Monthly IRA Updates

ED SLOTT AND COMPANY, LLC
America's IRA Experts

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In This Update:

Resources

Expert Professional Assistance

?? Question of the Month: Does My Son Need Earned Income to Open a Roth IRA?

Q: My son is 15 years old and started mowing lawns this summer. I want to open a Roth IRA for him, but the employer wants to pay him under the table. Do I have to tell the employer to take taxes out so my son can open a Roth IRA and create tax-free savings for life?

A: The regulations state that you **MUST** have reportable earned income to make a Roth IRA contribution. Mowing lawns would constitute earned income. Check with your income tax preparer to determine how the earned income should be reported. This is a great idea, as you are beginning the retirement planning process at a very early age, and opening a Roth IRA at such an age creates a longer time frame for tax-free savings.

IRAs and Special Needs Trusts

The July issue of *Ed Slott's IRA Advisor Newsletter* hammers into a specialized topic, IRAs and Special Needs Trusts. A court case and several Private Letter Rulings are discussed, as well as an advisor action plan in this area and IRA Trust Rules for Special Needs Trusts (Discretionary Trusts).

Keep this Ed Slott quote in mind as you read through this month's issue: "Not every client has special needs issues, but every advisor will have a client who does."

READ MORE ABOUT THIS ISSUE IN JULY'S ISSUE OF ED SLOTT'S IRA ADVISOR NEWSLETTER

July Key Focus

Your IRA or Roth IRA is Included In Taxable Estate

Many taxpayers believe that because they have already paid the income tax on Roth IRAs that the Roth IRA balance will not be included in the estate for estate tax purposes. Many also believe that when you have a trust named as a beneficiary of the IRA or Roth IRA, that this will not be included as part of your taxable estate.

Both of these beliefs are wrong.

Your IRA or Roth IRA will be included as part of your taxable estate at your death. That, in itself, does not mean that your IRA will be taxable. The estate tax exemption for 2011 and 2012 is $5,000,000 per person and is portable to the surviving spouse. Only IRA owners with estates of more than $10,000,000 will pay federal estate tax if they die in these two years.

Where does it say this? Private Letter Ruling (PLR) 200230018 lays it all out for you. It includes mention of Code Section 2001(a) that imposes the estate tax on every citizen or resident of the United States. Section 2031 states that the value of all property is included in the estate, and Section 2033 provides for the inclusion of partial interests in the estate. Section 2039(a) and (b) deal with annuity payments. It concludes that IRAs are includable in the taxable estate.

IRS Publication 590, *Individual Retirement Arrangements (IRAs),* also includes a section on estate tax where it states that IRAs are includable in the gross estate of a decedent. The introduction to the Roth section of this publication also states that the same information applies to Roth IRAs unless noted in the Roth IRA section. Therefore, the estate tax inclusion applies to Roth IRAs as well as Traditional IRAs.

Ruling to Remember

Private Letter Ruling 201122033

A taxpayer we will call "Ben" maintained a Traditional IRA and decided to request a conversion of funds to a Roth IRA in December 2008. He did not receive confirmation of that conversion or a Form 1099-R reflecting the transaction prior to the due date for filing his 2008 tax return.

Ben assumed that the Roth conversion was not completed and prepared his tax return accordingly. He again looked at doing a Roth conversion in late 2009 and, to his shock, discovered that the 2008 conversion had been completed. He received his Form 1099-R for 2008 late in November 2009, after the date to recharacterize the conversion had passed. Ben filed a PLR requesting time to recharacterize his 2008 conversion back to a Traditional IRA.

IRS agreed and granted his request based on the Financial Institution's failure to provide a timely Form 1099-R, making it impossible for him to elect to recharacterize his Roth IRA conversion before the date prescribed by law.

LESSON TO LEARN:
Even though the PLR was granted, Ben should have followed up on the conversion instead of assuming it had not been completed. It is even more crucial to follow up on conversions and recharacterzations that are done late in the calendar year. A recharacterization after the due date cannot be completed without IRS approval through the PLR process (the IRS fee is $4,000). These recharacterizations will continue to be approved for advisor/custodian errors as in this case. They will generally not be approved for taxpayers who want to recharacterize because account balances have declined, or they find they cannot pay the tax bill.

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THE SLOTT REPORT

Inside Ed Slott's IRA Advisor Newsletter

Inherited IRA Allowed to be Transferred to a Special Needs Trust Without Triggering Income Tax

- PLR 201116005
- Facts of the Case
- IRS' Decision
- Favorable Ruling - But Remaining IRA Funds Are Lost
- First-Party Trusts vs. Third-Party Trusts
- Alternatives to Naming Special Needs Trusts as IRA Beneficiaries
  - Trust Tax Issues
  - Life Insurance Alternative for Special Needs Beneficiaries
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  - PLR 200620025
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- Can These Rulings be Applied Elsewhere?
  - PLR 201117042 - A Contrasting View
- Proactive Planning is a Must for Special Needs Beneficiaries
- Advisor Action Plan

IRA Trust Rules for Special Needs Trusts (Discretionary Trusts)

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