IRA HORROR STORIES:
THE 60 DAY REQUIREMENT

presented by:

J. Scott Dillon

Carruthers & Roth, P.A.

Phone: 336-478-1119

Email: jsd@crlaw.com

C|R
CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Some Basic IRA Rules

- Individuals generally can make contributions to IRAs up to $5,000/yr ($6,000 if eligible for catch up). IRC 219(b).
- IRA contributions must be made in cash – not in non-cash assets. IRC 219(e).
- IRA distributions before age 59-1/2 are subject to 10% penalty tax, subject to certain exceptions. IRC 72(t).

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Some Basic IRA Rules

- Contributions (excess or otherwise) withdrawn with allocable income on or before due date of tax return for year made treated as never being contributed and not included in income or subject to 10% premature distribution tax (but allocable income is taxed). IRC 408(d)(4).
- Excess contributions withdrawn after this date subject to 6% excise tax each year until withdrawn. IRC 4973.

Some Basic IRA Rules

- Distributions from IRA can be rolled over to same IRA, another IRA, or qualified plan that accepts rollovers within 60 days from date distributed. IRC 408(d)(3)(A).
- Only one IRA rollover per year is permitted. IRC 408(d)(3)(B).
  - Except where IRA holds only rolled over qualified plan money. IRC 408(d)(3)(A)(ii).

C|R
CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Some Basic IRA Rules

- To qualify for rollover treatment, taxpayer must rollover same cash or property received in distribution. *Lemishow v. Comm'r*, 110 T.C. 110 (1998); Rev. Rul. 87-77.
- However, if distributed property is sold, taxpayer may rollover proceeds from sale. *Id*.

Carruthers & Roth, PA
Attorneys at Law

Some Basic IRA Rules

- Attempted rollovers to IRAs that are ineligible for rollover constitute contributions and are subject to excess contributions excise tax until removed.
  - *Martin v. Comm’r*, TC Memo 1993-399
  - *Michel v. Comm’r*, TC Memo 1989-670

Some Basic IRA Rules

- IRAs are subject to prohibited transaction rules under IRC 4975, which precludes:
  - Sale, exchange, or leasing of property between IRA and disqualified person (DQP).
  - Lending of money or other extension of credit between IRA and DQP.
  - Furnishing of goods, services, or facilities between IRA and DQP.
  - Transfer to or use by DQP of income or assets of IRA (other than distributions).
  - Indirect use of IRA income or assets for benefit of DQP.
  - Other transaction in which IRA owner has conflict of interest.
- If IRA engages in prohibited transaction, IRA is disqualified and deemed to be distributed. IRC 408(e)(2).

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Some Basic IRA Rules

- IRAs can be invested in most types of assets, including real estate, mortgage notes, unsecured notes, and privately-held stock.
- But IRAs cannot be invested in:
  - Collectibles.   IRC 408(m).
  - Life insurance contracts. IRC 408(a)(3).
  - S corporation stock. IRC1361(b)(1).

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Some Basic IRA Rules

- By setting up self-directed IRA with custodian that permits self-directed investments, IRA owners (even physicians) can direct their IRA money into qualifying assets.
- Self-directed IRAs + physicians = TROUBLE

Real life example

- Dr. T, age 59.0, had $1.5 million IRA with Schwab.
- Had chance to invest $150K in IPO. On 9/1/10, directed Schwab to do so thru IRA.
- Schwab wired $150K to transfer agent for IPO but treated as taxable distribution to Dr. T.
- Within 60 days, Schwab then posted IPO stock to IRA as rollover. At that time, stock valued at $450K!
- On 4/1/11, CPA discovered error.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Example

- To fix error, Schwab treated $450K as ineligible rollover/excess contribution.
- To correct error, Schwab distributed $500K cash to Dr. T ($450K excess contribution plus $50K pro rata earnings). IPO stock remained in IRA.
- Dr. T happy because received $500K cash from IRA at tax cost of $95K! Paid down debt on lake house.
    - 40% X $150K distribution
    - 10% penalty X $150K distribution
    - 40% X $50K distributed earnings
    - No tax on return of excess contribution

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Waiver of 60-day Requirement

- Distributions from IRA can be rolled over to same IRA, another IRA, or qualified plan that accepts rollovers within 60 days from date distributed. IRC 408(d)(3)(A).
- Under Section 408(d)(3)(I) (added by EGTRRA in 2001), IRS may waive 60-day requirement if failure to do so would be against equity and good conscience.
- Code specifically lists casualty, disaster, and events beyond reasonable control of taxpayer.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Step 1 – Is it a rollover?

- If deposit didn't occur within 60 days, first determine if payment was trustee-to-trustee transfer (i.e., "direct rollover") rather than a distribution to taxpayer.
- PLR 201005057 – taxpayer elected direct rollover from Plan X and received check made out to Plan Y fbo taxpayer. Taxpayer held check for more than 60 days. Applied to IRS for waiver of 60-day rule. IRS said 60-day rule didn't apply, since check not made out to taxpayer.
  - 1099-R reported payment as direct rollover with no withholding – Code G, Box 7.

Carruthers & Roth, PA
ATTORNEYS AT LAW

Step 2 – Is automatic waiver available?

- Rev. Proc. 2003-16 – Automatic waiver allowed without IRS ruling if:
  - Financial institution receives funds before end of 60-day period.
  - Taxpayer followed procedures for rollover and gave instructions to rollover to IRA.
  - Funds not deposited into IRA solely due to error of financial institution.
  - Funds deposited into IRA within 1 year from date distributed.

Step 3 – Does it make sense to request a waiver?

- Rev. Proc. 2003-16 – IRS will issue ruling waiving 60-day requirement for good cause based on facts and circumstances, including:
  - Whether error caused by financial institution.
  - Whether taxpayer didn't complete rollover due to death, disability, hospitalization, incarceration, postal error, or restrictions imposed by foreign country.
  - Whether taxpayer used amount distributed.
  - How much time has passed.

Step 3 – Does it make sense to request a waiver?

- IRS has been lenient in granting waivers. Out of 1,000 requested, only few dozen rulings have denied taxpayers' requests.
- Still, cost of requesting PLR is significant.
  - Rev. Proc. 2011-1
  - Cost of preparing application.
  - User Fee:
    - $625 for person with gross income under $250K
    - $2,100 for person with gross income between $250K and $1M.

C R
CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Situations in which waiver request may be granted or denied

- Tax shock – taxpayer did not understand tax consequences.
- Ignorance of tax law.
- Advice of others.
- Using IRA distribution for short-term loan.
- Forgetfulness.
- Lack of awareness of IRA distribution.
- Medical condition of taxpayer or loved one.
- Error of financial institution.

Carruthers & Roth, PA
ATTORNEYS AT LAW

Tax shock ☹

- PLR 200508027 – IRS denied waiver where taxpayer signed withdrawal form acknowledging taxability of distribution and requested 20% withholding, but decided to rollover after tax preparer advised her of additional taxes she owed.

- PLR 200548030 – IRS denied waiver where taxpayer withdrew IRA due to losses being incurred and bought motorcycle instead, but decided to roll over after being informed of tax consequences.

- PLR 200707157 – waiver denied where taxpayer said banker gave her incorrect info regarding taxation, even though she had signed form clearly stating proceeds were taxable. IRS determined she decided to roll over only after she realized extent of taxes due.

C|R
CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Ignorance of tax laws ☹

- PLR 200422058 – taxpayer withdrew funds from 3 IRAs so he could use the gains to offset losses from other investments. He decided to roll over after learning gains inside IRA would not offset losses. IRS denied waiver request since he never intended to roll over and failed to seek tax advice.

- PLR 200643006 – IRS denied waiver where taxpayer withdrew IRA and deposited in non-IRA CDs. Taxpayer was not aware this was taxable event until tax returns were prepared. IRS said ignorance of tax law is no excuse, and it was not financial institution's responsibility to ensure that taxpayer understood the rules.

- PLR 200634073 – taxpayer thought he had 90 days to complete rollover and didn't learn otherwise until 60 days had passed. IRS denied waiver, stating that misunderstanding of tax law was not sufficient basis.

- PLR 200634056 – taxpayer misunderstood tax rules for mandatory distributions at age 70-1/2. IRS denied waiver, finding that taxpayer did not understand distribution was taxable and only sought to roll over after realizing tax implications.

Advice of others

- Improper advice from financial institution is proper reason to request waiver of 60-day requirement. Rev. Proc. 2003-16. ☺
- Several rulings held that bad advice from financial or human resource representatives justified waiver. PLRs 200650024, 200647031, 200704040. ☺
- PLR 200452042 – taxpayer's divorce attorney advised her to withdraw IRA to pay legal fees. Taxpayer stated she had no knowledge or experience with finances, investments, or taxes and relied on attorney. IRS denied waiver because she used funds to pay personal obligations and had no intent of rolling over at time of distribution. ☹
- PLR 200721023 – IRS denied waiver after taxpayer's friend told him he could take tax-free distributions after age 59-1/2. Funds used to pay personal debts. Advice of friend was not sufficient basis to justify waiver. ☹

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Advice of others

- PLR 2007050034 – taxpayer needed IRA funds to buy stock in employer's company that was going through hardship. CPA's associate advised him only option was to withdraw and pay taxes. Taxpayer later learned IRA could invest in stock directly as self-directed investment. IRS denied waiver since taxpayer understood tax effects and intent was to invest in stock rather than roll over. ☹
  - IRS will not allow taxpayer to change structure of transaction once he discovers different structure would have saved taxes.
- PLR 201122032 – former employee rolled funds from plan over to IRA, but then attempted to roll back into plan after plan administrator advised this was permissible. After 60 days, rollover back into plan denied since employee no longer participant in plan. IRS granted waiver and allowed taxpayer to put back in IRA, based on faulty advice. ☺

Carruthers & Roth, PA
ATTORNEYS AT LAW

Using IRA distribution for short-term loan ☹

- Taxpayer can receive IRA distribution and, within 60 days, roll back into <u>same</u> IRA, resulting in short-term loan.
- Taxpayer may need money for some other purpose and expect to be able to pay back within 60 days.
- If taxpayer's plans fall through and can't come up with money to complete the rollover, IRS has routinely denied waiver of 60-day period, even if circumstances are beyond taxpayer's control.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Using IRA distribution for short-term loan ☹

- PLR 200504037 – taxpayer withdrew IRA funds to <u>cover daughter's tuition</u>, expecting to pay back when student aid check came in. Promised aid was late, outside of 60-day window. IRS denied waiver.

- PLR 201118025 – taxpayer withdrew IRA to <u>purchase residence</u>, intending to receive <u>reverse mortgage</u> and roll funds back into IRA after bank made assurances as to timing. Bank's "<u>numerous and unreasonable processing delays</u>" resulted in receipt of mortgage proceeds after 60-day period expired. IRS refused to grant waiver, noting that bank's error did not relate to its administration of IRA. Taxpayer assumed risk of late payment.

- PLR 200637034 - taxpayer <u>owed back taxes and penalties</u> and was hoping for <u>second mortgage</u> to pay. Pending approval, withdrew IRA to pay taxes. When second mortgage denied, sold other property to pay back IRA, but sale occurred outside of 60-day window. IRS denied waiver, saying it was not intent of Congress to allow interest free, short-term IRA loans.

C|R

CARRUTHERS & ROTH, PA

ATTORNEYS AT LAW

Using IRA distribution for short-term loan ☹

- IRS takes similar position in cases involving unemployed workers.
  - PLR 200417033 – unemployed worker took IRA withdrawals to pay living expenses, including child's tuition. Intended to repay when reemployed. Found job after 60-days expired. IRS denied waiver.
  - PLR 200436018 – unemployed worker unable to make house payments and car was repossessed. Received IRA distributions to make ends meet. Applied for several loans to replenish IRA but was denied. Mother then took out loan so he could repay IRA, but it closed after 60-day period. IRS denied waiver.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Forgetfulness ☹

- PLR 200602051 – taxpayer withdrew funds to explore different investment opportunities. He failed to make note of the date and held distribution check until after 60 days expired. He then decided to forego investments and put funds back in IRA. Waiver denied.

- PLR 200518087 – taxpayer withdrew funds from IRA to fix up home prior to sale. Left check in drawer beyond 60 days. Ended up not using money to fix up home, and requested waiver to put back in IRA. Waiver denied. Taxpayer alleged home was making her sick, but IRS didn't agree illness warranted waiver.

- PLR 201003030 – IRS denied waiver where taxpayer cashed in annuity that he didn't remember was an IRA annuity and didn't discover until after 60 days had run.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Lack of awareness of distribution ☺

- PLR 201106025 – taxpayer had self-directed IRA invested in LLC interest; LLC owned real estate. Taxpayer had financial problems and didn't pay IRA custodian's fee. Custodian terminated IRA and sent taxpayer the LLC certificate. Taxpayer didn't receive until more than 60 days after date distributed. IRS waived late rollover, due to statement by taxpayer that she was unaware of distribution.

- PLR 201015040 – while taxpayer was in hospital, he asked his agent under power of attorney to cash out an account. The agent cashed out his IRA instead, and taxpayer didn't discover until after 60-day period expired. IRS allowed waiver.

C|R
CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Medical condition of taxpayer or loved one

- IRS routinely waives 60-day period where delay caused by death or serious illness/injury to taxpayer or close family member. ☺
  - PLR 200716028 – mother became ill and died and taxpayer engrossed in family affairs.
  - PLR 200614028 – daughter underwent surgery and hospitalization during 60-day period.
  - PLR 201141022 – elderly taxpayer having trouble with memory and handling affairs.
  - PLR 201051026 – taxpayer's spouse died suddenly and taxpayer engrossed in funeral and estate matters.
- But, waiver not allowed due to delay caused by death of close friend where death occurred 45 days after date of withdrawal. ☹ PLR 200703045

C|R
CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Medical condition of taxpayer or loved one

- Taxpayer must provided adequate documentation of medical condition to obtain waiver.
  - PLR 200719016 – taxpayer claimed he missed 60-day deadline due to mental problems caused by stroke 2 years earlier. IRS denied waiver on basis that no medical documentation was submitted supporting a disability making him incapable of handling his affairs within 60-day period. ☹

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Error of financial institution ☺

- Automatic waiver not applicable if funds aren't delivered to financial institution within 60-day period.
- But, IRS routinely waives 60-day period when delay caused by error or bad advice of financial institution.
  - PLR 201145029 - taxpayer called financial firm's hotline and was told rollover had to occur by end of calendar year, even though 60-day period not expired. Taxpayer thought she was too late and let 60-day period expire. IRA granted waiver due to improper advice.
  - PLR 201144039 – taxpayer received plan distribution and sought to roll over to new IRA. Investment firm mistakenly set up non-IRA investment account and deposited money there. Taxpayer didn't learn of error until 2 years later. IRS granted waiver and permitted taxpayer to roll over following discovery of error.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Error of financial institution ☹

- However, taxpayer must establish to IRS that financial institution in fact was at fault.
  - PLR 201034025 - taxpayer alleged that financial institution failed to deposit distribution into another IRA as requested. IRS denied waiver, stating that he failed to provide either (1) "contemporaneous written document (such as an application form or letter)" establishing that he applied to firm for establishment of rollover IRA, or (2) written statement from firm that it had erred in placing distribution in nonqualified account.
  - PLR 201029021 – taxpayer engaged in on-line transaction directing IRA trustee-to-trustee transfer to new account at different financial institution he also set up on-line. He thought new account was IRA also, but he fouled up on-line registration and created non-IRA account instead. Taxpayer alleged internal systems of financial institutions should have caught error. IRS refused to grant waiver, since taxpayer created problem himself and failed to show fault on part of financial institutions.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW

Conclusion

- In most cases where failure to meet 60-day rollover requirement outside of taxpayer's control, IRS has shown leniency and granted waiver.
- Important to analyze likelihood of success of PLR request.
  - If taxpayer accessed IRA for 60 day loan and couldn't repay, waiver unlikely.
  - If taxpayer simply ignorant of tax laws, waiver unlikely.
- In most cases, cost of preparing and filing PLR request is relatively cheap insurance in light of protection afforded.

CARRUTHERS & ROTH, PA
ATTORNEYS AT LAW