YOUR Money AND Family Today

AMERICA'S TAX SOLUTIONS™ NEWSLETTER

MARCH 2014

LITTLE KNOWN TAX AND RETIREMENT FACTS

The NUA Advantage

Many corporations offer their employees different kinds of incentives and/or bonuses. One of these is company stock held in a 401(k) or other qualified pension plan. If you hold stock from a previous employer in a qualified plan, you are eligible, under the IRS code, for special tax treatment on those assets based upon a concept called Net Unrealized Appreciation (NUA).

To put it simply, if you rollover the stock to an IRA, the company stock's NUA will be taxed at your ordinary income tax rate when you distribute the stocks. If, however, you transfer the company stock in kind to a regular brokerage account, your ordinary income tax rate will apply to the basis (which is recognized as a distribution). But, the long-term capital gains tax rate in effect at the time you eventually sell the stock will apply to the NUA upon distribution.

When you decide to sell those shares, you will only pay the capital gains tax rate, not ordinary income tax on the appreciation. This rule holds true for *whenever* you choose to sell – once you trigger an NUA strategy, the 1 year holding period for long-term capital gains treatment is automatically satisfied.

Your personal retirement distribution specialist and tax professional can explain to you some of the other stipulations in the Tax Code involving NUA.

These include:

- There must be a triggering event - separation from service, turning 59½, full disability (if self-employed) or death.
- The stock must have been purchased with pre-tax contributions or employer matches.
- To qualify for the break, you must take the entire pension plan account balance in a lump sum distribution over the course of one tax year – all assets must be distributed, not just the stock.
- Dividends paid on the stock are not tax-deferred.
- For inherited stock in an IRA, beneficiaries are taxed at a different cost basis, called a step-up in basis. Your advisor can describe for you how step-up in basis works, and how it may affect you and your heirs.

Keep in mind that even though an NUA strategy may be available to you, it may not necessarily be wise or appropriate for you. You shouldn't make an NUA decision without first consulting with your personal advisors to fully assess your individual objectives, taking into account crucial factors like age, tax implications, income requirements, retirement needs and any potential risk or downside with respect to an NUA strategy. Especially in light of the 2012 American Taxpayer Relief Act, it is important to carefully analyze the pros and cons of an NUA strategy in your particular situation before committing.

What is the "Still Working Exception?"

There is no still working exception for IRAs, Simple IRAs or SEP IRAs. This exception only applies to certain qualified employer retirement plans.

If you have a qualified employer retirement plan, you generally need to start taking required minimum distributions (RMDs) by April 1st of the year following the year you turn 70½, just like the standard IRA RMD rule. However, your employer plan may have a "still working exception" for employees who are still actively working for that employer but are over the age of 70½.

Under this exception, as long as the employee doesn't own more than 5% of the company, an employee who is over 70½ but is still working for the company, may choose to delay his/her first RMD from that employer retirement plan until April 1st of the year following the year the employee retires.

Note: Many are confused by this rule so to clarify, if the 70½+ employee also has an IRA, the employee must begin taking his/her RMDs from that IRA even though he/she is still working and has elected to delay RMDs from his/her employer qualified retirement plan.

To illustrate the still working exception, assume you have a 401(k) and the plan permits a still working exception, an option you elected. You are now 72 years old and you decide to retire today. Your retirement immediately triggers your required beginning date for distributions as April 1, 2015 and thus begins your RMD requirement. The catch in this scenario is, if you choose to delay your first RMD and do not take it until, say, March 2015, you will still need to take your regular RMD for 2015 by December 31st next year.

For some people, having to take two RMDs in the same tax year is not a good idea from a tax planning perspective. Be sure to consult with your personal retirement distribution expert and tax advisor to determine your best course of action.

7 Tax Facts From the IRS About Dependents and Exemptions

1. **Exemptions cut income.** There are two types of exemptions: personal exemptions and exemptions for dependents. You can usually deduct $3,900 for each exemption you claim on your 2013 tax return.

2. **Personal exemptions.** You can usually claim an exemption for yourself. If you're married and file a joint return you can also claim one for your spouse. If you file a separate return, you can claim an exemption for your spouse only if your spouse had no gross income, is not filing a return, and was not the dependent of another taxpayer.

3. **Exemptions for dependents.** You can usually claim an exemption for each of your dependents. A dependent is either your child or a relative that meets certain tests. You can't claim your spouse as a dependent. You must list the Social Security number of each dependent you claim. See IRS Publication 501, Exemptions, Standard Deduction, and Filing Information, for rules that apply to people who don't have an SSN.

4. **Some people don't qualify.** You generally may not claim married persons as dependents if they file a joint return with their spouse. There are some exceptions to this rule.

5. **Dependents may have to file.** People that you can claim as your dependent may have to file their own federal tax return. This depends on many things, including the amount of their income, their marital status and if they owe certain taxes.

6. **No exemption on dependent's return.** If you can claim a person as a dependent, that person can't claim a personal exemption on his or her own tax return. This is true even if you don't actually claim that person as a dependent on your tax return. The rule applies because you have to right to claim that person.

7. **Exemption phase-out.** The $3,900 per exemption is subject to income limits. This rule may reduce or eliminate the amount depending on your income. See Publication 501 for details.

Source: www.irs.gov

Correcting Retirement Plan Mistakes by the Deadline

Do you have an IRA, 401(k) or other retirement plan? If so, you know how easy it can be to overlook things like taking your first RMD or contributing too much to your retirement plan. The good news is it's early in the year and there is plenty of time to mark your calendar and plan for 2014. In addition, there is still time to correct a few 2013 errors before the applicable deadlines.

Taking Your First RMD

Do you have a traditional IRA and turned 70½ last year? If you didn't take a required minimum distribution (RMD) in 2013, you have until April 1st to take your very first RMD. The IRS allows you extra time for your first

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RMD only, the standard December 31st deadline applies to all of your subsequent RMDs. If you delayed your first RMD and plan to take it by April 1st, keep in mind that you still must take your regular RMD for 2014 by December 31st.

Contribution Mistakes

Did you inadvertently contribute too much money to your IRA or 401(k)? If so, you need to correct your contribution. The statutory deadline is the standard tax filing deadline, April 15th this year, but the IRS actually gives you until October 15th to make this correction, provided you filed a timely return. However, if you make a correction after you have filed your tax return, you may need to amend your return. P.S., don't forget to account for any net income or net loss attributable when making a contribution correction.

Year of Death RMDs

If you inherit an IRA from someone who passed away when he or she was 70½ or older, be sure to check with the IRA custodian regarding the status of the deceased person's RMD. Why? If the IRA owner died before having a chance to take his or her RMD, the beneficiary (you) are responsible. Just like any other missed RMD, failure to take a year of death RMD by December 31st of the year the owner dies results in a **50% penalty** on the undistributed amount!

IRA Rollover News

The Tax Court is at it again. Just when you thought you knew the ins and outs of the IRA rollover rules, a curve ball is thrown. Page 25 in the latest version of IRS Publication 590 interprets the one per year IRA rollover rule limit to *each* IRA you own. The Tax Court has successfully muddied the waters on this aspect of the 60-day rollover rule, at least for now.

Say hello to a recently published case, Bobrow v. C.I.R. (T.C., Jan. 28, 2014, 7022-11). The background of this case is as follows: Petitioners were on the hook to the IRS for a significant income tax deficiency PLUS early distribution penalties AND accuracy related penalties. This was all related to "unreported distributions" from their IRAs, stemming from alleged violations of the once per year 60-day IRA rollover rule.

The Tax Court in this case stated that the one rollover per year rule applies to *all* IRAs, not *each* IRA. Its reasoning was: "Had Congress intended to allow individuals to take nontaxable distributions from multiple IRAs per year, we believe section 408(d)(3)(B) would have been worded differently." It concluded this particular discussion with: "Regardless of how many IRAs he or she maintains, a taxpayer may make only one nontaxable rollover contribution within each one-year period."

This is a pretty shocking interpretation since the Code has been routinely interpreted to mean that the rule applies to *each* IRA. For now, conservative IRA owners are following this interpretation to ensure they are in compliance. Of course, there is an appeal process and this opinion could be overruled or perhaps the rule may be clarified in the near future.

A rollover isn't the only way to relocate your retirement funds. It is important to keep in mind that if you request a trustee-to-trustee transfer, sometimes called a "direct" rollover, it is not subject to the one per year rule. In fact, trustee-to-trustee transfers are unlimited… well, they are unlimited for now. The above case goes to show you that almost anything is possible, specifically a wildly different interpretation of a long standing rule.

The Impact of the American Taxpayer Relief Act on Long-Term Capital Gains and Qualified Dividends

Tax Rate	Single Filing Status	Married, Filing Jointly
23.8%	Applies if you are subject to 3.8% Medicare Surtax on Net Investment Income	Applies if you are subject to 3.8% Medicare Surtax on Net Investment Income
20%	Applies if your MAGI is over $400,000	Applies if your MAGI is over $450,000
18.8%	Applies if you are in the 15% Long-Term Capital Gains bracket and subject to 3.8% Medicare Surtax on Net Investment Income	Applies if you are in the 15% Long-Term Capital Gains bracket and subject to 3.8% Medicare Surtax on Net Investment Income
15%	Applies if your MAGI is $36,251 - $400,000	Applies if your MAGI is $72,501 - $450,000
0%	Applies if your MAGI is $0 - $36,250	Applies if your MAGI is $0 - $72,500

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Prohibited Transaction Disqualifies IRA

We often discuss the pitfalls of self-directed IRAs and the increased risk of prohibited transactions. In a recent Tax Court case, Ellis v. C.I.R. (T.C. 2013) 106 T.C.M. (CCH) 468, Mr. Terry Ellis' entire IRA was disqualified, subjecting him to not only accuracy related penalties imposed by the IRS but also a 10% early distribution tax on the entire IRA.

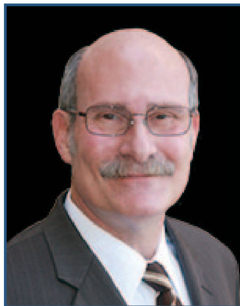
The Background: Mr. Ellis rolled over sizable distributions from his 401(k) to a newly opened, self-directed IRA. He then used his new IRA as start-up capital for a new business he established as an investment for this self-directed IRA. Mr. Ellis was designated as the general manager of the newly formed company and he received benefits and compensation from the company. He ran the business himself and it was his primary source of income. As a fiduciary of his IRA and 98% owner of the company, Mr. Ellis was clearly a "disqualified person."

The Facts: In this case, Mr. Ellis not only ran the company and earned income but the company also paid rent to another entity owned by Mr. Ellis, his wife and their children. The Court found that Mr. Ellis participated in prohibited transactions with his self-directed IRA by engaging in self-dealing. The Court also pointed out that although there were a few prohibited transactions involved, it only took one to disqualify the IRA.

The Result: Approximately $320,000 converted from Mr. Ellis' 401(k) to the IRA was deemed fully distributed and fully taxable. Not only was he liable for the income taxes, he was dinged with accuracy related penalties as well as a 10% early distribution penalty because he was under 59½.

The Moral: A single prohibited transaction can destroy your entire retirement plan that you worked your entire life to accumulate. Before you decided to go down the path of a self-directed IRA or use your IRA as business start-up capital, make sure you consult with your personal advisors.

About America's Tax Solutions™



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