THE Pension Digest

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ALSO IN THIS ISSUE –

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

Planning For 2022 RMDs

An IRA custodian/trustee has the IRS duty to furnish living IRA accountholders an RMD notice for tax year 2022 by January 31, 2022. The IRS does not require an IRA custodian/trustee to furnish an IRA beneficiary with an RMD notice. Many IRA custodians/trustee will do so as a customer service and to lessen possible claims by a beneficiary that the IRA plan agreement form requires that required distributions must take place.

The RMD Notice must be furnished by January 31, 2022. The RMD notice must be furnished to each IRA accountholder who attains age 72 in 2022 or who is older. Note this RMD Notice is not furnished to the IRS.The IRS may assess a $50.00 fine for each failure to furnish the required RMD Notice. The notice may be a print version or an electronic version.

In November of 2020 the IRS released revised versions of the three life expectancy tables or mortality tables. For living accountholders there are two tables: the Uniform Lifetime Table and the Joint Life Expectancy tables. For beneficiaries there is the Single Life table. These revised tables are set forth in CWF's MINCAL. These tables will be set forth in the 2021 version of Publication 590-B, but most likely that publication will not be released by January 31, 2022.

The revised life expectancy tables are required to be used for the 2022 RMD notices. You may wish to check with your Core provider that they will be using the revised life expectancy tables.

You may obtain a PDF version of the 3 tables from CWF for a fee of $25. We have simplified the Joint Life and Last Survivor Expectancy table. Send us an email requesting the 3 tables.

There are three common methods used to furnish the RMD Notice.

Method #1. Furnish a stand alone RMD notice by January 31, 2022. The notice must set forth three items of information. First, the individual must be informed that when the IRA custodian/trustee files the individual's 2021 Form 5498 with the IRS that the IRS is informed that he or she has an RMD for 2022. This is done by the checking of box 11. Box 11 is not to be checked for an IRA beneficiary. Second, the individual is informed what deadline applies to him or her to withdraw their RMD for 2022. The deadline is April 1, 2023, for those individuals who attain age 72 in 2022 and it is December 31, 2022 for those individuals who are older than age 72. Third, the individual is informed what their RMD amount is for 2022 or that the IRA custodian/trustee will calculate it if requested to do so.

Method #2. By January 31, 2022, furnish a combined statement setting forth the individual's FMV statement and the individual's RMD statement. It must be clear that there are TWO statements on the combined statement. The FMV statement may be designed to be a substitute Form 5498.

Method #3. By January 31, 2022, furnish each individual with their 2021 Form 5498 with boxes 11, 12a (RMD

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2022 RMDs,
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amount) and 12b (RMD deadline) being completed along with any other applicable boxes. An IRA custodian with the help of its Core processor may send each IRA accountholder with their 2021 Form 5498 with these 3 boxes completed, but send the IRS a version which only has box 11 completed. Most likely your Core processor does not give you this capability. If not, it is in your institution's best interest that your IRA accountholders have consented that you may send information to the IRS that the IRS does not require to be furnished. Again, boxes 11, 12a and 12b should not be completed for an IRA beneficiary. You may wish to send them a special letter.

Use of method #3 allows the IRA custodian to meet three requirements (RMD notice, FMV statement and Form 5498) by furnishing one Form 5498. The IRA custodian will be required to furnish a corrected 2021 Form 5498 if the IRA accountholder makes a carryback contribution for 2021 during January 1, 2022, to April 15, 2022.

Email Guidance – Reporting Codes for an Inherited Roth IRA

Q-1. I feel confident you have told me in the past, IRS code 4 should not be used when making a distribution from any Roth IRA, but rather, it would be a Q, T, or possibly a J when applicable. Our transaction codes reflect this input.

However, I have a tax vendor who is under the impression that it is a 4, B combination when making a distribution from an inherited IRA. I certainly don't agree with the "B" code unless it's coming out of a Designated Roth. However, I can see how the explanation in the IRS Guide to Distribution Codes for Death-4 could be interpreted to mean that code is for all payments to a decedent's beneficiary.

May I ask you to verify for me one more time what codes to use when making a distribution from an inherited Roth IRA and why?

A-1. Use of codes 4B in this situation would allow the IRS to fine the IRA trustee $560 (280 x 2) for preparing an incorrect Form 1099-R.

Here is my discussion.

1. You are correct. Code B is not to be used because the distribution is not coming from a Designated Roth account from a 401(k) plan or similar plan. I understand this distribution is coming from an inherited Roth IRA.

2. There are reporting codes for distributions from a qualified plan (including a qualified plan with a Designated Roth account) or from a traditional IRA, SEP-IRA or SIMPLE-IRA. Under the tax laws there are exceptions to the 10% tax which apply to distributions from both qualified plans and the three types of IRAs. However, there are some codes or exceptions which only apply to the IRAs or only apply to distributions from a qualified plan.

There are special codes to report distributions from Roth IRAs. See·below from page 11 of the IRS instructions for Form 1099-R. This discussion overrides any general discussion applying to distributions from qualified plans or the other three types of IRAs. There is no indication code 4 or code B is to be used to report a distribution from a Roth IRA or an inherited Roth IRA. The IRS chart of distribution codes is consistent with the discussion on page 11.

Hopefully, the tax vendor understands that the method he or she thinks is to be used may well cause tax problems for the beneficiary. Most distributions from a Roth IRA are not required to be included in income because the distribution is either qualified and tax free or it is not taxable because it is the withdrawal of basis. Use of Code 4 implies that the distribution is taxable and the person must include the distribution amount in his or her income. The IRS may follow up with the taxpayer beneficiary for an explanation why the distribution amount was not included in income.

IRS discussion on page 11.

Roth IRA. For a distribution from a Roth IRA, report the total distribution in box 1 and leave box 2a blank except in the case of an IRA revocation or account closure and a recharacterization, earlier. Use Code J, Q, or T as appropriate in box 7. Use Code 8 or P, if applicable, in box 7 with Code J. Do not combine Code Q or T with any other codes.

However, for the distribution of excess Roth IRA contributions, report the gross distribution in box 1 and only the earnings in box 2a. Enter Code J and Code 8 or P in box 7.

New Eligibility Laws For 401(k) Plans for Part-Time Employees

The SECURE Act (December 2019) grants certain part-time employees the right to be eligible to participate in an employer's 401(k) plan even though they have never met the 1000 hours of service requirement.

This new law applies to plan years beginning after December 31, 2020. That is, it applies to the 2021 plan year.

The law now requires that certain part-time employees (less than 1000 hours per year) must be able to participate in the 401(k) plan and make elective deferral contributions. All 401(k) plans must be amended accordingly.

A part-time employee who has worked at least 500 hours in three (3) consecutive years and has attained the age of 21 is eligible to participate in the 401(k) plan. The plan's normal entry date rule would apply. The law does provide that an employer may disregard service prior to 2021. Thus, an employer may require that a part-time employee have 500 hours or more in 2021, 2022, and 2023 before becoming eligible to participate. Of course, an employer could adopt a less restrictive rule by considering years prior to 2021.

So, there may be employees who have been excluded in the past because they had never met the 1000 hour requirement who will now be eligible to participate in the 401(k) plan – either in 2023 or earlier.

This new rule does not require an employer to make a matching contribution or other contributions on behalf of these part-time employees. However, if an employer would make such contributions, then the plan requirement for having 1000 hours to gain a year of vesting service would be modified to be 500 hours. The IRS will be issuing additional guidance.

DOL Issues Guidance on Lifetime Income Illustrations and a Model Supplement to a Participant's Benefit Statement

In general a plan sponsor must furnish each plan participant with an annual pension benefit statement. Commencing with pension benefit statements furnished after September 18, 2021, such statements must discuss and express a participant's current account balance in two ways. First, as a single life annuity income stream and then secondly as a qualified joint and survivor annuity income stream. Payments are to be made monthly. These new disclosures are required by the SECURE Act.

These income stream illustrations must be furnished at least annually and may be produced more frequently. Benefit statements must be provided at least quarterly if an individual account plan permits participants and beneficiaries to direct the investments of their account balance.

A participant benefit statement must set forth the following information

1. The statement period with a beginning date and an ending date.
2. The value of the individual's account balance as of the last day of the statement period.
3. Such value must be expressed as an equivalent lifetime income stream payable in equal monthly payments for the life of the participant. This determination of a single life annuity must be determined using certain assumptions.
4. Such value must be expressed as an equivalent lifetime income stream payable in equal monthly payments for the joint lives of the participant and spouse. This determination of a qualified joint and survivor annuity (QJSA) must be determined using certain assumptions.

These two income streams are to be determined by using the following assumptions and factors.

1. The income payments would start on the last day of the statement period and it is assumed the participant is age 67 on the commencement date. However, if the participant is older than age 67, his or her actual age must be used.

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2. For purposes of the QJSA, it is assumed the participant has a spouse who is the same age as the participant and the survivor annuity percentage is 100% of the monthly payment paid to both of them while both are a alive.
3. The interest rate used is the rate equal to the 10-year constant maturity Treasury securities yield rate for the first day of the last month of the period to which the benefit statement relates.
4. The mortality factor is determined by using the applicable mortality table under section 417(e)(3)(B) in effect for the calendar year which contains the last date of the statement period.
5. The participant's value includes any outstanding loan unless such loan is in default.

The participant statement must set forth a comprehensive discussion of the lifetime income streams which have been calculated. See the Dol model form for the topics which must be discussed and how comprehensively.

Email Guidance – SEP-IRA

Q-1. I was doing some research on SEP-IRAs and noticed that, according to the IRS, form 5305-SEP is required. Is this on ALL SEP-IRAs?

Would self-employed individuals with no employees perhaps be excluded?

A-1. There is no special rule for a one person business. A business must adopt a SEP plan document, including a one person business. Most employers will use the Form 5305-SEP as the SEP plan document, including most one person businesses.

The individual may find the Form 5305-SEP on the IRS website, or their accountant or attorney may furnish it to them or a bank may furnish it.

A person will also need to have a SEP-IRA into which the employer's SEP-IRA contribution is made. A SEP-IRA is a traditional IRA to which an employer has made a SEP-IRA contribution.

Email Guidance – SIMPLE-IRA Plan Versus SIMPLE 401(k) Plan

Q-1. I have a customer who has SIMPLE 401(k) funds. He wants to move them to his traditional IRA. Can he? Must he meet the 2-year rule?

A-1. There is a SIMPLE-IRA plan but there is also a SIMPLE 401 plan. These are two distinct plan types each with its own rules.

You want to confirm that the funds are coming from a SIMPLE 401(k) plan.

The 2-year rule applies only to distributions from an IRA. The two year rule does not apply to a distribution from a SIMPLE 401(k) plan.

A-1A. Yes, the direct rollover is the procedure I presume your customer will instruct for the distribution of his or her plan balance.

A QRP may be a 401(k) plan which has a SIMPLE 401(k) provision.

Does he have an existing traditional IRA?

Record the direct rollover contribution either on the IRA application or a contribution form.

The QRP will give him a request for distribution form to complete. It is best if he will give the bank a copy of that form for his file. If he doesn't, then have him complete Form 65-B.

Email Guidance – Excess HSA Contributions

Q-1. We have a customer that has contributed WAY over the legal limit on his HSA ($26,500). We've had the conversation with him that he's over the limit and to talk to his accountant. Below is what he responded. Is this correct? Do I not need to worry about the excess contributions as long as there is nothing left of the excess contributions in his account? I feel like that would be getting away with more health expenses that would be tax free correct? Or am I thinking out in left field?

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Customer's Response

Thank you for the update. I did follow up with my accountant and there are no penalties or concerns on how much is contributed to the account as long as only $7,000 is deducted for tax purposes and there are no excess contributions left in the account. Does the bank/you have concerns with my account activity? I can certainly find an alternative method if it causing issues at the bank.

A-1. The accountant is wrong. I don't believe there are any tax benefits to be realized by over-contributing to an HSA. There will only be much extra work for the bank, the individual and the accountant to correct the excess contributions.

The bank's perspective. The HSA plan agreement limits the amount which a person may contribute in any given tax year to amount which a person who has a family HDHP may contribute plus the $1000 catch-up if age 55 or older. See the attached. The IRS does not update their model HSA forms because the IRS believes mentioning the cost of living adjustment is satisfactory.

The bank is not required to know whether the person has single HDHP coverage or family coverage. It is the individual who has the primary duty to monitor and comply with the excess contribution rules. There is a major exception. The bank is not to accept contributions in excess of the family maximum amount ($7000/$8000 for 2019, $7100/$8100 for 2020 and $7200/$8200 for 2021). If the bank accepts such excess amounts it must proactively work with the person to stop making such contributions and to withdraw such excesses. As you know the bank has the duty to prepare the Form 1099-SA to report all HSA distributions. There must be a separate Form 1099-SA when the reason code 1 applies and when the reason 2 applies. Assuming the limit is $7200 for 2021, once he has made HSA contributions equaling $7200, then any subsequent contribution is an excess and when such funds are withdrawn, they must be coded as the withdrawal of an excess even if the person uses the funds to pay a qualified medical expense.

The individual's perspective. I would suggest he get a written explanation from the accountant explaining what is the tax benefit for this approach. I see problems and no benefits. He has the duty to prepare his tax returns showing that he made excess contributions and that he corrected such excesses. If this individual and his tax accountant believe there are some special tax benefits to be realized, I disagree.

Email Guidance – Inherited IRAs

Q-1. I have the following situation that I was hoping that you might be able to confirm my intentions on how to treat and open this IRA.

I have a lady who is 59 years old and her husband just passed away. No children.

Her husband listed her as the primary beneficiary of both IRA's.

One IRA was an inherited IRA from his mother, and he was taking distributions annually as is required. Vanguard has now transferred this to an IRA titled "Mary Hill's" $125,176

The other IRA was a 401(k) rollover from his working years. Vanguard has now transferred this to an IRA titled "Mary Hill's Inherited IRA" $25,112 ;

My questions are:

• As a surviving spouse, she should be able to treat these IRA's as her own and not subject to non-spouse inherited IRA rules requiring RMD's?

• Why did Vanguard open two separate IRA's rather than combining into one?

• Can I facilitate a Trustee to Trustee transfer and combine both IRA's into one IRA, titled "Mary Hill's IRA" and not reference "Inherited IRA" or be required to make distributions annually?

A-1. There are two types of inherited IRAs.

The first situation is when a person is the beneficiary of an IRA beneficiary.

The second situation is when a person is the initial inheriting IRA beneficiary.

I understand the original IRA owner (her husband's mother) died before 2020 and that her husband as the beneficiary was using the life distribution rule. The SECURE Act provides that upon the death of a beneficiary using the life distribution rule your client as his ben-

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Inherited IRAs,
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eficiary now must will use the 10-year rule to close this inherited IRA. As discussed below, a spouse does NOT have the right to elect to treat their spouse's inherited IRA as their own. If her husband died in 2021, her close-out deadline is 12/31/31. If her husband died in 2020, her close-out deadline is 12/31/30.

With respect to the second situation this inherited IRA need not stay an inherited IRA. Additional information should be understood about the 401(k) funds of which she was the beneficiary. The 401(k) plan should have given her a form which gave her two options - she could directly rollover these funds into her own IRA or into her inherited IRA. Did she make this decision or did Vanguard? Is this a situation where Vanguard serves as both the 401(k) plan and the IRAs?

Most spouse beneficiaries will elect to move the funds into their own IRA and not maintain it as an inherited IRA. If she would make this election, then there will no required "beneficiary" distributions until she reaches age 72. Sometimes a surviving not yet 59½ will keep the account as an inherited IRA because the 10% tax is not owed when a beneficiary takes a distribution from an inherited account prior to age 59½.

Your client still has the right to treat as her own the inherited IRA originating from the 401(k) plan. She could make this election with Vanguard or with you.

These two inherited accounts cannot be combined because there are two original owners, her mother-in-law and her husband. Inherited IRA and pension funds can be combined only when the original owner is the same person. There is an exception for a spouse who elects to treat an inherited IRA from their spouse as their own IRA. However, a spouse has no right to treat as their own their spouse's inherited IRA.

I have sent you two transfer forms to consider.

Q-1A. Do I need to title the spousal IRA that she has made the election for a certain way? Does it have to reference the decedents name or is the Mary Hill's IRA sufficient to comply with IRS requirements?

A-1A. I'm assuming she has elected to treat as her own IRA the inherited ,funds coming from her husband's 401(k) plan. The IRA funds she received with respect to her husband should be in her name only. Under the tax rules this IRA is not a spousal IRA.Once the IRA is hers, the age 72 RMD rules will apply to her and this IRA.

With respect to the IRA funds inherited from her husband who inherited from his mother, this IRA must remain in an inherited IRA. It too is not a spousal IRA. It should have the title - Jane Doe as beneficiary of John Doe's IRA even though the funds originated with his mother. The 10-year rule applies to this inherited IRA.

Email Guidance – Box 11 Form 5498

Q-1. For an inherited IRA, does box 11 need to be checked and amount (if accountholder deceased before 12/31/19) in 12b? If so, what about deceased after 1/1/20?

Ex. 1. Son inherited IRA from dad who died in 2015.
2. Daughter inherited IRA from dad who dies in 2020.

A-1. I See the IRS instructions.

Box 11 is not to be completed or checked for an inherited IRA. Note the IRS in the instructions for box 11 uses the term "participant" and such term does not include a beneficiary.

An IRA trustee must leave boxes 11, 12a and 12b blank for all inherited IRAs. My guess is, the IRS' attitude is, if an IRA custodian is willing to furnish this information we will take the info and review it.

As you know, the IRS has furnished very little guidance as to when it could fine or would fine a bank for submitting an incorrect Form 5498.

Does your software give you the impression that these boxes apply to inherited IRAs?

I'm probably being extreme, but I could see some beneficiaries claiming that the IRA trustee breached a duty owed them when the IRA trustee sent info to the IRS about the inherited IRA when not required to do so.

Q-1A. Most of the inherited IRAs are marked with an X in box 11, some show an amount others do not. For those inherited before 2020, the system generates an RMD amount and I assume that information is then put on the 5498.

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Box 11,
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A-1A. Who is your CORE Provider?

You've probably told me, but I don't recall.

Here is my understanding on the RMD topic. Others may have a different understanding. I believe I'm correct.

By January 31, 2021, an IRA trustee had the duty to furnish an RMD notice to living accountholders age 72 or older in 2021.

There is no requirement to furnish an RMD notice to an IRA beneficiary. Although we at CWF believe to lessen possible liability claims that one may or should be furnished. With the new 10-year rule it no longer may be desired to furnish the beneficiary an RM D notice each year, but you definitely want to give some notice in that 10th year.

The RMD notice must meet three requirements: (1) indicate that person's specific deadline (either 12/31/21 or 4/1/22); (2) indicate to the person that the IRS is being informed by the filing of the 2020 form 5498 that the person has an RMD for 2021 and (3) inform the person the amount of their RMD for 2021 or instruct you will calculate it upon request.

Not all of the information on the RMD notice must be furnished the IRS. You must only complete box 11 on the 2020 Form 5498. The IRS is informed the person has an RMD for 2021. You are not required to complete boxes 12a (amount) and 12b (deadline). Why does the IRS limit itself to this small amount of information. A long time ago the IRS agreed (reluctantly) with the U.S. Senate that it would only require this limited RMD information be furnished to the IRS.

I understand the IRS concluded - we might not have the right to require an IRA trustee to send us participant or beneficiary RMD information, but they may be willing to share it voluntarily. So, the IRS issued guidance that a bank can furnish the 2020 Form 5498 by January 31, 2021, and that one form can be used to satisfy three requirements: (1) furnish the 2020 Form 5498; (2) serve as the RMD information as long as boxes 11, 12a and 12b are completed and (3) provide 12/31/20 FMV balance. The IRS believed core providers and banks would probably not have one form 5498 to go the IRS and one form to go to the participant. If someone makes a carryback contribution a corrected Form 5498 would need to be prepared.

May or will the IRS fine a bank which completes for a beneficiary the RMD boxes 11, 12a and 12b? I have seen no guidance by the IRS on this topic. My guess is, the IRS would not impose a fine. If an IRA trustee voluntarily shares this beneficiary information, the IRS will use it.

If I was an IRA beneficiary and my IRA trustee shared information with the IRS not required to be furnished to the IRS, there could be possible liability claims.

Email Guidance – Exception to the 10% Tax

Q-1. I have a customer that had a work injury a couple of years ago and is no longer able to work. His workplace has now stopped his payroll and is working with work comp to settle his claim and his 401(k) is going to need to be transferred to another investment. He is 51, but he will need to have monthly income until he can start drawing disability. If he transfers his 401(k) to an IRA, since he is disabled, is there a special rule so that he can take monthly distributions from it without a penalty?

A-1. One of the exceptions to the 10% tax is disability. That is, a person who is disabled does not owe the 10% additional tax. Normally, the person furnishes an IRA custodian with a letter from a doctor (or social security) stating that he or she is disabled. An IRA custodian then should use the applicable transaction code on its IT system so that a reason code "3" will be inserted into box 7 on the Form 1099-R.

For a person who is not disabled but who needs to withdraw some funds, that person should consider using the special rules applying to a substantially equal periodic payment schedule.

Most likely a person who has separated from service will wish to directly rollover their 401(k) funds into an IRA, but most employees have the right to leave the funds in the 401(k) plan even though they have separated from service. It would be rare (most likely illegal) if the plan would mandate that he had to take a distribution and move his funds.

Email Guidance – Rolling Over SEP Funds

Q-1. We have a SEP-IRA Customer that deposited a late Rollover deposit yesterday.

He has filled out the appropriate paperwork for this but when the branch deposited the check they coded it as Rollover Contribution.

Should this be coded as a Late Rollover Contribution?

I have not seen this before and would like to make sure this is coded correctly before end of year comes around and we need to make changes.

A-1. A person is entitled to make a late rollover contribution under the late rollover certification rules. An IRA custodian is authorized to accept such a late rollover contribution and process it.

The IRS' late rollover certification rules apply to a distribution from any type of IRA and also to distributions from a qualified plan.

An IRA custodian is required to prepare the person's Form 5498 for the year the IRA custodian receives the late rollover. This is true even if the person received the distribution in a prior year. Because you are receiving this contribution in 2021 you are to report this contribution on the 2021 Form 5498.

A late rollover contribution is to be reported in box 13a of the Form 5498. Box 13b is left blank.

The individual may want to attach a note to their tax return explaining the late rollover, especially when it relates to a prior tax year.

Email Guidance – Directly Rolling Over Inherited 401(k) Funds

Q-1. I have a customer who was the sole beneficiary on his wife's 401(k) plan and she passed away 02/05/2021 her date of birth was 03/21/1962. There were ROTH contributions and Pre-tax contributions in the 401(k). He would like to directly roll these over to IRAs at the bank. These would not be considered inherited IRAs correct? What are the proper forms to use in this situation?

A-1. What form has he been provided by the 401(k) plan? It should be similar to the CWF form discussed below.

See the attached first few pages of copy of CWF's QP distribution form. This form 857A is on our IRA Form System so you may review the entire form if you wish.

I presume he would decide to put the pre-tax 401(k) elective deferrals into a traditional IRA and the Designated Roth funds into a Roth IRA. The Designated Roth funds must go into a Roth IRA. That is, he wants to and needs to do two direct rollovers.

If he wanted, he could "convert" some of the pre-tax dollars by directly rolling them over into his Roth IRA. He would need to include this amount in his income.

Most often a surviving spouse will move the funds into their own IRA (which is not an inherited IRA), but a spouse technically may move the funds into an inherited IRA. This might be done with respect to pre-tax funds going into a traditional IRA if the surviving spouse was younger than age 59$^1/_2$.