THE Pension Digest

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ALSO IN THIS ISSUE –

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

Financial Institutions With Qualified Plan Clients Amending and Restating Existing Keogh/PS/401(k) Plans – Deadline is June 30, 2022

CWF provides qualified plan services to financial institutions. In order to establish and maintain a qualified plan a business must adopt a complying plan document.

The IRS issued CWF's pre-approved a favorable opinion letter on June 30, 2020. The IRS has set a deadline of June 30, 2022, as to when a plan sponsor must amend and restate their plan by adopting a pre-approved plan.

Covid-19 has created difficulties for many. This includes Collin W. Fritz and Associates, Ltd. (CWF). We fell behind on this project, but meeting the deadline of June 30, 2022 is certainly doable.

This article discusses what needs to happen in order for your business customers with a profit sharing plan, an old Keogh plan or a 401(k) plan to amend and restate their existing plans. Each employer needs to sign/adopt a revised plan document and an authorizing corporate resolution if a corporate entity is the plan sponsor.

Small business employers, including those with a one person plan, must periodically update their plan. The IRS has established a 5-7 year cycle for keeping a plan updated and qualified on a retroactive basis. Rolling over QP funds into an IRA or another QP requires that the distributing plan be qualified at the time the distribution is made.

CWF's pre-approved plan may be completed to be a profit sharing plan or a 401(k) profit sharing plan.

A business client will need to be furnished the following documents:

(1) Adoption agreement #001;
(2) Basic Plan Document;
(3) Trust document;
(4) IRS Favorable Opinion Letter; and
(5) Good Faith Amendments for 2018-2021.

The adoption agreement must be completed by the employer with the possible assistance of your institution, CWF or its attorney or accountant.

Note that signatures are required on the adoption agreement and the trust agreement. The sponsoring employer must sign both documents. The trustee of the plan may be the individual or your institution. The pre-approved plan sponsor is Collin W. Fritz and Associates, Ltd. The IRS revised its approach. It used to be the basis plan document included both the plan and the trust. The IRS now requires that these documents be separate.

CWF has two methods for assisting a financial institution with its helping its business clients update their plans. We at CWF will complete a packet for you for each employer or you will complete these forms internally.

Our fee to prepare a conversion packet for each client is $65 per packet plus shipping charges. There is a minimum charge

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Qualified Plans,
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of $125 if a bank has 1 or 2 client plans. The packet would include the 5 previously mentioned documents plus a cover letter addressed to your business client with instructions for them . We would furnish you the cover letter to review and make any final changes.

In prior years for many institutions we initially completed the adoption agreements and other materials for each client and then the bank reviewed them and then furnished them to your clients. We will do that again if that is what an institution instructs.

If you wish to prepare the updating documents, we charge a fee of $225 to furnish you one master copy of each item. You may make copies of these documents as needed. If you wish, I would conduct a 30-45 minute phone training session with your institution . I discuss how I believe the adoption agreement should be completed. Our fee for this training session is $75.

We have updated the 3 distribution forms and beneficiary designation forms.

A plan sponsor of a plan to which contributions have ceased should discuss this situation with their tax adviser. The IRS believes the employer should terminate this plan and a participant may do a direct rollover in an IRA after the plan has been updated and restated.

Some of your business customers have plans with multiple participants. An SPD really should be customized based on how the adoption agreement has been completed. Our standard fee is $250 to prepare a customized SPD.

Upon request we will provide a basic sample of an SPD if an employer has other employees.

This sample will need to be modified but its purpose is to provide a starting point. The fee for this sample generic SPD is $150.

Time will go quickly. If we have not already contacted you about this project we will do so very soon.

Please contact jmcarlson@pension-specialists.com if you want us to assist you in having your customers update their plans. Please instruct us which of the two methods you wish to use.

IRS Issues New Guidance for Substantially Equal Periodic Payments in 2022 and Subsequent Years

What Is the Impact of the Revised Life Expectancy Tables?

The IRS has issued Notice 2022-6. It modifies and supersedes its prior guidance provided in Rev. Rul. 2002-62 and Notice 2004-15 regarding substantially equal periodic payments.

The IRS continues the approach that the IRA accountholder (or the pension plan participant) may use any one of three safe harbor methods to establish their substantially equal periodic method: the amortization method, the annuity factor method or the required minimum distribution (RMD) method.

In this Notice 2022-6 the IRS updates its safe harbor approach regarding establishing a substantially equal periodic payment schedule. In theory an IRA accountholder is able to devise their own substantially equal periodic payment schedule because the statutory law does not define this term. There would be a tax risk associated with a person or adviser creating their own substantially equal periodic payment schedule. Most individuals want tax certainty and will choose to adopt one of the three IRS safe harbor methods.

This IRS guidance is to be used for any substantially equal periodic payment distribution schedule commencing on or after January 1, 2023. However it may be used for 2022.

This guidance provides no transition rule for a schedule established prior to 2022 using the amortization method or the annuity factor method. The IRS has not granted any relief or a transition rule for those schedules established before 2022 using the amortization method or the annuity factor method. This makes sense because the annual distribution amount would decrease if the revised life expectancy tables were allowed to be used or required to be used.

In contrast, a schedule established prior to 2022 using the RMD method is allowed to use the applicable revised life expectancy table - single, joint or Uniform Lifetime table.

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A person under age 59½ does not owe the 10% additional tax imposed by Code section 72(t) with respect to an IRA distribution if their distribution is made pursuant to a substantially equal periodic payment schedule. The general rule is - if the schedule is changed too early the individual will have significant adverse tax consequences. The individual did not owe the 10% tax because of this exception for the year the schedule started plus subsequent years. However, if an impermissible change is made, then the person will owe this 10% tax amount related to the prior years and he or she will also owe an interest charge because that 10% amount was not paid in that prior year.

A person is able to change their schedule once he or she is age 59½ or older if their schedule has been in effect for 5 years. Otherwise the change is an impermissible modification. A change is permitted to be made if the IRA accountholder dies or is disabled.

Changes in any of the following factors will generally result in an impermissible change: the life expectancy table being used, the life expectancy divisor, the interest rate , the amount of the distribution (but not for the RMD method) or the account balance. An impermissible change occurs if after the first distribution there is any addition to the account balance other than by reason of investment experience or a decrease in the account balance on account of any transfer.

Most of the new guidance provided in Notice 2022-6 applies to the RMD method. Under the RMD method the annual payment will generally change each year whereas under the other two methods the annual distribution amount once calculated is fixed and does not change.

The general rule is - the same life expectancy table that is used for the first distribution year must be used in each following distribution year. That is, you cannot change the life expectancy table after the first year. The amortization term is based on the age of the IRA owner in the first distribution year.

The IRS has issued some new guidance regarding the interest rate to be used under either the fix amortization method or the fixed annuity method. This guidance applies to such schedules established in 2022 or subsequent years. The interest rate is defined to be acceptable as long as it is not more than the greater of (i) 5% or (ii) 120% of the federal mid-term rate for either of the two months immediately preceding the month in which the distribution applies. This change is very favorable. Many IRA accountholders will elect to use the 5% rate. The higher the interest rate the larger will be the fixed payment amount. The IRS may be inferring that the use of any interest rate greater than 5% may be contested by the IRS.

Use of the RMD method requires the use of the FMV of the IRA as of the preceding December 31.

The IRS has issued some new guidance regarding the account balance if the fixed amortization method or the fixed annuity method is being used. The IRS requires the account balance must be determined in a reasonable manner based on all of the facts and circumstances. However, the IRS adopts a safe harbor, The IRA account holder may select the account balance on any date within the period which begins on the December 31 of the year prior to the first distribution and ends on the first distribution. So, there is some flexibility in choosing the account balance to be used in the calculation.

Planning Pointer. Although a person may set up their substantially equal periodic schedule using either the joint life table or the Uniform Lifetime Table it makes no sense to do so. Using either of these "joint" tables reduces the amount of the distribution because the divisor will be larger which means the distribution amount will be smaller An IRA accountholder should maintain at least two IRAs. One IRA will have the substantially equal periodic schedule. The other will not. The second IRA exists so that if the IRA accountholder needs to withdraw IRA funds they withdraw them from the second IRA so there will no impermissible distribution from the first IRA.

Email Guidance – Is it Permitted to Combine Multiple Inherited IRAs?

The general answer is "no" it is not permitted for a beneficiary to have only one inherited IRA when he or she inherited the IRAs from different IRA accountholders. We understand some Core vendors limit a beneficiary to having only one inherited IRA. Until the IRS furnishes additional guidance there is compliance problems with this one inherited IRA approach and so multiple inherited IRAs must be maintained. We discussed this situation in the following email.

Q-1. We have a customer that had an Inherited IRA that she received from her mother quite a few years back. She was set up to take automatic distributions each year for her mother's IRA.

Recently her sister passed away (she is also less than 10 years younger than her making her an eligible designated beneficiary). She decided to do an inherited IRA with the funds from her sister also. So now she has two inherited IRAs from two different people. One using the old rules and one with the new rules.

I just want to make sure that I'm correct on the RMD that she will be taking each year. Since she has been doing life expectancy payments on her mother's inherited IRA using her non-recalculated single life expectancy. I will be okay to Just continue that exact type of payments for her sisters also correct? Under the new rules on the sister's inherited IRA, I can use the life expectancy of the longer/oldest beneficiary (which she is the only) non-recalculated. I would Just need to combine the two inherited IRA totals together for this year's required amount and going forward.

A-1. I appreciate you asking this question because I assume there are more and more IRA beneficiaries who have this situation, they have more than one inherited IRA.

Under existing IRA laws and IRS guidance, inherited IRAs arising from different beneficiaries must be kept separate. There is no rule/law allowing them to be combined or aggregated. I assume there may well be investment benefits to be realized by combining the two inherited iRAs.

She must maintain two inherited IRAs. There will need to be two Form 5498s prepared. Plus a third Form 5498 would be needed if she would have her own IRA.

She will have her inherited IRA from her mother. You will reset the divisor as discussed in our November 2021 newsletter. This schedule started the year after her mother died.

She will have her inherited IRA from her sister. Did the sister die in 2021 or 2022? Your client will use the life distribution rule as she is an EDB. Her initial divisor will be based on her age in the year following the year the sister died.

There are at least two rules/reasons these two inherited IRAs cannot be combined. First, the divisors used in the RMD calculation will be different. Secondly, it would be possible that there would be basis within one or both inherited IRAs. For determining what portion of a distribution is taxable one cannot combine IRAs arising from a different decedent.

Could she instruct you, I don't want two inherited IRAs so combine these two accounts into one inherited IRA and I agree the divisor to be used is the smaller one? For example, the mother died in 2012 so her initial divisor is for 2013 when she was age 55. The reset divisor is 31.6. So the divisor for 2022 is 22.6. If her sister died in 2021, then she is age 64 is 2022 so the divisor is 23.7. So the divisor of 22.6 would be used for the combined account.

I have never seen the IRS address this situation. In the instructions for Forms 1099-R and 5498 the IRS indicates that two 5498 Forms must be prepared, each one references the applicable original owner.

My technical suggestion is, until the IRS issues guidance on this situation the person should maintain two inherited IRAs.

My practical suggestion is, a beneficiary should be able to combine more than one inherited IRA if they have the documentation so they can prove they are in compliance with the RMD rules because they are taking more than the minimum and they know there was no basis within either inherited IRA.

There could be no combining of two inherited IRAs if one inherited IRA is using the life distribution rule and the other is using the 10-year rule.

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There could be no combining if there are two inherited IRAs subject to the10-year rule, but they have different closeout dates. Possibly the IRS might permit this if the person agreed to close the combined inherited IRA by the earliest closeout deadline.

Q-2. We have the two Inherited IRAs in separate IRA CDs. In order for me to set up the auto distributions our system here at the bank I don't believe has the ability to separate the two and do two different distributions. I can only set up one date and one total amount. I may have to reach out to my systems vendor to see if it's even a possibility to do what needs to be done on their end.

Sister passed away 12-29-2021. She did take her 2021 RMD before she passed also. So if I'm understanding correctly due to the divisors being different from when she started taking the RMD for her Mom's IRA and what the divisor would be for her sister's that would be starting this year I'm unable to combine this to go automatically. Unless I'm playing the devil's advocate (which I think you were getting at this point in your email), if we would use the divisor that would make her take more than required (so smaller numbered divisor) we could possibly get away with getting the auto distributions taken care of.

A-2. I agree with your summary.

I'm not surprised if a Core Vendor has limited capabilities for this situation.

Email Guidance – Form 5498 Reporting for an Inherited IRA Special Titling is Required

Q-1. Hi Jim - a quick question regarding Inherited IRA and a 5498. Should the 5498 reflect that this is an Inherited/Beneficiary IRA in the name and address section? Our system produced the 5498 with the client name and address but not the "title" which would reflect the Inherited IRA language. I can see from a client's perspective that this is confusing as they would not be able to tell if this 5498 was for their Inherited IRA or their regular IRA. I suppose true as well from the IRS standpoint?

A-1. IRS instructions are clear - the beneficiary indication is required on the 5498 form. Example, Sara Doe as beneficiary of Mother Doe's traditional IRA.

I understand the IRS would have the right to fine the bank $50 (x two) because the Form 5498 has not been prepared as instructed.

I would want to research - when this information is being furnished to the IRS electronically is there to be the special titling. I would think it must have the special titling because how else does the IRS and the individual understand this is an inherited IRA.

Note that the instructions don't make clear where the decedent's info is to be shown.

Although the IRS does not have a similar requirement for the Form 1099-R, they should. When determining how an IRA distribution will be taxed a person does not aggregate personal IRAs and inherited IRAs. There must be separate calculations.

Example. Susan takes a distribution from her personal IRA, one with respect to her inherited IRA from her mother and one with respect to her inherited IRA from her sister. There must be three calculations and three different 1099-R forms. Susan may not understand things as well as she should if she is furnished three 1099-R forms issued to Susan. Admittedly, two will have a reason code 4 and one will have a 7.

Email Guidance – Inherited IRAs

Q-1. We have some confusion surrounding the SECURE Act and the death of a 1st generation beneficiary of an Inherited IRA.

IRA account owner died in 2015 naming his father as beneficiary . An Inherited IRA was opened for Father as bene of Son's IRA. Father named his wife (Son's mother) as beneficiary of the Inherited IRA. Father died in 2022. The RMD has not yet been taken, and of course, must be withdrawn. What is the appropriate way to proceed with future RMDs? Do RMDs continue as previously calculated for the second generation beneficiary as a spouse beneficiary to the 1st generation beneficiary? Or, is the spouse subject to the 10-year rule since they are not the spouse of the original account owner?

A-1. Your last question/statement/situation is correct. Upon the death of a grandfathered IRA beneficiary who was using the life distribution rule, the next beneficiary is required to close the inherited IRA by using the 10-year rule. The next beneficiary is unable to continue the schedule which applied to the deceased beneficiary. This is required even if the beneficiary is the spouse of the deceased IRA beneficiary. There is no special rule or treatment of a spouse beneficiary of an inherited IRA.

So, she as the next beneficiary must withdraw the 2022 RMD as calculated for her deceased spouse by 12/31/2022. She will then use the10-year rule to close the inherited IRA. Her deadline is 12/31/2032 or is it???????.

See page 11 from the 2020 version of Publication 590-B. The IRS says the 10-year period ends on the 10th anniversary of the beneficiary's death So, if the person died on 1/15/2022. The 10th anniversary would be 1/15/32. This might be the deadline rather than 12/31/2032.

The IRS should furnish additional guidance on this situation and it will when it writes its proposed and final regulation. Although the IRS should, the IRS rarely explains why it adopts a certain position. I would argue-the IRS should not have this special rule where the deadline is the 10th anniversary rather than 12/31.

Email Guidance – Can't Show a Distribution Made in 2022 as a 2021 Distribution

Q-1. I have a client that did not take their 2021 RMD. They are now coming to us wanting us to fix it. They said that they signed up for an auto distribution but we do not have paperwork showing this. Is there anyway to still do a 2021 distribution. What is the best way to handle this?

A-1. There is no way to show that the distribution occurred in 2021 if it did not. It would be tax fraud to report a distribution occurring in 2021. The law does not depend upon whether the client or the bank or both were at fault.

The individual should withdraw their 2021 RMD as soon as possible. The client will have two RMDs in 2021 because the person includes a distribution in their income in the year they receive the distribution.

The individual can ask the IRS to waive the 50% tax which applies when a person has an excess accumulation. That is, they failed to withdraw all of their RMD. The individual should read the instructions as set forth in the instructions for Form 5329. The individual is permitted to prepare this form showing that they do not owe the 50% tax amount because they are allowed to assume the IRS will waive the 50% penalty.

The individual must in writing request the waiver and explain why the IRS should grant the request. The individual if they truly believe it was the bank's mistake may make that argument. The IRS is not required to waive the 50% tax.

The bank may furnish a letter to your client admitting fault or partial fault if there is some evidence the bank made an error. The client would attach the bank's letter to their request for waiver.

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Email Guidance – Excess Deferrals to SIMPLE-IRAs. Who is Primarily Responsible to Correct?

Q-1. We have a SIMPLE IRA that contributed 16 cents more than allowed in 2021. Do we have to distribute the 16 cents and issue a 1099R on such a small amount?

A-1. Will the individual have other distributions in 2022?

If not, he may withdraw the amount as an excess contribution. Remember the rule is - a Form 1099-R needs to be prepared only if the annual distribution amount is $10 or more.

You would have to determine if you can instruct your system not to prepare the Form 1099-R. Or, you could decide to code the withdrawal as transfer so that the Form 1099-R would nor be prepared.

Q-1A. What about the 5498 report and his w2? They will both show an excess contribution . Do we still send the 5498 with that on it?

A-1B. Is he withdrawing the 16 cents? If he does , there no longer is a n excess .

The excess deferral was made so there is no right to change his Form 5498.

As for his W-2 form, the tax accountant and the employer must decide what is to be done. I presume his W-2 would report the corrected deferral amount and it would not include the 16 cents. His income might go up by 16 cents????

In my opinion, the 16 cents just is not material.

Q-1B. I thought you said he will withdraw it but I guess an excess contribution requires something more?

A-1B. A SIMPLE-IRA excess contribution situation is very different from an excess traditional IRA or SEP excess contribution situation.

When a mistake occurs and an employee contributes/defers more than the law permits this can impact the employer's preparation of the person's Form W-2. This is the job of the accountant or the payroll company.

For 16 cents I personally would take the position the employer need not modify the Form W-2 as it is not material.

Q-1C. The month we receive the contribution is the month the IRS uses to add up the total contribution in a year, correct? i.e. December 2020 withholding was contributed in January 2021. So it is a 2021 contribution and not 2020.

A-1C. A good question and you are right - the amount to be repo rted in box 9 (SIMPLE-IRA contributions) is based on the year the bank receives the contribution. The bank does not indicate on the Form 5498 for what tax year the contribution relates. The employer and the employee do this on their tax returns.

I don't see the IRS calculating or trying to calculate if a person has exceeded the SIMPLE-IRA elective deferral limits for 2021 or for any year. You are concern ed that the IRS monitors this limit and then contacts someone. I don't think the IRS does. I don't think the IRS computer systems are designed to monitor this limit. Why?

The amount reported in box 9 is the aggregate of two amounts; a participant's elective deferral amount plus the employer contribution which is either a match with a limit of 1-3% of compensation or the 2% non-elective contribution. There is no way for the IRS to know whether the employer contribution amount is correct or incorrect or whether an employee has exceeded the applicable deferral limit unless an audit of the employer or the employee is conducted.

Deadline is 4/15/22 for Withdrawing a 2021 Excess Salary Deferral

Many individuals benefit by making elective deferrals under their employer's 401(k) or 403(b) plan. Some individual may have two jobs and two employers who both sponsor a 401(k) plan. Some individuals may operate a self-employment business in addition to their main job. There are some individuals who make elective deferral contributions to multiple plans. For example, Davi d makes 401(k) deferrals under his employer's 401(k) plan, but he is self-employed as an artist. He has established a SIMPLE-IRA plan for his art business.

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Excess Salary Deferral,
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The law limits a person's elective deferrals. The total of all salary deferrals a participant makes to various retirement plans - including 401(k), 403(b), SARSEP and SIMPLE-IRA plans - is limited to $19,500 (plus an additional $6,500 if age 50 or over) for 2021. Individuals who made salary deferral contributions to two or more retirement plans in 2021 may be most at risk for exceeding

If a person exceeds this limit for 2021, they must take corrective action to withdraw the excess deferral amount, plus earnings, by April 15, 2022.

If a person withdraws the excess salary deferrals, plus earnings, by April 15:

- Excess deferrals are taxed in the calendar year deferred (2021)
- Earnings on the excess are taxed in the year withdrawn (2022)
- Excess is not subject to the 10% early distribution tax, 20% withholding, or spousal consent requirements

If a person doesn't withdraw the excess salary deferrals, plus earnings, by April 15:

- Excess deferrals are taxed in the calendar year deferred (2021) and again in the year withdrawn
- Earnings on the excess are taxed in the year withdrawn
- Withdrawals may be subject to the 10% early distribution tax, 20% withholding, and spousal consent requirements
- Make correction to the affected plan using the Self-Correction or Voluntary Correction Programs

Much Additional Work for Everyone if a Rollover or a Transfer is Handled Incorrectly

Although many individuals don't know the difference between a rollover or a transfer the following email response illustrates why it so important for bankers to know the difference.

When there is a transfer there is no taxable event which needs to be reported to the IRS. The IRS custodian/trustee remitting the IRA funds to the successor IRA custodian/trustee is not required to prepare a Form 1099-R to report the distribution being made to the successor custodian/trustee because no distribution was "received" by the individual.

There must always be IRS reporting if a person has received an IRA withdrawal. A form 1099-R must be prepared even if the person subsequently makes a rollover contribution. The IRS believes a person needs to pay tax on the distribution unless the person makes a qualifying rollover and completes their tax return to reflect the rollover and claim the distribution is not required to be included in their income.

The situation. FF (brokerage) had issued a check to Jane Doe for $42,000 in June of 2019. Jane Doe had brought the check to ABC bank within 15 days. The $42,000 was contributed to her traditional IRA. ABC Bank processed the transaction as a transfer. FF issued Jane Doe a 2019 Form 1099-R showing she had received a distribution of $42,000. The 2019 Form 5498 prepared by ABC Bank did not show a rollover contribution in box 2. Jane prepared her tax return and she excluded the $42,000 from her taxable income.

Because there was no Form 5498 prepared showing that she had made a rollover contribution the IRS sent her in 2021 a tax bill for $8,400 including penalties and interest. She (or H&R Block on her behalf had written the IRS) and explained she had made a rollover. ABC Bank had written a letter indicating it should have processed the $42,000 contribution as a rollover.

The IRS in .January of 2022 has informed .Jane Doe that her explanation was not being accepted. Why? Although ABC Bank wrote a letter explaining that it should have reported her $42,000 contribution as a rollover, it did not prepare a corrected 2019 Form 5498 showing the rollover. The IRS apparently will not remove a tax assessment unless an IRA custodian prepares a corrected Form 5498.

It appears the IRS has the policy - we are not going to treat the transaction as a rollover and non-taxable unless the financial institution serving as the IRA custodian prepares a corrected Form 5498 showing there was a rollover.

Now that Jane Doe has furnished the IRS with the corrected 2019 Form 5498 we expect the IRS will remove its claim for $8,400. The IRS may not be in a good mood, however, because they have spent a lot of time on this situation.

It is possible the IRS will assess ABC Bank a $100 fine for preparing her 2019 Form 5498 incorrectly and then not correcting it once the bank learned of the error. Making corrections is always time consuming for everyone involved - Jane Doe, ABC Bank and the IRS.