore, the surviving spouse may also name a beneficiary for any remaining benefit at his or her death, regardless of whether the surviving spouse dies before or after his or her RBD. The surviving spouse may engage in this activity even if he or she has received distributions as a beneficiary after the participant’s death. Treas. Reg. § 1.408-8, Q&A-5 to Q&A-7.

Whenever the participant’s spouse is less than 10 years younger than the participant, there is a significant difference between the distribution period available to the surviving spouse if the surviving spouse rolls over an IRA or qualified plan (and is able to recommence the lifetime distribution period under the Uniform Lifetime Table under Treas. Reg. § 1.401(a)(9)-9, Q&A-2) and the life expectancy calculation (under IRC § 72), which is the distribution period available to the surviving spouse (whether or not the surviving spouse is less than 10 years younger than the participant) if he or she simply takes MRDs as a designated beneficiary after the participant’s death without implementing a rollover. The Uniform Lifetime Table is available to the participant or the surviving spouse and is based on the life expectancy of the designated beneficiary or the participant along with the life expectancy of a person 10 years younger.

Compare the distribution period, MRDs and the value of the IRA under the Uniform Lifetime Table for a person aged 70 - 75, with the life expectancy calculation of a person aged 70 - 75.

Uniform Lifetime Table Calculation				**Life Expectancy Calculation**			
Age	***Account Value***	***Distribution Factor***	***MRD***	***Age***	***Account Value***	***Distribution Factor***	***MRD***
70	100,000	27.4	3,650	***70***	100,000	17	5,882
71	96,350	26.5	3,636	***71***	94,118	16.3	5,774
72	92,714	25.6	3,622	***72***	88,344	15.5	5,700
73	89,092	24.7	3,607	***73***	82,644	14.8	5,584
74	85,485	23.8	3,592	***74***	77,060	14.1	5,465
75	81,893	22.9	3,576	***75***	71,595	13.4	5,343
Total Distributions			***21,683***				***33,748***
Balance in Account	***78,317***				***66,252***		
			Percent Difference from Uniform Table		***(15.4%)***		***64.2%***

As can be seen, when distributions are based on the Uniform Lifetime Table, a larger balance is left to the ultimate beneficiaries, such as children or charities. The results are far more dramatic when one takes into consideration account earnings, which compound tax-free within the IRA or qualified plan. Thus, the Uniform Lifetime Table will be preferable as long as the surviving spouse will not need additional distributions for his or her support.

D. IRS Denies Rollover Treatment for Spouse's Community Property Interest PLR 201623001 (March 3, 2016)

This PLR illustrates an insidious difficulty for practitioners in community property states in transferring a surviving spouse's community property interest in a deceased spouse's IRA to the surviving spouse without incurring income taxes on the transfer. Choate, "Community Property Claim on Death, Another Point of View," *LISI Employee Benefits & Retirement Planning Newsletter* #660 (July 18, 2016), http://www.leimbergservices.com. Decedent and Taxpayer A were married and lived in a community property state. Taxpayer B was the child of Decedent and Taxpayer A. Taxpayer B was the sole beneficiary of his three IRAs. Following Decedent's death, Taxpayer A filed a claim against Decedent's estate for her one-half interest in the community property owned by her and the Decedent. A settlement was negotiated between Decedent's estate and Taxpayer A, and the court subsequently ordered the custodian of the IRAs to assign the surviving spouse's interest from Taxpayer B's inherited IRAs to Taxpayer A as a "spousal rollover IRA." The parties requested a ruling that the court-ordered distribution from the inherited IRAs for Taxpayer B to Taxpayer A would be considered a tax-free rollover. The IRS reasoned that because Taxpayer A was not a named beneficiary of Decedent's IRA, Taxpayer A may not be treated as a payee of the inherited IRA, regardless of the applicable community property laws. IRC § 408(g). Therefore, any "assignment" of an interest in the inherited IRAs to Taxpayer A is treated as a taxable distribution to Taxpayer B, regardless of who actually received the funds.

E. IRS Provides Guidance Concerning the 60-Day Rollover Requirement
Rev. Proc. 2016-47, 2016–37 I.R.B. 346 (September 12, 2016)

The IRS has provided a self-certification procedure to assist recipients of retirement plan distributions who have missed the 60-day deadline for rolling over distributions to another IRA or qualified plan. IRC §§ 402(c); 408(d)(3). The IRS can waive the 60-day limit if the failure to make such a waiver would be "against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement." IRC §§ 402(c)(3)(B); 408(d)(3)(I). The IRS first provided guidance regarding this waiver in Rev. Proc. 2003-16, 2003-4 I.R.B. 359, where the IRS listed the types of circumstances for which it would grant a waiver upon receiving a private letter ruling request. Rev. Proc. 2016-47 modifies Rev. Proc. 2003-16 and lists 11 different circumstances in which the self-certification procedure for granting a waiver of the 60-day time limit may apply. The Revenue Procedure also includes a sample self-certification letter for taxpayers to notify the administrator of the IRA or qualified plan receiving the rollover that the distribution qualifies for the waiver.

To qualify for the waiver, a taxpayer who missed the deadline must show that the requirements for one or more of the 11 circumstances have been met. These circumstances include: (1) showing that a distribution check was misplaced and never cashed; (2) the taxpayer's principal residence was severely damaged; (3) a family member died; (4) the taxpayer or a family member was seriously ill; or (5) an error was committed by the financial institution receiving the rollover contribution. These circumstances are similar to the typical situations for which the IRS regularly granted a waiver in its private letter rulings issued since Rev. Proc. 2003-16.

Once the circumstances that prevented the waiver have been resolved, the taxpayer has 30 days to complete the rollover. The taxpayer must give the completed self-certification document to the administrator of the IRA or qualified plan that received the rolled over funds.

F. Avoiding Penalties Applicable to Qualified Plans and IRAs

1. Early Distributions

In general, if a participant, IRA owner or beneficiary receives a distribution from a qualified plan or IRA before reaching 59½ years of age, a 10% additional tax will be imposed on the amount included in gross income unless the distribution meets the requirements for a statutory exception. IRC § 72(t).

If a distribution is "made to a beneficiary (or to the estate of the employee) on or after the death of the employee," the distribution will not be subject to the 10% additional tax. IRC § 72(t)(2)(A)(ii). A beneficiary will not meet this exception if the beneficiary rolls over the funds from the deceased spouse's qualified plan or IRA into his or her own qualified plan or IRA and thereafter withdraws funds from his or her qualified plan or IRA. *See Ozimkoski v. Commissioner*, T.C. Memo. 2016-228; *Sears v. Commissioner*, T.C. Memo. 2010-146; *Gee v. Commissioner*, 127 T.C. 1 (2006). Thus, if the surviving spouse is under age 59½, treating an IRA or qualified plan as his or her own or rolling over his or her interest may not be an appropriate option if the surviving spouse needs any of the funds in the IRA or qualified plan for the surviving spouse's support before reaching that age. One strategy for taking advantage of rollover opportunities for the younger surviving spouse is to keep in the decedent's IRA or qualified plan only that amount of property needed to provide for the surviving spouse's support before he or she reaches age 59½ and to distribute that portion of the IRA or qualified plan to the surviving spouse in a manner that satisfies the applicable post-death MRD rules and meets the surviving spouse's support needs. The surviving spouse can then rollover the balance of the IRA or qualified plan.

Another exception for the 10% additional tax applies to distributions made as part of a series of substantially equal periodic payments (at least annually) for the participant or owner's life or life expectancy, or the joint lives (or joint life expectancies) of the participant or owner and the designated beneficiary. If from an employer plan, distributions must begin after separation from service. IRC § 72(t)(2)(A)(iv). The downside of this strategy is that the recipient's ability to change the amount of distributions during the rest of his or her life is limited. *See* Rev. Rul. 2002-62, 2002-42 I.R.B. 710.

There are several other exceptions to this penalty under IRC § 72(t). Some of the more common exceptions include the following:

- Distributions due to total and permanent disability. IRC § 72(t)(2)(A)(iii).
- IRA distributions made for qualified higher education expenses. IRC § 72(t)(2)(E).
- IRA distributions up to $10,000 for the purpose of purchasing a first home. IRC § 72(t)(2)(F).
- Any distribution (except distributions from an IRA) to an alternate payee pursuant to a qualified domestic relations order. IRC § 72(t)(2)(C), (t)(3)(A).
- Distributions from a qualified plan (not an IRA) that the participant receives after separation from service if the separation occurs in or after the year in which the participant reaches 55 years of age (50 for public service employees). IRC § 72(t)(2)(A)(v), (t)(3)(A), (t)(10).

The latest Priority Guidance Plan states that the IRS is considering or soon will be considering "[r]egulations on exceptions to additional tax under § 72(t) on early distributions from retirement plans and IRAs." Dept. of the Treasury, "Joint Treasury, IRS 2016-2017 Priority Guidance Plan," (August 15, 2016), First Quarter Update (October 31, 2016).

2. Failure to Take a Minimum Required Distribution

If the full amount of a MRD is not made in any year, or no distribution is made at all, IRC § 4974(a) imposes a penalty on the person who would have been the recipient of the distribution equal to 50% of the amount that was supposed to be distributed but was not. Treas. Reg. § 54.4974-1. *See* Natalie B. Choate, *Life & Death Planning for Retirement Benefits*, http://www.retirementbenefitsplanning.com. The individual who has failed to take an MRD, or the full amount of the MRD, must file Form 5329, Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts, with such individual's income tax return for the year at issue.

If a Form 5329 is filed, the IRS generally has three years from the date of filing to assess the penalty. IRC § 6501(a). Thus, recipients of MRDs should consider filing Form 5329 each year regardless of whether such recipients believe that the full MRD may not have been distributed. *See* Choate, *supra*.

The IRS is able to grant a waiver of the penalty. IRC § 4974(d) provides that the penalty may be waived if the payee "establishes to the satisfaction of the Commissioner" that "(1) the shortfall . . . in the amount distributed during any taxable year was due to reasonable error; and (2) reasonable steps are being taken to remedy the shortfall." Treas. Reg. § 54.4974-2, A-7(a). The request for a waiver is made on Form 5329. The taxpayer does not have to pay the penalty as a condition to requesting the waiver. *See* Choate, *supra*.

3. Excess Contributions

The IRC imposes an additional tax for contributions made by a taxpayer to a traditional or Roth IRA in any year that is in excess of the limit imposed on such taxpayer for deductible contributions. The tax is equal to six percent of the amount of the excess contributions to such individual's accounts. IRC § 4973(a) (listing other accounts and annuities that are subject to this additional tax as well); Notice 2016-62, 2016-46 I.R.B. 725 (limits on deductible contributions for 2017). "Contributions" for purposes of this tax does not include rollover contributions.

A taxpayer can withdraw some or all of the taxpayer's excess contributions for a year and such contributions will be treated as not having been contributed if: (a) the taxpayer makes the withdrawal by the due date, including extensions, of the tax return for the year at issue; (b) the taxpayer does not claim a traditional IRA deduction for the withdrawn contributions; and (c) the taxpayer withdraws any earnings on the withdrawn contributions and includes the earnings in gross income. IRC §§ 408(d)(4); 4973(b)&(f). If not withdrawn, the IRA owner can treat the excess contributions as an additional IRA contribution for a later year if the IRA owner does not contribute the maximum amount for that later year. This carryforward is automatic even if the IRA owner does not claim the carryforward amount as an IRA contribution. The additional tax will continue to apply for each year that the excess contribution is not withdrawn or the carryforward amount exceeds the deductible amount. IRC § 219(f)(6); Kennedy, 367-2nd T.M., IRAs.

4. Prohibited Transactions

a. <u>Introduction</u>. The Internal Revenue Code and ERISA contain broad prohibitions against transactions with an IRA (as well as many other retirement assets (IRC § 4975(e)(1)) that give rise to any risk of self-dealing between the "plan" and a fiduciary or another "disqualified person." IRC § 4975; ERISA § 408(a)&(b) (29 U.S.C. § 1106(a)&(b)). A prohibited transaction may give rise to excise taxes, income taxes and disqualification of the IRA. Kennedy, *supra*. The Internal Revenue Code and ERISA consider the following transactions to be prohibited transactions:

- Sale or exchange, or leasing, of any property between a plan and a disqualified person, which includes using IRA assets as security for a loan.
- Lending of money or other extension of credit between a plan and a disqualified person.
- Furnishing of goods, services or facilities between a plan and a disqualified person.
- Transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan.
- An act by a disqualified person who is a fiduciary whereby the fiduciary deals with the income or assets of a plan in the fiduciary's own interests or for the fiduciary's own account.
- Receipt of any consideration for the disqualified person's own personal account when such disqualified person is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

IRC § 4975(c)(1); Kennedy, *supra*. Whether the IRA benefited from the prohibited transaction or the intent of the parties involved is irrelevant. The disqualified person has the burden of proving that no prohibited transaction occurred. *Rollins v. Commissioner*, T.C. Memo. 2004-260; Choate, Hoyt & Sherby, "For Estate Planners: Hot Topics in Employee Benefits," ALI-CLE (November 6, 2013).

The IRA owner, beneficiaries, trustee, custodian and other persons providing services to the plan are included in the definition of a "disqualified person" as well as the members of the family of any such party. IRC § 4975(e)(2). A fiduciary of an IRA may not enter into a prohibited transaction with anyone, and not just a disqualified person, if the fiduciary's "best judgment" may be affected. Treas. Reg. § 54.4975-6(a)(5)(i).

b. <u>Prohibited Transaction Examples</u>. The prohibited transaction rules prohibit an IRA owner from directing IRA funds to be invested in notes being offered by a corporation when relatives of the IRA owner are the majority owners and stockholders. Department of Labor ("DOL") Adv. Op. 2005-09A; Kennedy, *supra.*

A lease between an LLC and S corporation where (1) the IRA invested funds into the LLC and became a member and (2) the S Corporation was controlled by the IRA owner and his wife constituted a prohibited transaction. DOL Adv. Op. 2006-01A; Choate, Hoyt & Sherby, *supra*.

Prohibited transactions include transferring encumbered property from the IRA owner to the IRA, which is considered a sale or exchange. IRC § 4975(f)(3).

c. **<u>Effects of Prohibited Transaction</u>**. Engaging in a prohibited transaction results in the disqualification of the IRA. The IRA's earnings lose their tax exempt status retroactive to the first day of the taxable year in which the prohibited transaction occurs. In addition, the IRA is considered to have made a constructive distribution of the fair market value of the account as of the first day of such year, subjecting the entire account to income tax. IRC § 408(e)(2); Treas. Reg. § 1.408-1(c)(2)(i). If the IRA owner is under 59½, the distribution will result in a 10% early distribution penalty. Choate, Hoyt & Sherby, *supra*.

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Elephant in the Room: Disposition of Qualified Plans and IRAs

January 24, 2017

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  Cannon is designated as a qualified education sponsor by the IRS and can offer continuing education credit to Enrolled Agents. Cannon's agreement with the IRS' Office of Professional Responsibility does not constitute an endorsement by the IRS as to the quality of the programs or their contribution to the professional competence of the enrolled individual.
  Course # (VRUGV-T-00067-16-O)
- **Certified Financial Planner (CFP™)** — **1.5 credit hours**
  Course #234348
- **Accredited Fiduciary Investment Manager (AFIM™)** — **1.5 credit hours**
- **Certified Wealth Strategists (CWS®)** — **2.0 credit hours**
- **Certified Investment Management Analyst (CIMA®)** — **Pending**
  Course # **TBD**
  If you hold the CIMA®, CIMC® or CPWA® certification, you may report this pre-accepted CE program online by logging into your My IMCA account at www.imca.org/user
- **Certified Trust Financial Advisor (CTFA™)** — **2.0 credit hours**
- **Certified IRA Services Professional (CISP™)** — **2.0 credit hours**
- **Certified Retirement Services Professional (CRSP)** — **2.0 credit hours**
- **Chartered Life Underwriter & Chartered Financial Consultant** — **1.5 credit hours**
  (**No Individual State Insurance Credit Available)
- **Fiduciary Investment Risk Management Association (FIRMA®)** — **2.0 credit hours**

Any questions regarding CE credit, please contact Laurie Frye at (706) 353-3346.
Fax (706) 353-3994, Email lfrye@CannonFinancial.com
PO Box 6447, Athens, Georgia 30604

CANNON

FINANCIAL INSTITUTE

Certificate of Attendance

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(Participant Name)

____

(Attorney Bar # or Social Security #)

Has successfully completed the Cannon Financial Institute, Inc. course:

Elephant in the Room: Disposition of Qualified Plans and IRAs

January 24, 2017

CANNON FINANCIAL INSTITUTE, INC. CORPORATE SEAL GEORGIA

Laurie Frye
Laurie Frye
Professional Education Coordinator

Continuing Legal Education Credits for this course are as follows:

The following states have been approved for 1.5 hours of General Credit: (Course number is indicated in parenthesis):Alabama, Arkansas (TAX56358), California, Delaware, Georgia, Idaho, Illinois, Iowa (248537), Kentucky (172704), Louisiana, Maine (042560), Mississippi, Montana (15207), Nebraska(134412), New Mexico, New York, North Carolina, North Dakota, Pennsylvania, South Carolina, Tennessee (Distance Ed), Texas(901367121), Utah , Vermont, Virginia, Washington, Wisconsin, & Wyoming.
These states have been approved for the following General Credit: Colorado – 2 hours, Florida - 2 hours (1608826N), Missouri –1.8 hours, Oklahoma – 2 hours, West Virginia – 1.8 hours
The following states are pending credit: Minnesota, Nevada, and Oregon

The following states either do not require/do not accept outside CLE Credit/or do not accept teleconference calls for CLE Credit: District of Columbia, Hawaii, Maryland, Massachusetts, Michigan & South Dakota
The following states have special circumstances:
Alaska-Attorneys can use this certificate to submit to Alaska State Bar
Arizona-On honor system
Indiana & Ohio-Site Coordinators must apply for credit as the sponsor in order for participants to receive credit
Kansas–Attorney or Site may apply 30 days prior to program
New Hampshire- *NHMCLE does not approve or accredit CLE activities for the NH Minimum CLE requirement. NH attendees must self-determine whether a program is eligible for credit and self-report their attendance.*
New Jersey-Attorneys can use this certificate to submit to New Jersey State Bar for 1.5 General credits (Reciprocity Rule)
New York–Attorneys may use this certificate to report their attendance as it is accredited by Approved NY Jurisdictions: AL, AR, CO, DE, GA, KY, LA, MS, NM, NC, ND, OK,. Type of credit: Areas of Professional Practice, 1.5 Credits
* In order for PA attorneys to receive credit they must listen to the teleconference in a live classroom setting. The teleconference site must also be listed on the PACLE website and the site must be open to any PA attorney who desires to listen to the program. Call PACLE at 1-800-497-2253 with questions on website listing.

****As required by the following State Bars, and in order to obtain CLE in these states, Cannon will submit the mandatory attendance rosters for the attorneys seeking CLE credits **ONLY** in the following states: Alabama, Delaware, Georgia, Idaho, Louisiana, Montana, Nebraska, Nevada, New Mexico, North Carolina, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Texas, Utah, West Virginia and Washington. ****

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