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Issue Contents

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Disclaiming An Inherited IRA to Allow Spousal Rollover

-by Robert P. Achenbach, Jr.

A recent IRS letter ruling[1] provides guidance where a decedent's choice of beneficiary for an individual retirement account (IRA) did not provide the most advantageous outcome for the surviving spouse. Fortunately, the beneficiary, a trust established by the decedent, and heirs were able to disclaim their interests and allow the surviving spouse to rollover the inherited IRA to the spouse's personal IRA, thus avoiding income tax to the trust and the trust beneficiaries.

Basic Facts of the Ruling

The decedent died when over age 70½ and was survived by a spouse, a son, and two grandchildren. The decedent owned an IRA which had a trust as the sole beneficiary. The trust's beneficiaries were the two grandchildren. Within nine months after the death of the decedent, the trustee executed a "Renunciation and Qualified Disclaimer," to disclaim any and all interest in the IRA to which the trust was entitled. Also within nine months after the death of the decedent, the son executed a "Renunciation and Qualified Disclaimer," to disclaim any and all interest in the IRA to which the son was entitled. Within nine months after the death of the decedent, both grandchildren individually executed a "Renunciation and Qualified Disclaimer," to disclaim any and all interest in the IRA to which they were entitled. The disclaimers were claimed to be qualified disclaimers under I.R.C. § 2518.[2]

Note that the letter ruling assumes the disclaimers were qualified for federal income tax purposes but there was no discussion as to whether the disclaimers were timely executed. Generally, a disclaimer is timely if executed within nine months after the day the transfer creating the interest was made or after the day the person disclaiming reaches age twenty-one, whichever is later.[3] The ruling does not give the date of the creation of the trust, the ages of the son and grandchildren, or when the trustee, son and grandchildren learned about their interests in the IRA.

The disclaimers effectively placed the IRA back in the decedent's estate and passed the IRA under the decedent's will to the surviving spouse as beneficiary of the decedent's estate. The surviving spouse sought the letter ruling to determine the income tax consequences of rolling over the decedent's IRA to the spouse's personal IRA, given the qualification of the disclaimers.

IRA Distribution Rules

Under I.R.C. § 408(d)(1) any amount paid or distributed out of an IRA shall be included

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in gross income by the payee or distributee in the manner provided under I.R.C. § 72. Some exceptions apply:

(1) I.R.C. § 408(d)(3) provides that I.R.C. § 408(d)(1) does not apply to a rollover contribution if such contribution satisfies the requirements of I.R.C. §§ 408(d)(3)(A) and (d)(3)(B).

I.R.C. § 408(d)(3)(A) provides that I.R.C. § 408(d)(1) does not apply to any amount paid or distributed out of an IRA to the individual for whose benefit the account is maintained if: (a) the entire amount received (including money and any other property) is paid into an IRA for the benefit of such individual not later than the 60th day after the day on which the payment or distribution is received; or (b) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to I.R.C. § 408(d)(3)).

(2) I.R.C. § 408(d)(3)(B) provides that I.R.C. § 408(d)(3) does not apply to any amount described in I.R.C. § 408(d)(3)(A) received by an individual from an IRA if at any time during the one-year period ending on the day of such receipt such individual received any other amount described in I.R.C. § 408(d)(3)(A)(i) from an IRA which was not includible in gross income because of the application of I.R.C. § 408(d)(3).

However, under I.R.C. § 408(d)(3)(C)(i) in the case of an inherited IRA, I.R.C. § 408(d)(3) shall not apply to any amount received by an individual from such account and such inherited account shall not be treated as an IRA for purposes of determining whether any other amount is a rollover contribution. Thus, amounts in an IRA received through inheritance are included in gross income of the payee or distributee.[4] In addition, in general no IRA amount transferred from an inherited IRA to another IRA is excluded from gross income by reason of such transfer. I.R.C. § 408(d)(3)(C)(ii) provides that an IRA will be treated as inherited if the individual for whose benefit the account is maintained acquired such account by reason of the death of another individual and such individual *was not the surviving spouse of such other individual*.

Thus, under the original disposition of the decedent's IRA, the passing of the IRA funds to the trust and then to the son and grandchildren would have been taxable income to the son and grandchildren.

The IRS ruled that, for purposes of section 408(d)(3), (1) the surviving spouse will be treated as having acquired the decedent's IRA directly from the decedent, and not from the decedent's estate or trust; (2) the surviving spouse was eligible to roll over the IRA to one or more IRAs established and maintained in the surviving spouse's name pursuant under I.R.C. § 408(d)(3)(A)(i), provided that the rollover occurs no later than the 60th day following the day the proceeds of the IRA are distributed; and (3) the surviving spouse will not be required to include in gross income for federal income tax purposes for the calendar year in which the distribution and rollover occur the amount distributed from the IRA and timely rolled over into an IRA established and maintained in the surviving spouse's name, provided the rollover contribution meets the requirements of I.R.C. § 408(d)(3).

ENDNOTES

[1] Ltr. Rul. 201901005, Oct. 10, 2018. See discussion of individual retirement accounts at Achenbach, *Farm Income Tax Manual*, § 3.29 (Matthew Bender/LEXIS 2018); Harl and Achenbach, *Agricultural Law* § 28.06[20] (Matthew Bender/LEXIS 2018).

[2] See Harl and Achenbach, *Agricultural Law* § 44.09 for discussion of qualified disclaimers.

[3] I.R.C. § 2518(b)(2).

[4] I.R.C. § 408(d)(1).

CASES, REGULATIONS AND STATUTES

BANKRUPTCY

CHAPTER 12

AUTOMATIC STAY. The debtor was the sole owner of a limited liability company (LLC) and operated a farm. The LLC purchased farm equipment using the proceeds of a loan which was personally guaranteed by the debtor. The debtor's 2016 and 2017 tax returns included a Schedule F to report the LLC's income and expenses, which include a "Depreciation and Amortization Report" listing equipment owned by the LLC, and the farm equipment at issue here was included on that list. The debtor filed for Chapter 12 and the debtor 's Amended Schedule A/B lists the debtor's 100 percent ownership interest in the LLC with a directive to refer to the "list of corporate equipment" attached to the schedules. The attached list includes the farm equipment at issue here and was titled "List of Secured Corporate Debt with Personal Guarantees." The creditor filed an unsecured proof of claim for the amount of the unpaid purchase loan. The court found that there was no evidence presented that the debtor personally owned any of the equipment in issue. The creditor moved for relief from the automatic stay, arguing that the equipment was not estate property because it was purchased by the LLC. The debtor argued that the debtor's personal guarantee makes the automatic stay enforceable because the equipment was necessary for a successful reorganization. The court looked to S.C. Code Ann. § 33-44-201 which provides that "A limited liability company is a legal entity distinct from its members." A comment to S.C. Code Ann. § 33-44-501 states that the members of an LLC "have no property interest in property owned by [the LLC]." Instead, a member holds a distributional interest in the LLC. See S.C. Code Ann. § 33-44-501. Thus, the court held that that an LLC's member's bankruptcy estate has no interest in property of an LLC