THE Pension Digest

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ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc.,
"The Pension Specialists"

IRS Issues 2019 Indexed Amounts for HSAs

The HSA contribution limits for 2019 are $50 higher for single HDHP coverage and $100/$150 higher for family HDHP coverage. The Treasury Department and Internal Revenue Service issued new guidance on the maximum contribution levels for High Deductible Health Plans (HDHPs) that must be used in conjunction with HSAs. The 2019 limits are set forth in Revenue Procedure 2018-30.

Maximum Contribution Limits Under Age 55

	2018	2019
Single HDHP	$3,450	$3,500
Family HDHP	$6,850/$6,900	$7,000

Maximum Contribution Limits Age 55 & Older

	2018	2019
Single HDHP	$4,450	$4,500
Family HDHP	$7,900	$8,000

HSA Catch-Up Contributions

	2018	2019
Age 55 and Older	$1,000	$1,000

High Deductible Health Plans

	Minimum Annual Deductible		Maximum Annual Out-of-Pocket Expenses	
	2018	2019	2018	2019
Single Coverage	$1,350	$1,350	$6,650	$6,750
Family Coverage	$2,700	$2,700	$13,300	$13,500

IRS Issues New Guidance on Withholding and IRS Reporting For IRA Distributions To a State Unclaimed Property Fund

Many states have laws requiring IRAs meeting certain inactivity rules to be paid by an IRA custodian to the state's unclaimed property fund. Many states are not all that concerned about the income tax consequences that arise from these mandated distributions.

The U.S. Treasury is concerned and it wants it share of the revenues. It does not want all of these distributions (i.e revenues) going to a state without some plan of action as to how and when it will be paid the taxes it is owed. The U.S. Treasury wants to collect the federal income taxes it is taxes owed with respect to each and every IRA distribution. The general tax rule is, a person is required to include an IRA distribution in their taxable income and will pay the applicable marginal tax rate. A person younger than 59½ owes an additional 10% tax unless an exception applies.

The IRS has recently issued Rev. Rul. 2018-17. This guidance changes old IRS guidance as to how an IRA custodian is to prepare the Form 1099-R to report an IRA distribution made to a State's Unclaimed Property Fund. Under the old guidance the IRA custodian issued the Form 1099-R to the state and used the state's tax identification number.

The new guidance requires the IRA custodian to prepare the Form 1099-R identifying the IRA account holder as the recipient. Thus, the Form 1099-R will show this individual as the recipient. The IRA custodian will have the person's tax identification number and will have a mailing address which may or may not be currently accurate. The IRS guidance does not discuss the address topic.

In the new guidance, the IRS makes clear the IRA custodian has the duty to withhold for federal income tax purposes 10% of the amount being remitted to the respective state's unclaimed property fund. The reason 10% must be withheld is because Internal Revenue Code section 3405 sets withholding requirements for non-periodic IRA distributions. The IRA custodian must remit these withheld IRA funds to the IRS/U.S. Treasury as other withheld amount. Although the tax rules permits an individual to elect not to have any withholding, the IRS has concluded that an individual in this situation will not elect to have no withholding and so the 10% needs to be remitted to the IRS/U.S. Treasury.

The IRA custodian is to remit the other 90% of the IRA to the respective state's unclaimed property fund.

The IRS will process the submitted 1099-R forms and the IRS will contact these individuals if these individuals failed to properly report these distributions on their tax returns and if they failed to pay the amount owed. Most taxpayers have a marginal tax rate in the range of 15%-30% so if only 10% was withheld, an additional amount will be owing.

This new IRS guidance is effective immediately and so an IRA custodian wants to implement new procedures as soon as possible. The IRS has issued temporary transition relief. An IRA custodian must start complying with the new rules for payments made to a state's unclaimed property fund on or after January 1, 2019. However, if it is reasonably practicable for an IRA custodian to comply sooner, it must comply sooner.

An IRA custodian wants procedures to minimize the number of inactive IRAs.

The IRS guidance makes clear that it is only traditional IRA funds which are subject to these new withholding and reporting rules. The new guidance does not apply to Roth IRAs, SEP IRAs and SIMPLE IRAs. The IRS guidance does not explain why these new procedures do not apply to Roth IRAs, SEP-IRAs and SIMPLE IRAs.

The IRS guidance does discuss the general tax rule that the withholding rules only apply to an IRA distribution to the extent it is reasonable to believe the distribution must be included in the recipient's income. With distributions from Roth IRAs it is not generally reasonable to believe the distribution must be included in the recipient's income.

We expect the IRS in the near future will issue additional guidance regarding what an IRA custodian is to do with Roth IRAs, SEP-IRAs and SIMPLE IRAs that must be remitted to a state's unclaimed property funds. If a SEP-IRA and/or a SIMPLE IRA is related to an ERISA employer plan, the position of the IRS and the DOL most likely is - federal law supersedes any state unclaimed property law and such funds could not be remitted to the state.

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IRS Reconfirms the Proper Reporting By a Roth IRA Custodian of a Roth IRA Distribution - Determining If the 5-Year Rule Has Been Met.

Roth IRA owners and the tax accountants of such Roth IRA owners want to be furnished a Form 1099-R with the reason code "Q" in box 7. The Q is used to report a distribution which the Roth IRA custodian knows to be a qualified distribution (i.e. a tax-free distribution). The individual is not required to include this distribution in their income.

The withdrawal of income from a Roth IRA is a qualified distribution (and tax-free) if the individual has met the 5 year rule and the distribution is on account of being age 59½ or older, being disabled, or if it qualifies as a first time home purchase or if it is made to a beneficiary.

What procedures are to be used by the Roth IRA custodian to determine if the individual has met the 5 year rule? Is the Roth IRA custodian only to consider for purposes of preparing the Form 1099-R the time the Roth IRA has been at its institution or may the Roth IRA custodian consider when the individual previously opened his or her Roth IRA with another Roth IRA custodian.

Many large Roth IRA custodians/trustees (e.g. Fidelity) wrongly believe they are permitted to report a Q even though the 5 year has not been met at their institution.

Many Roth IRA computer systems and many Roth IRA plan agreement forms will ask for the date when the individual first established his or her Roth IRA or the January 1st of the first year for which a Roth IRA contribution was made.

The IRS for a long time has had the reporting procedure - the Roth IRA custodian is not to insert a code "Q" in box 7 if the individual has not met the 5 year rule at its institution. For example, Jane Doe opened her Roth IRA with IRA custodian #4 in 2014 by transferring in her Roth IRA from Roth IRA custodian #3. She originally had opened her Roth IRA in 2004 with Roth IRA custodian #1. Jane Doe is now age 64. If she withdraws funds from her Roth IRA with Roth IRA custodian #4 in 2018, such custodian is to insert reason code (T) into box 7. Reason code (T) means, the Roth IRA custodian knows the distribution is a non-qualified distribution with an exception known. That is, the 10% tax is not owed if the distribution would be required to be included in income.

Jane Doe and/or her accountant are given the task of explaining on her tax return that her Roth IRA distribution is qualified (notwithstanding that the 1099-R has been prepared with a reason code T) because she has met the 5 year rule because she had made her first Roth IRA in xxxx (more than 5 years ago) with financial institution AAAA.

We recently called the IRS Martinsburg location and the IRS representative confirmed that the IRS has not changed its procedure on this issue.

The real world difficulty is, so many ROTH IRA have been preparing their 1099-R forms incorrectly, that your customer may well believe it is your institution which is doing it incorrectly.

Remember, the IRS may assess two fines of $260 if the Form 1099-R is prepared with errors.

The IRS should acknowledge their instructions on this subject need to be improved. This applies to the instructions for their print versions and for their e-versions. The IRS should revise its instructions to make very clear that for determining if code Q is to be used the Roth IRA custodian only considers the time the Roth IRA has been at its institution.

A Be Careful Situation – RMD Calculation for a Trust Beneficiary With a Spouse Beneficiary

We at CWF recently furnished the following guidance:

You called with two situations involving an irrevocable trust which is the designated IRA beneficiary with a spouse as the sole beneficiary of the trust versus when the spouse is not the sole beneficiary of the trust.

In the first situation the IRA grantor is over age 70½ and has designated an irrevocable family trust to be the IRA beneficiary. There must be an annual RMD calculation for this person's IRA.

In the second situation the IRA grantor was over age 70½ and had designated an irrevocable family trust to be the IRA beneficiary and the IRA grantor has passed. There must be an annual RMD for this inherited IRA.

If the RMD is not calculated correctly for these situations and the amount distributed is less than the RMD, then the 50% excess accumulations tax will be due and owing.

The software being used to assist with the RMD calculations allows the RMD calculation to be made using a special look-through calculation in certain situations when a spouse is a beneficiary of the family trust.

I wanted to write this memorandum because I believe the look-through calculation only applies to one very narrow situation. The spouse beneficiary of the family trust must have an unlimited right to all of the trust property arising from the IRA. If any portion of the IRA assets are guaranteed to go to a party other than the spouse, the look though rule is unavailable. Its use would mean the RMD for the given year would be calculated incorrectly.

The RMD regulation provides that when a trust has been designated as the IRA beneficiary a spouse beneficiary of such trust cannot elect to treat the decedent's IRA as his or her own IRA or to rollover such funds into the spouse's IRA.

What is the practical effect of the special look-through rule?

This rule can apply while the IRA owner is still alive and also after the IRA owner has died.

For discussion purposes, the following two factual situations are assumed. Under the first situation John Doe age 75 who is still alive has established an irrevocable trust and he has designated his wife Mary, age 56 to be the sole beneficiary of the trust. Under the second situation John Doe age 75 who is still alive has established an irrevocable trust and he has designated multiple beneficiaries of his trust. His wife Mary, age 58, is not guaranteed to be the sole beneficiary of the trust.

The RMD rules grant a number of special rights to a spouse beneficiary who is the sole primary beneficiary of the IRA or is the sole beneficiary of the trust which is the IRA beneficiary.

The IRA owner who has a spouse beneficiary who is more than 10 years younger is able to use the joint life expectancy table to calculate the RMD divisor rather than being required to use the divisor from the Uniform Lifetime Table. John's RMD divisor is 30.4 under the first situation (Joint LE Table with ages 75 and 55) and the divisor is 22.9 under the second situation (Uniform Lifetime Table).

For discussion purposes, the following two additional situations are assumed. Under the third situation John Doe died during 2017 at age 76. His wife, Mary, age 56 in 2018 is the sole beneficiary of the irrevocable trust. She has the right under the trust document to designate her successor trust beneficiary(ies). Under the fourth situation there are multiple beneficiaries of the trust and Mary is the oldest of such beneficiaries.

Under this third situation the look-through rule applies. She must take an RMD for 2018 (the year following his death). While she is alive, the recalculation method and the Single Life Table will be used to determine the applicable divisor for 2018 and subsequent years. The following schedule would apply:

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Year	Her Age	Divisor from Single Life Table (Ea. Yr.)
2018	56	28.7
2019	57	27.9
2020	58	27.0
2021	60	26.1
2022	61	25.2
2023	62	24.4
2024	63	23.5
2025	64	22.7
2026	65	21.8
2027	66	21.0
Continue		

Upon her death, the schedule applying for the trust for subsequent years is determined by subtracting one from her last divisor. For example, if she dies in 2026, the divisor for the trust for 2027 is 20.8 (21.8-1.0).

Under the fourth situation, the look-through rule does not apply as she is not the sole beneficiary. She must take her first RMD for 2018 (the year following his death). The recalculation method is not used The one year reduction method is used along with the Single Life Table to determine the applicable divisor for 2018 and subsequent years. The following schedule would apply:

Year	Her Age	Divisor from Single Life Table (reduce by 1.0 each year) Determine initially
2018	56	28.7
2018	56	28.7
2019	57	27.7
2020	58	26.7
2021	60	25.7
2022	61	24.7
2023	62	23.7
2024	63	22.7
2025	64	21.7
2026 6	5	20.7
2027	66	19.7
Continue		

Upon her death, this schedule would continue to apply to the trust for subsequent years.

In summary, the ability of a spouse to gain the benefit of the pass-through rule is very limited. If the pass-through rule is used to reduce the trust's RMD when its use is unauthorized, the 50% tax will apply. The 50% tax is owed for each year the excess accumulation remains in the inherited IRA The tax amount owing can become a substantial amount when the incorrect calculation is used for a number of years.

For example, there is $750,000 in an inherited IRA. If the RMD divisor is 21.0, the RMD is $35,714.29. If the RMD divisor is 19.7, the RMD is $38,071.07. The excess accumulation (under-distribution) is $2,356.78 so the 50% tax would be $1,178.39 for each year the excess accumulation remains in the inherited IRA.

Informing Others About the Qualified Charitable Distribution Rules

Charities and churches do not communicate as well as they should the tax benefits to be realized when a person makes a qualified charitable distribution with respect to their IRA.

Statutory law provides that a person age 70 1/2 or older may give funds from their traditional IRA to a charity and this individual is not required to pay tax on this IRA withdrawal to the extend of $100,000 per year. This law benefits all IRA owners age 70 1/2 and older, but is does benefit wealthy individuals more.

The IRS on its own decided to expand the tax benefit by allowing a person to use a QCD to satisfy their RMD for a tax year. The statutory law does not set forth this tax benefit.

Set forth below is text found in CWF's IRA brochure discussing QCDs. QCDs can be used by communities to meet their goals.allowed.

What is the benefit of the law?

In general, a person age 70½ or older will be able to direct his or her IRA custodian to withdraw an amount of up to $100,000 from his or her IRA and have such proceeds sent directly to a qualifying charitable organization. The distribution will be tax free if certain rules are met.

Under the existing tax rules, approximately two-thirds of tax filers use the standard deduction and are unable to claim a deduction for their charitable contributions. There are many people over age 70½ who use the standard deduction. There will now be an incentive for these individuals to withdraw funds from their IRA and give them to a charity.

What is the main effect of the QCD rules?

Many individuals are interested in contributing their IRA RMD to their church or other qualifying charity.

Due to the fact that these rules in prior years were not permanent, many individuals may not have been aware of the QCD rules.

Is there a deadline to make a QCD?

Yes, if you wish to make a QCD for the 2017 tax year, it must be made by December 31, 2017. The deadline for the 2018 tax year is December 31, 2018 and for any subsequent year by December 31st of such year.

What requirements must I meet in order to take advantage of this charitable contribution law?

1. You must be age 70½ or older.
2. You must have a traditional or Roth IRA.
3. Your charitable contributions must otherwise be deductible. A distribution qualifies to be a qualified charitable distribution only if a deduction for the entire distribution would be allowable to be deducted under Code section 170 (but you are able to disregard the percentage limits). **Caution:** You receive the tax-free charitable contribution treatment only if the entire amount would have qualified as a charitable deduction. Thus, if the contribution amount is reduced because of a benefit received by you in exchange, or because the custodian does not obtain sufficient substantiation, the exclusion is not available with respect to any part of the IRA distribution.
4. The distribution, but for this rule, must otherwise have been required to be included in your gross income. The withdrawal of basis (i.e. nondeductible contributions) from a traditional IRA is not includable in income, and consequently, such withdrawal does not qualify as a tax-free charitable contribution. If the withdrawal from a Roth IRA will not be taxed because it is either the withdrawal of basis or because the distribution is a qualified distribution, such withdrawal does not qualify as a tax-free charitable contribution.
5. Payment, no matter in what form (electronic transfer, check, etc.), must be made directly from the IRA to the qualifying charitable organization. The instrument used for payment must not be negotiable by the IRA accountholder.

Is there a limit on the amount which can be contributed to a charity each year?

Yes, you may contribute up to a maximum of $100,000 each year.

May my spouse and I both make this type of contribution?

If you and your spouse have separate IRAs, you may each contribute the maximum of $100,000 per year.

If I have two or more IRAs, may I contribute $100,000 from each one?

No, the maximum you can contribute per year is $100,000. This maximum is "per person," NOT "per IRA."

Will the amount I contribute under this distribution option count toward my required minimum distribution (RMD) for the year?

Yes, the IRS has issued guidance that any amount distributed as a qualifying charitable contribution for a given year, will be counted toward your RMD for that year.

May I deduct this contribution on my Schedule A as a charitable contribution?

No, any amount which you donate to charity under this new charitable contribution rule cannot be deducted as an itemized deduction for that year on Schedule A of your Form 1040 income tax return.

Continued on page 7

Would it benefit me to have the distribution come from my Roth IRA rather than my traditional IRA?

Almost never. It will benefit you to use this new rule, and you are eligible to use this new rule only if the distribution from your Roth IRA would be a nonqualified distribution and would be comprised of taxable income.

For example, Roth distributions are always qualified and tax free if the 5-year rule has been met and the accountholder is age 59½ or older. A qualified Roth distribution cannot be used to make a qualified charitable distribution.

Additional Tax Benefits to the IRA Accountholder

In the case of a distribution of funds from a traditional IRA, the special pro rata taxation rule as set forth in Code section 72 for IRAs is not to be used. In the case of a nonqualified distribution from a Roth IRA, the standard ordering rules (annual contributions, conversion contributions, and then earnings) will not be used.

Rather, the distribution is treated as consisting of income first, up to the aggregate amount that would be includable in gross income (but for this provision) if the aggregate balance of all IRAs were distributed during the same year. Proper adjustments in calculating the tax treatment of future distributions are to be made to reflect the fact that "taxable income" was transferred to the charity. These distributions which were excluded from gross income are not taken into account in determining the deduction for charitable contributions under section 170.

What charities qualify in order for the IRA distribution to be tax free for the accountholder?

The so-called 50-percent organizations, as defined in Code section 170(b)(1)(A) will qualify. However, the supporting organizations described in Code section 509(a)(3) are excluded, as are donor advised funds. The qualifying 50-percent organizations are: churches, a convention or association of churches, educational institutions, hospitals, organizations supporting government schools, medical research organizations, governmental units, publicly supported organizations, common fund foundations, certain private operating foundations, and conduit foundations. Publication 526, Charitable Contributions, lists the following organizations as being the most common:

1. Churches, synagogues, temples, mosques, and other religious organizations;
2. Federal, state, and local governments, if your contribution is solely for public purposes (for example, a gift to reduce the public debt);
3. Nonprofit schools and hospitals;
4. Public parks and recreation facilities;
5. Salvation Army, Red Cross, CARE, Goodwill Industries, United Way, Boy Scouts, Girl Scouts, Boys and Girls Clubs of America, etc.
6. War Veteran's groups.

A distribution given to a private foundation does not qualify as a tax-free charitable contribution, since a private foundation is not a public charity. Also, a distribution used to fund a charitable remainder trust or gift annuity does not qualify as a tax-free charitable contribution.

How do I indicate that I wish to make a qualifying tax-free charitable contribution?

If you are an individual who qualifies for this special tax benefit, you will want to contact your IRA custodian or trustee. Your IRA custodian will have the proper form to complete to indicate the amount of the distribution and the charity to which you want the funds sent. The IRA custodian/trustee remitting the funds may also want to have the charity sign a special certification form prior to remitting the funds. The funds will then be withdrawn from your IRA and will be paid directly to the qualifying charity of your choice. This distribution will be tax free. The charity should furnish you with a receipt for your gift.

Can the charitable distribution be made from a SEP-IRA or SIMPLE-IRA?

Distributions from SEP-IRAs or SIMPLE-IRAs are generally <u>ineligible</u> for this special treatment, as are distributions from qualified plans and other types of retirement plans. However, funds within a SEP-IRA or a SIMPLE-IRA are ineligible to be a QCD only if the SEP-IRA or the SIMPLE-IRA is "ongoing." The IRS has defined "ongoing" to mean there needs to be an employer contribution made for the plan year ending with or within the IRA owner's taxable year in which the charitable contributions would be made. If an employer has <u>not</u> made an annual contribution, then funds may be directly transferred from a SEP-IRA or SIMPLE-IRA as a QCD, assuming the other requirements have been met.

In addition, it would be possible to roll over funds from a SEP-IRA, SIMPLE-IRA (after the two-year holding period has been met), and other types of retirement plans to a traditional IRA and then make the charitable contribution from the traditional IRA.

Can a beneficiary who has inherited an IRA make a qualified charitable distribution and use it to satisfy his or her RMD?

Yes, but the beneficiary must comply with all of the requirements, including being age 70½ or older.

Is special IRS reporting required?

Your IRA custodian will prepare a Form 1099-R, as they would for any IRA distribution. You will be responsible to show on your Form 1040, why the distribution is not taxable.

The IRS instructions for reporting a qualified charitable distribution on Form 1040 state:

"If the distribution is a qualified charitable distribution (QCD), enter the total distribution on line 15a. If the total amount distributed is a QCD, enter -0- on line 15b. If only part of the distribution is a QCD, enter the part that is not a QCD on line 15b (unless another exception applies to that part of the distribution). Enter QCD next to line 15b."

Should I discuss this subject with my legal or tax advisor to make sure I qualify for this special tax treatment?

Yes. You are entitled to exclude the transferred amount from your taxable income only if numerous conditions are met.

What to do? A Securities Firm Balks at Doing an IRA Transfer

We at CWF recently furnished the following guidance:

Subject: A Securities Firm Representative Cites "Old Law" For Not Being Willing To Accommodate a Person By Doing an IRA Transfer

Sara,

Good morning. I understand you have a customer who has asked the bank to serve as the IRA custodian. He or she has IRA funds with a securities firm in the brokerage division. Your client has established or will establish an IRA with First American Bank.

Your client wishes to transfer their IRA funds from the securities firm to First American Bank. An IRA transfer form has been prepared, signed by your client and the bank, and furnished to the securities firm.

The representative has informed a bank representative that the securities firm is unwilling to transfer the IRA funds unless the bank makes a written determination explaining why the person's best interest will be served by this transfer.

The bank has no duty to make this determination. The individual by signing the transfer form has determined that it is his or her best interest to have the IRA transfer. This should be sufficient.

I suggest talking with the security firm representative's supervisor and possibly that person's supervisor to determine what the corporate policy is regarding IRA transfers. It may well be that this representative has been trained to respond as he or she has responded. Many in the securities world believed the DOL's fiduciary rule would require banks to conclude that bank IRA products are not in the best interest of the individual and that the bank funds would need to move to securities and insurance products or stay in securities and insurance products.

The "best interest" rule being cited by the security firm representative was vacated by the recent decision (March 5, 2018) of the Fifth Circuit Court of Appeals in Chamber of Commerce of the USA vs. U.S. Department of Labor. This decision applies to the entire United States as the DOL under the Trump administration did not appeal the court's ruling. Vacated means the fiduciary rule never went into effect. It may be the DOL will propose a new definition of fiduciary or Congress will.

The 5 part definition of fiduciary again applies. Under this definition the individual determines what is in his or her best interest. The bank as the IRA custodian is not required to make this determination.

Your client and every other IRA owner should understand there is no federal statutory law requiring the securities firm or any other IRA custodian to participate in an IRA transfer even though it is in the person's best interest from a taxation standpoint to have an IRA transfer. However, it would be hypocritical and self-serving if the securities firm is unwilling to accommodate the client with an IRA transfer.

If the securities firm will not agree to the IRA transfer, the individual should proceed with a distribution/rollover, but only if the person has determined that he or she is eligible to make a rollover contribution. That is, the individual will comply with the once per year rule.

I'm hoping this memorandum will lead to a securities firm representative accommodating your client with an IRA transfer. You may furnish it to others. If the securities firm has not yet changed its corporate policy regarding transfers and rollovers, I expect it will soon do so. Please contact me if you wish to discuss further.