

Financial PERSPECTIVES

FOURTH QUARTER 2013

Q&A on IRAs

At the end of the first quarter of 2013, total retirement assets in the U.S. reached \$20.8 trillion. IRAs had a 27.4% “market share” of the total, with an estimated \$5.7 trillion. Most retirement capital is being managed by institutional professionals, but not so the IRAs. Accordingly, there are a great many possibilities for missteps. Here are three examples.

Failed Roth conversion of RMD

Q. I'm 73, so I have to take required minimum distributions (RMDs) from my \$1 million IRA. To get around that, I transferred the full balance to a Roth IRA, and paid the taxes from my taxable portfolio. Any problems with that?

A. Just one. You can't convert an RMD to a Roth IRA. In your case, the RMD comes to about \$40,485. The good news is that you will be deemed to have taken the RMD, so there's no 50% penalty for not taking it. The bad news is you've made an excess contribution to your Roth IRA of \$40,485. There is a 6% excise tax penalty imposed on the excess contribution. Your best remedy is to cure the problem with a corrective distribu-

CONTINUED ON NEXT PAGE

Estate planning strategies

Start the Clock

Meticulous documentation is needed for major intra-family transfers, especially gifts of closely held business interests. When the gift is made, it is critical to file a gift tax return, even if the transfer is not so large as to trigger immediate gift tax liability. Filing the gift

tax return starts the statute of limitations running at the IRS, which might choose to challenge the value of the gift. Failure to file can lead to tax headaches decades down the road, as the Redstone family has now learned.

Mickey Redstone built a theater empire

CONTINUED ON NEXT PAGE

Mixed Message

October 1—The headline for the jobs report in September sounded good, as unemployment fell to 7.3%. But a closer look revealed more economic weakness than strength.

- Total jobs created in June and July were revised downward, a shortfall of 74,000. The revisions are generally more accurate than the initial reports.

- If the current rate of job creation continues, we won't close the jobs gap until 2023.

- Although 169,000 jobs were created in August, 312,000 people dropped out of the labor force. That's the new math that underlies the falling unemployment rate.

The labor force participation rate, which measures the percentage of people who are working, has fallen to the lowest level in 35 years. At the peak, more than 67% of working-age Americans were working, and now we are down below 63%. That 4% swing has enormous implications for tax and Social Security revenue collections, and for the federal deficit.

Gridlock

Political controversy over what to do about the federal deficit led to a government shutdown on October 1, which remains unresolved at this writing. Conventional

CONTINUED ON BACK PAGE



tion of the excess amount.

Missed the 60-day deadline

Q. I received a big retirement plan distribution, which I meant to roll over to an IRA, but I didn't get to it within 60 days. What can I do now?

A. The best way to handle a rollover is a trustee-to-trustee transfer. Are you certain that you received a distribution? That is, if the distribution check is made out to the recipient plan, instead of to you, this may still be a trustee-to-trustee transfer. Such a check may be delivered to the payee plan after the 60-day deadline has passed.

If that solution is not available, the next question is whether an exception to the 60-day rule might apply. These exceptions include:

First-time homebuyer. Let's say that your withdrawal was a "first-time homebuyer" distribution. If there is a delay or cancellation of the purchase or construction of the home, the amount withdrawn may be recontributed back into the IRA without penalty. The time limit on this is 120 days, instead of 60 days.

Disaster-based extensions. If a disaster has been declared in your area by the federal government, the IRS may issue a pronouncement on the availability of automatic extensions for various filings, which may include your rollover.

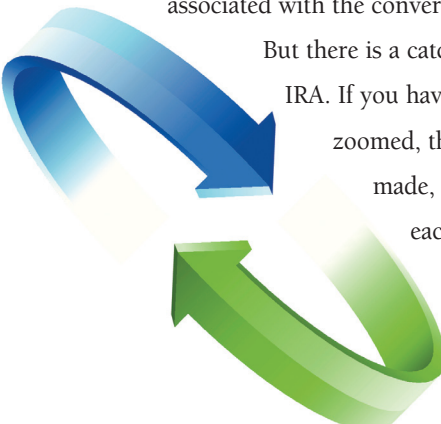
Financial institution errors. If you took action within 60 days, but the deposit to the IRA happened after 60 days solely due to an error by your financial institution, you can get an automatic waiver of the 60-day rule. This works provided the funds are deposited in the eligible plan within a year of the original distribution.

Excess income

Q. My income is above the limits for a Roth IRA contribution (in 2013, \$127,000 for singles, \$188,000 for marrieds filing jointly, and \$10,000 for marrieds filing separately). Is there a workaround on this?

A. Maybe. If your income is too high, you can't directly contribute to a Roth IRA, but you still can make a nondeductible contribution to a traditional IRA no matter how much you earn. Later you can convert that traditional IRA to a Roth IRA. There is no income limit associated with the conversions.

But there is a catch. The IRS considers all of your IRAs to be a single IRA. If you have older traditional IRAs, created before your income zoomed, they will be taken into account when the conversion is made, and it will be considered made proportionately from each account, with possibly nasty tax consequences. If you don't have any existing traditional IRAs, the conversion strategy should work fine, but if you do have such accounts, the guidance of an experienced tax attorney is needed. ■



in the Northeast, first with drive-in theaters and later with conventional theaters. His sons, Edward and Sumner, joined the business.

In the late 1960s, there was a falling out over the management of this company (NAI). Sumner was President, and Edward decided to withdraw from the company. When he sought to redeem his 100 shares, or to sell them, Mickey claimed that half of the shares owned by Edward and Sumner were subject to an oral trust, that they were intended for the grandchildren. Litigation ensued.

A settlement was reached in 1972, in which one-third of Edward's shares were transferred in trust to his children. To satisfy Mickey's desire that the sons be treated the same, Sumner at that time voluntarily joined the settlement and transferred one-third of his shares to a trust for his children as well. Given that the transaction was in satisfaction of an oral trust, and that it was a settlement of a bona fide dispute, no one thought that a gift had been made, and no gift tax return was filed.

The IRS was unaware of these transactions until Edward died in 2011. In January 2013 a gift tax deficiency notice was issued to Sumner for the 1972 transfer of one-third of his shares of NAI to his children. The gift was valued at \$2.5 million, the gift tax deficiency was \$737,625. A 50% fraud penalty was tacked on, or in the alternative, penalties for failure to file and negligence. Should the deficiency be upheld, there will be substantial interest payments due as well. Redstone is challenging the deficiency in the Tax Court. ■



E-mail 1:

So I met with 2 lawyers yesterday to talk about the beef. They are very interested in going by the book.

E-mail 2:

What do your guys mean by "by the book"? Another interpretation of "by the book" would entail each of us paying 750 lbs. to the FDA, plus more each year if the beef grows mold.

The Trouble With Foreign Bank Accounts

The writers of these cryptic e-mails, as reported in *Crain's New York Business*, were not butchers. They were two of Harry Seggerman's adult children, referring in code to a \$12 million secret Swiss bank account. Seggerman had enjoyed a very successful 50-year career on Wall Street, including a stint as vice chairman at Fidelity Investments and supervising the launch of a hedge fund called International Investment Advisors, specializing in Korea. At his death in 2001, Seggerman's estate was worth an estimated \$24 million. Under his will Seggerman's surviving spouse inherited \$5 million of the \$12 million Swiss account, with the balance divided among five of his six children.

The issue being discussed in the e-mail exchange was whether to reveal the Swiss account to the IRS. The account was fully subject to the federal estate tax, which in 2001 would have eaten up 55% of the children's inheritance. They decided to leave the money in Switzerland, not reporting it to the IRS. They set up Swiss accounts of their own to receive the money, and they used surreptitious means to transfer funds back into the U.S. By disguising the trans-

fers as loans, they also hoped to avoid income taxes on the money.

Enter FATCA

The practice of wealthy families hiding assets in offshore accounts has long been of concern to Congress. A U.S. Senate report in 2008 claimed that the annual lost revenue from offshore banking could be as much as \$100 billion. In response, the Foreign Account Tax Compliance Act (FATCA) was introduced in Congress in 2009, and it was enacted in 2010 as part of the HIRE Act (Hiring Incentives to Restore Employment Act). However, IRS had been going after secret offshore accounts long before FATCA was adopted.

In 2009 the IRS reached a settlement with Swiss bank UBS concerning accounts of American citizens. UBS paid a fine of \$780 million and turned over information on about 4,500 of its clients. That's when the Service discovered what the Seggerman heirs had done.

The surviving spouse, the disinherited child, and another child who is mentally impaired were not prosecuted, but the other four children were charged with tax evasion. All four have pled guilty. They

could spend up to 11 years in prison. (They haven't been sentenced as of this writing.)

Compliance costs

FATCA imposes significant regulatory costs on foreign banks, and it also requires new reports by Americans of their foreign holdings via Form 8938. The burdens are such that many foreign banks reportedly are no longer willing to accept American depositors. Many have questioned whether the new revenue will outweigh the substantial compliance costs. Nevertheless, at least ten countries already have concluded new treaties with the U.S. for implementing FATCA.

According to *Time* magazine, the number of Americans renouncing their citizenship rose sevenfold from 2008 through 2011. *BBC News Magazine* reported another surge in the second quarter of 2013. The IRS maintains that FATCA created no new tax obligations on U.S. citizens living abroad; it only put in place mechanisms for detecting tax evasion. But it may be that for some expatriates, the mechanism is onerous enough that they will change their citizenship. ■

Mixed message . . . CONTINUED

wisdom long has suggested that investors prefer a divided government to an activist one, holding down the pace of change. However, the polarization at this time is deep enough to characterize as dysfunction.

Regardless of how the continuing resolution to fund the government is resolved, it is but a dress rehearsal for the question of raising the debt ceiling later in the month. Going without nonessential government services for some days or weeks won't have the same impact as the loss of the Treasury's borrowing power.

Markets

At the end of the third quarter, stocks were ahead 18% on the year, outperforming most economists' forecasts and far ahead of the pace of economic growth. The S&P 500-stock index set an all-time high on September 18 and finished the quarter 2% below that mark. Much of that growth happened early in the year, as the S&P 500 was up only 0.7% from May 21, the day before Fed Chairman Ben Bernanke warned that the Federal Reserve was going to consider easing off its monthly bond purchases.

Current stock valuations are on the high side, as expected after such a run-up. The price/earnings ratio of the S&P 500 is 14.3 times the next 12 months' expected earnings. That's higher than the 10-year average of 14.0, and sharply higher than the 12.9 multiple for the past 5 years. Still, that's well off the 18.0 p/e the index hit back in 2004.

Corporate profits continue to grow, if weakly. That, plus the relative unattractiveness of the alternatives, may be supporting stock prices. The Fed has a major puzzle on its hands in determining how to

COLLECTORS CORNER



Image courtesy of RM Auctions

History was made recently in a California two-day sale by RM Auctions at which 120 cars went for a total of over \$125 million, 26 going for more than \$1 million each. The results were crowned by the sale of this **1967 Ferrari 275 GTB/4*S N.A.R.T. Spider**, one of only 10 ever made, for \$27.5 million, the second-highest amount ever fetched for any car sold at auction.

The Ferrari had remained in one family ever since its purchase new for \$14,000 by Edward Smith, Sr., a North Carolina businessman and philanthropist, who enjoyed driving kids around his small town in it. Smith's son announced that the \$27.5 million proceeds would be given to charity and commented: "RM Auctions . . . linked Dad's legacy of giving with the car he loved so much."

taper off its bond purchases without disrupting the bond market.

DJIA

On September 20, S&P Dow Jones Indexes announced a change to the Dow Jones Industrial Average (DJIA) lineup. Alcoa, Bank of America and Hewlett-Packard were dropped from the index. The newcomers are Goldman Sachs, Visa and Nike. The change will better reflect

the changing American economy, according to the index managers.

The DJIA is a price-weighted index, unlike the capitalization-weighted S&P 500. The companies with the highest share prices exert a larger pull on the index, even if they aren't the largest companies. The companies that were dropped from the index each had share prices in the single or low double digits. ■