



# Dear IRS, Please Help

A “private letter ruling” by the agency can provide a way out of tax goofs.

**BY LYNN O'SHAUGHNESSY**

**W**HEN HOPE Lange, an Emmy Award-winning actress, died during the Christmas holidays in 2003, she left behind her New York apartment and a portfolio of bonds and cash. But much of her net worth was tied up in an individual retirement account.

The star of the late 1960s television series *The Ghost and Mrs. Muir* intended for her two children to receive her sizable IRA, but she could never have imagined how an accountant and a lawyer, who should have known better, had botched her plans. Thanks to lousy advice, Lange had designated her estate as the beneficiary of her IRA instead of directly nam-

STUART BRIERS

The tax breaks can enhance investment returns, especially over time horizons of 10 or more years, says Sam Beardsley, director of the investment tax division at T. Rowe Price. For starters, earnings on the accounts grow free of federal and state income taxes, and once you withdraw them they're tax-free if used for college or some qualified form of higher education. In addition, residents of 27 states and the District of Columbia can deduct on their state tax returns at least a portion of what they contribute to their home state's plans. Pennsylvania, Kansas, and Maine provide up-front state tax deductions for contributions to any 529.

How much are these tax benefits worth? The answer depends largely on your tax bracket, as well as the investment mix in your account and your rate of return. If you're in the 25% federal tax bracket and invest for a newborn in an all-stock portfolio that earns 7% a year, the federal tax exemption will enhance returns by about 0.9% a year over 18 years, compared with saving without the tax exemption, Hurley calculates. If you live in a high-tax state such as California, the tax break is worth an additional 0.30% or so. That adds up to a total performance advantage of 1.20% a year for the college savings plan. (The value of the benefit rises for those in higher tax brackets and for portfolios that contain bonds, which would otherwise be taxed at a higher rate than stocks.)

California doesn't offer a state tax deduction or credit for putting money in a plan. But those breaks, where available, make the 529 even more attractive. For an estimate of how much your state's tax deduction will boost your annual returns, check the calculator at [archimedes.com/franktemp/stdc\\_529.phtml](http://archimedes.com/franktemp/stdc_529.phtml).

Of course, these benefits won't mean much if you make poor investment choices or allow high fees to siphon off a big chunk of the tax savings. Make sure the investment you have in mind has a solid track record, compared with its benchmark. Then calculate the difference between what you'll pay

## The Lowdown on Low-Cost Plans

These 529 plans charge 0.6% or less in annual fees on their cheapest options that invest in equities. You can find links to their Web sites at [savingforcollege.com](http://savingforcollege.com).

STATE	SAVINGS PLAN	LOWEST FEE*
OHIO	CollegeAdvantage	0.25%
OREGON	Oregon College Savings Plan**	0.26
UTAH	Utah Educational Savings Plan**	0.28
VIRGINIA	Virginia Education Savings Trust***	0.33
WISCONSIN	EdVest**	0.35
ALASKA	Univ. Alaska College Savings Plan	0.38
ARIZONA	Fidelity Arizona College Savings Plan	0.50
CALIFORNIA	ScholarShare College Savings Plan	0.50
DELAWARE	Delaware College Invest. Plan	0.50
MASSACHUSETTS	U. Fund College Investing Plan	0.50
NEVADA	Vanguard 529 Savings Plan**	0.50
NEW HAMPSHIRE	UNIQUE College Investing Plan	0.50
KANSAS	Learning Quest**	0.51
NEW YORK	New York's 529 College Savings Program	0.55
MICHIGAN	Michigan Ed. Savings Program	0.60

\*For plans that include equities. †Lowest-cost option. \*\*Charge annual account maintenance fees ranging from \$20 to \$27 which may be waived under certain conditions. \*\*\*\$25 one-time enrollment fee.  
Data: [Savingforcollege.com](http://Savingforcollege.com)

for this investment in a 529, vs. a regular, taxable mutual fund.

Suppose you're a California resident. If you want to save for college using a Standard & Poor's 500-stock index fund, the cost for that in the California plan is 0.50%. That's five times the 0.10% cost of investing in Fidelity's Spartan 500 Index fund. Still, the 529 is well worth the extra 0.40%. Why? The tax benefits amount to 1.20% a year, so you still come out ahead.

As a general rule, if your home state offers a generous tax deduction, give it serious consideration, says Hurley. Otherwise, shop around. You may just find a better deal in another state's plan (table). If you're already in a plan, you can switch your child's account once a year,

free of taxes and penalties.

To ascertain the cost of a specific investment, dig into plan disclosure documents. ([Savingforcollege.com](http://Savingforcollege.com) publishes links to plan Web sites, where you can download these documents.)

That's not as hard as it sounds. To get the bottom line on California's ScholarShare College Savings Plan, for example, simply flip to the fee tables in the disclosure documents (table, below). Like a growing number of plans, California's offers both actively managed funds and cheaper index funds. All you have to do is glance at the second-to-last column, titled "Total Annual Asset-Based Fees." In the case of the index funds, you'll see that each charges 0.50%.

### SHOP AROUND

IF YOU WANT to see what goes into that fee, start with the first column, "Estimated Underlying Fund Expenses." This tells you the annual cost of investing in each mutual fund. In the case of the Spar-

tan 500 Index fund, for example, the tab is 0.10%. The next column, "Program Manager Fee," tells you how much Fidelity receives for administration. It pockets 0.30% on the Spartan 500 Index fund. The "State Fees," of 0.10%, go to California to cover its expenses. California imposes no annual account maintenance fee. But if it did, it would be listed in the last column, and you'd want to add it in as well.

Sure, it takes a little time to shop for a plan. But when you're trying to amass enough to pay your newborn's tuition in 2025, those tenths of a percentage point can really add up. ■

### SCHOLARSHARE PLAN FEE AND EXPENSE STRUCTURE (AS OF 11/16/06): INDEX FUNDS

Portfolio	Estimated Underlying Fund Expenses <sup>1</sup>	Program Manager Fee <sup>2</sup>	State Fee <sup>3</sup>	Miscellaneous Fee <sup>4</sup>	Total Annual Asset-Based Fee <sup>5</sup>	Annual Account Maintenance Fee <sup>6</sup>
International Index Portfolio	0.10%	0.30%	0.10%	N/A	0.50%	N/A
Spartan 500 Index Portfolio	0.10%	0.30%	0.10%	N/A	0.50%	N/A
Total Market Index Portfolio	0.10%	0.30%	0.10%	N/A	0.50%	N/A

ing her son and daughter.

This might seem like a minor technicality, but it's a serious matter to the Internal Revenue Service. Leaving the IRA in the estate meant the account had to be closed within five years and proceeds distributed, which would have left the grown children with a monster tax bill. "It was disastrous," recalls Christopher Murray, who is trying to get a star on Hollywood Boulevard for his late mother. "The so-called experts who drew up the documents and oversaw the distributions didn't do it correctly."

## CREATIVITY COUNTS

MURRAY AND HIS sister Patricia could have dodged the tax cudgel if they had been the only beneficiaries named in the trust. But other heirs, including Lange's hairdresser and The Actors' Fund of America, had their bequests parked in the same trust. Ultimately, Lange's accountant, who admitted she had never before had a client who died, suggested a way that the children might unravel the mess. She recommended that they ask the IRS for a so-called private letter ruling (PLR), which involves a process akin to a mini court case. To Murray's delight, a favorable ruling arrived in the mail in December that allowed the IRA to be distributed to him as though he were an original beneficiary. (His sister did not seek a ruling, so she did not get the same tax treatment.)

A PLR can be a godsend to desperate taxpayers who are searching for a creative way out of a tax jam. "Private letter rulings can save fortunes," says Seymour Goldberg, senior partner at Goldberg & Goldberg in Jericho, N.Y., who has filed more than 100 PLR requests. "Millions of dollars can be involved."

The process typically starts when a lawyer or accountant submits written arguments to the IRS that detail why a taxpayer should receive a favorable ruling for what could be a murky tax question. The overwhelming majority of the decisions sought by individuals—corporations seek them as well—involve estate and trust matters, as well as retirement accounts. Getting a response from the tax folks can take anywhere from a few months to a year and a half.

In recent years, the IRS has weighed in on some unusual requests. For instance, a widow persuaded the tax collectors to let her late husband open up an IRA. The reason she asked? Her husband had died with a big chunk of money in his workplace retirement plan, but since she was young, she would have been slapped

with a 10% early withdrawal penalty if she had rolled the money into a spousal IRA and tapped into it. She avoided the penalty when the IRS gave its approval to the posthumous IRA.

In another case, a man turned to the IRS after learning that his bank, through an account mix-up, had dispatched \$200,000 from his IRA to another customer. It took the guy four



years to discover the money was missing because he had blamed the cash drain on the dot-com market implosion. The bank agreed to pay for the tax request to ward

off a costly lawsuit. Plenty of PLRs are sought by financial institutions and investment advisers who have made bone-headed, potentially irrevocable mistakes that could cost their clients dearly.

A PLR also helped John Striano's family after his father, who deteriorated rapidly after receiving a cancer diagnosis, didn't have the time or the strength to move his pension from his S corporation into an IRA that his children could preserve. The sports consultant had begun the process, but chemotherapy sapped any energy he had to deal with paperwork. "The idea of losing out on this money because my dad couldn't roll it over in time was flat-out rude," says Striano, an accountant at Deloitte & Touche in Orlando. The IRS permitted Striano and his sister to move the money into special annuities that will allow the twentysomething siblings to make minimum withdrawals from their tax-sheltered inheritance for decades.

By far the most common plea the IRS hears comes from taxpayers who botch the 60-day IRA rollover rule. Someone transferring money from a retirement plan, such as a 401(k) or another IRA,

has 60 days to make sure the cash gets tucked into another retirement account. Tardy taxpayers, however, must dismantle their IRAs and cough up the cash for the taxes, as well as a possible 10% early-withdrawal penalty. Congress, with its ambitious tax legislation in 2001, allowed some exceptions for rollover procrastinators, which has triggered a spate of "Mother-may-I" requests to the IRS.

Since then, more than 300 individuals have won rollover reprieves. "I look at the 60-day rulings like the Nielsen ratings for TV," says Ed Slott, a CPA in Rockville Centre, N.Y., and an IRA expert. "Everybody who goes for a ruling probably represents 1,000 others who could have sought one but didn't know about it."

A common thread runs through successful 60-day rollover rulings. "If you didn't use the money and you can show that you intended to do the rollover all along, and the reason you didn't was because of an error on the part of a financial institution or some physical limitation such as you were hospitalized, then you should get the ruling," says Barry Picker, a CPA in Brooklyn, N.Y., who handled

Murray's PLR request.

One taxpayer who won a PLR was an alcoholic who tapped his IRA right before he was involuntarily hospitalized. By the time he emerged from his confine-

ment, the 60-day clock had stopped. The IRS allowed him to roll it over anyway because he was incapacitated during the time he should have done it.

## NO GUARANTEES

IF YOUR TAX SNAFU isn't a significant one, seeking a PLR may not be worth the cost. The IRS charges \$9,000 for most PLRs, while the least expensive rulings, involving 60-day rollover mistakes, max out at \$3,000 for six-figure IRAs. Of course, you also have to pay an accountant or attorney to research and file your claim.

Not everybody who has been squeezed by a tax tourniquet ultimately experiences relief from a PLR. Just ask the fellow who pulled his money out of his IRA to protect it from a possible tax levy while he was battling the IRS over a tax dispute. Once the conflict ended, the taxpayer wanted to return the money to the IRA long after his 60-day window had closed. In the PLR, he even admitted that he had yanked the cash to hide it. So what happened to his case? The IRS was definitely not impressed with his candor and turned him down. ■

**HOPE LANGE** A private letter ruling regarding her estate allowed her son to avoid a monster tax bill

