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ALSO IN THIS ISSUE –

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

Overview – The IRS' Proposed RMD Regulations, Rollover Regulations, Plus Other Related Regulations

IRS Issued its New Proposed RMD Regulation on February 24, 2022 Effective For 2022 RMDs

The IRS has proposed new RMD rules for IRAs, 401(k) plans, other pension plans, 403(b) plans and certain 457 plans. The new rules are to be used for 2022 RMD calculations, including the 50% tax when there is an excess accumulation of an RMD.

The IRS has proposed some changes which some in the public will not like. There are other changes which will be liked. The purpose of this article and articles in the April newsletter is to present a summary of the changes which affect IRAs. People should not assume all of these proposals will be adopted. Some should not be. The Treasury and the IRS have invited comments on the impact of these proposed regulation on small entities. The IRS should start by defining who or what is a small entity for purposes of these proposed regulations.

The IRS encourages a commenter to make their submission electronically. The IRS will give paper submissions consideration only to the extent practicable. Use the Federal eRulemaking Portal at wwwregulationsgov. Be sure to follow the on line instructions and reference IRS and REG-105954-20.

If you do submit a comment on paper send it to: CC:PA:LPD:PR (REG-105954-20), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington DC 20044.

Written or electronic comments must be received by the IRS by June 22, 2022 (90 days after February 24, 2022). The IRS is holding a public hearing on June 15, 2022. The IRS is trying to expedite the adoption of this proposed regulation as its final regulation. It should slow down the process.

Hopefully, the IRS will seriously consider what the IRA/pension and tax professionals suggest along with general taxpayers. The proposed RMD rules are too complicated. There is no need that they be this complicated.

The IRS position is - a regulatory flexibility analysis under the Regulatory Flexibility Act is not required for various reasons. The IRS believes and certifies that the regulations will not have a significant economic impact on a substantial number of small entities. Obviously, the IRS is wrong. It will affect many small entities - either small employers sponsoring retirement plans or IRA owners and beneficiaries. These new rules are going to affect many small plans and they affect millions of IRA owners and beneficiaries. The IRS tries to argue that the proposed regulations do not impose new compliance burdens and are not expected to result in economically meaningful changes. Obviously, they do impose economically meaningful changes and new burdens. Many of the IRS proposed beneficiary changes are being added to require beneficiaries to take their withdrawals sooner so more income taxes are paid sooner.

Financial institutions should be seeking help from their senators and trade associations such as the American Bankers Association and state banking associations. The IRS can and should be acting to simplify the rules.

RMDs for IRA Owners Age 72 or Older

An IRA owner has a required beginning date of April 1 of the year following the year he or she attains age 72. The rule which applies to some employer plans does not apply to IRAs. Some employer plans are written to defines a participant's required beginning date as the April following the year the person retires if after age 72.

An IRA owner born before July 1, 1949 has a required beginning date of April 1 of the year following the year he or she attained age 70½. A person attained age 70½ as of the date six calendar months after the person's 70th birthday.

The RMD rules for SEP-IRAs and SIMPLE IRAs are the same rules applying to traditional IRAs and not the rules applying to a qualified plan.

A Roth IRA owner does not have a required beginning date.

The formula used to calculate the RMD for an IRA has not changed. The 12/31 balance as of the preceding year is divided by a divisor. The IRS used to use the term, "applicable distribution period." The IRS now uses the term, "applicable denominator." Divisor and denominator are the same.

The account balance does not include the value of any qualifying longevity annuity contract (QLAC).

The 12/31 balance as of the preceding year is adjusted only in one situation. A rollover distribution or a transfer distribution occurs late in the year (November or December) so it is not reflected in the 12/31 balance, then the balance of the distributing IRA must be increased to reflect the outstanding distribution amount. There is no adjustment when the IRA owner makes a prior year contribution or recharacterizes an IRA contribution.

The divisor or applicable denominator comes from the Uniform Lifetime Table as revised by the IRS in 2020. There is no requirement to designate an individual as the beneficiary. In one situation the Uniform Life Table is not used. If the sole designated beneficiary of the IRA owner is their spouse who is more than 10 years younger, then the divisor is to come from the Joint Life Expectancy Table using their two ages for the applicable year. And the RMD denominator (divisor) is to be recalculated each year.

In general, any withdrawal by a IRA owner is applied to satisfy his or her RMD. Because the law provides that an RMD is ineligible to be rollover over, the first distributions of an IRA owner are used to satisfy his or her RMD. Once satisfied any additional distributions are eligible to be rollover over. However the following distributions from an IRA cannot be used to satisfy the IRA owner's RMD:

A. excess contributions plus the related income withdrawn before the due date under Code Section 408(d)(4);

B. excess contributions withdrawn after the due date under Code Section 408(d)(5);

C. Any corrective distribution of an excess SEP-IRA contribution plus the related income under Code section 408(k)(6);

D. Any deemed distribution pursuant to code section 408(e);

E. Any deemed distribution of a collectible pursuant to code section 408(m);

F. Any corrective distribution of Excess SIMPLE-IRA deferrals plus the related income and

G. Similar items as determined by the commissioner in revenue rulings notices and other published guidance.

The IRS should revise the regulation to expressly provide that an IRA owner may satisfy their RMD by making a qualified charitable distribution.

The Basic RMD Beneficiary Rules Under the SECURE Act

It is important to understand certain terms after the enactment of the SECURE Act. A designated beneficiary is a person. A trust, estate or charity is not a designated beneficiary. A designated beneficiary will either be an eligible designated beneficiary (EDB) or someone who is not an eligible designated beneficiary. A trust which meets certain rules will be treated as an EDB for purposes of certain RMD rules.

Who is an eligible designated beneficiary?

An eligible designated beneficiary is a designated beneficiary who as of the IRA owner's death is:

1. the surviving spouse of the IRA owner;
2. a child of the IRA owner who has not reached the age of majority;
3. disabled;
4. chronically ill; or
5. not more than 10 years younger than the IRA owner; or
6. A designated beneficiary of an IRA owner who died on or before December 31, 2019 is an EDB and is required to continue using the life distribution rule appling to them before the enactment of the SECURE Act. A beneficiary generally has the right to withdraw more than the RMD.

EDB Category #1. The surviving spouse of the IRA owner regardless of age. The status of being married is determined by applying federal law and state law.

EDB Category #2. A child of the IRA owner who has not reached the age of majority;

The IRS has proposed the following additional and clarifying rules.

1. The person must be a minor at the time the IRA owner dies.
2. Although the law uses the term age of majority which in most states is age 18, the IRS has chosen to override this by defining a person's age of majority as the day the person reaches their 21st birthday.
3. The law is that when a minor beneficiary attains the age of majority then the 10-year rule will apply. But what happens if there are multiple beneficiaries?

EDB Category #3. The beneficiary is disabled.

The IRS has proposed the following additional and clarifying rules.

1. The person must be disabled at the time the IRA owner dies.
2. The IRS is proposing to use the existing rules and procedures for defining when a person is disabled. The standard is - the individual is unable to engage in substantial gainful activity.

   The IRS makes clear a person who becomes disabled after the IRA owner's death is not disable for RMD calculation purposes.

   Apparently, a person who is disabled as of the day the IRA owner dies, but later improves so he or she is no longer disabled is to be treated as disabled for purposes of the RMD rules.
3. The IRS creates a special rule if the beneficiary is under age 18. Should this now be 21? The IRS creates a comparable standard rather than the standard. A minor beneficiary will be disabled if he or she has a medically determinable physical or mental impairment that results in marked and severe functional limitations which can be expected to result in death or be of long-continued and indefinite duration.
4. The beneficiary who is disabled must meet certain documentation requirements even though the beneficiary is also a minor. __
5. The IRS creates a safe harbor. If as of the date of death the commissioner of Social Security has already determined the beneficiary is disabled within the meaning of USC 1382c(a)(3). If so, the beneficiary is deemed disabled.
6. The beneficiary must furnish the IRA custodian/trustee with documentation confirming the disability no later than October 31 of the year following the year the IRA owner died. The documentation must include a certification by a licensed health care practitioner.

Although the law uses the term age of majority which in most states is age 18, the IRS has chosen to override

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this by defining a person's age of majority as the day the person reaches their 21st birthday.

The law is that when a minor beneficiary attains the age of majority then the 10-year rule will apply. There's special rules when there are multiple beneficiaries.

EDB Category #4. The beneficiary is chronically ill.

The IRS has proposed the following additional and clarifying rules.

1. The person must be chronically ill at the time the IRA owner dies.
2. The IRS makes clear a person who becomes disabled after the IRA owner's death is not chronically ill for RMD calculation purposes.
3. A person is chronically ill if the person is unable to perform at least two daily living for an indefinite period that is reasonable expected to be lengthy in nature.
4. The beneficiary must furnish the IRA custodian/trustee with documentation confirming the beneficiary is chronically ill no later than October 31 of the year following the year the IRA owner died. The documentation must include a certification by a licensed health care practitioner.

EDB Category #5. The beneficiary is more than 10 years younger. Note that a beneficiary who is older than the IRA owner is more than 10 years younger than the IRA owner.

EDB Category #6. A designated beneficiary of an IRA owner who died on or before December 31, 2019 is an EDB and is required to continue using the life distribution rule applying to them before the enactment of the SECURE Act. A beneficiary generally has the right to withdraw more than the RMD.

<u>What rules apply to a traditional IRA Beneficiary if the IRA owner died before his or her required beginning date?</u>

The 5-year rule applies if the beneficiary is not a designated beneficiary.

The 10-year rule applies if the beneficiary is a designated beneficiary or is a qualified (see-through) trust.

The life distribution rule applies if the beneficiary is an EDB, including an EDB trust. Presumably the special life distribution rule will apply when the deceased IRA owner is younger than their beneficiary.

<u>What rules apply to a traditional IRA Beneficiary if the IRA owner died on or after his or her required beginning date?</u>

The IRS has written its regulation in a unique manner. The IRS position is - a non-EDB beneficiary who is ineligible to use the life distribution rule when the IRA owner dies before their required beginning date is now required to use the standard life distribution rule when the IRA owner has died after their required beginning date. However, this distribution period cannot exceed 10 years and in some cases the distribution period might be less than 10 years.

The IRS approach is not clearly authorized by the SECURE Act. The IRS does not explain why they believe Code section 401(a)(9)(H((i)(I) as added by the SECURE Act authorizes or requires this two step approach:

The proposed RMD regulation set forth the following over-riding rule. An inherited IRA be closed (i.e. a full distribution) by the <u>earliest</u> of the following dates:

1. The end of the 10th calendar year following the calendar year the IRA owner died if the beneficiary is not an EDB;
2. The end of the 10th calendar year following the calendar year the IRA beneficiary (who was an EDB) died;
3. The end of the 10th calendar year following the calendar year a beneficiary who is a minor as of the date of the IRA owner's death attains age 21; or
4. The end of the calendar year in which the applicable divisor (denominator) would have been less than or equal to 1.0 if the divisor was determined using the beneficiary's remaining life expectancy. This deadline applies only if the beneficiary was an EDB and if the applicable divisor was being determined using the IRA owner's remaining life expectancy. That is, the IRA owner had designated an older beneficiary, but that beneficiary has now died. The remaining distribution period is based on the older beneficiary and not the deceased IRA owner.

There will be substantial additional discussion of the proposed RMD regulation in the April newsletter. The proposed RMD regulation is 275 pages

Email Guidance – What Forms are Completed for a Recharacterization?

Q-1. I have a client, Julie, who made a 2021 contribution to a traditional IRA of $6,000 in 2021. She is now in March of 2022 looking to open a Roth IRA and recharacterize that contribution to the Roth IRA.

She is looking to do this before she files her taxes for 2021. Could you walk me through this process?

Julie wasn't sure if it would be possible since we have already completed the reporting for 2021 contributions, and thought it might be reported for 2022 instead?

Also she was concerned about the interest, do you have a way to calculate that? The traditional IRA that she contributed the $6,000 into was an existing account so the interest that was deposited to the IRA will be off if we recharacterize his contribution.

A-1. I have sent you three forms which may be used. You and she should review the special explanation set forth on our Form 56-TREX.

I will discuss the related income topic later. For illustration purposes I am assuming there was $80.00 of earning with respect to the $6,000 contribution. The amount to be moved to the Roth IRA is $6,080.00.

She needs to instruct to do the "internal" recharacterization by completing our Form 54-TR1.

The concept of the law is - by doing a recharacterization before her tax filing deadlines she is treated as having made a Roth IRA contribution in 2021 for tax year 2021. If she has no other Roth IRA her 5-year period commenced on January 1, 2021.

Recharacterizations are form intensive.

IRS Reporting Forms

1. She is to receive a 2021 Forms 5498 by 5/31/2022 indicating she made a $6,000 contribution to her traditional IRA. Box 1 will be completed to show this $6,000 contribution.

   She should attach the special explanation to both her 2021 and 2022 tax returns.
2. She will receive a 2022 Form 1099-R by 1/31/2023 indicating there was a deemed withdrawal of the $6,080. Box 1 is completed with $6,060. Box 2a is completed with 0.00 and box 7 will be completed with a "R".

   She will need to complete her 2022 Form 1040 to show that her deemed IRA distribution from the traditional IRA is not taxable because this distribution was a recharacterized distribution.
3. She will receive a 2022 Form 5498 by 5/31/2023 indicating there was a deemed contribution of the $6,080. Box 4 is completed with $6,080.

Discussion of the related income topic.

In order for a person to use this beneficial tax rule, the income earned by the $6000 must be determined and transferred. A person wants to do this because ultimately the $80.00 will be tax-free when withdrawn from the Roth IRA whereas if it stays in the traditional IRA it will be taxed when withdrawn.

See the attached worksheet to be used to calculate the income. To complete this form one should know the amount of accrued interest in the account on the day the initial contribution was made and when the withdrawal occurs.

Understanding the Making of a Backdoor Roth IRA Contribution

The law expressly provides that individuals with high incomes are ineligible to make an annual Roth IRA contribution. However, the law permits an individual with any income, even a high income, to make a nondeductible traditional IRA contribution. Another law permits a person with a traditional IRA, SEP-IRA or SIMPLE IRA, regardless of income to make a Roth IRA conversion contribution.

So a person with a high income is able to make a nondeductible traditional IRA contribution and then convert that contribution into a Roth IRA. The net effect is the same as making a direct Roth IRA contribution. This is the back-door Roth IRA contribution.

Some people seem to think there is one transaction to make a back-door Roth IRA contribution. There isn't. There are always two transactions - make a nondeductible contribution to a traditional IRA and then convert it to a Roth IRA. Note, the person must not have

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any traditional IRA, SEP-IRA or SIMPLE IRA holding any taxable funds to make a true back-door Roth IRA contribution.

The second transaction (i.e. the conversion) may happen immediately after making the non-deductible contribution or it may occur later. Most individuals will want to do the conversion as soon as possible so that any earnings occur within the Roth IRA and not in the traditional IRA. Earnings within in a traditional IRA are always taxable.

A 2021 non-deductible traditional IRA may be made from January 1, 2021, through April 18, 2022. This non-deductible traditional IRA contribution must comply with the IRA contribution limit (lesser of 100% of compensation or $6000/$7000).

A 2021 conversion contribution must be made between January 1, 2021 through December 31, 2021. A 2022 conversion contribution must be made between January 1, 2021 through December 31, 2022.There is no conversion contribution limit other than the conversion amount cannot exceed the fair market value of the traditional IRA.

The tax consequences of these two transaction are easy to understand and to report on a person's tax return if both transaction occur within the same tax year and for the same tax year.

For example, a person who makes a $6000 non-deductible contribution on August 7, 2021 for 2021 and also converts it on August 7 2021 will prepare their tax return showing - the making of the $6000 nondeductible contribution on the 2021 Form 8606, the conversion withdrawal of $6000 on the 2021 Form 8606 and the 2021 Form 1040 and the fact that no portion of the $6000 is to be included in income because it is basis.

In the above situation the IRA custodian will prepare the IRS reporting forms as follow::

1. The 2021 Form 5498 for the traditional IRA will show in box 1 a contribution of $6000;
2. The 2021 Form 1099-R will show a distribution of the $6000 from the traditional IRA (box 1 and 2a showing $6000, box 7 with a reason code 2 if under 59½ and 7 if age 59½ or older, and
3. The 2021 Form 5498 for the Roth IRA will show in box 3 a conversion contribution of $6000.

The person must complete their tax return (Forms 1040 and 8606) and explain - a conversion was done but the taxable portion is 0.000 because the converted amount of $6000 was 100% basis. That is, there were no earnings.

The tax consequences of these two transactions becomes more complicated when both transactions do not occur within the same tax year and for the same tax year. There are two situations to be illustrated.

Situation #1. A person makes a $6000 non-deductible contribution on August 7, 2021 for 2021 and then waits until April 7, 2022 to convert it. There are $300 of earnings between August 7, 2021 and April 7, 2022. The person must report the making of the $6000 nondeductible contribution on his 2021 tax return. Although not required it is assumed the person converts the entire $6300.The person must report the conversion of $6300 on his 2022 tax return, He will complete the Form 8606 and Form 1040 to show that $300 is included in income but $6000 will be excluded as it is basis. In the above situation the IRA custodian will prepare the IRS reporting forms as follow:

1. The 2021 Form 5498 for the traditional IRA will show in box 1 a contribution of $6000;
2. The 2022 Form 1099-R will show a conversion distribution of the $6300 from the traditional IRA (box 1 and 2a showing $6300, box 7 with a reason code 2 if under 59½ and 7 if age 59½ or older,
3. The 2022 Form 5498 for the Roth IRA will show in box 3 a conversion contribution of $6300.

The person must complete their 2021 Form 8606 to report the making of a nondeductible contribution. The person must also complete their 2022 tax return (Forms 1040 and 8606) and explain - a conversion distribution was done. $6000 is not taxable as it is basis, but the $300 is taxable.

Situation #2. A person makes a $6000 non-deductible contribution on April 7, 2022 for 2021 and then immediately converts it The person must report the making of the $6000 nondeductible contribution on his 2021 tax return. He must complete his 2021 Form 8606. He will report the making of his conversion contribution of $6000 on his 2022 tax return. He must complete his 2022 Form 8606 to report this conversion and his 2022

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Form 1040 so that no portion of the distribution is included in his income. In the above situation the IRA custodian will prepare the IRS reporting forms as follow:

1. The 2021 Form 5498 for the traditional IRA will show in box 1 a contribution of $6000;
2. The 2022 Form 1099-R will show a conversion distribution of the $6300 from the traditional IRA (box 1 and 2a showing $6300, box 7 with a reason code 2 if under 59½ and 7 if age 59½ or older, and
3. The 2022 Form 5498 for the Roth IRA will show in box 3 a conversion contribution of $6300.

The person will prepare their tax return showing - the making of the $6000 nondeductible contribution on the 2021 Form 8606, the conversion withdrawal of $6000 on the 2022 Form 8606 and the 2022 Form 1040 and the fact that no portion of the $6000 is to be included in income because it is 100% basis.

The Interrelation of the Recharacterization Process and Making a Backdoor Roth IRA Contribution

Sometimes a person will make a Roth IRA contribution and then learn they are ineligible to make that Roth IRA contribution directly. The person wants to make a back-door Roth IRA contribution, if eligible. Set forth below is a discussion of such a situation.

Jane Doe made a contribution of $6000 to a Roth I RA on June 10, 2021. She thought she would be eligible to make such a contribution. She went to see her tax preparer in March of 2022 because she wanted to file her 2021 federal income tax return. Her tax preparer informed her that her permissible Roth IRA contribution limit for 2021 was 0.00 because her income was too high. Her tax preparer told her - go to the IRA custodian, do a recharacterization and whatever else needs to be done to make a back-door Roth IRA contribution. The $6000 has realized $15 of earnings.

The tax preparer thinks the back-door Roth IRA contribution can be done for 2021. It cannot be, at least not fully. See Situation #1 as discussed about. The non-deductible contribution is deemed made in 2021. However the conversion does not occur until 2022. Again it is assumed the entire $6015 is converted. Of this amount she will have to include the $15 in her income for 2022. The 10% additional tax does not apply to a conversion distribution.

In the above situation the IRA custodian will make the following IRS reporting:

1. The 2021 Form 5498 for the Roth IRA showing in box 10 a contribution of $6000;
2. The 2022 Form 1099-R showing the recharacterized distribution of $6015 from the Roth IRA (box 1 is $6015, box 2a is 0.00 and the reason code in box 7 is an "R") and
3. The 2022 Form 5498 for the traditional IRA showing in box 4 a recharacterized contribution of $6011.

Note that she may make a back-door Roth IRA contribution for 2022. As discussed above it will be simplest if she makes the non-deductible contribution of $6000 and the conversion in the same year, but that is not required.

Jane Doe has the duty to explain on her tax returns for 2021 and 2022 that she did a recharacterization.

In the above situation the IRA custodian will make the following IRS reporting:

1. The 2021 Form 5498 for the Roth I RA will show in box 10 a contribution of $6000;
2. The 2021 Form 1099-R will show the recharacterized distribution of $6000 from the Roth IRA (box 1 is $6000 and box 2a is 0.00) and
3. The 2021 Form 5498 for the traditional IRA will show in box 4 a recharacterized contribution of $6000.

Email Guidance – Direct Rollover of Designated Roth Funds into Roth IRA

Q-1. I have a question (I hope it will be an easy one) about distributions from a Roth account.

I have an employee who had been making payroll contributions to a Roth 401(k) that we offer in our retirement plan. She has recently retired and has rolled over the Roth balance of her plan to a new Roth IRA here, and wants to start taking distributions from that Roth account. The 5-year rule was met in the 401(k) plan, so do the distributions qualify as tax-free? My contact with our 401 k plan indicated that they would, but I wanted to double check with you to be sure that is correct.

A-1. There are two separate 5-year rules - one applies to the 401(k) plan and one applies to the Roth IRA.

I assume if she would have taken an actual distribution of her Designated Roth account (contributions plus earnings) then the distribution would have been tax-free because she was over age 59½ and she had met the 5-year rule.

An illustration. She contributed $30,000 to her Designated Roth Account and it increased to $50,000 because of earnings. If she had taken an actual distribution of the $50,000 it would be tax-free.

Because she directly rolled over the $50,000 into a Roth IRA the $50,000 is basis within the Roth IRA. When she takes a distribution from her Roth IRA there is the ordering rule - contributions or basis comes out first, conversion basis comes out second and earnings within the Roth IRA come out last. Basis is not taxed.

So, the first $50,000 she withdraws from her Roth IRA will come from the basis and will be tax-free. If she withdraws any of the earnings of the Roth IRA before she has met the new 5-year rule which applies to the Roth IRA, she would have to include the withdrawal of that income in her income. Once she has met the 5-year rule for Roth IRAs, the Roth IRA income too will be tax-free.

Has she discussed with her adviser? I realize she may need the funds to live. In my opinion withdrawing funds from a Roth IRA should be done only as a last resort because all income earned by the Roth IRA one day will be tax-free.

Q-2. The amount rolled in from the Roth 401 is $17,400, so that is now the basis of the new Roth IRA, which she can take out tax-free. (She wants to do $800 monthly, so that would be $16,800 through Dec. 2023.) If she then stops and leaves it sit, is that going to work out? She also added $14,000 for 2021 and 2022 contributions from her earnings. So she could leave the remaining Roth money in there until the 5 years has elapsed.

There is still a considerable amount in Traditional 401(k) that she will be able to use for living expense in additional to the Roth account.

A-2. She must act on the advice of her adviser.

What is the reason why she wants to withdraw funds from the Roth IRA? There is no requirement to do so even if she would be age 72 or older.

In my opinion, a person should withdraw all taxable funds from a traditional IRA before withdrawing anything from a Roth IRA.

The Roth IRA will earn tax-free income while she is alive and for 10 years thereafter for her beneficiary. She will pay tax on the earnings realized by the traditional when ultimately withdrawn. There are few situations under our income tax laws where a person can realize income and have that income not be taxed.

It may your bank and other banks in the next few years will start paying 3-6% on deposits and so the real value of a Roth IRA may be realized.

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IRS Proposes Major RMD Changes for Spouse Beneficiary

After the death of the IRA owner under existing rules, a surviving spouse who is the sole primary beneficiary has the right to elect to treat the deceased spouse's IRA as his or her own IRA. This is a very valuable tax planning tool for certain marriage/death situations. Generally, a surviving spouse will want to elect to treat their deceased spouse's IRA as their own IRA. And then if the surviving spouse is age 72 or older the standard RMD rules will apply to the surviving spouse. But there are situations where a spouse beneficiary does not want to elect to treat their deceased spouse's IRA as their own The survivor wants to keep it as an inherited IRA. See the two examples discussed later.

From 2002-2021 the right of spouse to elect to treat as own was unlimited. The election could be made at any time. That is, even if a spouse decided initially to maintain the inherited IRA as an inherited IRA he or she had the right to later elect to treat the deceased spouse's IRA as their own IRA.

The IRS has proposed that there will be a deadline for a surviving spouse to make the election. The election must be made by the later of-

1. December 31 of the calendar year in which the surviving spouse reaches age 72 or
2. December 31 of the calendar year following the year the deceased IRA owner died.

A surviving spouse loses the right to treat the deceased spouse's IRA as their own if the election is not made by the deadline. The surviving spouse must then use the life distribution rule or the 10-year rule as applicable.

Why is the IRS wanting to make this change? The IRS believes without these limits a spouse has tax planning options which favor some spouses too much.

How may a surviving spouse benefit too much by electing to treat their deceased spouse's IRA as their own IRA?

The first two examples deal with the IRA owner being younger than their spouse and the IRA owner dies before their required beginning date.

Example#1. An IRA owner dies in 2014 at age 69. His spouse beneficiary was older than he was. She was age 74. The IRA owner had died before his required beginning date. She had the right to use either the life distribution rule or she could elect to use the 5-year rule because he had died before his required beginning date. Under the 5-year rule she was required to close this inherited IRA by 12/31/2019. If she elected to use the 5-year rule she was not required to take any RMD for years 2015-2018. And with respect to 2019 she had until 12/30/2019 to elect to treat the inherited IRA as her own IRA. Her election would require her 2019 RMD to be recalculated using the balance of that inherited IRA as of 12/31/2018, but she has definitely benefited by electing to use the 5-year rule. The IRS thinks she should not be able to benefit in this way.

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Example#2. This example is similar to Example #1 except the IRA owner died in 2021 at age 70. His spouse beneficiary was older than he was. She was age 75. The IRA owner had died before his required beginning date. She had the right to use either the life distribution rule or she could elect to use the 10-year rule. Under the 10-year rule she is required to close this inherited IRA by 12/31/2031. If she elected to use the 10-year rule she is not required to take any RMD for years 2022-2030. And with respect to 2031 she has until 12/31/2031 to elect to treat the inherited IRA as her own IRA. Her election would require her 2031 RMD to be recalculated using the balance of that inherited IRA as of 12/31/2030, but she definitely will benefit by electing to use the 10-year rule. The IRS thinks she should not be able to benefit in this way.

Example #3. An IRA owner died in 2014 at age 82. His spouse beneficiary was age 86. She did not elect to treat his IRA as her own in 2014. Rather she kept it as an inherited IRA. Because she had elected the 5-year rule, this inherited IRA had to be closed by December 31, 2019. Under the existing rules she could elect to treat his IRA as her own in 2019. This meant her 2019 RMD had to be recalculated and was larger, but she did have to withdraw any amount for years 2015-2018. She might have died during this period.

The IRS is now proposing to place a new limit on the right of a spouse to elect to treat their deceased spouse's IRA as his or her own. It is Example #2 and Example #3 which the IRS wants to limit. Under the SECURE Act the 5-year time period has been replaced with the 10-year rule and the benefits to the spouse (and to her beneficiaries) can be very good.

Note a surviving spouse loses the right to treat the deceased spouse's IRA as their own if the election is not made by the deadline.

If the old rules are allowed to be continued many IRA owners/IRA beneficiaries would elect to use the 10-year rule because no distributions are required for years 1-9 and then the electing as own means their 2301 RMD will be larger but it need not be a lump sum distribution.

Example #3A. An IRA owner died in 2021 at age 82. His spouse beneficiary was age 86. She did not elect to treat his IRA as her own in 2021. Rather she kept it as an inherited IRA. If she is able to use the 10-year rule then she is not required to take any RMD for years 2022-2030. This would mean her 2031 RMD would be much larger, but still a lump sum distribution would not be required.

So a spouse will no longer be able to use the 10-year rule and then at the end of this period elect as own. They would be required to take the lump sum distribution in the 10th year.

What is the IRS not proposing to change regarding RMDs for IRAs?

The prior election procedures have not changed. First, the spouse beneficiary must inform the IRA custodian/trustee that he/she is redesignating the account from being an inherited account to being their own personal IRA. We at CWF have designed our forms so the spouse checks a box instructing the IRA custodian/trustee that he or she is make the election to treat as their deceased spouse's IRA. Second, a spouse's failure to withdraw an RMD automatically results in an automatic election as does the spouse making an annual contribution.

Special Rule for Certain Distributions to Surviving Spouses

This special rule limits the ability to initially use the 5-year rule or the 10-year rule and then later commence annual distributions because the spouse either elects as own or makes a rollover contribution.

The concept is - although the spouse is not required to take any distribution in years 1-4 or years 1-9, a portion of their account balance each year will be deemed to be an RMD and ineligible to be treated as own or rolled over.

This rule applies if the spouse takes a distribution from their inherited IRA in or after the year the spouse attains age 72. A portion of this distribution will be a deemed RMD and is ineligible to be rolled over.

The annual deemed RMD is the sum of each years hypothetical RMD as reduced by any actual distributions. The RMD is calculated by using the life expectancy rule. The first year is the later of the year the spouse reaches age 72 or the calendar year in which IRA owner died. The last year is the year the distribution occurs. The RMD is calculated by using the life expectancy

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rule, but it is modified. The balance as of the preceding 12/31 must be modified each year. It is reduced by the sum of the hypothetical RMDs for the prior years over any actual distributions during those prior years.

If a spouse misses the deadline for electing to treat as hie or her own, the spouse still has the right to rollover to his or her own IRA, but the spouse would be subject to the rule that a portion of the distribution would be an RMD ineligible to be rolled over.

What Should an IRA Custodian/Trustee be Doing to Respond to the IRS Issuing its Proposed RMD Regulations on February 24, 2022?

You should not over react to the proposed regulations, but you must plan for their final implementation. At this point the regulations are only proposed. Hopefully the IRS will revise the proposals. We at CWF believe the IRS has made certain RMD proposals which should not be included in the final regulation.

The main concern is that the IRS made clear in this proposed regulation that a non-EDB beneficiary of an IRA owner who died after 2019 and on or after their required beginning date must comply with two RMD rules. The beneficiary must commence distributions over their life expectancy commencing the year after the IRA owner died and the beneficiary is required to close this inherited IRA under the 10-year rule.

An IRA custodian may wish to furnish an explanation to your beneficiaries who are in this situation. Depending upon the position adopted by the IRS in its final regulation, a beneficiary may need to withdraw their 2022 RMD where originally it was understood the beneficiary was not required to take an RMD for 2022.

Code section 401 (a)(9)(H) was added by the SECURE Act. It applies to IRA owners or plan participants who died after December 31, 2019. It reads,

(H) Special rules for certain defined contribution plans. In the case of a defined contribution plan, if an employee (the IRA owner) dies before distribution of the employee's entire interest

(i) In general. Except in the case of a beneficiary who is not a designated beneficiary, subparagraph (B)(ii) -

(I) shall be applied by substituting "10 years" for "5 years", and

(II) shall apply whether or not distributions of the employee's interest have begin in accordance with subparagraph(A).

Subdivision (II) clearly states that the 10-year rule applies regardless if the IRA owner had already commenced distributions under subparagraph(A).because they had attained their required beginning date. The IRS read this provision to mean, the 10-year rule is to apply to the beneficiary in addition to the life distribution rule. We believe the best reading is, the 10-year rule is to apply which means then that the life distribution rule is not to apply.

For the reasons discussed below we at CWF aren't sure the IRS is right on this subject. Never before has a beneficiary been required to comply with two beneficiary distribution rules. What has changed?

We at CWF don't read the law as having this dual requirement. We believe the SECURE Act clearly sets forth that a non-EDB beneficiary is entitled to use the 10-year rule regardless of whether the IRA owner died before or after their required beginning date. Under the 10-year there is no requirement to take annual distributions for years 1-9.

What did Congress intend? Normally there are comments made by a tax committee. I don't believe those comments existed with respect to this part of the SECURE Act.

Set forth below is an illustration of the 10-year rule and the IRS belief that both rules must be complied with.

Illustration. Jane Doe, age 58 in 2021, is the beneficiary of Mary Doe. Mary was age 81 when she passed in 2021. The IRS is contending that Jane is required to use the life distribution rule because Mary had died after her required beginning date. Jane must commence distributions for 2022 using her age in 2022. However, she must also comply with the 10-year rule. The inherited IRA must be closed by December 31, 2031. See the schedule set forth on the next page:

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Proposed RMD Regulations,
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		Table #1	Table #2	
		10-year Only	Life Distrib. Rule & 10-Year Rule	
Year	Jane's Age	RMD Divisor	RMD Divisor	Closeout Deadline
2022	59	0	28.0	
2023	60	0	27.0	
2024	61	0	26.0	
2025	62	0	25.0	
2026	63	0	24.0	
2027	64	0	23.0	
2028	65	0	22.0	
2029	66	0	21.0	
2030	67	0	20.0	
2031	68	100%	19.0/1.0	12/31/2031

The IRS finally discussed in Publication 590-B that both rules must be met. But the IRS does not state this as expressly as it should be stated. The IRS could have illustrated its position by having an appropriate example. The IRS did not set forth an example.

The basic intent of the SECURE Act was to take away for many beneficiaries the right to use the life distribution rule. Congress acted to have a simpler approach. Congress required most beneficiaries to use the 10-year rule regardless of whether the IRA owner died before or after their required beginning date (in general age 72).

Yet, the IRS in its proposed regulation is stubbornly wanting to continue to use the life distribution rule for those beneficiaries of IRA owners who have died <u>after</u> their required beginning date. Why? The IRS has not explained The IRS should. The IRS seems hung up on the concept that an IRA or pension distribution should be periodic.

CWF's Suggestions to the IRS For Changes to the Proposed RMD Regulations and Rollover Regulations

We propose the following changes:

1. A non-EDB beneficiary of an IRA owner who died after 2019 is eligible to use the 10-year and is NOT required to the special two rule distribution procedure. That is, the beneficiary is not required to use the life distribution rule as modified by the 10-year rule.
2. The IRS should delete its proposals to restrict the right of a spouse beneficiary who is the sole beneficiary to elect to treat their deceased spouse's IRA as their own IRA The current rules should be continued unchanged. A qualifying spouse has the right at any time to treat their deceased spouse's IRA as their own. The IRS describes this change as being a small change. It isn't, it is a major change. The rollover rules which would be placed on spouse's are very complicated. They don't need to be.
3. The IRS should revise the RMD regulation to provide one rule which applies to both a spouse beneficiary and a non-spouse beneficiary. If the IRA owner dies before their required beginning date then there is no RMD for that year. Currently the IRS requires a spouse beneficiary take the RMD which was calculated to the extent it had not been withdrawn. There is no good reason a spouse beneficiary is required to take that distribution.
4. The IRS should revise its discussion regarding that certain distributions are not eligible to be used to satisfy a person's RMD. The regulation states that certain distributions under code sections 408(e) and 408{m) will not be eligible to satisfy a person's RMD. The IRS does not explain its reasons for this law change. It may be the IRS does not believe such distributions should be eligible to be rolled over. And the IRS should delete the broad authority it grants itself that the Commissioner has the authority to define other distributions as being ineligible to satisfy's a person's RMD as long is guidance is set forth in revenue rulings, notices and other guidance. The law is clear that an RMD is ineligible to be rolled over, but the law is not clear that a deemed distribution can't be used to satisfy an RMD.
5. The IRS should revise its discussion regarding that certain distributions are eligible to be used to satisfy a person's RMD. For example, qualified charitable distributions ..
6. The IRS should expand its discussion of the rules applying to a Roth IRA beneficiary.
7. The IRS should scrap its proposed rules for determining when eligible rollover amounts must be

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CWF's Suggestions,
Continued from page 4

reduced by certain deemed RMDs. There is no good reason for such a confusing rule.

8. The regulations should furnish safe harbors for RMDs for 2021 and 2022. For example, one can rely on the IRS guidance set forth in the 2021 IRS Publication 590-8.
9. The applicability date of the new regulations should be delayed from 2022 to 2023.
10. With respect to rollovers, the regulation should discuss the fact that certain IRS levies are eligible to be rolled over.

11. With respect to rollovers, the IRS should adopt a simple rule. Any distribution made before December 31 of the deadline year is eligible to be rolled over. There is no good reason to define any distribution occurring during the final close-out year as being an RMD and ineligible to be rolled over. The beneficiary must still comply with the applicable RMD deadline of December 31.

12. The RMD regulations is modified to set forth express authority that a distribution which is a qualified charitable distribution is one which will satisfy a person's RMD requirement.

13. The rollover regulations should be expanded to discuss new Roth IRA conversion rules. RMDs are ineligible to be a converted. A Roth IRA conversion contribution is a type of rollover even though its format may either be a distribution rollover, internal transfer or an external transfer.

14. The rollover regulations should discuss in more detail the rules applying to direct rollovers. The rules should mandate that a person is entitled to at least two direct rollovers - one into a traditional IRA and one into a Roth IRA. Too many administrators cite the existing rule that a person is entitled to only one direct rollover. There should be a defined time period. For example, after 12 months a person should be entitled to another direct rollover.

New IRS Guidance on General Rollover Rules and Transfers

The IRS had <u>not</u> updated their regulation on direct rollovers and rollovers for some time. Code Section 402(c) had been revised numerous times because of law changes.

An RMD is ineligible to be rolled over and ineligible to be directly rolled over. Code section 402(c)(4)(B) provides that any distribution required by section 401 (a)(9)(an RMD) is excluded from the definition of an eligible rollover distribution.

An RMD with respect to an IRA is eligible to be transferred.

Thus, it is very important to determine what amount in any given year is an RMD because it is ineligible to be directly rolled over or rolled over. The IRS has proposed that there be new rules which complicate this RMD determination.

Code section 402(c)(11) as enacted in 2006 provides that a non-spouse beneficiary of a retirement plan who is a person does have the right to have portion of the distribution made in the form of a direct trustee to trustee transfer to an inherited IRA. Note the IRS does not use the term direct rollover. The IRS states that an RMD is ineligible to moved via a direct trustee to trustee transfer.

In determining whether a distribution to a beneficiary is an eligible rollover distribution, the portion of the distribution which is an RMD must be determined. In general the rules set forth in Notice 2077-07 will continue to apply, but they are expanded to cover spouses and non-spouse beneficiaries.,

The direct trustee to trustee transfer is treated as an eligible rollover distribution.

If the IRA owner dies before their RBD, there is no RMD for that year. So the entire amount may be directly rolled over. For subsequent years the rule to be used depends upon which rule applies to the beneficiary - the 5-year rule, the 10-year rule or the life distribution rule.

If the 5-year rule applies, then there is no RMD until

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Rollover Rules and Transfers,
Continued from page 5

that 5th year. That is there is no RMD for years 1-4. Thus a total rollover is permitted in years 1-4. No rollover is permitted in year 5 because the entire amount is an RMD.

If the 10-year rule applies, then there is no RMD until that 10th year. That is there is no RMD for years 1-9. Thus a total rollover is permitted in years 1-9. No rollover is permitted in year 10.

General Rollover Rules and RMD Rules Impacting Rollover Rules and Transfers.

A rollover has two transactions. First a distribution and then a rollover contribution into an eligible retirement plan within 60 days of the distribution. This rollover transaction is non-taxable as long as the recipient plan is not a Roth IRA. If the rollover is into a Roth IRA the distribution must be included in the person's income.

There are 3 types of rollover distributions: (1) a standard 60 day rollover; (2) a direct rollover or (3) a repayment that the law permits may be made well after the 60 day limit. In many instances the rollover contribution may be made by the tax filing deadline.

The IRS has proposed that the list of distributions which are ineligible to be rolled over be increased to include the following:

1. a deemed distribution of a collectible; and
2. similar items designated by the commissioner in revenue rulings, notices and other guidance.

The "similar items" is very broad and the IRS can define a transaction as being ineligible for rollover treatment. It appears the IRS wants to create rules so that a person who has a prohibited transaction would be ineligible to rollover that distribution.

Note that the IRS fails to discuss the new rollover rules that if the IRS wrongfully levies someone's IRA and has to repay the person, that person may rollover the repayment amount (levied amount plus statutory interest).

The IRS list of those distributions which would be ineligible to be rolled over is set forth below:

1. Any distribution which is one of a series of distributions for the !person's life expectancy, the person's joint life expectancy, or where the distribution period is 10 years or more.
2. an RMD
3. A hardship distribution
4. Return of an elective deferral because of section 415
5. corrective distributions of excess deferrals
6. corrective distributions of excess contributions (matching)
7. Loans treated as distributions
8. Dividends paid on employer securities
9. Current cost of life insurance (PS 58 costs from pension plan investment)
10. Prohibited allocations pursuant to section 409(p)
11. Distributions allowed to be withdrawn and returned under certain automatic contribution rules;
12. Certain distributions of premiums for accident or health insurance
13. a deemed distribution of a collectible; and
14. similar items designated by the commissioner in revenue rulings, notices and other guidance.

IRS Clarifications.

If a participant has established a distribution schedule which makes them ineligible to rollover any distribution, the beneficiary of that participant is also ineligible to rollover the remaining balance. This is true if the remaining distribution period would no less than the time period making one ineligible.

Multiple Designated Beneficiaries

The oldest beneficiary is the measuring life for purposes of determining the divisor when the life distribution rule applies. The oldest beneficiary is also the measuring life for purposes of determining when the inherited IRA must be closed. That is, by the end of the 10th calendar year following the death of the oldest beneficiary.

The IRS originally had used the description that the measuring life was the beneficiary with the shortest life expectancy. The IRS now uses the description, the oldest designated beneficiary.

There are, of course, some exceptions to this general rule. There are times when the measuring life is someone other than the oldest beneficiary.

There is an exception for a type II applicable multiple trust. This type of trust may have some beneficiaries who are disabled or chronically ill and others who are not disabled or chronically ill. The measuring life will be the oldest of the beneficiaries who are disabled or chronically ill. The other beneficiaries are not considered for purposes of determining who is the measuring life.

There is an exception when one or more minor children are a designated beneficiary as of the day the IRA owner died. Only those children who are minors are considered for purposes of determining the measuring life. The oldest minor child will be the measuring life. The non-minors are not considered for this purpose. The deadline will be: what is calendar year during which the following occurs - the date the oldest child will attain age 18 plus 10 years.

For a type II applicable multiple trust. This type of trust may have some beneficiaries who are disabled or chronically ill and others who are not disabled or chronically ill. The measuring life will be the oldest of the beneficiaries who are disabled or chronically ill. The other beneficiaries are not considered for purposes of determining who is the measuring life.

A Trust is the Beneficiary

There are different trust classifications - non-qualified, qualified, see-through, conduit, accumulation, type I applicable multi-beneficiary and type 2 applicable one which requires multi-beneficiary. The RMD rules which apply to a trust depend upon the trust's classification.

The existing trust rules in general are continued under the proposed regulations. There are two terms describing this trust - a qualified trust and a see-through trust. After the SECURE Act the main benefit of being a see-through trust is, it is able to use the 10 year rule rather than being forced to use the 5 year rule if the IRA owner dies before their required beginning date and the trust will be able to use the 10 year rule or the duals rules if the IRA owner dies on or after their required beginning date. .

Four requirements must be met to be a see-through trust:

1. The trust is valid under state law or would be but for the fact there is no corpus;
2. the trust is irrevocable or will by its terms become irrevocable upon the death of the IRA owner;
3. the beneficiaries of the trust who are beneficiaries with respect to the IRA funds are identifiable; and
4. the specified documentation requirements are satisfied.

The general rule is - a beneficiary of a see through trust is treated as a beneficiary of the IRA owner if the beneficiary is a primary beneficiary of the trust. That is, the beneficiary is entitled to receive amounts in the trust arising from the IRA and such amount is not contingent nor delayed until the death of another trust beneficiary who does not predecease the IRA owner or is not treated as having predeceased the IRA owner.

Whether any other beneficiary of that trust is treated as a beneficiary of the IRA owner, depends upon whether the trust is a conduit trust or an accumulation trust.

A conduit trust is one which requires that any IRA distribution to the trust will, upon receipt by the trustee, be paid directly to or for the benefit of certain beneficiaries. The conduit trust is not required to make an immediate total close-out distribution just because all of the trust's specified beneficiaries have died.

In the following situation the surviving spouse beneficiary is treated as the sole primary beneficiary. The IRA owner has designated a conduit trust as his or her beneficiary. The conduit trust requires all distributions from

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the IRA be immediately distributed to the surviving spouse. The surviving spouse is treated as the sole beneficiary because the spouse could receive amounts that are neither contingent upon nor delayed until the death of another beneficiary. Even if IRA funds have not been totally withdrawn from the IRA and paid to the trust prior to the death of the surviving spouse, the subsequent beneficiary is NOT treated as a beneficiary for RMD purposes.

If a subsequent beneficiary's interest is minimal or remote, that beneficiary is to be disregarded for RMD calculation purposes. A beneficiary is to be disregarded if the beneficiary could receive payments from the trust arising from the IRA only upon the death of another trust beneficiary whose sole benefit is a residual interest in the trust and that beneficiary did not predecease the IRA owner. For example, there are three beneficiaries - the surviving spouse, a brother of the IRA owner and a charity. The spouse is the primary beneficiary. The bother must survive the spouse and the IRA owner. The charity will only receive both the brother and the surviving spouse die after the IRA owner. The charity is disregarded for purposes of the RMD rules. However, if the brother could receive some amount, then the charity could not be disregarded for RMD purposes.

A residual beneficiary's interest may be disregarded for RMD purposes if the beneficiary' interest is minimal or remote. This will occur in the following situation. The trust requires a full distribution of the trust's IRA funds to a person by the later of: (1) the calendar year following the year the IRA owner died and (2) the end of the 10th calendar year following the calendar year in which that specified person attains age 21 , then any other beneficiary whose sole entitlement to distributions is conditioned on the first beneficiary dying before full distribution is required is disregarded. For example, the IRA owner has a trust beneficiary. The IRA owner's niece is the beneficiary of the trust. The trust is to terminate when the niece attains age 31 with a full distribution of all trust assets. However, should the niece die before the trust is fully distributed, then the remaining trust assets are to be paid to the IRA owner's sibling. The sibling can be disregarded for RMD purposes. Both the niece and sibling must be considered to be a beneficiary if any of the requirements are not met. For example, the full distribution is to take place when the niece is age 35 or there is not to be a full distribution.

An accumulation trust is a see-through trust which is not a conduit trust. The accumulation trust may have multiple beneficiaries who all must be considered in determining who is the oldest beneficiary. A beneficiary of an accumulation trust is treated as a beneficiary of the IRA owner if the beneficiary has a residual interest in that part of the trust entitled to the IRA funds.

The two applicable multi-beneficiary trusts - Type I and Type II.

An applicable multi-beneficiary trust is an EDB entitled to use the life distribution rule. A trust is an applicable multi-beneficiary trust if it has more than one beneficiary, at lease one beneficiary is disabled or chronically ill and all the beneficiaries are considered when determining the distribution period.

A type I multi-beneficiary trust is where the trust terms require upon the death of the IRA owner the trust to be immediately divided into separate trusts for each beneficiary.

A type II applicable multi-beneficiary trust is one which requires that all distributions must be limited and made to the beneficiaries who are disabled or chronically ill. Once all of these individuals have died, then the remaining funds may be made to the other trust beneficiaries.

Note that the separate accounting rules will apply to the separate trusts set up under a type I multi-beneficiary trust.

The Trust Beneficiaries To Receive the IRA Funds Must Be Identifiable.

The Trust Beneficiaries To Receive the IRA Funds Must Be Identifiable.

For RMD purposes the applicable distribution period will generally be determined by using the oldest designated beneficiary. There are, of course, exceptions. Who is considered when determining who is the oldest designated beneficiary?

Trust beneficiaries are identifiable with respect to an IRA owner if it is possible to identify each person who has been designated to receive a portion of the IRA funds through the trust. The IRA owner may define a class of persons to receive the IRA funds.

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The fact that the IRA owner has given a third party a power of appointment does not mean the identifiable requirement cannot be met. It can still be met. The power of appointment if exercised by the September 30 of the year following the year the IRA owner died means the new beneficiaries must be considered. A power of removal if exercised by the September 30 of the year following the year the IRA owner died means a removed beneficiary no longer would be considered. If the power of appointment/removal is not exercised then original beneficiaries must be considered.

If a beneficiary is added after September 30, the distribution period might have to change. A determination how and if the addition of the new beneficiary requires a change in the RMD distribution period must be made. If the addition of a certain beneficiary would require a full distribution by the trust, then the full distribution is not required until December 31 of the year following the addition of the beneficiary.

Example #1. The trust is an accumulation trust. The primary beneficiary of the trust is the spouse of the deceased IRA owner. The spouse has a power of appointment with respect to the portion of the IRA funds not distributed prior to his or her death. If the spouse fails to exercise the appointment by the applicable September 30, then those funds are to go to the IRA owner's child. In this situation both the spouse and the child are considered to determine the applicable RMD distribution period.

Example #2. Same as Example #1, except that after September 30, the spouse exercises her power of appointment and she designates her sibling to be the subsequent beneficiary. All three must be taken into account when applying the rules for multiple beneficiaries for each calendar year after the sibling is added as a beneficiary.

The fact that a see-through trust is modified after the IRA owner has died does not necessarily mean that the trust beneficiaries are not identifiable. If state law permits the trust terms may be modified after the grantor's death then there could be a change in beneficiaries of the trust. If the change is made by the following September 30, the change is effective whether the change is the addition of a new beneficiary or the removal of an existing beneficiary. If the change is not made by the following September 30, then the same rules applying to when a beneficiary is added pursuant to a power of appointment would apply to this situation.

Which Beneficiaries Are to be Considered For Purposes of the RMD Rules?

The general rule is - a beneficiary will be considered to be a beneficiary of the IRA owner if he or she is a beneficiary as of the IRA owner's date of death and remains a beneficiary as of September 30 of the year following the death of the IRA owner.

The following persons are defined to not be a qualifying beneficiary if any of the following events occur by September 30 of the year following the death of the IRA owner:

1. the beneficiary predeceased the IRA owner;
2. the beneficiary is considered to have died before the IRA owner because of a simultaneous death provision or the execution of a qualified disclaimer, or.
3. the beneficiary receives the entire benefit to which he or she is entitled.

What are the separate accounting requirements and why are they important?

The requirement that the oldest multiple beneficiary must be the measuring life does not apply when the separate account rules are met. A beneficiary is able to have a separate RMD calculation independent of the calculations for the other beneficiaries.

1. The separate inherited IRAs must be set up by December 31 of the year following the year of the IRA Owner;s death;
2. A separate RMD calculation for each beneficiary is permitted starting with the year after the separate inherited IRAs are established;
3. The general rule is that the separate accounting rules do not apply to a trust beneficiary. However, there are special rules for a type I applicable multi-beneficiary trust. First, there must be a separate accounting of post-death distributions to each applicable beneficiary. Second, there must be separate accounting for allocating post death investment gains and losses. There can be separate investments, but this is not required.

Discussion of Numerous Examples of the See-Through Trust Rules

Example #1. John Age 35 maintains a traditional IRA. John designated as his beneficiary a testamentary trust (T). This trust is a conduit trust and it directs that the IRA balance to be paid to the trust is to be paid to his sister, Sara, who is 5 years older. If Sara dies before the IRA funds are totally distributed to her, the remaining funds are to be paid to another sibling, Mary.

Discussion #1. Mary is disregarded in determining who is/are the beneficiary(ies) because her interest is remote. Sara as the 1003/o primary beneficiary is an eligible designated beneficiary as she is not more than years younger than John. She is able to use the life distribution rule. However, upon Sara's death the rule requiring the inherited IRA be closed no later than 10 years after the year in which Sara dies. If Sara would die the distribution period for the next beneficiary (Mary) is still based on Sara's distribution schedule and she would be subject to the 10 year rule.

Example #2. As discussed below CWF believes this example is incorrect and the IRS will need to correct its explanation.

Marla age 55 maintains a traditional IRA. She designated her IRA beneficiary to be her testamentary trust (Trust T). Trust T is a conduit trust and it directs that the IRA balance which is paid to Trust Twill be paid to her spouse B who is 5 years younger as follows. The residual beneficiary of Trust T is a sibling of Marla. This sibling is age 48. If the sibling predeceases spouse B, then upon spouse B's death any remaining trust funds are to be distributed to Charity Z.

All trust income is payable annually to spouse B. Under the terms of the trust B the trustee must withdraw from the inherited IRA the greater of the RMD or the amount of the income earned for that year and pay that amount to spouse B. Under the terms of the Trust T spouse B has the power to annually compel the trustee to withdraw from the inherited IRA an amount equal to the income earned by the IRA assets and distribute that amount through Trust T to spouse B.

This trust is a see-through trust or qualified trust even though it is not a conduit trust requiring that 100% of the amount withdrawn from the inherited IRA be paid to spouse B. Spouse B is guaranteed only to receive the greater of the RMD or the amount of the income earned for that year.

For purposes of the RMD rules who must be considered for RMD calculation purposes? Spouse B and Marla's sibling must be considered. Charity Z is disregarded as a beneficiary because its interest is remote.

The IRS believes this trust is entitled to use the life distribution rule with the measuring life being spouse Bas oldest of these beneficiaries. Consequently annual distributions must commence the following year.

Note that in this example, both beneficiaries of Trust Tare EDB beneficiaries. And it appears their EDB status is allowed to continue within Trust T. The IRS cites no authority for this position.

We at CWF believe the 10 year applies in this situation because the IRA owner dies before their required beginning date and Trust T is not an EDB trust.

Example #3. The same facts as set forth in Example 2, except Marla's sibling is more than 10 year younger than Marla, the IRA owner. This means then that Trust T has at least one beneficiary which is not an EDB so the 10 year rule will apply. The life distribution rule may not be used or elected.

Example #4. Mario age 62 maintains a traditional IRA. He designated his IRA beneficiary to be his testamentary trust (Trust S). Trust S directs that all trust income is payable to Spouse K. Spouse K has a power of appointment to name the residual beneficiaries of Trust S. If Spouse K fails to exercise this power of appointment then Mario's descendants are entitled to the remainder interest per stirpes.

Mario dies. He has two children. Neither is disabled or chronically. Both are older than age 21.

Before September 30 of the following year, Spouse K irrevocably restricts this power of appointment so that only her two siblings may be the residuary beneficiaries of Trust S. These siblings of Spouse K are not more than 10 years younger than Mario and thus are EDBs. Spouse K is the oldest of the three beneficiaries.

For purposes of applying the RMD rules, Spouse K and the siblings of spouse Kare the beneficiaries which

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must be considered. The oldest beneficiary will be the measuring life. Because they are all EDBs the life distribution rule may be used. Upon the death of the oldest beneficiary, the 10 year rule applies.

Example #5. The same facts as set forth in Example 4, except Spouse K does not exercise her power of appointment/restriction.

For purposes of the RMD rules, who must be considered for RMD calculation purposes? Spouse K and the two children of Mario must be considered. Because there is a beneficiary who is not an EDB, the trust must use the 10 year rule. The life distribution rule may not be elected using the age Spouse K.

Email Guidance – Should a Married Couple Have 2 HSAs or Just 1 HSA?

Q-1. I have a question on health savings... one of our branches has a customer who currently is set up as having a Health Savings that is Family eligible (our system has a product code for Individual and family) Her kids are going off her health savings plan but going to another plan that is also a high deductible health plan. I am uncertain but believe they are going on a plan with her spouse.

So, would it be necessary for us to make any changes on her HSA account? They as a family would be eligible for the larger contribution amount but since they are not technically on her plan, can she continue to have the family type account we have established?

A-1. The amount which she is eligible to contribute to her HSA depends upon whether the HDHP plan covering her is a single HDHP plan or a Family HDHP. Family coverage means the plan covers two or more persons. I don't believe you are required to make any changes on the HSA account. Remember an HSA like and IRA is an individual account. There never can be two "owners."

Is she switching the HDHP coverage from Family to Single?

If so, then the amount she can contribute is reduced accordingly.

If not, she could continue to make her contribution based on the family coverage.

It does not matter how you have it coded on your computer system. You must check with your core vendor, but I think the intent of having the two product codes is so the bank can monitor the two contribution limits. Technically the bank only needs to monitor the Family limit.

Q-1A. Yes she is actually going from HDHP to just her. But the kids have a separate insurance policy that is also a HDHP.

A-1A. Then the maximum amount she may contribute will decrease.

If she is not 55 or older then her maximum contribution amount for 2022 will be:

months with family coverage/ 12 x $7300 =

plus

months with single coverage/ 12 x $3650 =

Total =

If she is age 55 or older, the $3650 changes to $4650 and the $7300 changes to $8300.

Q-1B. Okay that makes sense. If the dad and kids are on the same plan and it is HDHP -would he be able to open a health savings and use the family contribution?

If that would be the case are they still held to the one maximum family contribution total if she has her single health coverage and he has family coverage?

A-1B. I know it is dangerous to talk politics, but HSAs and IRAs are political creations since they exist because of the federal income tax laws. Sometimes the law benefits a married person (beneficiary rules) and sometimes being married "hurts" a married person.

A married couple is limited under the law (HSAs) to one family contribution limit. They don't get two even if covered under two different family plans. And if one is covered under a family plan and the other is covered by a single plan they are still limited to the one family contribution limit. This is because they are married.

In your situation if the two individuals were not married, then he could make a family contribution and she could contribute the single amount. But because they are married they are limited to one family contribution amount and the law assumes they will split it equally, but that is not required.

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Married Couple,
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Q1-C. In your opinion- would you think it is necessary then for him to open a Health Savings Account? The mom currently has one open but only is her on the insurance... since they truly are eligible to do the family contribution amount would it be okay for her to do that to her HSA you think?

A1-C. Will his employer being making any contributions? They should have two HSAs. Two reasons.

1. If the employer will make a contribution, it is best if he have an HSA to receive his employer's contribution.
2. They are authorized to split the family limit between the two of them. But because she has single coverage for most of the year she would not be eligible to put the full family amount in her HSA. She is still subject to her limit because has single coverage.

Q-1D. No, the employer is not contributing. I figured it would be better if we did have him open one even though the contribution result will be the same.

A-1D. I'm being technical but the contribution result will not be the same. She is not entitled to contribute the family limit of $7300. He is because he has family coverage, but she is ineligible to contribute the $7300 because she does not have family coverage for all 12 months or on December 1.

Email Guidance – Correcting an Excess HSA Contribution for 2021/2022

Q-1. I have a customer that contributed too much to his HSA. He contributed 4044.00 and should have only contributed 3600.00. He withdrew 444.20 from his HSA in February to correct the amount that he over contributed.

I correct the 2022 5498SA to show 3600.00 correct?

I understand how to correct the distribution and how to code it on the 1099SA. Will this result in 2 different 1099SA's if he also has distributions next year since there will be two different distribution codes?

A-1. I'm not totally understanding and I may need more information.

Was the contribution for 2021 or 2022?

I'm thinking 2021 because you state the maximum amount was $3600. Was the $4044 contributed in 2021 for 2021.His excess amount was $444.00

When his 2021 Form 5498 is prepared the amount of $4044 is to be reported in box 2 of the 2021 Form 5498-SA. You do not lower the contribution amount because he has withdrawn the excess amount.

You will report his withdrawal of the $444.20 on his 2022 Form 1099-SA. Box 1 is completed with $444.20; box 2 is completed with .20 and the reason code is a 2.

He should explain on the proper Form 8889 that he corrected an excess contribution by withdrawing it.

A person will have 2 1099-SA forms - one for regular distributions and one for withdrawing the excess.

Email Guidance – IRS Reporting for Escheating an HSA

Q-1. We have an HSA account that is due to be escheated. Can you please tell me is there a special retirement category that we need to use for escheatments and/or should we even be escheating an HSA?

A-1. There are no special rules for HSAs as there is for IRAs. There is no rule requiring the escheatment must occur after age 72. With IRAs there is a withholding concern for the IRS. That concern does not apply for HSAs.

In general, you escheat an HSA in the same manner you escheat an IRA Although you send the funds to the State of Michigan, the bank.will prepare a Form 1099-SA to report the distribution to the person.

The bank may wish to expend some additional effort in trying to locate the person because the person will have to include the distribution in their income and they will owe the 20% penalty tax because the withdrawal was not used to pay a medical expense.