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- Dig deep into the benefits of the IRC §645 election
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## Alimony audits — what the IRS looks for

**Expect audits to increase with the 2019 tax year.**

By Alan Pinck, EA  
*Guest Contributor*

Example of fluctuating dividends:

# How to retroactively make estimated tax payments late in the year

**See what to do if wage withholding isn't possible.**

By Richard B. Malamud, J.D., LL.M., CPA  
Guest Contributor

Taxpayers above certain income levels must make quarterly estimated taxes by paying any combination of withholding (generally on wages), estimated tax payments, or credit from a prior-year overpayment. To avoid an underpayment penalty, total estimated tax payments must equal the lower of 90% of the current-year tax or 100% of the prior-year tax (110% for those with prior-year AGI of \$150,000).<sup>1</sup>

Failure to pay the quarterly required estimate on time results in an estimated tax penalty on the underpayment each quarter until paid or by April 15 of the next year.<sup>2</sup>

How can a taxpayer retroactively pay in an estimated payment once the due date has passed? One way to make up for a missed payment is to pay in the tax through withholding. Unlike estimated payments, which are credited on the date paid, withholding is deemed paid in equally each quarter regardless of when actually paid (unless the taxpayer elects otherwise).<sup>3</sup>

**Example #1 of withholding:** To be safe from the federal underpayment of estimated tax penalty in 2019, Pat must pay a total of \$16,000 through withholding and estimates (\$4,000 per quarter if paid with estimates). If Pat's wage withholding is only \$6,000 through October, there is no penalty if he has at least \$5,000 per month (a total of \$10,000) of withholding in November and December. The \$16,000 yearly withholding is treated as it were paid equally during the year or \$4,000 quarterly, and there is no penalty.

**Example #2 of withholding:** Same as #1, but Pat's job terminated in October. If no other tax payments are made and his estimated tax liability is still \$16,000, there will be an underpayment of \$2,500 per quarter (\$16,000 due and \$6,000 paid in; \$10,000 underpayment ÷ 4 quarters = \$2,500 per quarter short).

**Comment:** Pat may be able to use the annualized income method to reduce the penalty.

Fortunately, there is a way to make "retroactive" estimated tax payments if wage withholding isn't possible. For those on Social Security, withholding can be taken from the monthly benefit (limited to 22% of the benefit). Similarly, Pat could withhold on his unemployment benefits, but only at 10%.<sup>4</sup> A taxpayer may also withhold on pension distributions.

There is another way to withhold taxes that can provide flexibility, and it does not even increase taxable income. Taxpayers with IRAs and certain other qualified plans can:

- Make a taxable distribution from an IRA (or other qualified plan);
- Have tax withholding taken out from the distribution; and
- "Roll over" the full amount of the distribution back into the original account or into an eligible retirement plan within 60 days of the original distribution.<sup>5</sup>

**Comment:** If stock is taken out, the stock can be recontributed, or the proceeds from the stock sale can be recontributed if the stock is sold during the holding period.<sup>6</sup>

In this situation, the taxpayer must replace the withholding from their own funds or there will be an amount subject to tax and possibly a penalty.

When a 100% rollover occurs, because the amount distributed, including a payment of the tax withheld, is redeposited within 60 days, the original amount is not taxable.<sup>7</sup>

**Example #3 of withholding using an IRA distribution:** The facts are the same as Example #2. Pat could take an IRA distribution of \$10,000 and withhold \$10,000 of taxes. If within 60 days he redeposits \$10,000 back into the IRA, it will be a nontaxable IRA rollover. Pat would have \$16,000 of withholding (\$6,000 on wages and \$10,000 on the IRA distribution).

To accomplish the tax-free rollover in Example #3, Pat must use \$10,000 of other funds in order to roll over \$10,000, because the entire “distribution” was withheld and an amount withheld cannot be refunded by the IRS or the IRA administrator.<sup>8</sup> This is the reason this planning works. Most distributions will be subject to mandatory 20% withholding. At the end of the year, a Form 1099-R will reflect the \$10,000 distribution and the \$10,000 withheld and since the full amount was rolled over, there is no taxable income.

The rollover must be made within 60 calendar days, even if that is a Saturday, Sunday, or legal holiday.<sup>9</sup> It is possible to request a waiver by a ruling request “where the failure ... would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the (taxpayer).”<sup>10</sup>

If less than \$10,000 is rolled over, the amount not rolled over is taxable. In addition to the income tax, a 10% federal penalty applies<sup>11</sup> if the taxable distribution is made prior to attaining age 59½ or if one of the many exceptions doesn’t apply.<sup>12</sup> A state penalty may also apply. California imposes a 2.5% penalty.

### **Failure to pay an estimated tax payment**

This tax-free solution doesn’t work very well if the taxpayer missed a first quarter estimate. That is because only one-quarter of the withholding applies to each quarter.

**Example #4 of withholding after failure to pay estimated tax:** Pat received four 2019 estimated tax vouchers of \$4,000 each. Pat forgot to file the first estimate but timely filed the second and third. To fix this retroactively, Pat would have to withhold the full prior-year tax of \$16,000 because only one-quarter of the withholding (\$4,000 ( $\$16,000 \div 4$ )) is treated as paid during the first quarter. The result is total payments of \$24,000 (\$4,000 + \$4,000 + \$16,000) rather than the required \$16,000. At least Pat would not have to make a fourth quarter estimate, and any overpayment can be used to pay additional tax due in 2019, or it can be applied to the 2020 estimates.

### **IRA one-rollover-per-year rule**

You can only make a tax-free rollover if it is later than one year after the receipt of the distribution of a prior rollover.<sup>13</sup>

### **Bonus idea**

If an IRA distribution isn’t feasible, a special rule provides that where the tax return is filed on or before January 31 and the total tax liability for the year is paid in full, no penalty will apply for the fourth quarter required payment. But who can file a tax return by January 30?

### **Conclusion**

If there is an underpayment of estimated taxes and it’s near the end of the year, by increasing withholding, the penalty can be reduced or eliminated.

**About the Author**

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| <sup>1</sup> IRC §6654(d)(1)(B) and (C) for 110%   | <sup>8</sup> <a href="http://www.irs.gov/retirement-plans/plan-participant-employee/rollovers-of-retirement-plan-and-ira-distributions">www.irs.gov/retirement-plans/plan-participant-employee/rollovers-of-retirement-plan-and-ira-distributions</a> |
| <sup>2</sup> IRC §6654(b)(2); see Form 2210  | <sup>9</sup> See PLR 201039041  |
| <sup>3</sup> IRC §6654(g)(1)   | <sup>10</sup> See Rev. Proc. 2003-16  |
| <sup>4</sup> See Form W-4V   | <sup>11</sup> IRC §72(t)  |
| <sup>5</sup> IRC §408(d)(3)(A)(ii)   | <sup>12</sup> <a href="http://www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-tax-on-early-distributions">www.irs.gov/retirement-plans/plan-participant-employee/retirement-topics-tax-on-early-distributions</a>            |
| <sup>6</sup> See <i>Lemishow v. Comm.</i> (1998) 110 TC 346; Treas. Regs. §1.408-4(b)(1) | <sup>13</sup> IRC §408(d)(3)(B)   |
| <sup>7</sup> IRC §408(d)(3)  |   |
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by David Ellis, CFA