

UNSCRAMBLE A NEST EGG: STRETCHING IRA'S INTO THE NEXT GENERATION

Upon inheriting several IRAs after his father died last year, sales manager Dick Groves was happy to hear from an attorney that he could avoid an immediate income tax hit by rolling the money into a new individual retirement account. Yet when he checked with his CPA, he was warned that only a surviving spouse could avoid taxes by rolling an inherited IRA into a new account. Had Groves followed the lawyer's lead, he would have paid taxes right away on the full distribution.

IRAs are tax-deferred accounts, which means that income tax on the account becomes payable only when the funds are withdrawn. This rule applies even after the death of the account owner. Typically, when an IRA account owner dies, his/her spouse inherits the assets in the account. Unfortunately, taxes can reduce the account's assets significantly.

Groves' experience is becoming more common. The growth of IRAs, 401(k)s, self-employment plans, and other retirement accounts in which a person has a balance that can be passed on is making

inheritance questions on the accounts routine. IRAs, for example, can grow to be quite large even though contributions are generally limited to \$3,000 a year (temporarily \$3,500 for age 50 and older). This is because many retirees roll over balances from other retirement plans into their IRAs.

With help, Groves, 41, was able to employ a formula in the tax code that will let him stretch withdrawals over as long as 36 years, a period based on the life expectancy of his older brother, who shared in the bequest. He can take more than the minimum required annual distribution, but by limiting his withdrawals, he cuts the yearly tax bite and will benefit from tax-deferred compounding of the remaining balance. He is earmarking that balance for his children's education and his own retirement.

The timing of distributions and the tax on an inherited retirement account can depend on factors such as the age of the deceased, the tax treatment when deposits were made, and the relationship to the beneficiary.

Beneficiaries who want to take the money and run generally face simpler rules than those who want to let the inheritance continue to grow tax-deferred. In either case, a beneficiary may have to try to discern an

adviser's qualifications by asking specific questions. Here are some points to keep in mind:

Tax consequences. Estate and income taxes may be levied on an inherited retirement plan. However, there is a break that is often overlooked. A beneficiary may take an itemized deduction on his/her individual tax return for the estate tax paid on this asset. Estate tax may apply when the deceased's total assets exceed a certain amount—currently \$1,000,000 (but amounts left to a spouse don't count in that total). Income tax is paid by the beneficiary based on the amount distributed from the retirement plan each year. Withdrawals from a standard tax-deductible IRA, for example, or from an IRA formed to hold a lump-sum payment from a company retirement plan, are fully taxable. Withdrawals from Roth IRAs, which have their own set of rules, generally are not taxable.

Longer payout. A non-spouse beneficiary who inherits a retirement plan balance from someone who was over age 70½ and, as required by law, was withdrawing yearly amounts, may have to continue to take those same annual payments until the account is depleted. However, a beneficiary who was more

than 10 years younger than the deceased may be able to reduce the withdrawals by electing to receive the payout over a modified life expectancy.

In many cases, a spouse may elect to roll over an inherited retirement account into her own account and may be able to delay or lengthen distributions. In other cases, a surviving spouse may want to disclaim his/her interest. It all depends on the facts and circumstances.

Age matters. When the deceased was under age 70½, the non-spouse beneficiary must generally take the full retirement balance—and pay tax on it—by the end of the fifth year after the death. Or, he or she can take distributions over a period generally based on the beneficiary's life expectancy—if the payments start by the end of the first year after the death. A spouse can maintain the deceased's account and defer withdrawals until the deceased would have been 70½, or perhaps even later if the surviving spouse was younger than the deceased.

Most people cry “Uncle” at this point, but there may be even more aggravation. Specific plans can impose their own rules. So while the law may allow you to stretch out withdrawals, a specific plan may not. Company plans such as 401(k)s, for example, are usually more limited in options than IRAs.

A few precautions by account holders can make things easier for beneficiaries. A review of your current retirement plans and your designated beneficiaries now could simplify and reduce the taxes for them later. See your Auto Team America advisor with your IRA questions before taking any action.

RECEIVED \$10,000 CASH? IRS CONTINUES TO ENFORCE FORM 8300 FILING

The IRS has been strictly enforcing the filing of Form 8300 cash reports and has already conducted audits and compliance sweeps in certain regions of the country. These audits have become important in the “war against terrorism.”

The IRS normally conducts what is called a compliance audit. Typically, all the retail businesses in a particular area are audited to determine whether or not they are complying with the cash reporting laws. The local IRS office will contact a dealership by phone or letter to request that it make available certain records—cash receipts, journals, bank deposit slips, and copies of Form 8300—that have been filed for a particular year.

For purposes of reporting, cash means:

- (1) United States and foreign currency in excess of \$10,000
- (2) Cashier's checks (by whatever name called, including treasurer's check and bank check), bank drafts, traveler's checks or money orders having a face amount of not more than \$10,000.

Cashier's checks, bank drafts, traveler's checks or money orders in this category are considered reportable when two or more are presented to a dealership and the total amount exceeds \$10,000. Personal checks, checks drawn on the account of a business, certified personal and business checks, and amounts charged to credit cards are not considered cash

under the IRS regulations.

The new *Patriot Act* requires that financial institutions establish procedures that enable employees to track all cash transactions to determine when a Form 8300 should be filed. Dealerships should develop a written policy that explains how cash transactions over \$10,000 will be handled in the dealership.

Make sure that all affected employees are aware of—and fully understand—their responsibilities as set out in the policy statement. The policy statement should include a statement instructing salespeople not to discuss the cash reporting law with customers at any time or for any reason. All cash reporting inquiries should be referred to a designated compliance person who fully understands all aspects of the cash reporting laws.

The following procedures are recommended as part of the educational program in your dealership:

- 1) Provide ongoing training programs for salespeople, managers, and office staff to explain the procedures and controls that will be followed when handling a cash transaction over \$10,000.
- 2) Designate a cash reporting compliance officer.
- 3) Document all meetings and educational activities in writing.
- 4) Establish an independent audit function to test the program.

The Form 8300 should be filed with the IRS and the Treasury's Financial Crimes Enforcement Network. Copies filed must be retained for 5 years from the date the

dealership files them. Criminal and/or civil penalties of up to \$25,000 per form can be assessed for disregard of the rules.

Dealerships should always be prepared for some type of cash reporting audit in the future. Immediately develop policies and procedures that will help your dealership comply with the cash reporting laws and educate your employees as to their responsibilities under the regulations.

For more information on Form 8300 filing and compliance, contact your ATA member firm.



Tax Tip

IRS Calls PORCs Tax Shelters

In a surprise move, the IRS announced that producer owned reinsurance companies (PORCs) for credit-life insurance and extended service contracts are “listed transactions.” This means they are subject to registration and tax reporting requirements and penalties on the promoters, participants and preparers.

After many years of allowing PORCs and other dealership related insurance companies, the IRS is now saying that arrangements with PORCs and “substantially similar transactions” may not qualify for the tax benefits previously approved by the IRS.

Right now there are more questions than answers. We hope the IRS will provide some guidance as to where it sees the abuse and which dealership companies should be making the required tax return disclosures. With the tax-filing season on us, more information is needed sooner rather than later.