Jack Straw Fortnightly*

simplicity

By now you will have heard that the so-called "SECURE Act of 2019," which would effectively kill the "stretch" IRA, was incorporated into the "further consolidated" appropriations bill, H.R. 1865, which passed both chambers by very large margins and was signed into law on December 20.

There is a lot of other stuff in just that portion of the legislative package, Division O -- which runs forty-odd pages in a seven hundred page bill --,[1] but folks working in the nonprofit sector have been focused on

(a) the requirement -- with a handful of exceptions[2] -- that a defined contribution plan such as an IRA pay out within ten years after the account holder's death, regardless whether she was in pay status at the time,

(b) the delay until age 72 of the minimum distribution requirement, for account holders who have not already turned 70-1/2 by December 31, 2019 and

(c) the repeal of Code section 219(d)(1), which has disallowed deductions for contributions to an IRA by an account holder older than 70-1/2 (with a conforming amendment to remove language from section 408A that had clarified that the age limit did not apply to contributions to a Roth IRA).

This latter provision, section 107(a) of Division O, pages 615 and 616 of the bill, comes with a complication, added by the sponsor, Rep. Richard Neal (D-MA), as a "conforming amendment" after the bill had already cleared the Ways and Means committee, which he chairs.

And that complication is this.

If the taxpayer does make deductible contributions to an IRA after age 70-1/2, these will reduce the amounts she may exclude from income through qualified charitable distributions under section 408(d)(8), the so-called "charitable IRA rollover."

Not dollar for dollar, exactly, but in any given year in the amount by which aggregate deductible contributions she has made after age 70-1/2 have exceeded aggregate reductions under the same rule.

If that makes any sense. Maybe with some numbers attached. Keeping in

mind that the amount excludible from income through QCDs in any given year is limited to $100k.

So let's say Jane, our taxpayer, makes deductible contributions to her IRAs -- after age 70-1/2 and after 2019 -- of $10k per year. And she makes QCDs of $25k per year.[3]

The first time this happens, the exclusion is reduced by $10k, meaning only $15k of the otherwise QCD is excluded from income,

and the remaining $10k either is or is not fully offset by an itemized charitable deduction.

The second time it happens, we do some math. Jane has now made deductible contributions to her IRAs aggregating $20k, but she has previously suffered a $10k reduction in amounts excludible as QCDs. So the rule says she can exclude only the difference -- again $10k in the particular example.

The function of the rule, in other words, is to prevent Jane priming the pump.[4]

Note, however, that Jane is not required to claim deductions for her ongoing additions to her IRAs. She can elect to treat these in whole or in part as nondeductible, so that the rule would not be implicated.

And because section 408(d)(8)(D) treats QCDs as being paid first from amounts that would have been includible in gross income -- rather than pro rata, as otherwise required by section 72(b)(1) --, it would appear that over time Jane could use some combination of nondeductible contributions and QCDs to shift the balance in her IRAs toward nontaxable accumulations.[5]

In any event, the new regime will require someone in Jane's situation to keep a running tab on deductible contributions versus QCDs.

short takes

item: In our last issue we mentioned briefly the decision of the Tax Court in *Coal Property Holdings*, granting the Commissioner a partial summary judgment which denied altogether a claimed deduction of $155.5 million for a conservation easement, where the deed included an "improvements" clause.

At the time, there was a motion for reconsideration pending. That has since been denied, in a three-page order. What we should expect to see next is a notice of appeal, presumably to the 6th Circuit, as this case arose in Tennessee. The taxpayer is continuing to lawyer up for the fight.

item: The Greystocke Project submitted comments on the proposed regs that would relieve exempt orgs other than (c)(3)s, 527s, and nonexempt trusts from the requirement to disclose their substantial contributors.

Our letter pointed out that

> [i]n rationalizing the suggestion that IRS does not "need" this information in order to carry out its functions, the preamble asserts twice that these other organizations will still be required to report amounts received from "each" substantial contributor. But,

we continued,

> this is not a literal requirement of existing reg. section 1.6033-2(a)(2)(ii)(f), which speaks only in terms of "total" contributions, in the aggregate.
>
> And while it is true[,]

we went on,

> that schedule B in its present iteration does require that contributions be listed separately, it is also true that forms and schedules and their supporting instructions are subject to revision with notice and comment only as to the compliance burden, not on substance, except with respect to "ways to enhance the quality, utility, and clarity of the information to be collected."

We then added, somewhat gratuitously,

> The present regulatory project, then, might be seen as laying the groundwork for future revisions to the schedule and/or the instructions that would allow (c)(4)s, for example, to report only the aggregate amounts received from substantial contributors.

Your correspondent has also written his representative in Congress, asking him to sponsor legislation to disapprove the rule when it is finalized.

item: The 7520 rate is holding at 2.0 pct. for a third month, after a brief dip to 1.8 pct. in October. Still a hundred forty basis points off where we were a year ago.

Also, the deemed rate of return on a "new" pooled income fund will again be 2.2 pct., as it was this year. Which is another way of saying the average of 7520 rates for 2019 was lower than the average for at least one of the two preceding years.[6]

On the plus side, we seem to have escaped the inversion of the Treasury yield curves, if only because short-term bond rates have also fallen.

item: In our last issue we briefly mentioned PLR 201947007, which approved the reformation of a nonqualifying testamentary charitable remainder unitrust,[7] and we said "probably" would follow up here with more detail. So.

As drafted, the trust was to distribute a unitrust amount of 3.5 pct. among six of the settlor's children and the descendants of a seventh, predeceased child, with the remainder over to a private foundation.

There were a couple or three of features here that would disqualify the trust under sections 2055(e) and 664(d), most obviously that the unitrust payout was less than the required minimum five pct., but also

- the payout to a special needs trust for one of the children was not expressly limited to her life or a term of years,

- the special needs trust itself did not meet the requirements of Rev. Rul. 2002-20,[8] and

- the payout to descendants of a deceased child was not limited to a term of twenty years.[9]

The trustee caught the first issue right away,[10] and petitioned the state court to reform the trust to increase the unitrust payout to 5.0 pct.

It was only later that the trustee recognized the other difficulties and initiated a second reformation action, this time seeking

- to allocate a fixed portion of the unitrust payout to the foundation on a current basis,[11]

- to limit the term of the payout to descendants of the predeceased child to twenty years, and

- to reform the special needs trust itself to provide that the remainder at the death of the disabled child would be paid over to her estate.[12]

The letter ruling determined that these measures sufficed to bring the trust into compliance, so that both the present value of the remainder over to the foundation and the present value of its fixed portion of the unitrust payout would be deductible under section 2055(a).

The trustee had submitted calculations with its letter request, in part to illustrate that the present value of the amounts payable to the foundation after reformation was within five pct. of the present value of the "reformable" interest [see footnote 11].

The ruling notes that IRS came up with somewhat different numbers, but these were still within the five pct. tolerance.[13]

loose ends

[1]

Notably, section 204 greatly relaxes the fiduciary obligation of a 401(k) plan sponsor in selecting the provider of commercial annuity contracts included in plan offerings. Minimum due diligence, no recourse if the provider goes under, etc.

Jack is not going to get into that whole discussion.

[2]

Exceptions where the designated beneficiary is a surviving spouse, a minor child of the account holder, a disabled or chronically ill individual, or someone not more than ten years younger than the account holder. In each of those cases, you still get a minimum required distribution based on the age of the beneficiary, except that in the case of the minor child you fall into the ten-year rule when she attains majority.

[3]

Probably these figures do not represent a typical case. The purpose here is simply to illustrate the rule.

[4]

If you flip the numbers, so that Jane is making deductible contributions to her IRAs in amounts larger than she is taking out as

QCDs, she will get no exclusions at all.

[5]

The tradeoff being of course that Jane is paying income tax now on contributions for which she is not claiming deductions. On the surface, at least, this would appear to be purely a question of timing.

But note that the exclusion ratio, section 72(b)(1), applies also to earnings and growth in the account, so there may be some leverage there.

Incidentally, what section 408(d)(8)(D) literally says is that the allocation first to amounts that would have been includible in income is specifically for the purpose of determining "the extent to which" an otherwise QCD actually does qualify for exclusion.

One might ask whether this means the allocation has no effect on the characterization for purposes of section 72(b)(1) of amounts remaining in the IRAs.

But Jack notes that the last sentence of subparagraph (d)(8)(D) requires that "proper adjustments" be made "in applying section 72 to other distributions," which he takes to mean, in calculating the exclusion ratio, in the same and subsequent years.

[6]

For the record, the average of 7520 rates for 2017 was 2.4167 pct., the average for 2018 was 3.25 pct., and the average for 2019 was 2.6 pct. Hard to say what the trend line is.

[7]

Using the word "testamentary" here to mean that the remainder trust took effect at the death of the settlor.

[8]

Briefly, that the remainder after the death of the disabled beneficiary be payable to her estate, or after reimbursing the state for any Medicaid benefits paid, to her appointees under a general power.

[9]

The text of the ruling is unclear on this point.

The trust as drafted did provide that the unitrust payout to the descendants of the deceased child would cease at the earlier of the death of the last of them or a stated date -- which may have been more than twenty years after the settlor's death, though this is not stated.

But the description of this class of beneficiaries, "Child 7's children or the survivor of them," suggests that these were individuals who were alive at the settlor's death, so that it should not have been necessary to limit their interest to a term of years --

-- unless their life expectancies would bring the present value of the remainder over to the foundation below ten pct., which is not mentioned in the text of the ruling.

[10]

Because the payout to noncharitable beneficiaries was expressed as a unitrust amount, albeit less than

five pct., the requirement of section 2055(e)(3)(C)(ii) that a reformation proceeding be commenced within 90 days of the due date, with extensions, of the estate tax return did not actually apply.

Nonetheless, the trustee did bring the first reformation action within that timeframe.

[11]

Although this is not made explicit in the text of the ruling, apparently the purpose here was to bring the present value of the amounts payable to the foundation after reformation within five pct. of the value of the "reformable" interest.

The trust as drafted had already provided that the portion of the unitrust amount otherwise payable to a beneficiary who had deceased would be paid out to the foundation on a current basis.

[12]

The text of the ruling does not mention whether the second reformation directly addressed the problem that the unitrust payout to the special needs trust was not limited to her life or a term of years. Presumably it did.

[13]

Again, your correspondent gave a detailed paper on the subject of reforming the nonqualified split-interest trust at the NCPG conference in DC in 2009. Not all that much has occurred since then to require any significant revision to that paper.

Jack says, this wilderness up in my head