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Planning for Retirement Benefits: Recent Developments and Current Trends

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This Seminar Handout discusses some recent developments in the area of estate and distribution planning for retirement benefits. Background necessary to understand each development is briefly summarized in some cases. More detail regarding the underlying subject matter can be found in the authorities cited, or in the referenced section of the author's book *Life and Death Planning for Retirement Benefits,* available as a paperback bound book (7th ed., 2011; www.ataxplan.com) or in a web-based electronic edition by subscription at www.retirementbenefitsplanning.com.

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Abbreviations Used in this Seminar Handout

§ Refers to a section of the Code, unless otherwise indicated.

¶ Refers to a section of the author's book *Life and Death Planning for Retirement Benefits* (7th ed., 2011; Ataxplan Publications), which can be purchased (bound version) for $89.95 plus shipping through www.ataxplan.com, through Amazon.com, or by calling 800-247-6553. The book is also available in a web-based electronic edition by subscription at www.retirementbenefitsplanning.com.

Code	Internal Revenue Code of 1986, as amended through February 28, 2018.
IRA	Individual retirement account or individual retirement trust under § 408.
IRS	Internal Revenue Service.
PLR	IRS Private Letter Ruling
QCD	Qualified charitable distribution.
Reg.	Treasury Regulation.
RMD	Required minimum distribution under § 401(a)(9).

I. HOW THE TCJA AFFECTS PLANNING FOR RETIREMENT BENEFITS

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EXECUTIVE SUMMARY:

The Tax Cuts and Jobs Act (TCJA) made sweeping changes to the Tax Code, but few directly impacting retirement benefits. The biggest change is the elimination of the ability to undo a Roth conversion. Minor changes include an extended rollover deadline for some plan loan distributions, comments blessing "back-door Roth contributions," special deals for "qualified 2016 disaster distributions," elimination of the ability to deduct IRA losses or the payback of small plan overpayments, and an indirect boost to qualified charitable distributions. Also interesting is what is *not* included in the law—we still have the life expectancy "stretch" payout and the ability to use recharacterization to fix some IRA mistakes, and we still do NOT have lifetime RMDs for Roth IRAs.

No more ability to undo a Roth conversion...effective when?

The most significant change TCJA makes regarding our clients' retirement benefits is the elimination of the right to undo ("recharacterize") a Roth IRA conversion.

Since 1998, individuals have had the right to "convert" all or part of a traditional IRA to a Roth IRA—at the cost of paying income tax currently on the converted amount. There have been lots of changes over the years since 1998: For conversions in some years, the taxable income from

a conversion could be spread over several taxable years. Prior to 2010, only individuals with modified adjusted gross income under $100,000 were permitted to convert; now there is no income limitation. For some years, only traditional IRAs could be converted to Roth IRAs; now, a distribution from almost any traditional retirement plan can be transferred (converted) to a Roth IRA. At one time, Roth IRAs were the only possible “destination” for conversion contributions; in recent years, “in-plan conversions” (transfer from a traditional plan account to a designated Roth account in the same 401(k) plan) have been permitted (if permitted by the plan).

Through all these changes, throughout the 20-year existence of Roth IRAs, the Roth IRA converter has had a unique privilege—the option to change his mind and reverse the conversion, until the extended due date of his tax return for the conversion year. “Extended due date” has a special meaning here: Reg. § 301.9100-2(b) provides an automatic six-months extension (from the unextended due date of the return) for all “regulatory or statutory elections whose due dates are the...due date of the return including extensions provided the taxpayer timely filed its return for the year the election should have been made and the taxpayer takes” necessary corrective actions (such as filing an amended return if necessary).

Note: The option to recharacterize a Roth conversion applied only to conversions to Roth IRAs—“in-plan conversions” have never been reversible.

The TCJA eliminates the right to undo a Roth IRA conversion. For Roth IRA conversions in 2018 and later, there will be no option to “recharacterize” the conversion; all Roth conversions will be irrevocable.

It is not clear from the statute exactly how TCJA impacts 2017 conversions. Under pre-TCJA law, the 2017 conversion of a traditional plan or IRA to a Roth IRA would have been reversible (i.e., the converter would have been entitled to “recharacterize” it) until October 15, 2018 (assuming the individual timely filed her 2017 income tax return). The provision of TCJA disallowing recharacterization for a Roth IRA conversion contribution “shall apply to taxable years beginning after December 31, 2017.” This could be read to mean that the ban applies to *Roth conversions that occur after 2017*—meaning that conversions that occurred *in* tax year 2017 can still be reversed until the 10/15/18 deadline.

But it could also be read as simply banning, after 12/31/17, the recharacterization of *any* Roth conversion, regardless of when such conversion occurred. Under this more pessimistic reading TCJA effectively accelerated the recharacterization deadline for 2017 conversions from 10/15/2018 to 12/31/17. If this reading prevails, it’s a bit rough on 2017 converters who reasonably understood and believed, when they did their conversions, that they had until October 15, 2018, to change their minds. It seems likely that few such 2017 converters could have learned of the accelerated deadline in time to act on it.

If it turns out that the “pessimistic” reading is correct, is there any way a 2017 converter can recharacterize in 2018? There is a process under IRS regulations, nicknamed “9100 relief,” for obtaining extension of a tax deadline if various (extensive) requirements are met—but the cost of obtaining such relief on an individual basis starts with a $10,000 filing fee and goes on to include legal fees, delay, etc. See Treas. Reg. § 301.9100-1 *et seq.*

Fortunately for 2017 converters, the IRS has adopted the interpretation that the new law applies to *conversions after* 2017, so a 2017 Roth-IRA converter still has until October 15, 2018 to undo that conversion (assuming she files her 2017 tax return on time). The IRS has posted the following statement on its website under Frequently Asked Questions:

"How does the effective date apply to a Roth IRA conversion made in 2017?

"A Roth IRA conversion made in 2017 may be recharacterized as a contribution to a traditional IRA if the recharacterization is made by October 15, 2018. A Roth IRA conversion made on or after January 1, 2018, cannot be recharacterized." Find this IRS post at:

https://www.irs.gov/retirement-plans/ira-faqs-recharacterization-of-ira-contributions

The same statement appears in IRS Publication 590-A, "Contributions to Individual Retirement Arrangements (IRAs)," 2017 ed., pp. 2 and 29.

This interpretation makes sense—not only is it fairer for people who relied on the pre-2018 law that applied when they did their conversions, it makes life easier for the IRS since they've already printed up all their tax forms, instructions, and publications for the 2017 year based on the prior law.

Of course, neither an IRS website posting of "FAQs" nor an IRS Publication constitutes legal authority. Some IRA providers may require a more authoritative IRS pronouncement (such as a Revenue Procedure) before processing recharacterizations of 2017 conversions. However, since this reading of the statute appears to be one of the two possible valid interpretations, and it is fairer to taxpayers, and it will probably save the IRS headaches in trying to deal with its already-published forms and publications for 2017 returns, it seems likely this interpretation will prevail.

But recharacterization to fix some IRA mistakes still lives!

On the bright side, TCJA as finally enacted preserves "recharacterization" as a method for fixing some IRA contribution mistakes. Earlier versions of the bill would have thrown out the recharacterization-as-mistake-fixer baby along with the recharacterization-as-a-way-to-undo-a-Roth-conversion bath water.

So, under the new tax law as finally enacted, a contribution to one IRA can still (after 2017) be "recharacterized" as a contribution to another IRA (just as was true before 2018), except as otherwise limited by the statute or by the IRS. IRC § 408A(d)(6)(A). There are two primary limitations on the recharacterization option. One is the new statutory ban on recharacterizing a Roth conversion contribution, discussed above. § 408A(d)(6)(B)(iii). The other is the IRS's long-standing regulatory prohibition against recharacterizing any tax-free rollover contribution. Treas. Reg. § 1.408A-5, A-4.

So there is still plenty of room to use recharacterization to fix mistakes:

Bob Example: in Year 1, Bob retires from Acme. He has a traditional IRA and a Roth IRA at ABC Financial Institution. He directs the plan administrator of his Acme 401(k) plan to transfer his designated Roth account in that plan via direct rollover to his Roth IRA. Because of errors by Acme and/or ABC Financial, the money is deposited in Bob's traditional IRA. That's not a valid rollover—it's not legal to transfer designated Roth account money to a traditional IRA. Because it's not a valid rollover, if nothing is done, the transaction would be treated as a distribution to Bob from the Acme plan followed by a "regular" (and excess) contribution to the traditional IRA. How can Bob fix this without incurring those bad results?

Bob needs to "recharacterize" the contribution that was made to the wrong IRA. Recharacterizing is done by transferring the contribution plus earnings thereon directly from the IRA to which it was contributed, to a different IRA by the extended due date of the individual's tax return. So Bob directs ABC Financial to transfer, from his traditional IRA to his Roth IRA, the amount incorrectly rolled into the traditional IRA from the Acme plan plus any earnings accrued on that amount while it "lived" inside the traditional IRA. If this is accomplished by October 15 of Year 2 [see special definition of "extended due date" discussed above], Bob has made a successful recharacterization of the improper "rollover" contribution.

When it's an option, recharacterization, as a way of fixing a mistaken IRA contribution, has three advantages over the more common "60-day rollover." First, in a recharacterization, Bob can (in fact must) transfer the earnings along with the contribution; with a 60-day rollover, only the contribution itself and not the earnings can be rolled into the transferee account. Second, recharacterization is not subject to a 60-day deadline; the deadline is the extended due date of the individual's income tax return (generally meaning October 15 of the year after the mistake occurred, if the income tax return is timely filed). Third, recharacterization is not subject to the once-per-12-months limitation normally applicable to IRA-to-IRA rollovers.

For full details on recharacterizing IRA contributions, including how to compute "earnings thereon," read the author's *Special Report: IRA Mistakes and How to Fix Them*, downloadable at www.ataxplan.com.

Back-door Roth IRA contributions blessed

Though not part of the law itself, the Conference Committee's Explanatory Statement of the TCJA explicitly blesses a popular technique that some had questioned, namely, the "back-door Roth contribution." An individual who is under age 70½ and who has compensation income, but whose adjusted gross income is too high to permit her to make an annual-type contribution to a Roth IRA, can instead make her annual contribution to a traditional IRA, then convert that traditional IRA to a Roth (because there is no income limit applicable to conversions).

Some had questioned the legality of such an indirect Roth IRA contribution, saying it might be illegal under the "step transaction doctrine." The Conference Committee confirms that back-door Roth contributions are legal—under both prior law and the TCJA. The Explanatory Statement states *four times* that, "Although an individual with AGI exceeding certain limits is not permitted to make a contribution directly to a Roth IRA, the individual can make a contribution to a traditional IRA and convert the traditional IRA to a Roth IRA...." See the "Joint Explanatory Statement of the Committee of Conference," footnotes 268, 269, 276, and 277.

This should put an end to skepticism about back-door Roth contributions.

New extended rollover deadline for certain plan loan distributions

Under TCJA, an employee who gets a plan loan gets a new little break: If the plan terminates, or the employee's employment terminates, the loan typically becomes due immediately in full. If the employee can't pay it back, the outstanding loan balance is treated as a distribution to him.

He can roll over that distribution to avoid being taxable on it, but until now the rollover deadline was the usual 60 days. Under TCJA *this particular type of distribution* gets a longer

rollover deadline—the extended due date of the employee's tax return for the year of the distribution. § 402(c)(3)(C).

Note that this new grace period applies only when the plan loan repayment date is accelerated due to termination of the plan or of the employee's employment. The new provision will not help the employee who simply defaults on his regular plan loan repayments—that type of deemed distribution is still not eligible for rollover at all.

Special deals for "qualified 2016 disaster distributions"

This change is found in Sec. 11028 of the TCJA, "Relief for 2016 Disaster Areas."

IF your client made one or more retirement plan withdrawals in 2016 or 2017, you might want to determine whether she is eligible for special treatment on any such distribution by virtue of (1) having her principal place of abode located in a declared 2016 disaster area and (2) sustaining an economic loss "by reason" of the applicable disaster. The disaster relief may require amending some 2016 returns.

Here we go: A new type of retirement plan distribution is created and given various special breaks and deals by the TCJA. The new type of distribution is the "qualified 2016 disaster distribution" ("QDD"). A QDD is defined as follows:

- The distribution is made from an "eligible retirement plan" after 2015 and before 2018 (i.e., anytime during 2016 or 2017). Eligible retirement plans are (as defined in § 402(c)(8)(B)), IRAs, qualified retirement plans (such as a 401(k) plan), 403(b) plans and contracts, and governmental 457(b) plans.

- The distribution is made to an individual (1) whose principal place of abode at any time during calendar year 2016 was located in a "2016 disaster area" and (2) who has sustained an economic loss by reason of the events giving rise to the Presidential declaration applicable to the disaster area.

A "2016 Disaster Area" is "any area with respect to which a major disaster has been declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act during calendar year 2016." TCJA Sec. 11028(a). Two websites that may help you determine whether your client's particular disaster qualified for tax relief are https://www.irs.gov/newsroom/tax-relief-in-disaster-situations and https://www.fema.gov/disasters/grid/year/2016?.

Note that although QDDs can be made in 2016 or 2017, the *disaster itself* must have occurred *in 2016.* Thus, for example, this particular tax relief does not help victims of Hurricanes Harvey and Irma, both of which occurred in 2017.

If you determine that your client suffered an economic loss due to a presidentially-declared 2016 major disaster, AND your client's "principal place of abode" was located in the official disaster area, AND your client took one or more withdrawals from his/her retirement plan(s) in 2016 and/or 2017, your client qualifies for the special treatment for "QDDs." Here is what that special treatment is:

- ✓ **$100,000 limit.** Regardless of how much money your client withdrew from his/her retirement accounts in 2016-2017, the maximum amount that can be treated as QDD is $100,000. TCJA Sec. 11028(b)(1)(B). For example, if the client withdrew $150,000 from his IRA, only the first $100,000 of that is treated as a QDD. If the individual received potentially eligible distributions in both 2016 and 2017, the maximum amount available for 2017 is $100,000 minus whatever the individual treated as QDDs in 2016.

- ✓ **10% penalty does not apply.** The 10 percent "additional tax" on distributions taken prior to age 59½ (§ 72(t)) does not apply to a QDD. TCJA Sec. 11028(b)(1)(B).

- ✓ **Extended rollover period.** Rather than the usual *60-day* rollover deadline, a QDD can be rolled over at any time within *three years* after the distribution. TCJA Sec. 11028(b)(1)(C)(i).

- ✓ **Income averaging for amounts not rolled over.** To the extent the QDD is not rolled over, the income it generates is included in gross income ratably over the three taxable years beginning with the year of distribution, unless the taxpayer elects out of this averaging treatment. TCJA Sec. 11028(b)(1)(E).

- ✓ **Certain other rollover requirements waived?** It appears that the intent of TCJA Sec. 11028(b)(1)(C)(ii) and (iii) is, with respect to the would-be rollover of any QDD, to exempt such distribution from some other normal rollover requirements (over and above the 60-day deadline), by treating the rollover of a QDD as "a direct trustee to trustee transfer within 60 days of the distribution." Thus, the QDD rollover would apparently be exempted from (*e.g.*) the once-per-12-months rule of IRC § 408(d)(3)(B) normally applicable to IRA-to-IRA rollovers. Practitioners may wish to study these clauses to see whether they overcome other normal rollover restrictions, such as the prohibition against rolling over a hardship distribution or a distribution from an inherited plan.

The TCJA contains various technical and conforming rules designed to make sure plans are not somehow disqualified by making these distributions, and dealing with the requirement of amending the plan, etc. Other TCJA provisions offer potentially increased casualty loss deductions to 2016 disaster victims.

IRA losses will be non-deductible

Now for some bad news that (hopefully) affects very few people. If you close out all your IRAs, or all your Roth IRAs, and the net amount thus distributed to you is less than your "basis" in those accounts (i.e., less than the amount of your after-tax contributions to the accounts) (including conversion contributions, in the case of Roth IRAs), the IRS position is that the loss you have thus realized is deductible only under IRC § 212, "Expenses for production of income." As such, the loss is a "miscellaneous itemized deduction" subject to IRC § 67(a), meaning that (until now) the loss was deductible only to the extent the total of such loss and your other "miscellaneous itemized deductions" exceeded 2% of your adjusted gross income.

Under TCJA, deductions formerly subject to the 2% floor become completely nondeductible....effectively the 2% floor becomes a 100% floor. Thus, such a loss upon cashing out all your IRAs (or Roth IRAs) will not be deductible *at all* for the years 2018–2025.

Someone affected by this might challenge the IRS classification of the transaction as an IRC § 212 deduction, and try to claim the loss under a different Code section, such as capital losses. The problem is, the Code says IRA distributions are taxable under IRC § 72, and § 72 has no provision for losses.

Payback of small plan overpayment

Suppose you retire and your company's retirement plan says congratulations, you're entitled to $10,000 under the plan, here's your check. You take the money, cash the check, and have some fun with the money. Of course the distribution is includible in your income, so you pay tax on it.

Some years later it turns out the company goofed—they paid you someone else's money, turns out there were two employees with the same name, how were they supposed to know, etc. Bottom line: You were actually entitled to only $7,000. You owe the plan $3,000. You pay back the $3,000. It seems like you should get a tax deduction for that, right?—since after all you did include it in income back when you received it.

According to the IRS, repayment of an overpayment of this type, if $3,000 or less, is an "employee business expense." Rev. Rul. 2002-84, 2002-2 C.B. 953. Employee business expenses are "miscellaneous itemized deductions," subject (pre-2018) to the 2% floor and (post-2017) totally nondeductible under TCJA. Thus you have the obligation to pay income tax on the $10,000 distribution when you get it, but when you are forced to repay part of it, if the overpayment was $3,000 or less, you get no tax deduction!

IF you are lucky enough that the overpayment was over $3,000, then you can deduct your repayment in full, because then your payment comes under the "claim of right" rule. IRC § 1341. A claim of right deduction is not subject to the old 2% floor rule and therefore remains fully deductible even under TCJA. IRC § 67(b)(9).

Indirect impact on QCDs

TCJA may make qualified charitable distributions (QCDs) even more popular than they already are.

IRC § 408(d)(8) permits an individual over age 70½ to transfer up to $100,000 per year from his IRA directly to most types of charities. This device allows the IRA owner to satisfy his charitable giving and his RMD without having either the income or the deduction appear on his tax return. That effect has always meant that some individuals could use the standard deduction on their income tax return, while also getting the benefit of the "charitable deduction" by virtue of excluding the QCD from income altogether. Presumably more people will take advantage of that effect now that TCJA has substantially increased the standard deduction (and slashed other deductions).

Crescent Example: Crescent is single and over age 70½. She lives in a low-tax state and has no mortgage; her only significant itemized deduction in 2018 will be her annual $10,000 charitable contribution. If she donates $10,000 to charity from her taxable account in 2018 she gets no tax benefit from the contribution, because she will be better off using the standard deduction ($13,600;

$12,000 for a single individual, plus $1,600 for being a single-filer over age 65). By paying the contribution directly from her IRA as a QCD, she gets an income exclusion for the $10,000 IRA distribution (it totally bypasses her return) *and* she gets the $13,600 standard deduction against her other income.

What's not in the new law....

Finally, here's what's NOT in the new law: Other retirement plan changes proposed in the original House version of the bill (*e.g.*, lowering the age for in-service distributions from pension plans, easing rules on hardship distributions) did not make it into the final legislation.

And, TCJA does NOT eliminate the life expectancy payout method for retirement plan death benefits, nor does it impose lifetime RMD requirements on Roth IRAs. We've heard for years now that "everyone" in Washington supported both these changes—but there is no such provision in the TCJA.

II. PLRS DEMONSTRATE IRS'S GROWING HOSTILITY TO POST-DEATH ALTERATIONS OF ESTATE PLAN

No matter what it is
Or who commenced it
I'm against it!
—Groucho Marx (in "Horsefeathers")

The IRS's attitude these days towards any attempt, post-death, to improve the income tax results for inherited retirement benefits via reformation and/or judicial intervention is, well, hostile. It sometimes seems that no matter how you've changed it or condensed it, they're against it. But not so long ago some reformations and settlements won the IRS's blessing.

A. PLRs 2016-28004, -28005, and -28006 (7/8/16): Post-death Reformation of Beneficiary Designation Form Not Recognized.

The participant had two IRAs with "Custodian A," the firm that employed his financial advisors. The named beneficiaries were Trust C (50%) and Trusts D and E (25% each).

When the financial advisors moved to a different firm (Custodian B), the participant moved his IRAs to a single IRA at the new firm. "The financial advisor" presented the participant with a beneficiary designation form naming the participant's estate as sole beneficiary of the new IRA. The participant signed the form and then later died while that form was still in effect.

It was represented to the IRS that the participant did not intend to change the beneficiary of his IRA—he merely intended to move the account to a different company. The trustees of the trusts obtained a court order retroactively changing the beneficiary designation form so that the trusts, as named on the original account, were also named directly as beneficiaries on the new account.

The trusts qualified as "see through trusts," and accordingly the life expectancy payout would be available based on the life expectancy of the oldest trust beneficiary(ies)—if the IRS recognized the court-ordered reformation of the beneficiary designation form. If the IRS considered

the estate as the beneficiary, then the maximum payout period would be the participant's remaining single life expectancy (since he died after his Required Beginning Date).

The IRS refused to give effect to the reformation. Citing many cases as precedents (which is unusual for the IRS to do in a letter ruling) the IRS ruled that it was not bound by a state court reformation, and that a post-death reformation of the beneficiary designation by the state court was not effective to change the tax results. Offering policy reasons why it should not be bound by a reformation in a case such as this, the IRS mentioned the possibility of collusive state court actions and the need for finality (noting how "unsettled" decedents' affairs would be if they were subject to endless changes post-mortem).

This conclusion is consistent with other post-2006 IRS rulings on post-mortem changes to the beneficiary designation form.

Once upon a time, the IRS recognized such s reformation. See PLRs 2006-16039 and 2006-16040, in which the participant had an IRA that named his wife as primary beneficiary and his two daughters as contingent beneficiaries. He moved the IRA to a different firm and instructed the new firm to prepare a beneficiary designation form identical to that of the old IRA. The new firm mistakenly did not insert the name of any contingent beneficiary and apparently the participant didn't notice this mistake when he signed the form, with the result that his estate was the default contingent beneficiary of the account at the time he died. His wife survived him for only a short time, and her executor disclaimed the benefits on her behalf. A court reformed the beneficiary designation form to name the daughters as contingent beneficiaries, so that the disclaimed benefits would pass to them rather than to the decedent's estate, and the IRS ruled that the daughters would be treated as the decedent's "Designated Beneficiaries" for minimum distribution purposes. This is a classic case of reformation to correct a "scrivener's error."

Is there any factual difference between these 2006 PLRs and the 2016 PLRs? In the older rulings, the IRS seemed to have evidence that the decedent had specifically instructed the new firm to name his daughters as contingent beneficiaries and that the new IRA provider simply disregarded these instructions. In the 2016 PLRs, it appears that the decedent did not give such specific instructions, he just signed what was put in front of him. However, we can't know if there really was some such factual difference to justify the different outcomes or whether the IRS is just emphasizing or de-emphasizing particular facts to support its conclusion.

In another ruling that is closer to the 2016 PLRs facts, PLR 2007-42026, the IRS refused to honor a post-death reformation for RMD purposes. The participant had named his spouse as primary beneficiary. Though he had named his daughter as contingent beneficiary on a prior beneficiary designation form, there was no contingent beneficiary named on the form that was in effect at the participant's death. Unlike in PLRs 2006-16039 and 16040, where the financial institution testified that its own error had caused the contingent beneficiary line to be left blank, in PLR 2007-42026 the IRA provider had actually mailed the participant a new form, after his wife died, to name his daughter as beneficiary of the IRA, but the participant never signed it. Because there was no named beneficiary, the IRA would pass to the participant's estate as beneficiary. Two years after the participant's death a court order was obtained reforming the beneficiary designation to name the daughter as beneficiary. The IRS refused to grant a ruling that the daughter should be treated as the participant's "Designated Beneficiary" for minimum distribution purposes. Its language in this 2007 ruling suggests that the IRS was closing the door on post-death reformations as a way to improve the Designated Beneficiary situation for RMD purposes, reversing the prior longstanding trend of

the IRS's apparent strong approval of post-death "cleanup" actions. So the 2016 PLRs are the natural successors to PLR 2007-42026.

B. PLR 2016-23001 (6/3/16): Court-ordered Transfer of Inherited IRA to Spouse Not Recognized for Spousal Rollover. Compare PLR 2014-32029 (8/8/14) in Which Court Approved Settlement Was Recognized for Tax Purposes.

PLR 2016-23001: IRS does not honor court-ordered settlement regarding IRA

A dilemma for practitioners in community property (CP) states is whether it is possible, and if so how, to get a spouse's CP interest in a participant's IRA over to the spouse without incurring income taxes on the transfer. The only known, and therefore the recommended, ways to do this are, to name the spouse as beneficiary of the IRA upon the participant's death, or (if a transfer during life is desired) for the parties to get divorced and have the divorce court order a tax-free division of the IRA between the spouses pursuant to § 408(d)(6).

PLR 2016-23001 illustrates a method that does NOT work.

Participant (P) and Spouse (S) were married to each other. They lived in a CP state. P died, leaving his three IRAs to Beneficiary (B), who was the child of P and S, as sole named beneficiary. S filed a claim against P's estate to recover her community property. S and the estate reached a settlement agreeing that the value of her CP interest in the estate was Amount 1. The state court then approved the settlement and ordered the IRA provider to transfer to S, "as a spousal rollover IRA," a portion of B's inherited IRAs equal to Amount 1.

Note that S's claim, and the court order, stated that Amount 1 was the value of her *entire CP claim against P's estate*, not just the value of her CP share of the IRAs.

S sought rulings from the IRS to the effect that Amount 1 of the IRAs was S's CP; that S was entitled to be treated as the payee of the IRAs to the extent of Amount 1; that Amount 1 could be distributed to S as a surviving spouse rollover IRA; and that this would not be an income-taxable event.

The IRS refused to grant these rulings. First, it would not rule on whether any part of the IRA was CP because that was a state law question and not a matter of federal tax law. Second, third, and fourth, it would not allow the spousal rollover as a nontaxable event because § 408 must be "applied without regard to any community property laws." § 408(g). Therefore S's CP interest could not be recognized as giving her any rights to the IRAs, and a distribution occurring after P's death would accordingly be includible in the income of B, who is the owner of the account for federal income tax purposes, regardless of who actually got the money.

Is this ruling correct? Some lawyers in CP states disapprove, saying this ruling deprives S of her state-law granted property rights. But that objection may go a bit too far—the IRS isn't denying that S owns Amount 1, the IRS is just saying B is the one who is income-taxable on the IRA distribution, regardless of who owns it under state law.

And it would appear to a non-CP-state practitioner that to allow the spouse to claim part of the IRA as belonging to her as CP, and remove the taxable income burden from the named nonspouse beneficiary, would directly contravene § 408(g). But at least one CP-state practitioner asserts that the IRS is misreading 408(g)–it wasn't intended (says he) to dictate the income tax result of distributions, it was only intended to control who could make contributions to an IRA based on "community" income.

Several things are noteworthy about this ruling:

1. Usually, the IRS seems to bend over backward to allow spousal rollovers of inherited retirement benefits. For example, there are several dozen PLRs allowing the surviving spouse to roll over retirement benefits that are paid to her through an estate or trust, even though the spouse was not the named beneficiary, provided she had the right (as beneficiary and/or fiduciary of the estate or trust) to pay those retirement benefits to herself "through" the estate or trust. However, the IRS bucked that trend in PLR 2016-23001. Was that because of the clear language of § 408(g)? Or was there something else that they didn't like about this fact situation?

2. One thing maybe the IRS "didn't like" was the "overreaching" in this PLR. It appears that the parties wanted to satisfy all of S's CP interest with the IRA rollover money, not just her interest in the IRA itself. Also, the parties had the state court rule, not just on the value of S's CP interest (a state law question) but also that the transfer to S should be in the form of a spousal rollover IRA. That's a federal tax matter, and the IRS (I think) doesn't like it when parties to state court litigation seem to try to "end run" the IRS by having the state court rule on the rollover or minimum distribution effects of a transaction.

This PLR reminds me of PLR 2008-46028 (also issued as PLR 2008-49020) where the family got a state court to interpret a beneficiary designation which left the IRA "as stated in will." The will paid the entire estate to a trust. The parties got the court to order, not just that the IRA was payable to the trust, but that the IRA was payable directly to the individual trust beneficiaries in separate shares over their life expectancies. In my view the parties seeking that ruling over-reached and offended the IRS by getting the state court to rule not only on the interpretation of the beneficiary designation form (a proper state law question) but also to try and improve the minimum distribution results by decreeing the benefits were actually payable to the individual trust beneficiaries in separate shares. The same problem is visible in PLR 2016-23001: They did not just get a state court ruling that this IRA belonged to wife as CP and therefore had to be paid to her, they got the state court to rule that this was a "spousal rollover IRA."

Having the state court rule on federal income tax issues may offend the IRS not just because of "turf" issues (that's OUR department!) but also because it shows that the state court is simply doing the bidding of the "litigants." A state court that was actually considering a case should refuse to rule on matters outside its jurisdiction, like spousal rollovers. By ruling on such federal issues, the court sends a signal that it will sign whatever the parties put in front of it.

3. Millions of IRA owners live in CP states, and presumably many wrestle with the question of how to recognize the non-participant spouse's CP interest in the participant's IRA. Yet there are very few cases or rulings dealing with this issue. One such case was *Bunney*, 114 T.C. 259 (2000), which held that when the participant withdrew funds from his IRA and paid them to his wife in satisfaction of her CP interest, that was a taxable distribution to the participant. PLR 2016-23001 in effect confirms *Bunney* in a post-death situation.

I do NOT think PLR 2016-23001 upsets the prior "precedents" in the form of numerous PLRs that allow the spouse to roll over benefits that become payable to her outright through an

estate or trust. In almost every one of those rulings, there was no court order needed to say that spouse was the beneficiary of the estate or trust—she already was the beneficiary of the estate or trust. Even though the benefits were payable to the estate or trust and not the spouse personally as "named beneficiary" of the account (or default beneficiary of the account), the benefits were still payable to the spouse as beneficial owner because she was the beneficiary of the estate or trust.

True, there were a couple (literally maybe two) PLRs where there was some fudging to get to the result that spouse was sole beneficiary of the estate or trust...for example there was one where another trustee had to resign first in order to make spouse the "sole" decider about which share got the retirement benefits...and there was the famous will contest case where spouse became the beneficiary only because there was a court-approved settlement of a family dispute ...but those were outliers. And the IRS in this new PLR has decided not to go further out on that limb by enforcing CP laws that the Code says must be ignored.

PLR 2014-32029 IRS DOES honor court-ordered settlement regarding IRA

Compare and contrast PLR 2016-23001 with this ruling in which a settlement agreement involving IRAs was honored by the IRS:

B died on 8/13/06 prior to his required beginning date leaving his two IRAs to C as primary beneficiary, with various charities including Charity D as contingent beneficiaries if C were to predecease B.

B had also established a trust which gave a life income interest to C with remainder to charities including Charity D. Upon B's death, A (a personal friend and business associate of B) became trustee of the trust.

The IRAs were to be distributed to C by 12/31 of the fifth calendar year after B's death unless C elected an instalment payout. C did not make any such election, but transferred the inherited IRAs into two new IRAs. He named A as beneficiary of these new IRAs. C died on 4/5/07 without having taken any distributions from the IRAs.

A then established two new inherited IRAs for herself as beneficiary of C [these accounts should have been established for her as successor beneficiary of B] and transferred the balances from C's inherited IRAs into the new inherited IRAs. In May 2007, A moved the accounts again, to new inherited IRAs for herself at yet another financial institution.

Litigation commenced. C's estate sued A "alleging facts that, if sustained by Court, would, pursuant to" state law preclude A from inheriting from C. A entered into a tentative settlement to divide the IRA account balances...and in "anticipation of this settlement's being approved by" the court, A moved the proposed settlement amount into different IRAs for the benefit of C's estate in September 2008. At this point Charity D joined the litigation and claimed a share of the IRAs based on breach of trust. After a further year and a half of litigation, there was a final court approved settlement in December 2010. Basically the entire balance of all the IRAs was divided between C's estate and Charity D, with no share passing to A.

A sought IRS rulings confirming that she was not liable for income tax or gift tax in connection with these IRAs. The IRS granted the rulings (in August 2014, six years after B's death!) she sought, because the litigation was a "bona fide controversy regarding enforceable claims of the parties," the settlement was "based on arm's length negotiations among the parties after years of litigation," and the approved settlement was "within the range of reasonable outcomes under the governing instruments and applicable state law."

Note there was not even a whiff of possible "collusion" here, nor was there any particular tax advantage to the settlement. See another similar IRS-approved settlement ruling at PART III(E) below.

III. PLR 2016-33025 *et al.*: ARE THE IRS'S RMD TRUST RULES EVOLVING?

The IRS's final required minimum distribution (RMD) regulations became effective for 2003 and have applied, without relevant amendments, since then. One aspect of these regulations is the set of "IRS minimum distribution trust rules" which dictate, whenever a trust is named as beneficiary of a decedent's retirement benefits, whether we can "look through" the trust instrument and treat the individual trust beneficiaries as if they had been named directly as beneficiaries of the retirement plan.

These rules are extremely important to estate planners and to fiduciaries and beneficiaries of decedents' estates and trusts. Since only an individual can be a "designated beneficiary" under the Tax Code (entitled to the "life expectancy payout method" for inherited benefits), if a trust doesn't qualify as a "see-through" or "look-through" trust under these IRS rules, the life expectancy payout method will not be available. The trust will be stuck with potentially a much shorter distribution period (one to 11 or so years) for the inherited benefits.

In my book *Life and Death Planning for Retirement Benefits* (7th ed. 2011), I describe two ways to qualify a trust as a see-through. One is called a conduit trust—a trust under which all distributions from the retirement plan made during the life of the individual trust beneficiary must be paid out to or for the benefits of such individual (not "accumulated" in the trust). The other method involves more complicated testing: Basically the benefits must be traced on a prospective journey through the future life of the trust, counting all persons who will or might be entitled to a share of the benefits, until the point is reached where the trust will terminate and be distributed immediately outright to a "final" individual beneficiary.

These two "IRS-approved" methods of achieving see-through status were based on the regulation and on subsequent PLRs interpreting and applying the regulation. And these two methods still work and are still recommended as the "safe harbor" method of trust-drafting to achieve a see-through trust.

However, some IRS rulings have approved trusts that do not seem to fit these molds. The outlier rulings (summarized here) approve trusts as "see-through" without testing in the same rigorous manner as seemed to be demanded under other PLRs. There are rulings in which the IRS does not seem to consider all possible "destinations" for the trust assets if (for example) a power of appointment is not exercised (**PLR 2002-35038**), or whether assets will pass to the next beneficiary outright or in further trust (see, *e.g.*, PLR **1999-03050**). In these rulings, unlike in (*e.g.*) PLR 2012-03033, the IRS does not follow the retirement benefits on a hypothetical journey down the chain of beneficiaries until an "immediate outright" beneficiary is reached. Rather the IRS seems to "stop looking" at a much earlier point, when the "primary" or most obvious beneficiary is reached, with incomplete or no regard to what happens to the money if that beneficiary dies, or dies prematurely, etc.

In **PLR 2013-20021**, the participant died, leaving her IRA to "Trust A." This testamentary trust provided that funds were to be paid to her only child at various ages, with the final payment at age 35. If the child died before reaching age 35, the remaining trust property would pass to the deceased child's issue if any otherwise to the decedent's issue. However, there were no other such

issue living when the participant died, and the trust instrument did "not provide for additional contingent beneficiaries for Trust A." But the IRS did not analyze state law to determine *what would become of the retirement benefits if the child-beneficiary died before age 35*. Rather the ruling-writer stated that, since the Trust instrument did not name any beneficiaries beyond the participant's child, there *were no beneficiaries* other than the child, and therefore all the trust beneficiaries were individuals.

This ruling would make sense if, at the time of the participant's death, the participant's child was *already over* age 35, and therefore entitled to immediate outright distribution of the entire trust fund upon her mother's death. In that case, a holding that this child was the sole beneficiary of the trust and therefore of the IRA would make sense and be consistent with prior IRS pronouncements. But the PLR does not say how old the child was when the participant-mother died, creating the impression that, even if the child was under 35, the trust "passed" the rules because no other beneficiaries were named in the trust instrument.

In **PLR 2016-33025**, P died at age 59 leaving his IRA to a trust. All income of the trust was payable to P's child E for life; in addition, the trustee could make principal distributions to E. The trust was to terminate and be distributed outright to E when she reached age 50. If E died before reaching age 50, the trust would be held for the benefit of E's children F and G, to be distributed to them outright at age 21. F and G were apparently under age 21 at the time of the ruling, though the ruling does not specifically so state. If these grandchildren of P, having survived E, later died before reaching age 21, the trust property would pass to their "personal representatives" (i.e., their estates), unless E and her children were all deceased at the applicable time, in which case all remaining assets would be distributed to P's siblings, H and I. The questions presented were, did the trust have only individual beneficiaries and if so who was the oldest one.

Under the approach illustrated in PLRs 2004-38044 and 2008-43042, this trust would have been analyzed by assuming that E would die before age 50, causing the funds to pass to trusts for grandchildren F and G, and since the grandchildren would not inherit the funds immediately and outright, we would assume they in turn would die before reaching age 21, causing at least the first such grandchild's share to pass to his or her estate (a nonindividual beneficiary), causing the trust to "flunk," or to older individuals, the participant's siblings H and I. However, the IRS did not so rule. Instead, it apparently *ignored* the possibility that the grandchildren could die before age 21 and treated them as if they were "immediate outright" beneficiaries after E's death. Therefore the IRS ruled the sole countable beneficiaries of the trust were E, F and G. In effect the IRS ignored any "wipe-out" beneficiaries who would inherit the trust if the primary and contingent beneficiaries died before reaching ages 50 and 21 respectively. The IRS ignored the possibility that benefits could pass to a grandchild's estate (possibly reasoning that since the estates "didn't exist yet" they could not be counted) or to the older siblings of P.

Some have long argued that the IRS *should* ignore, for purposes of determining who were the beneficiaries of a trust, the possibility that a minor child would not reach the age of majority. Did the IRS adopt that rationale here? Others have argued that a beneficiary's "estate" should not be considered as an "entity" separate from the individual beneficiary; rather, it should be considered "the same as" the individual beneficiary. Was that the rationale for this ruling? There is no way to reconcile this PLR with some of its predecessors, so whether it represents a new direction for IRS policy on these points, or just an aberration, will not be known until further rulings are issued.

One must conclude from these PLRs blessing trusts that did not appear to qualify as see-through trusts under the standards in the PLRs discussed at ¶ 6.3.08 of *Life and Death Planning for*

Retirement Benefits that the definition of a see-through trust in ¶ 6.3.08 is not the last word. Accordingly, if confronted with a situation in which a decedent's benefits have been left to a trust that does not meet the strict standards stated in ¶ 6.3.08, the practitioner should not despair of getting a favorable IRS ruling on see-through status. For planning purposes, however, there is no way to know at this time whether the nonconforming PLRs indicate that the IRS has relaxed its standards, or whether these PLRs are aberrations (possibly due to facts' not being correctly stated in the ruling, or simply IRS error).

IV. PLR 2016-11002 (3/11/16): HOW TO LEAVE IRA TO CHARITY

PLR 2016-11002 is an example of a successful way to leave retirement benefits to charity through a trust. The decedent's IRAs were left to a trust as sole beneficiary. The trust stated "that Decedent's IRAs shall be distributed to" a particular charity. The trust proposed to cash out each IRA in a lump sum in cash, "then pay that cash to Foundation within the same taxable year." The IRS ruled that the trust would be entitled to a § 642(c) fiduciary income tax charitable deduction for the distributions to charity, equal to the amount of income caused by the IRA distributions.

This ruling is an example of successful trust drafting and administration.

When retirement plan benefits are distributed out of the plan to a trust, the trust generally has to include that distribution in its gross income. If the trust then pays the money over to a charitable beneficiary of the trust, you would hope there is a charitable deduction to offset that gross income. The problem is, there are at least five requirements (under § 642(c)) a trust must meet in order to take that charitable deduction. A trust will not "automatically" meet those requirements–careful advance drafting and planning is required.

One way to avoid dealing with those requirements is to name the charity(ies) directly as beneficiaries of the IRA, so the benefits don't pass through a trust or estate at all. But when that approach can't be used, and you end up passing the benefits to charity through a trust or estate, meeting (or end-running to avoid) those 642(c) requirements is difficult if the documents are not drafted properly. But when, as here, the trust is drafted to specifically deal with this issue, it is smooth sailing.

Moral for estate planners: If your client wants retirement benefits to go to charity at his death, draft the documents correctly or risk unwanted income taxes! For more detail, see the author's *Special Report: Charitable Giving with Retirement Benefits* (2017 ed.), downloadable at www.ataxplan.com.

V. QCDS ARE HERE TO STAY!

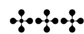
The following is adapted from ¶ 7.6 of the electronic edition of the author's book Life and Death Planning for Retirement Benefits *(7th ed. 2011), Chapter 7. Cross references may refer to other parts of the book that are not reproduced here.*

A "qualified charitable distribution" under § 408(d)(8) (QCD) is a transfer directly from an individual retirement account (IRA) to a charity that meets (needless to say—it's a tax code provision after all) a laundry list of requirements. For the charitably inclined IRA owner who is age 70½ or older at the time, QCDs have provided a (usually) tax-favored way to make his charitable gifts since 2006.

If QCDs have been with us since 2006, then what's the new development? It's this: Until the very end of 2015, QCDs were always just a "temporary" measure. Congress would add the provision to the Code (in some years, retroactively), but with an expiration date. So in many of the 2006–2015 years individuals had no way to know, until very late in the year, if these transfers would be recognized for that year. Planning was....difficult to say the least.

Effective with the enactment of by the "Protecting Americans from Tax Hikes (PATH) Act of 2015" enacted December 18, 2015, QCDs became a "permanent" part of the Code. Specifically, PATH re-enacted § 408(d)(8) but this time for the first time without "subsection (F)" (the expiration date). See PATH, section 112.

Since QCDs are now "permanent" (as much as anything in the Code is permanent), planners need to familiarize their clients with this very valuable income-planning tool.



Generally, lifetime gifts of retirement benefits are not a tax-favored way to deal with such benefits; see discussion at ¶ 7.7.01 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011) (electronic edition). One minor but very popular exception is the "qualified charitable distribution" (QCD)—the ability of *some people* to transfer *a limited amount* of funds directly from *certain types of IRA* to *certain types of charities*. Specifically, an over-age-70½ IRA owner or beneficiary (see ¶ 7.6.02) can instruct the administrator of the IRA (see ¶ 7.6.03) to transfer up to $100,000 in any calendar year (see ¶ 7.6.04) to one or more eligible charities (see ¶ 7.6.05). The amount(s) so transferred is not includible in the gross income of the IRA owner-donor (see ¶ 7.6.06), even though it is a distribution from his or her IRA, and even though it may be used to satisfy the required minimum distribution (se ¶ 7.6.08(A)).

This ¶ 7.6 explains QCDs—the requirements, mechanics, limitations, and benefits.

7.6.01 ***Where to find the law***

The QCD is created by § 408(d)(8), which has in effect been part of the Tax Code since 2006—"in effect" because it was enacted several times on a temporary and often retroactive basis before being made a permanent part of the Code in December 2015.

QCDs were first permitted in calendar year 2006. § 408(d)(8) Originally enacted as a temporary measure (good for IRA distributions in 2006 and 2007 only), § 408(d)(8) was extended in late 2008 for two more taxable years (2008 and 2009). In December 2010, § 408(d)(8) was extended for two more years (2010–2011). The American Taxpayer Relief Act of 2012 (ATRA) extended them *again*, but only through 2013. (All the rest of ATRA's provisions were permanent). They were again allowed by late-in-the-year legislation for 2014, but again as a temporary provision: Subsection (F) of § 408(d)(8) stated that the section would not apply to distributions after 2014. QCDs were re-authorized retroactively for 2015 *and made permanent* for 2015 and later years by the "Protecting Americans from Tax Hikes (PATH) Act of 2015" enacted December 18, 2015, which struck subsection (F). See PATH, section 112. So finally § 408(d)(8) does not have an expiration date!

The Treasury's only authoritative pronouncement on QCDs was and so far remains IRS Notice 2007-7 (Part IX), 2007-5 I.R.B. 395, Q & A 34 through 44.

7.6.02 ***Who can make QCDs: Individuals over age 70½***

Only individuals who are age 70½ or older can make QCDs. § 408(d)(8)(B)(ii).

The QCD donor can be either an IRA participant donating from his own IRA or a beneficiary donating from an inherited IRA. IRS Notice 2007-7, A-37. The only requirement is that the donor (whether owner or beneficiary) must be age 70½ or older.

This is the only tax code provision to make the age 70½ "birthday" itself a significant event. Required minimum distributions are based on the YEAR the participant reaches age 70½, not the DAY he reaches that age. Someone who reaches age 70½ on (say) December 30 could have a tough time getting his IRA provider to make the QCD on the last day of the year. It would have been easier for all concerned to allow QCDs to occur anytime during or after the calendar year the individual reaches age 70½—but that's not what the law says.

Example: In 2014, Jonathan inherited an IRA from his mother. He also has an IRA of his own. Jonathan's 70th birthday was April 1, 2015. He turned 70½ on October 1, 2015. He can make QCDs from either his own IRA or the inherited IRA he holds as beneficiary of his mother (or both) any time on or after October 1, 2015.

7.6.03 ***From IRAs only (but not ongoing SEPs or SIMPLEs)***

QCDs may be made *only* from IRAs. § 408(d)(8)B). So, a QCD can not be made from a "qualified retirement plan," i.e., a plan qualified under § 401(a) of the Code, such as a pension, profit-sharing, Keogh, or 401(k) plan); or from a 403(b) plan; or from a 457 plan.

A QCD can be made from *any type of IRA* (including a Roth IRA) subject to the following exceptions/limitations:

✓ A QCD may **not** be made from an "ongoing" SEP-IRA or SIMPLE IRA. SEPs and SIMPLEs are IRAs funded directly by contributions from the individual's employer. See § 408(k) and § 408(p). An "ongoing" SEP or SIMPLE in any particular year is one that receives an employer contribution in such year. IRS Notice 2007-7, A-36.

✓ A QCD can come from a Roth IRA (to the extent the amount distributed would be included in the owner's gross income if distributed to him or her; see ¶ 7.6.06). § 408(d)(8)(B). But generally a person would not make a QCD from a Roth IRA. For one thing, most Roth IRA distributions are income tax-free, and so not eligible to be the subject of a QCD; see ¶ 5.2.03 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011). Even if an over-age 70½ person holds a Roth IRA distributions from which could be partly includible in his/her income (because he/she had not held a Roth IRA for the required 5-year holding period of § 408A(d)(2)(B); see ¶ 5.2.05 of *Life and Death Planning for Retirement Benefits*), the Roth IRA owner can expect that these funds eventually will qualify for income-tax free treatment and it would not be advantageous to throw away that future tax benefit just to make a QCD.

Example: Carl is age 76 and still working at Acme Widget. In 2016, he holds an IRA he inherited from his father, a Roth IRA he had owned for 10 years, a SEP-IRA to which Acme Widget is contributing in 2016, and a 401(k) plan account in the plan of his prior employer, Bacchus Detective Agency. He can make a QCD in 2016 from the inherited IRA. He cannot make a QCD from the Roth IRA because anything distributable to him from that account would be excludible from his income and thus not QCD-eligible. He cannot make a QCD from the SEP-IRA this year because it is "ongoing" (receiving an employer contribution) in 2016. He cannot make a contribution from the 401(k) plan because it is not an IRA.

7.6.04 ***How much? $100,000 per year per IRA owner***

The QCD income exclusion is limited to $100,000 per year. § 408(d)(8)(A). The limit is per IRA owner, not per IRA. "For married individuals filing a joint return, the limit is $100,000 per individual IRA owner." IRS Notice 2007-7, A-34. So, a husband and wife who are both over age 70½ and who both have IRAs can each transfer up to $100,000 to charity from their respective IRAs in the same year. But if (for example) wife has an IRA and husband does not, wife cannot "borrow" husband's limit and give $200,000 from her IRA.

The donor does not have to give that much. $100,000 per IRA owner per year is the maximum and there is no minimum (other than what the IRA provider may impose administratively).

Example: Jody, age 83, gives $5,000 per year to her church and does not make any other charitable gifts. Since 2006 she has made these annual gifts directly from her IRA as QCDs. Her sister Agatha, age 81, gives $200,000 a year to charity. She makes half her annual gift in the form of a QCD and the rest using appreciated stock held in her taxable account.

7.6.05 ***Requirements applicable to charity and donation***

A QCD can be made to any charity EXCEPT a donor-advised fund (§ 4966(d)(2)) or a supporting organization (§ 509(a)(3)). § 408(d)(8)(B)(i).

Also, the QCD must be a contribution that would be 100 percent deductible if paid from the owner's nonIRA assets, so a split-interest gift will NOT qualify. Thus, QCDs can NOT be made to a charitable remainder trust (¶ 7.5.04), pooled income fund (¶ 7.5.10), or charitable gift annuity (¶ 7.5.08), or in exchange for any consideration. Note however that in determining whether the gift would be 100 percent deductible if made with nonIRA assets the percentage-of-income limits in § 170(b) are ignored. § 408(d)(8)(C).

The gift must meet all other requirements applicable to the income tax charitable deduction under § 170, such as the substantiation requirement. IRS Notice 2007-7, A-39.

7.6.06 ***Income tax aspects; effect on basis***

The QCD is excluded from the individual's gross income for all purposes. § 408(d)(8)(A). Thus it cannot be counted as part of the individual's gross income for purposes of applying the percentage-of-income limits in § 170(b) with respect to his other charitable gifts. Of course, there is no income tax charitable deduction for the QCD. IRS Notice 2007-7, A-39.

The QCD must be a distribution that would otherwise be includible in the donor's gross income. § 408(d)(8)(B). Here is the effect of this rule on:

✓ Distributions from Roth IRAs: A qualified distribution from a Roth IRA (see ¶ 5.2.01 of *Life and Death Planning for Retirement Benefits*) cannot be a QCD because a qualified Roth IRA distribution is nontaxable. Thus, QCDs could be made from a Roth IRA only if the Roth IRA had not yet met the requirements for a "qualified distribution." But even then it would normally not be good planning to make a QCD from a Roth IRA; see ¶ 7.6.03.

✓ IRAs where the IRA owner has no after-tax money in any IRA: If the traditional-IRA owner does not have any after-tax money in any of this IRAs, this rule is "no problem" since all distributions from any of his IRAs will consist 100 percent of pretax money (includible in gross income).

✓ If the IRA owner has any "basis" (after-tax money; also called "investment in the contract") in any of his IRA accounts, then the requirement that QCDs must be all pretax money would pose a problem. Under the rule nicknamed the "cream-in-the-coffee rule" of § 72 (explained at ¶ 2.2.08 of *Life and Death Planning for Retirement Benefits* (7th ed. 2011)), any distribution from an IRA carries out proportionate amounts of the "pretax" and "after-tax" money in the individual's IRAs (with all of his traditional IRAs being treated as single account for purposes of determining the proportions).

To accommodate this requirement, there is a special "basis recovery rule" in the Tax Code for QCDs: QCDs are deemed to come out of the IRA's pretax money first. § 408(d)(8)(D).

Burton Example. Burton is a charitably-inclined individual age 71 who does not like to pay taxes. He owns a $70,000 IRA with a $20,000 basis resulting from nondeductible contributions in prior years. He owns no other IRAs. He directs the IRA provider to transfer $50,000 from his IRA directly to the Red Cross. This is a QCD, so the $50,000 is deemed to come from the IRA's pretax money "first." Now he is left with a $20,000 IRA which is 100 percent after-tax money. He can then convert this small "stub" IRA to a Roth IRA tax-free, or cash it out tax-free.

Note that this federal rule does not necessarily have any effect on state tax treatment of the distribution. For example, a particular state's "basis recovery rule" for IRA distributions may or may not accommodate this special federal rule for QCDs. The client and preparer must determine the client's income tax basis (investment in the contract) both before and after the QCD occurs, for both federal and (if applicable) state purposes.

7.6.07 ***How to do it; how to report it***

To effect a QCD, the IRA owner directs the IRA provider/administrator to transfer funds from the IRA to the charity. The donor-IRA owner should communicate with her IRA provider regarding its policies and preferred procedures for carrying out these transfers. One acceptable procedure is for the IRA provider to cut a check payable to the charity and have the donor physically deliver the check to the charity. IRS Notice 2007-7, A-41.

The IRA custodian is supposed to report the QCD on Form 1099-R, just as if it had paid the distribution to the individual donor rather than to a charity. There is no special code or other indication on Form 1099-R signaling that the distribution is a QCD. Thus, nothing in the 1099-R will reveal that the distribution is nontaxable! As the IRS put it in the instructions for Form 1099-R (2013), p. 1, "There's no special reporting" that IRA providers have to do for qualified charitable distributions.

Instead, it's up to the IRA owner-donor to report the nontaxable status, in the following manner: First, he enters the total distribution (as shown on Form 1099-R) on Line 15a of his personal income tax return, Form 1040. Then he enters the taxable portion of the distribution (zero, if the QCD was the only distribution for the year) on Line 15b. See instructions for IRS Form 1040, 2014, p. 24, Lines 15a and 15b, Exception 3. Then the donor is supposed to "Enter 'QCD' next to line 15b," apparently by hand in the margin of the tax form.

This method of reporting QCDs presumably means that some QCD-donors will not get the benefit of the income tax exclusion. This will happen if the IRA owner-donor simply turns over all his 1099-Rs to his tax preparer without alerting the preparer to the fact that there was a QCD. The preparer will then presumably simply report the entire distribution as taxable, and if the client doesn't notice that discrepancy but simply signs and files the return, the U.S. Treasury will collect a bit more money than it's entitled to.

*7.6.08 **Using QCDs for the RMD; other QCD planning uses, pitfalls***

The QCD will not save anyone millions of dollars of taxes, but it is nevertheless a safe legal tax-favored way for an over-age-70½ client to use his IRA to benefit charity. Despite a few kinks and pitfalls, the QCD is a low-tax way to fulfill the minimum distribution requirement for the charitably inclined client.

A. **Use QCD to fulfill RMD.** A QCD will count as a distribution for purposes of determining whether an individual has fulfilled the RMD requirement. IRS Notice 2007-7, A-42. This is consistent with Regs. § 1.401(a)(9)-5, A-9(a), and § 1.408-8, A-11(a), which state that, except as otherwise provided in A-9(b) or A-11(b) of such regulations, or as may later be otherwise provided by other IRS pronouncements, "all amounts distributed" from a plan or IRA "are taken into account in determining whether section 401(a)(9) is satisfied…." The charitable IRA rollover is an ideal way for a charitably-inclined individual over age 70½ to fulfill the RMD requirement.

B. **Mixing up QCDs and RMDs.** Someone who has already taken his RMD for a particular year cannot use a QCD later in the year to fulfill his RMD requirement for that year; he cannot roll the already-taken RMD back into the IRA (to enable him to use a QCD instead) because RMDs are not eligible rollover distributions. See ¶ 2.6.03 of *Life and Death Planning for Retirement Benefits*. He can still make a QCD from his IRA; it just will not be his RMD. People will get confused about the RMD/QCD relationship. The two things have nothing to do with each other (other than the fact that a QCD counts towards the RMD, to the extent the RMD has not already been taken). A person can make QCDs of up to but not more than $100,000 (in any year QCDS are permitted), *regardless* of: whether his RMD for

the year is more or less than $100,000; *regardless* of whether he has already taken the RMD; and *regardless* of what other distributions he has taken or later takes from the IRA.

C. Advantages of the QCD. The QCD eliminates *some* of the problems that arise when making lifetime charitable gifts from an IRA (see ¶ 7.7.01). A QCD does not increase AGI and therefore does not: increase the individual's adjusted gross income for purposes of determining the extent to which his "net investment income" will be taxed (§ 1411); decrease the deductibility of medical expenses (§ 213(a)) or miscellaneous itemized deductions (§ 67(a)); increase the reduction of itemized deductions (§ 68(a)); increase the taxability of Social Security benefits (§ 86); increase Medicare premiums (42 U.S. Code §1395r(i)); or increase state income taxes (in a state that uses federal AGI as the basis for computing state income tax but does not allow a charitable deduction). Since there is no itemized charitable deduction for the QCD gift, the gift does not "count" for purposes of the percentage-of-income limits on charitable deductions in § 170(b); does not get reduced by § 68(a); and is in effect "deductible" even for someone who does not itemize deductions.

D. Fulfilment of pledge. A QCD is considered a payment "to" the participant for purposes of the prohibited transaction rules. Thus, it is not a prohibited transaction even if it is used to fulfill a pledge to the charity. IRS Notice 2007-7, A-44.

E. Drawbacks, problems, and what will go wrong. QCDs are allowed only for direct transfers from the IRA to one of the permitted types of charitable recipients. If the money is first distributed to the individual, then donated to charity, it is not a QCD, and all the usual limits and drawbacks described at ¶ 7.7.01 will apply (there was an exception to this for certain charitable transfers in January 2013). While it might appear desirable for an over-age 70½ individual to use QCDs to fund all of his charitable contributions, there will be practical limits on this: Presumably, IRA providers will start charging "distribution fees" or setting minimum distribution amounts if they are asked to issue dozens of tiny QCDs. Finally, for an IRA owner who wants to give more to charity than just the amount of his/her RMD, the donor-owner should determine whether another form of charitable gift would be more advantageous for such additional gifting (such as gifts of appreciated stock from a taxable account).

VI. PROPOSAL: ELIMINATE THE STRETCH IRA?

Over the last 8 years or so, proposals have regularly surfaced in Washington that would "require non-spouse beneficiaries...to take inherited distributions over no more than five years." Essentially, the "5-year rule" that now applies only when a participant dies before his required beginning date with no "designated beneficiary" would apply to almost all inherited benefits.

Rationales for killing the stretch (and why they are wrong)

One justification sometimes stated for this proposal is that our law "gives tax preferences for retirement savings accounts primarily to provide retirement security for individuals and their spouses. The preferences *were not created with the intent of providing tax preferences to the*

non-spouse heirs of individuals. Because the beneficiary of an inherited account can be much younger than a plan participant or IRA owner, the current rules allowing such a beneficiary to stretch the receipt of distributions over many years permit the beneficiary to enjoy tax-favored accumulation of earnings over long periods of time." Other reasons offered in support of the proposal are to bring the law back into line with the purpose of the tax Code's retirement provisions which is to provide for retirement, not wealth transfer, while also raising revenue and (of course) simplifying the rules. Unfortunately, all three of those justifications are wrong.

With no death benefits, people won't save

It's true that the purpose of the Code's retirement plan provisions is to encourage people to save for their retirement years, but it's not true that providing a substantial benefit to the participant's heirs is inconsistent with that purpose. Building a legacy for future generations is a major motivation for people to save. Society can benefit from that urge to save for future generations, if the result is that people save adequately for their later years. Presumably in recognition of that fact of human nature, a significant death benefit has always been a component of the Code's retirement-savings rules.

The ancestor of today's minimum distribution rules was the "incidental death benefit rule," which has decreed (since the inception of the tax-favored retirement provisions of the Code) that retirement benefits had to be distributed to the owner, upon retirement, in a form that would cause at least half of the benefits' value to be distributed to the owner during his/her lifetime. Not 100%, *half*! Thus a 50 percent death benefit "wealth transfer" component for heirs was considered "incidental" and has *always* been part of the retirement plan-tax savings "deal."

If a 5-year across the board payout is mandated for retirement plan death benefits, many individuals will probably reduce or eliminate their retirement plan contributions. A prudent saver will not wish to place money in a format that will generate an income tax "meltdown" upon his death. Rather, the prudent saver seeks to invest in a way that will provide for himself in his future retirement years and leave an inheritance for his heirs. "Straight" life annuities, though seemingly the ideal way to provide retirement income, are not terribly popular just because they do not provide any inheritance for the annuitant's descendants.

Few "non-spouse heirs" actually stretch

Also (except possibly by discouraging people from contributing to plans), ending the stretch payout will not raise significant revenue. Despite the allure of the stretch IRA, very few stretchouts (in my experience) actually get implemented. Most beneficiaries want immediate cash, not a stretch payout. Even when the participant plans for a long term stretch payout to his beneficiaries, what happens in most cases is that the participant lives a long time and spends the money down during life. A participant who dies "young," typically leaves the benefits to a surviving spouse who rolls them over and then spends them down during his long overlife. So how many substantial stretch payouts to young beneficiaries actually get implemented? Not that many!

The world's most complicated simplification

Finally, even though a fixed term payout period for everybody would theoretically be simpler than the life expectancy payout, it will not work that way because the 5-year term is too short. It means the law then has to contain lots of exceptions. For example, President Obama's proposed contained seven exceptions; more recent versions contain eight!

President Obama's version included exceptions (5-year payout does not apply) for (1) disabled beneficiaries, (2) chronically ill beneficiaries, (3) the surviving spouse, and (4) any beneficiary who is close in age to the decedent. A minor beneficiary (5) could use the life expectancy payout method, except he would have to switch to a 5-year payout upon reaching majority. The life expectancy payout period would be preserved to the extent embodied in any irrevocable annuity payout initiated prior to the effective date of the new law (6).

Finally, a beneficiary of someone who died before the effective date of the new law could continue his "grandfathered" life expectancy payout (Exception #7), but the payout period would switch to the 5-year rule for successors to that original beneficiary. Note that this seventh exception would require keeping the entire complicated system of today's life expectancy payout rules "alive" for potentially *80 more years* after the life expectancy payout was supposedly "killed!" 80 years is the life expectancy of a newborn baby beneficiary named by a participant who died just before the effective date of the new law who would be "grandfathered" under this proposal.

And more recent versions have proposed using the "old rules" for the first $450,000 of a decedent's retirement benefits, with the 5-year-rule-and-its-7-exceptions would apply to benefits in excess of that.

Whew! Whatever that is, it's not simplification! It would be the estate planner's full employment act.

How does this affect our planning and trust-drafting?

The proposal to kill the stretch reminds us of the hazards of building an entire estate plan or trust document around a fragile Code provision. Though planning for a stretch payout makes sense for a client's existing retirement benefits, it might not be wise to encourage massive or disproportionate accumulations in tax-favored retirement plans based on the hope of achieving a post-death stretch payout that could be eliminated with the stroke of a pen. Balance makes sense here as usual.

Here's how the kill-the-stretch proposal would affect particular clients' estate plans:

<u>Already deceased</u>: Most proposed amendments would not apply in this situation (until after the death of the original beneficiary), so any stretch that is already in payout status upon the effective date of the new law should have few worries. A trust document that spells out the current minimum distribution rules might have to be reformed to reflect the new requirement that the payout would switch over to a 5-year rule on the original beneficiary's death. Possibly the purchase of life insurance on the life of the original beneficiary would cushion tax losses caused by his premature death.

<u>New clients and revisions of existing plans</u>: If the proposal becomes law, trusts that are named as beneficiary of retirement plans may have to be revised to reflect the fact that the stretch

payout is no longer an option. The biggest problem would be the high income tax brackets applicable to trusts. Under today's stretch payout rules, the high bracket can be avoided (without giving the individual beneficiary immediate access to the entire plan) by using a conduit trust. The trustee controls the IRA, and dribbles out minimum distributions to the human "conduit" beneficiary gradually over the beneficiary's life expectancy. With no life expectancy payout available, the stark choice for many participants would be between leaving benefits to a trust (with a punishing income tax rate) or outright to an individual beneficiary who (though in a lower income tax bracket) is potentially improvident or creditor-vulnerable. Leaving benefits to an (income tax-exempt) charitable remainder trust that gives a creditor-proof lifelong payout to the individual beneficiary may become a popular compromise.

The client who doesn't update his plan: Finally, what will become of the clients who have estate plans built on the expectation of a stretch payout (using a conduit trust), but fail to update their estate plans prior to dying? Obviously that could produce a very bad situation, and suggests the importance of urging and reminding clients to update regularly. A "conduit trust" could produce a very unfortunate result if it simply requires that all retirement plan distributions received by the trustee be forthwith transmitted to the individual beneficiary.

What is preferable is, in drafting a conduit trust, to limit the "conduit" requirement to ONLY retirement benefits that otherwise qualify for a life expectancy payout. With that limiting clause included, benefits paid out to the trust under a mandatory 5-year rule would not be subject to the conduit requirement. Thus the disaster of an immediate total payout of the benefits (when the client was expecting a gradual life expectancy payout) is avoided. But even if the trust contains that (highly desirable) language limiting the "conduit" requirement to benefits that qualify for a life expectancy payout, the client should still update his estate plan as soon as possible if the President's proposal becomes law, to review other alternatives for disposition of the retirement benefits.

What would President Choate do?

Many people ask me[1] what I would do to improve, reform, or simplify our current life expectancy payout system. My answer: I agree with former President Obama, former Senator Max Baucus, and others that a fixed-term payout period would be preferable to the incredibly complicated and chance-y life expectancy payout method we have now, but five years is too short (in my opinion). It discourages savings and necessitates numerous exceptions.

I would suggest, instead, replacing the life expectancy system with a mandatory 21-year fixed term payout period for all post-death benefits (and keep the spousal rollover as the sole exception). That's a long enough payout period (in my opinion) to fairly be applied retroactively to beneficiaries of people who are already deceased (if the 21 years begins upon enactment); that way, we don't have to keep the existing life expectancy payout rules in operation for another 80 years.

21 years would also be a long enough period so people wouldn't be discouraged from saving in retirement plans. It would be long enough to allow minor beneficiaries to get to adulthood. I would suggest not having special minimum distribution rules for the disabled and the chronically

[1] Not really.

ill; give them lower tax rates or higher exemptions, but not their own special minimum distribution system!

My proposal would truly simplify, fairly and without the need for numerous exceptions, and it would eliminate the "designated beneficiary" lottery system we now have. Vote for me if you want this superior system!

VII. REV. PROC. 2016-47: NEW "SELF-CERTIFICATION" PROCEDURES FOR HARDSHIP WAIVERS OF ROLLOVER DEADLINE

The IRS has had a major flip-flop—in a way that's good for taxpayers. If you missed your 60-day rollover deadline, you MAY well be able to complete the rollover anyway, using the "self-certification" process laid out in Rev. Proc. 2016-37 (8/24/16). Prior to this Rev. Proc., you could get a waiver of the 60-day rollover deadline—but you had to apply to the IRS for it and pay a $10,000 filing fee and wait a year or more to get an answer. Now (if you fit into certain common "hardship waiver" situations) you can DIY—no filing fee, no wait.

Background: Generally, a retirement plan distribution is taxable. But generally a retirement plan distribution is *not* taxable if the distribution is "rolled over" within 60 days into the same or another retirement plan. Of course there are many rules surrounding tax-free rollovers: Some distributions don't qualify for it, some recipients are not eligible to roll over distributions, etc. For complete explanation of the rules regarding tax-free rollovers see ¶ 2.6 of the author's book *Life and Death Planning for Retirement Benefits*.

But assuming a rollover-eligible recipient receives a rollover-eligible distribution, that recipient generally has 60 days during which he/she can deposit the distributed amount into the same or another eligible retirement plan in order to make the distribution nontaxable. § 402(c)(3)(A); § 408(d)(3)(A).

Prior to 2002, if the recipient missed that 60-day deadline, he or she was totally out of luck. There was no way to get any extension of the 60-day time limit regardless of the reason it was missed—whether war, flood, famine, illness or any other good excuse.

In 2001, the law was changed. Effective for any distribution received after 2001, the law now provides that the IRS "may waive the 60-day requirement…where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement." § 402(c)(3)(B); § 408(d)(3)(I) (effective for distributions after 2001).

So what constitutes the type of hardship justifying a waiver of the deadline? In Rev. Proc. 2003-16, 2003-1 C.B. 359, the IRS set out to answer that question. The legislative history of the 2001 legislation indicates that Congress wanted the IRS to issue "objective standards" for granting hardship waivers of the 60-day deadline, but (until now) the IRS has never done that. Instead, the 2003 Rev. Proc. said only that the IRS will consider "all relevant facts and circumstances," such as "death, disability, hospitalization, incarceration, restrictions imposed by a foreign country or postal error;...the use of the amount distributed (for example...whether the check was cashed); and...the time elapsed since the distribution occurred." Basically the IRS said that each person seeking a waiver had to apply for a private letter ruling to ask for one.

Since then, the IRS has issued hundreds of PLRs responding to these waiver requests. Though the PLRs are not always consistent (some deny waivers despite facts that seemed to be the

basis of a ruling in which the IRS granted a waiver), in general the rulings seem to line up with the idea that someone who has one or more of the factors listed in Rev. Proc. 2003-16 will get a waiver, whereas someone who missed the deadline due to factors not listed in Rev. Proc. 2003-16 will not get a waiver. However, despite Congress's intent in enacting this statutory change, there were (until 8/24/16) still no "objective standards" that taxpayers could safely rely on to assume they are entitled to a waiver of the 60-day deadline—anyone who wanted a waiver had to request their own PLR.

Perhaps because the IRS knew it hadn't really carried out this statute exactly the way Congress had in mind, the IRS (until 2016) granted a separate reduced user fee (filing fee) schedule for people requesting waiver of the 60-day rollover deadline. The "regular" fee you must pay to the IRS to obtaining a private letter ruling is $10,000; but for the years prior to 2016, the following reduced-rate user-fee schedule of $500–$3,000 applied to these ruling requests. See, *e.g.*, Rev. Proc. 2010-8, 2010-1 IRB 234, § 6.01(4), (14); and the same in Rev. Procs. 2012-18, 2013-8, and 2014-8, section 6.01.

But in Rev. Proc. 2015-8, 2016-1 IRB 243 (12/31/15), effective for 2016, the special low rates for these deadline-waiver requests were eliminated. Instead, these requests must now pay the usual "general" fee for a letter ruling which is $10,000! (A lower fee may apply for a lower income taxpayer.) This huge fee increase was expected to slow and perhaps even totally stop the steady stream of requests for waiver of the 60-day deadline.

But then.....In August 2016, the IRS issued Rev. Proc. 2016-47, creating a new self-certification procedure. The procedure lays out the facts under which someone will be deemed to have qualified for a hardship waiver of the rollover deadline. With this procedure, if you have received a plan distribution, but you have not completed the rollover of that distribution within 60 days, you can make the rollover late, provided you can "certify" to the plan administrator of the plan you are rolling over to that you qualify for a waiver of the 60 day deadline. The plan administrator can rely on your self certification and accept the rollover.

To qualify for the self-certification approach, you must meet three requirements. First, you must not have been previously denied a waiver by the IRS for this particular distribution. Second, you must have been unable to complete the rollover due to one or more of the 10 reasons in the following list. Third, you must complete the rollover as soon as practicable after the reason(s) that prevented you from completing it no longer prevent you. Completing the rollover within 30 days after the "reasons no longer prevent you" will automatically be deemed to comply with condition #3.

Here is the menu of reasons justifying the waiver based on the self-certification procedure:

1. An error was committed by the financial institution receiving the contribution or making the distribution to which the contribution relates.

2. The distribution was made in the form of a check which was misplaced and never cashed.

3. The distribution was deposited into and remained in an account that the taxpayer mistakenly thought was an eligible retirement plan.

4. The taxpayer's principal residence was severely damaged.

5. A member of the taxpayer's family died.

6. The taxpayer or a member of the taxpayer's family was seriously ill.

7. The taxpayer was incarcerated.

8. Restrictions imposed by a foreign country.

9. Postal error.

10. The distribution was made on account of a levy under § 6331 and the proceeds of the levy have been returned to the taxpayer.

11. The party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite the taxpayer's reasonable efforts to obtain the information.

The self certification procedure is not invulnerable. If the IRS happens to audit your return, and finds that (for example) you made a material misstatement in your certification, or the reason(s) you claimed did not in fact prevent you from completing the rollover, or you did not complete the rollover as soon as practicable once the reasons were removed, the IRS can take away the waiver of the 60-day deadline. In that case you will of course be in big trouble: You will owe income taxes on the late-rolled distribution, plus penalties for an excess contribution to the receiving plan, plus interest and penalties on the foregoing.

Of the 10 reasons, #1 is the most common reason people are forced to seek waivers of the 60-day deadline—financial institution error. More waivers have been issued for that reason than for all the others combined. I would have thought reason #10 was just another example of reason #1—financial institution error.

And, regularly we see waivers issued where the rollover delay was due to the taxpayer's illness, or illness or death of his family members (#5, #6). There have been a few waivers for postal error (#9), and also for cases where the taxpayer thought he had rolled the money into a retirement plan but it wasn't actually a retirement plan (#3). As for the distribution check being lost and never cashed (#2), that's pretty rare. Similarly I don't recall having seen any waivers issued due to damage to the principal residence (#4), the taxpayer's being incarcerated (#7), or restrictions imposed by a foreign country (#9), or a returned IRS levy (#10). But there must have been some I suppose, I don't purport to have read all of them.

The list leaves out some "biggies"—reasons that have regularly led to waiver requests in the past: Error by a financial advisor; taxpayer's death; mental or emotional state of the taxpayer. This does not mean that waivers cannot be granted for those causes. It just means you must use the regular apply-for-a-private-letter-ruling approach (Rev. Proc. 2003-16).

Perhaps the IRS wants to personally review the facts in those situations. For example, the mental or emotional state of the taxpayer can be rather subjective and has a wide range. The IRS will normally grant the waiver if the taxpayer suffered from such mental impairment that he didn't understand the nature of the IRA distribution he took (documented by a doctor's opinion), but will not grant the waiver if the failure was due to the taxpayer's alleged extreme stress caused by getting ready to go on vacation.