THE Pension Digest

May 2021
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Collin W. Fritz and Associates, Inc.,
"The Pension Specialists "

IRS Clarifies and Corrects Publication 590-B, IRA Distributions

The IRS first issued the 2020 version of Publication 590-B on March 25, 2021.

The IRS issued its revised version on May 13, 2021.

We at CWF are unaware that the IRS has furnished any explanation why the March version needed to be changed. We understand sometimes the change was a clarification and sometimes the change was made to correct a mistake. The IRS like most of us hates to admit when a mistake has been made. We still believe there are errors which the IRS needs to revise, correct and explain further.

Set forth below is a side by side comparison from the March 25, version and the May 13 version of some of the provisions which were changed.

The most valuable point to be understood from the IRS' revised guidance in Publication 590-B <u>is that a beneficiary of an IRA owner who died after their required beginning date must use the 10-year rule to close the inherited IRA unless the beneficiary would be an EDB</u>. That is, even though the IRA owner died after their required beginning date and had commenced a periodic distribution schedule, the non-spouse beneficiary will be required to close the inherited IRA under the 10 year rule. In the April issue we stated incorrectly that we believed the revised example as set forth on page 12 supported the position that once an IRA owner had reached their required beginning date that the beneficiary could continue that schedule by using their single life expectancy factor. We were incorrect because the beneficiary in revised Example #1 was an EDB entitled to use the life distribution rules because he was age 65 and the deceased IRA owner was 74. He was an EDB because he was not 10 years younger. The IRS could clarify its guidance by having a second example where the beneficiary was age 60. That beneficiary would be required to use the 10-year rule.

The side by side discussion -

March 25 Version
A. Example #1 on Page 12

Example. Your father died in 2020. You are the designated beneficiary of your father's traditional IRA. You are 53 years old in 2021, which is the year following your father's death. You use Table I and see that your life expectancy in 2021 is 31 .4. If the IRA was worth $100,000 at the end of 2020, your required minimum distribution for 2021 would be $3,185 ($100,000 + 31.4).

May 13 Version
A. Example #1 on Page 12

Example. Your brother died .in 2020 at age 74. You are the designated beneficiary of your brother's traditional IRA You are 65 years old in 2021, which is the year following your brother's death. You use Table I and see that your life expectancy in 2021 is 21.0. If the IRA was worth $100,000 at the end of 2020, your required minimum distribution for 2021 would be $4,762 ($100,000 + 21.0).

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IRS Guidance,
Continued from page 1

B. Example #2 on Page 12

Example. The owner died in 2020. at the age of 80. The owner's traditional IRA went to his estate. The account balance at the end of 2020 was $100,000. In 2021, the required minimum distribution would be $10,870 ($100,000 + 9.2). (The owner's life expectancy in the year of death, reduced by 1.)

If the owner had died in 2020 at the age of 70 (before their required beginning date), the entire account would have to be distributed by the end of 2025, See *Death on or after required beginning date* and *Death before required beginning date* for more information.

B. Example #2 on Page 12

Example. The owner died in 2020 at the age of 80, and the owner's traditional IRA went to his estate. The account balance at the end of 2020 was $100,000. In 2021, the required minimum distribution would be $10,870 ($100,000 + 9.2 (the owner's life expectancy in the year of death, 10.2, reduced by 1)).

If the owner had died in 2020 at the age of 68 (before their required beginning date), the entire account would have to be distributed by the end of 2025. See *Death on or after required beginning date* and *Death before required beginning*

CWF's discussion. The IRS changed example #1. The March version had a father as the IRA owner and a son as the beneficiary. The May version has the IRA owner die in 2020 after his required beginning date, but his brother beneficiary is not more than 10 years younger so he is an eligible designated beneficiary. He is entitled to use the life distribution rule.

The IRS made no change to Example #2. The IRA owner died after his required beginning date with his estate as the beneficiary. One would think the 5-year rule applies, but the IRS indicates the special life distribution rule is used. This guidance is confusing. The IRS should provide further guidance.

March 25 Version

C. 5-Year-Rule

5-year rule. The 5-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw 100% of the IRA by December 31 of the year containing the fifth anniversary of the owner's death. For example, if the owner died in 2019, the beneficiary would have to fully distribute the plan by December 31, 2024. The beneficiary is allowed, but not required, to take distributions prior to that date. The 5-year rule never applies if . the owner died on or.after his or her required beginning date.

The 5-year rule generally applies to all beneficiaries if the owner died in a year ending before 2020, and to beneficiaries who are not individuals if the owner died in a year ending after 2019. For beneficiaries who are individuals, see *10-year rule*, next.

Caution! *The 5-year rule generally applies to all beneficiaries if the owner died in a year ending before 2020. It also applies to beneficiaries who are not individuals (such as a trust) if the owner died in a year ending after 2019. If the owner died in a year ending after 2019 and the beneficiary is an individual, see 10-year rule next.*

May 13 Version

C. 5-Year-Rule

5-year rule. The 5-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the fifth anniversary of the owner's death. For example, if the owner died in 2019 the beneficiary would have to fully distribute the plan by December 31, 2024. The beneficiary is allowed, but not required to take distributions prior to that date. The 5-year rule never applies if the owner died on or after his or her required beginning date.

Caution! *The 5-year rule generally applies to all beneficiaries if the owner died in a year ending before 2020. It also applies to beneficiaries who are not individuals (such as a trust) if the owner died in a year ending after 2019. If the owner died in a year ending after 2019 and the beneficiary is an individual, see 10-year rule next.*

CWF's discussion. The IRS changed very little in the two versions. The IRS realized it had included in the March version the same paragraph twice. The IRS does discuss the rule if the owner died before 2020 and if the IRA owner died after 2019. In both versions the IRS makes a statement we believe is wrong.

The IRS states, "the 5-year rule generally applies to all beneficiaries if the owner died in a year ending before 2020. This statement is wrong. Most IRA forms provide the beneficiary will use the life distribution rule unless they elect to use the 5-year rule.

The IRS also states, the 5-year rule generally applies to beneficiaries who are not individuals if the owner died in a year ending after 2019. This statement is inconsistent with Example #2 as discussed above and the statement in C that the 5-year rule never applies if the IRA owner died on or after his or her required beginning date.

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The Pension Digest

Proposed IRA and Pension Law Changes to be Enacted in 2021

Two Democrats (Mr. Neal and Mr. Brady) have introduced in the House of Representatives a proposed Act which has the title, "Securing a Strong Retirement Act of 2021." For purposes of this article we will refer to this proposed Act as SECURE II. A similar bill has been introduced in the U.S. Senate. This article discusses the IRA changes set forth in the U.S. House proposal. An article in the June or July issue will discuss the proposed changes for 401(k) and 403(b) plans.

Change #1. Increase in the RMD Age

The SECURE Act changed the RMD age from 70½ to 72. Under SECURE II the RMD Age would increase to be age 75 over a number of years as follows:

A It would be age 72 for any person attaining age 72 in 2022. That is, the person was born in 1950.

B. It would be age 73 for any person attaining age 73 during 2023-2027. That is, the person was born during 1951-1955.

C. It would be age 74 for any person attaining age 74 during 2028-2031. That is, the person was born during 1956-1957.

D. It would be age 75 for any person attaining age 74 after 2031. That is, the person was born in 1958 or later.

Change #2. Index the $1,000 Catch-Up Contribution Limit for traditional and Roth IRAs

Commencing with tax year 2023 the $1,000 catch-up limit would be adjusted by a COLA. The limit would increase in $100 increments. The base year would be 2016 and not 2021 as under current law. Most likely the limit will change to $1,100 or $1,200 in 2023 because of the inflation COLA.

Change #3. Certain Laws Applying to Qualified Longevity Annuity Contracts (QLAC)

There would be a repeal or an elimination of the premium limit of 25% of the aggregated balance. 100% of a person's traditional IRA, SEP-IRA or SIMPLE-IRA could be invested in a QLAC.

The change would certainly benefit greatly the insurance industry and lead to many IRA owners self-directing their assets into a QLAC versus bank IRA and mutual fund IRAs. Under a QLAC the RMD rules are suspended for a number of years.

Change #4. The Law Would Define an Inadvertent and Incorrect Payment From 401(k) or Other Pension Plan As Being Eligible to be Directly Rolled Over or Rolled Over Into an IRA

If a 401(k) or other pension plan makes a mistake and a person is overpaid., there can be many tax problems under existing laws. Has an excess contribution been made to the IRA? Must the pension plan somehow get that overpaid amount returned to the plan?

If the plan makes the decision not to recoup the overpayment, Secure II authorizes that the overpayment is treated as being eligible to be rolled over.

If the plan seeks the repayment, and the individual and the IRA custodian agree to repay the overpayment amount, the repayment is to be treated as a qualifying rollover.

If the plan seeks the repayment and the individual contests the repayment under the plan procedures and the plan notifies the IRA custodian then the IRA custodian must "hold" such overpayment amount until there is a determination whether the claim of an overpayment is correct.

Change #5. Reduce the 50% Tax to 25% and Possibly 10%

A person who fails to take their RMD by the applicable deadline owes a 50% tax on the excess accumulation (missed RMD). This 50% tax has been in the law since 1975. There have been only a few attempts from 1975-2020 to reduce this 50% tax. The IRS does have the statutory authority to waive this 50% tax. The IRS has no authority to lower the rate of the tax to something less than 50%.

The 50% tax would be reduced to 25% and in some cases to 10%. This would be a radical change. It would apply to 2022 and subsequent years.

The 10% rate will apply to an IRA owner or beneficiary who corrects , during a correction period, the short-

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Proposed Changes,
Continued from page 3

fall of distributions which had result in the penalty tax being assessed and submits a return during the correction period.

The correction period begins on the date the 25% tax was imposed on the shortfall and ends on the earlier of: the IRS demands payment on account of the shortfall or the last day of the second year that begins after the tax year for which the tax is owed.

Change #6. Creation of Federal Retirement Savings Lost and Found Will Only Have a Minor Impact on IRA Custodians

A qualified plan administrator of a plan that is not terminated and is to make a distribution to a non-responsive participant who would be eligible for a direct rollover shall transfer such funds to the Federal Retirement Savings Lost and Founds.

Under current law an employer cannot force most participants to withdraw their account balance on separation from service prior to when the RMD rules apply. A participant has the right to remain in the plan until they would reach normal retirement age. However, current law does allow an employer to require a participant with a balance of less than $5,000 to withdraw their entire account balance. This $5,000 limit would be increased to $6,000. The law requires the plan administrator with respect to those participants with a balance of less that $1,000 to establish a rollover IRA on behalf of such a nonresponsive participant. Under SECURE II such funds would be required to be sent to the Federal Retirement Savings Lost and founds.

Change #7. Current law requires an IRA custodian/ trustee or other filer of an IRS reporting form to file such form on magnetic media when the filer is required to file at least 250 forms. This limit would be reduced to be 50 forms

This change would apply to returns and reports relating to years beginning after the second December 31 occurring after the enactment of SECURE II.

Change #8, Expansion of the IRS Employee Plans Compliance System to IRAs

For many years the IRS has had a correction program for qualified plans, 403(b) plans and 457(b) plans. The proposal is now to grant certain correcting relief with respect to IRAs. The U.S. Secretary of the Treasury is to grant relief as it sees fit when there has been an inadvertent failure with respect to the following three situations and others as it would decide.

The first situation is, the IRS may waive the 50 % tax (or 25 % or 10%), but it should provide further guidance and procedures.

The second situation is, the IRS may waive the 60 day requirement where the deadline was missed for reasons beyond the control of the individual.

The third situation is one which has been discussed for a number of years. Sometimes an inheriting beneficiary has been paid an amount from an inherited IRA and learned that current law does not authorize a rollover contribution by a beneficiary regardless if the beneficiary requested the distribution or the distribution was made unilaterally by the IRA custodian. That is, the inadvertent error occurs by the IRA custodian of the inherited IRA.

The beneficiary would be able to correct this situation by returning the distributed funds to the inherited IRA. The correction is warranted when the beneficiary had reason to believe that the distribution could be rolled over but had received bad information from the inherited IRA custodian.

Change #9. One-Time Election For a Qualified Charitable Distribution To a Split-Interest Entity and Adjust $100,000 Limit by a COLA Adjustment

SECURE II would expressly authorize a qualifying IRA owner or a beneficiary to make a one-time election to make a QCD to a split interest entity. The IRA custodian must make the distribution directly to the split interest entity. The distribution amount cannot exceed $50,000. The term split interest entity means a charitable annuity remainder trust, a charitable remainder trust or a charitable gift annuity.

The annual $100,000 QCD limit will be adjusted by a COLA commencing with distributions made in the tax years ending after the date of the enactment of the SECURE II. This means it will be effective for 2021 if SECURE II is enacted in 2021 .

Change #10. Creation of a Statute of Limitations for Various IRA Transactions

This change is long over-due. IRA owners and IRA beneficiaries will find this change very beneficial. The law imposes the following taxes: a 10% additional tax for certain distributions prior to age $59^{1}/_{2}$; a 50% tax for an excess accumulations and a 6% excise tax for an excess contribution. For example, John Doe mistakenly made an excess Roth IRA contribution in 2000. The error is discovered in 2021. Under current law an excess contribution (plus interest and penalties) would apply for each year from 2000-2020.

The SECURE Act would create a statute of limitations which protects IRA owners and beneficiaries from the excise taxes in certain situations.

A taxpayer generally has the duty to file a tax return for a year if they have a certain amount of income or have to pay an excise penalty tax. There are some individuals who are not required to file an income tax return.

Code section 6501 sets forth in general a three year statute of limitations for reporting tax transactions. This provision will grant relief with respect to IRA transactions involving the excise taxes as long as the person has not made a willful attempt to evade or defeat a proper tax.

Change #11. Repayment Period Changed to 3 Years From 1 Year for the Repayment of a Qualified Birth or Adoption Distribution

The SECURE Act created a new exception to the 10% additional tax. As written the law authorized an IRA owner to repay this distribution within a one year time period. SECURE II would retroactively replace the 1 year repayment period with a 3 year repayment period. This revised rule applies as if the 3 year period had been set forth in the SECURE Act.

Change #12. Creation of a New Exception to the 10% tax for Withdrawals from IRAs and Other Retirement Plans For Individuals In Case of Domestic Abuse

The rules for this new exception follow the approach which apply to a birth or adoption distribution. The 10% tax will not apply. The distribution must occur within one year and then the person has three years to repay some or all of it. There can be multiple repayments.

Change #13. Lessening Greatly the Rules For When a Prohibited Transaction Occurs With Respect to IRA Assets

Under current law when there is a prohibited transaction with respect to an IRA, the entire IRA is deemed to be distributed. Normally, the individual must include the entire fair market value of the IRA in their income. SECURE II would repeal the law requiring the IRA to cease to exist. The IRA would be allowed to continue. There would be a deemed distribution, but only on the portion of the IRA used or involved in the prohibited transaction .

This change applies to tax years beginning after the enactment of SECURE II.

This change is also long over-due. IRA owners and IRA beneficiaries will find this change very beneficial. It is reasonable that the distribution amount is the amount used in the prohibited transaction and not the entire IRA account balance.

One wonders if the DOL will support this change or whether it to try to have this proposed change not adopted. Remember the DOL has used the prohibited transaction rules as its source of authority that the failure to provide required rollover advice may be a prohibited transaction in certain situations.

Changes #14. Designated Roth Accounts Within a SEP-IRA or a SIMPLE-IRA

An employee would have the right to elect that the employer contributions to be made to a SEP-IRA or SIMPLE -IRA plan could go into a Roth IRA.

This change would apply to contributions made for tax year 2022. This change could allow many individuals who are ineligible to a make an annual Roth IRA contribution , but they could make a Roth SEP or SIMPLE contribution.

Email Guidance – Converting a SEP-IRA to a Roth IRA In-house Brokerage Involved

Q-1. We have a customer that currently has a SEP plan. Our brokerage department (Raymond James) is wanting us to convert it to a ROTH and then transfer the funds up to their existing ROTH plan for our mutual customer. Is this something where I have to first open a new ROTH plan at the bank? Once that's opened and the funds are converted through the bank, then we can transfer the funds to Raymond James. Or is it "legal" to convert the SEP funds from our account not make an new plan ROTH Agreement and issue the funds to Raymond James and they would report it as a ROTH?

A-1. The brokerage department apparently wants you to do all the work.

Have you been furnished a Roth IRA transfer form or do they want you to prepare that form also?

Will you agree to the transfer approach? This approach will require you to set up a Roth IRA and then close it immediately. This step cannot be skipped. There must be a Roth IRA in existence to accept the Roth IRA conversion contribution. You would prepare the Form 1099-R to report the distribution from the SEP-IRA and the Form 5498 for the Roth IRA to report the conversion contribution.

As you know, you could transfer the SEP-IRA funds to a traditional IRA with the brokerage department and then they could do the conversion and the IRS reporting. This minimizes your work.

See the attached form. Does the brokerage department have such a form?

It is permissible that you issue the check to go into the person's Roth IRA with the brokerage firm. You will prepare the 2021 Form 1099-R to show the distribution. A reason code 7 is used if the person is age 59½ or older and a reason code 2 is used if the person is under age 59½. The brokerage firm will need to report the conversion contribution on the person's 2021 Form 5498.

Q-2. Yes I feel like they want me to do all the work. I haven't received any transfer form, yet but I have a feeling they are going to want me to do all the forms also.

I just want to make sure I'm understanding this correctly, no matter the option I have to set up a Roth IRA first to transfer the funds to brokerage firm? Or if I use the attached form and report it as a person under age 59½ distribution and I can skip having to set up a Roth as long as the brokerage firm reports it as a trad/sep rollover to roth conversion on their 5498? Would they then have to have a Trad plan to put it in or can they skip that step using this option and just put it right into customers' existing Roth plan?

A-2. The best approach for you is to say - we want to transfer to the SEP-IRA and then you the brokerage department should do the conversion and the related IRS forms.

The last approach requires a little bit of work by you but not much. You prepare the Form 65-R4 and then get the brokerage department to sign it. This form authorizes a special type of transfer (the conversion).

The brokerage department signs the 65-R4 firm and acknowledge that it will report the conversion contribution in box 3 on the person's 2021 Forms 5498. This approach seems reasonable to me. Both of you must handle a task.

To me it is unreasonable that they want you to do all of the work. You should not have to open a new Roth IRA simply to close it immediately. I realize there may be internal politics.

With any conversion the taxpayer must report it on his or her tax return. The individual includes the amount in income and pays the related tax. Which method is used does not change this requirement.

Q-3. I'm going to do the last approach where I would do a distribution and I would prepare the form You sent over and they report the SEP to Roth conversion. Would you still have the customer sign a transfer form since it's leaving and I know it's being transferred to brokerage? Or no transfer form, just a distribution form? Since in the end it's a rollover, they can still only do this once in a 12 month period correct?

Sorry for all the questions, just a different situation we don't see very often.

A-3. The 65-R4 is the only form which is needed. It handles both the distribution and the transfer subjects.

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IRS Guidance,
Continued from page 2

D. 10-Year-Rule

10-year rule. The 10-year rule applies if the beneficiary is an eligible designated beneficiary who elects the 10-year rule, if the owner died before reaching his or her required beginning date.

In all other cases, the 10-year rule applies if the beneficiary is a designated beneficiary who is not an eligible designated beneficiary, regardless of whether the owner died before reaching his or her required beginning date.

The 10-year rule also applies upon the death of an eligible designated beneficiary or upon a minor child beneficiary reaching the age of majority except that the 10-year period ends on the 10th anniversary of the beneficiary's death or the child's attainment of majority.

D. 10-Year-Rule

10-year rule. The 10-year rule requires the IRA beneficiaries who are not taking life expectancy payments to withdraw the entire balance of the IRA by December 31 of the year containing the 10th anniversary of the owner's death. For example, if the owner died in 2020, the beneficiary would have to fully distribute the plan by December 31, 2030. The beneficiary is allowed, but not required, to take distributions prior to that date.

The 10-year rule applies if (1) the beneficiary is an eligible designated beneficiary who elects the 10-year rule, if the owner died before reaching his or her required beginning date; or (2) the beneficiary is a designated beneficiary who is not an eligible designated beneficiary, regardless of whether the owner died before reaching his or her required beginning date.

For a beneficiary receiving life expectancy payments who is either an eligible designated beneficiary or a minor child, the 10-year rule also applies to the remaining amounts in the IRA upon the death of the eligible designated beneficiary or upon the minor child beneficiary reaching the age of majority, but in either of those cases, the 10-year period ends on the 10th anniversary of the beneficiary's death or the child's attainment of majority.

CWF's discussion. The IRS did clarify this discussion. There are three important points.

The 10-year rule applies if the beneficiary is a designated beneficiary who is not an eligible beneficiary regardless of whether the owner died before (or after) reaching his or her required beginning date.

The 10-year rule also applies if the beneficiary is an eligible designated beneficiary of an IRA owner who died before his or her required beginning date, but he or she does not use the life distribution rule but elects the 10-year rule.

The 10-year rule also applies if the beneficiary is a beneficiary of an IRA owner who died before 2020 and had elected the life distribution rule and the beneficiary dies after 2020.

Converting a SEP,
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The customer should sign as should the Roth custodian and FDNB.

You can have the person complete an IRA distribution if you want, but it is not necessary.

You don't need another transfer form.

Q-4. Thanks so much for all the information!

A-4. I failed to address your statement/question that because the IRS treats a conversion as a rollover for IRS reporting purposes that the individual must take this conversion transaction in account for purposes of the once per year rule.

A Roth IRA conversion is not counted as a rollover for purposes of the once per year rule.

See the attached. See the highlighted portion on the second page. It is the first box. I initially circled the second box by mistake.

When I reviewed the rollover section and the conversion section of Publication 590-A I did not see a sentence stating that a Roth IRA conversion is not to be considered for purposes of the once per year rule. The IRS should add it. The statutory law does provide a conversion is not to be considered for purposes of the once per year law.

IRS Guidance on the one-per-year rollover limit.

As before, Roth conversions (rollovers from traditional IRAs to Roth IRAs) rollovers between qualified plans·and IRAs, and trustee-to-trustee transfers- direct transfers of assets from one IRA trustee to another- aren't subject to the one-per-year limit and are disregarded in applying the limit to other rollovers.

IRS Issues 2022 Indexed Amounts for HSAs

The maximum HSA contribution for 2022 is $3,650 for single HDHP coverage and $7,300 for family HDHP coverage. The HSA contribution limits for 2022 are $50 higher for single HDHP coverage and $100 higher for family HDHP coverage.

The minimum annual deductible limits for the HDHP for 2022 do not change. The minimum deductible limit for single coverage for 2022 is $1,400 and the minimum deductible limit for family coverage is $2,800.

The maximum annual out-of-pocket expense limit for single coverage for 2022 increases to $7,050 from $7,000 and the out-of-pocket expense for family coverage increases to $14,100 from $14,000.

On May 10, 2021, the Treasury Department and Internal Revenue Service issued new guidance on the maximum contribution levels for Health Savings Accounts (HSAs) and out-of-pocket spending and deductible limits for High Deductible Health plans (HDHPs) that must be used in conjunction with an HSA. The HSA 2022 limits are set forth in IRS Revenue Procedure 2021-25.

High Deductible Health Plans

HSA Maximum Contribution Limits Under Age 55

	2020	2021	2022	Change
Single HDHP	$3,550	$3,600	$3,650	+ $50
Family HDHP	$7,100	$7,200	$7,300	+ $100

HSA Maximum Contribution Limits Age 55 & Older

	2020	2021	2022	Change
Single HDHP	$4,550	$4,600	$4,650	+ $50
Family HDHP	$8,100	$8,200	$8,300	+ $100

HSA Catch-Up Contributions

	2020	2021	2022	Change
Age 55 and Older	$1,000	$1,000	$1,000	$0

High Deductible Health Plans

	Minimum Annual Deductible			Maximum Annual Out-of-Pocket Expenses		
	2020	2021	2022	2020	2021	2022
Single Coverage	$1,400	$1,400	$1,400	$6,900	$7,000	$7,050
Family Coverage	$2,800	$2,800	$2,800	$13,800	$14,000	$14,100