

MEMO# 11823

April 19, 2000

TAX COURT CLARIFIES APPLICABILITY OF COMMUNITY PROPERTY LAWS TO TAXATION OF IRA DISTRIBUTIONS

[11823] April 19, 2000 TO: PENSION MEMBERS No. 23-00 PENSION OPERATIONS ADVISORY COMMITTEE No. 29-00 RE: TAX COURT CLARIFIES APPLICABILITY OF COMMUNITY PROPERTY LAWS TO TAXATION OF IRA DISTRIBUTIONS

The U.S. Tax Court, reviewing an issue of first impression, recently decided that distributions from an IRA were wholly taxable to an IRA owner, despite his former spouse's 50-percent community property interest in the IRA. In *Bunney v. Commissioner*, 114 T.C. No. 17, 2000 U.S. Tax Ct. LEXIS 23 (Apr. 10, 2000), the judgment dissolving the taxpayer's marriage ordered that distributions from his IRAs, for which contributions were made from community funds, be divided equally between the two parties pursuant to California's community property laws. Following the divorce, the taxpayer withdrew the balance from his IRAs and paid a portion of the proceeds to his spouse. The court found that the entire distribution was includable in the taxpayer's income under Code section 408(g), which provides that Code section 408 (governing IRAs) "shall be applied without regard to any community property laws." Furthermore, the court reasoned that recognizing community property interests in IRAs for federal income tax purposes would lead to conflicts with section 408 requirements. For example, an account maintained jointly for a husband and wife under community property principles would not fit within the definition of an IRA, which must be created or organized "for the exclusive benefit of an individual or his beneficiaries." Similarly, the application of community property laws to IRAs would conflict with IRA rules concerning rollovers and minimum distribution requirements — which, in the court's view, contemplate only one IRA owner. In addition, the court noted that because the deductibility of IRA contributions is determined without regard to community property laws, such laws also should be disregarded when distributions are made from IRAs. The opinion addressed two other issues relating to the taxpayer in this case. The court determined that distributions from the taxpayer's IRAs were subject to the 10-percent tax on early IRA withdrawals imposed by Code section 72(t); the taxpayer simply was unable to produce evidence that he qualified under an exception to the tax. The court also limited the taxpayer's liability under the section 6662 penalty provision for negligent underpayment of taxes. 2 A copy of the opinion is attached. Thomas T. Kim Assistant Counsel Attachment Note: Not all recipients receive the attachment. To obtain a copy of the attachment referred to in this Memo, please call the ICI Library at (202) 326-8304, and ask for attachment number 11823. ICI Members may retrieve this Memo and its attachment from ICINet (<http://members.ici.org>).

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.