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ALSO IN THIS ISSUE –

How Will the New Proposed IRA/401(k) Changes be Paid?, *Page 2*

New Proposed IRA Law Changes, *Page 2*

New Proposed 401(k) and Other Pension Law Changes, *Page 5*

Email Guidance – Making an HSA Qualified Funding Contribution, *Page 7*

Email Guidance – Two RMD Situations, *Page 7*

Email Guidance – Inherited IRAs for a Non-Spouse Beneficiary, *Page 8*

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7:45 am to 3:45 pm

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

Unclaimed Property Laws and IRAs, Including Inherited IRAs

An IRA custodian/trustee is required to remit unclaimed IRA funds to the proper state division or department when there has been no contact or activity by the IRA owner or beneficiary during the dormancy time period. This includes inherited IRA funds.

You must determine what is the dormancy time period applying to IRAs in your state. Many states have adopted a three (3) year period.

The concept applying to IRAs in most states - when does the IRA plan agreement require that a distribution be made to the IRA owner or the IRA beneficiary. The dormancy period commences on that date.

For example an IRA owner who attains age 72 on August 1, 2022 has a required beginning date of April 1, 2023. That is when his or her 3-year dormancy period commences (starts to run). If the IRA owner attained age on September 1, 2019, then his or her required beginning date was April 1, 2020 and that is when the 3-year dormancy period started to run.

The determination of the dormancy period for an IRA beneficiary is more complicated. It depends upon determining when must that beneficiary take their first distribution in order to comply with the RMD beneficiary rules.

Deadlines for Inherited IRAs

A determination must be made for the various beneficiary situations - what is the date when the beneficiary must take their first RMD?

Situation #1. The IRA owner died in 2022 before his or her required beginning date.

1. Certain beneficiaries must use the 5-year rule. The RMD deadline is 12/31/2027. The 3-year period commences on 1/1/2028.

2. Certain beneficiaries (non-EDB) must use the 10-year rule. The deadline is 12/31/2032. The 3-year period commences on 1/1/2033.

3. Certain non-spouse beneficiaries and spouse beneficiaries who are not the sole beneficiary but who are an EDB must commence there annual distributions by 12/31/2023. The 3-year period commences on 1/1/2024.

4. A spouse beneficiary who is the sole beneficiary is not required to commence distribution until December 31 of the year the deceased spouse would have attained age 72.

Situation #2. The IRA owner died in 2022 on or after his or her required beginning date.

This situation is where the IRS has proposed that a non-EDB must comply with annual distribution rule and the 10-year rule. This means a beneficiary must use the life distribution rule commencing on 12/31/2023. The 3-year period commences on 1/1/2024.

Situation #3, The IRA Owner Died Before January 1, 2020.

For each beneficiary you must determine when that beneficiary had to be distributed their first distribution from the inherited IRA. The dormancy period commences on such date.

How Will the New Proposed IRA/401(k) Changes be Paid?

There has been little if any discussion in the general media how these tax law changes would be paid. The concept is - if there will be less tax revenues collected because the elective deferral limit will be increased then that loss of revenue must be covered by increased revenues from some other source transaction.

There are two main sources of additional revenue.

1. The amount a person may claim as a disaster distribution would be reduced from $100,000 to $22,000.
2. Require that a person's catch-up contributions no longer may be a standard deferral lowering taxable income, but must go into a Designated Roth account.

Those individuals age 50 and older, who are presently making catch-up contributions are going to be surprised and disappointed to learn that they no longer can reduce their taxable income by the amount of their catch-up contribution.

Make an Extra Effort To Locate a Missing IRA Beneficiary. Why?

A non-spouse beneficiary has no rollover rights. If a IRA custodian/trustee remits the IRA funds of a person age 72 or older to a state's unclaimed property division that person most likely will be able to use the IRS approved late certification procedure to make a late rollover contribution. Since a non-spouse beneficiary has no rollover rights the late rollover procedure is unavailable to a beneficiary. The beneficiary will be required to include the distribution in their income. An IRA custodian/trustee should expend effort in trying to locate a beneficiary before it sends the beneficiary's inherited IRA funds to the state's unclaimed property division.

New Proposed IRA Law Changes

In June of 2022 the Senate Finance Committee approved proposed tax legislation with the title, "Enhancing American Retirement Now (EARN) Act." The vote in the committee was unanimous. If approved by the entire Senate it will need to be reconciled with the proposed legislation as approved by the House of Representatives.

The following law changes would become law.

1. RMD age will increase to age 75 from age 72.
2. Reduce the 50% Tax. Under the proposed law the tax rate would either be 25% or 10%. The 10% tax rate would apply if the excess accumulation is corrected within two years of the excess accumulation (missed RMD).
3. Index the $1,000 IRA catch-up for Inflation. A person eligible to make an IRA contribution who is age 50 or older is permitted to make an additional $1,000 contribution. This contribution is called a catch-up contribution. Under current law this $1,000 has not been indexed to increase on account of inflation. It would be indexed.

   CWF Comment. It is about time the $1,000 limit is indexed since the initial 401(k) catch-up amount of $1,000 has increased to $6,500.

   The $6,000 limit was initially indexed to increase at the same rate as other tax limits. A few years ago the law was changed so the $6,000 limit increases at a much slower rate. The $6,000 limit should be adjusted at the same rate the 401(k) limits are adjusted.
4. Additional exceptions to the 10% additional tax.

   The concept of current law is - a person should not be withdrawing these funds prior to age 59½ because these are retirement funds. But there are now many exceptions when the law permits a person to withdraw the funds and pay tax on the amount withdrawn even though not used for retirement, but the 10% tax is not assessed. The proposal is to create new exceptions for additional worthy causes.

Continued on page 3

New Proposed Law Changes,
Continued from page 2

A. An exception for a terminal Illness.

B. An exception for domestic abuse. There would be a limit of $10,000 or 50% of the account balance if the account balance was less than $20,000. Such a withdrawal could be rolled over under special rollover rules.

C. An exception for withdrawing IRA funds to be used to pay an "emergency expense". An emergency expense is an expenses which is unforeseeable or one which creates an immediate financial need. Special rules would apply. The person would be limited to withdrawing one distribution of $1,000 or less per year. The person would be able to repay the distribution within a 3-year time period.

D. An exception for withdrawing the income related to an excess IRA contribution.

E. A clarification that the waiver of the 10% tax for a distribution which is a substantially equal periodic payment applies when that account is rolled over, there is an exchange of an annuity or the annuity satisfies the RMD rules.

F. An IRA owner would be authorized to withdraw $2500 to pay premiums related to a qualifying long-term care insurance contract and the 10% additional tax will not be owed. The long term contract is one that will provide meaningful financial assistance if the IRA owner need home based assistance or nursing home care.

5. The Saver's Tax Credit would be changed. This credit is available to individuals who don't have high incomes. The applicable income limit would be raised to make more persons eligible to claim this credit.

   Currently there are three qualifying credit rates: 10%, 20% and 50%. The new law would phase out the 50% rate over the various income ranges.

   The other main change is - rather than being a credit which is used to lower a person's tax liability, the credit amount would be required to be deposited into the person's IRA.

6. A SEP-IRA for nannies and other domestic employees. Under current law most any business in the U.S., may establish a SEP-IRA retirement program. There must be a business. There is no business when a person or a family hires a domestic employee. The law requires that social security taxes are owed on the income paid to a domestic worker.

   This change would permit the person who has hired the nanny to set-up an SEP-IRA for the nanny.

   CWF Comment. This change is not needed. It is designed to give the person doing the hiring an additional benefit so it would be more likely the nanny would go to work for this person. Current law authorizes a nanny as a self-employed person to establish a SEP-IRA

7. An Employer Would be Authorized to Make Additional SIMPLE-IRA Contributions.

   An employer which presently sponsors a SIMPLE-IRA program is restricted in the amount of contributions which it can make. Most employers like the fact that the amount they are required to contribute is limited. It is the employees who make most of the contributions by making elective deferrals. The employer in general is limited to contributing either 2% of the employees' compensation or making a matching contribution of 3% of the amount deferred. Some employers would like to make an additional "profit sharing" contribution like is done under a profit sharing plan or a 401(k) profit sharing plan. The proposal would be to allow an employer to make an additional contribution for employees equal to the lesser of $5,000 or 10% of compensation.

8. Increase in the Catch-Up Amount for Certain SIMPLE-IRA Participants Age 60 -63.

   Current law authorizes a SIMPLE-IRA participant age 50 or older to increase their elective deferral by $3,000. The proposal is to increase this limit to $5,000.

9. Two QCD (Qualified Charitable Distribution) Changes.

Continued on page 4

New Proposed Law Changes,
Continued from page 3

Current law provides that an IRA owner age 70½ or older may annually make a QCD to the extent of $100,000. This would be indexed for inflation.

The second change is - the IRA owner rather than being required to have the IRA funds given to a charity would once in their lifetime be able to give $50,000 to charities through charitable gift annuities, charitable remainder unitrusts and charitable remainder annuity trusts.

10. A Major Change in the Disaster Relief Laws.

Current law permits a person to withdraw $100,000 on account of a federally declared disaster. This $100,000 limit would be reduced to $22,000.

Three of the current benefits would not be changed - 10% additional tax is not owed, may spread the distribution over 3 years for tax purposes and the person is allowed to repay the amount over 3 years.

The laws applying to loans from 401(k) plans would be changed to increase the permissible loan amount on account of a disaster and the repayment period could be longer than 5 years.

11. IRS is instructed it Must Expand EPCRS in two ways.

Under current law the IRS permits employer sponsored plans to correct tax qualification situations. In many situations an employer must pay the IRS a fee to retain its tax qualified status.

A. An employer which has made an inadvertent mistake (i.e one which is not an egregious mistake) would be permitted to self-correct it without paying the IRS and fee or penalty. The IRS would need to issue additional guidance.

B. This revised procedure would be expanded to cover various IRA failures.

12. 3-Year Repayment Period to apply to a qualified birth or adoption distribution.

The law has a 1-year period for certain distributions which the recipient repays. The SECURE Act did not define a time period when such a distribution was to be repaid. Most people assumed it would the 1-year rule. It will be 3 years under this proposal.

13. QLAC Changes - Good for the Insurance Companies, But Bad for Banks.

The insurance industry does a better job lobbying Congress than the banking industry. The proposed QLAC changes support this statement.

The amount in a QLAC is excluded from the RMD calculation until the person reaches age 85. Under current law there is a limit on the amount of premiums to be for the QLAC. The limit for 2022 is $135,000. The person also may not have more than 25% of their retirement plan assets invested in QLAC(s).

The proposal is to allow 100% of a person's retirement plan assets be invested in QLAC(s) and to increase the limit to $200,000. One would think that the banking industry would be smart enough to understand this change will hurt banks greatly. An IRA owner by moving 100% of their IRA funds into a QLAC can eliminate their RMD requirement until the year one attains age 85.

14. Increase in contribution limit for SIMPLE-IRAs.

Current limit is $14,000 if you are under age 50 and $17,000 if you are age 50 or older.

New proposed limit is $16,500 if you are under age 50 and $21,250 if you are age 50 or older. The catch-up amount is increased to $4,750 from $3000. However for these higher limits to apply the employer's match must be 4% of compensation rather than 3%.

15. "Radical" SEP and SIMPLE-IRA Proposed Changes - New Roth-SEP and Roth-SIMPLE Accounts.

A participant of a SEP-IRA or a SIMPLE-IRA plan would have right to instruct the employer/plan administrator that their elective deferral was to be treated as a special Roth IRA contribution or their employer's SEP contribution as special Roth IRA contributions.

This change is considered to raise revenue because the current tax revenues increase because the individual's taxable income is not decreased because of the SEP-IRA and SIMPLE-IRA contributions. The Senate needs to explain how this change would impact SEP-IRA contributions as the employer presumably expects to be able to a claim a tax deduction for its contribution.

New Proposed 401(k) and Other Pension Law Changes

In June of 2022 the Senate Finance Committee approved proposed tax legislation with the title, "Enhancing American Retirement Now (EARN) Act." The vote in the committee was unanimous. If approved by the entire Senate it will need to be reconciled with the proposed legislation as approved by the House of Representatives.

The following law changes would become law. We also offer our comments about these proposed changes. Unless indicated otherwise these changes would be effective for after 2023.

1. Major change #1. All catch-up contributions must go into a designated Roth account.

   Under current law a 401(k) plan is not required to authorize that a participant may make a Designated Roth contribution. This proposal would require that every 401(k) plan must allow for designated Roth accounts.

   Under current law a catch-up elective deferral may go into either a standard 401(k) account or a Designated Roth account. The proposal would require that all catch-up contributions must go into a Designated Roth account.

   This change is a revenue raiser since individuals are required to include in their income the catch-up amount since they are not able to invest it in a standard 401(k) account.

2. Major Change #2 participants would have the right to elect to have any employer matching contribution or other type of employer contribution be treated as designated Roth contributions.

   Under current law a 401(k) plan is not required to authorize that a participant may make a Designated Roth contribution. This proposal would require that every 401(k) plan must allow for designated Roth accounts.

   The proposal would give each participant the right to have some or all employer contributions made into a Designated Roth account.

   This change is a revenue raiser since individuals are required to include in their income the catch-up amount since they are not able to invest it in a standard 401(k) account.

3. Extended deadline to establish and fund a new 401(k) Plan for a self-employed person.

   Under current loan a person can not make an elective deferral with respect to income already earned. In general a self employed person had to complete their elective deferral by January 31 of the following year. This proposal would allow the self-employed person to establish a new 401(k) plan and make their contribution(s) by its tax return due date including a tax extension.

4. 401(k) change for certain part-time employees. Commencing in 2024, the SECURE Act requires a 401(k) to cover part-time employees who have worked at least 500 hours in the preceding 3 years. Such part-time employees are eligible to make elective deferrals. An employer may, but is not required to make a matching contribution for these part-time employees or to allocate to them a standard profit sharing contribution. The proposed law change is that only 2 years be required.

5. Authorization to automatically rollover certain default IRAs.

   Under current law an employer may close a person's 401(k) balance if it is less than $5,000. If the person fails to voluntarily close their 401(k) balance, then the plan administrator is required to establish a default IRA. Normally there will be a third party service provider with respect to these defaulted IRAs. The proposal is to allow the service provider to automatically rollover the defaulted IRA into a person's new employer's 401(k) plan.

6. The following IRA changes also applying to 401(k) participants

   A EPERS

   B. RMD Age Will Increase to age 75 from age 72.

   C. Reduce the 50% Tax.

   D. Changes in the Disaster Relief Laws.

   E. Saver's Tax Credit Changes -Applying to Those Who Make Elective Deferrals

Continued on page 6

New Proposed Pension Law Changes,
Continued from page 5

F. Increase in the Catch-Up Amount for Certain 401(k) Participants Age 60 -63.

G. Most of the new exceptions to the 10% tax.

7. Paying a small bonus so a person will participate in a 401(k) Plan

   Under current law this is prohibited. It would be permitted as long as the payment was small. The IRS will need to define.

8. An employer would be able to rely on a participant's hardship certification unless the plan had some knowledge the hardship conditions were not satisfied.

9. New Method 401(k) Default Enrollment and being deemed to have passed nondiscrimination testing.

   A plan is deemed to have met the nondiscrimination rules if it has default participation provisions. That is. A participation will be enrolled to commence deferrals unless he oe she expressly opt out.

   Default contributions must be at least 6% in the first year and then increase by 1% per year until reaching 10%. The employer would be required to make matching contributions of 100% of the first 2% of elective deferrals, 50% of the next 4% and 20% of the next 4%. So, if a participant deferred 10% then the employer's matching contribution must be 4.8%.

   Under current law, default contributions must be at least 3% in the first year and then increase by 1% per year until reaching 6%. The employer has two choices with respect to its contributions. It can make a matching contribution to those who make elective deferrals. It would be required to make matching contributions of 100% of the first 1% of elective deferrals, 50% of the next 5%. Or, an employer nonelective contribution of 3% of compensation for all participants.

10. The IRS is to issue additional guidance on rollovers. The IRS would need to furnish sample forms.

11. IRS to maintain a data base and assist with missing plan participants and to establish default IRAs for IRAs with a balance less than $1,000.

    The purpose of the data base is not meant to primarily help plan sponsors, but it is to be used by participants and beneficiaries in recovering lost or unknown plan benefits. When a participant has a vested balance less than $1,000 and fails to withdraw his or her balance then the plan administrator is to send those funds to the US Treasury. It would be treated as if it was an IRA because the US Treasury is not going to establish an IRA.

12. New rules regarding retirement plan overpayments.

    Under current law the retirement plan is almost always required to recover the overpayment. The law would be clarified to make clear in what situations will it be permissible for the plan not to seek to recover the mistaken payment. And the law would be clarified to make clear in what situations the recipient is still eligible to rollover the overpayment or the mistaken distribution and it will be permissible for the plan not to seek to recover the mistaken payment.

13. Repeal Law Requiring RMDs With Respect to Designated Roth Accounts.

    The RMD rules applying to 401(k) plans does require there be an RMD with respect to Designated Roth Funds. Such a rule does not apply to Roth IRAs while the Roth IRA owner is alive.

14. A special RMD rule would apply to a surviving spouse.

    A surviving spouse for purposes of the RMD rules would permit the surviving spouse to elect to be treated as the deceased employee. The IRS will need to clarify.

15. Special rule for certain school loan payments. A 401(k) plan could be written so that a participant who makes a student loan payment is treated as having making an elective deferral so that the employer must then make a matching contribution if such employer was otherwise making such matching contributions. In effect, the person is given credit for making an elective deferral even though they made no elective deferral.

Email Guidance – Making an HSA Qualified Funding Contribution

Q-1. If a person wants to convert their one time opportunity of funds from an IRA to a Health Savings - would they be eligible for 100% of their contribution limit for the year regardless of when they became eligible for a Health Savings Account or will it be prorated?

He is eligible for an HSA March 1st of this year and is eligible for the catch up contribution amount as well.

A-1. I understand the rule to be - the person is able to move IRA funds to their HSA to the extent the person is eligible to make an HSA contribution for 2022. So the person will need to decide - will he use the pro-rate rule to determine his maximum contribution amount or will he use the last month rule? Note I'm assuming neither he nor his employer made a 2022 contribution prior to his making this contribution with his IRA funds.

Under the pro-rate rule he could contribute 10/12 of the single limit for 2022 ($3,650 + $1,000) or $3,875 or 10/12 of the family limit ($7,300 + $1,000) or $6,916.67, as applicable.

Under the last month rule he could contribute 100% of the single limit for 2022 ($3,650 + $1,000 or $4,650 or 100% of the family limit ($7,300 +$1,000) or $8,300, as applicable. If he would elect to use the last month rule he must maintain HDHP coverage life until 12/31/2023 or he will incur the tax penalties.

She may contribute $1,000 to her HSA. The $1,000 most likely will come from their joint checking account. The $1,000 being contributed to her HSA cannot come from his IRA on a tax preferred basis.

Q-1A. Okay - so I got a few more details... he and his wife are both on the HDHP - he is 55 and she is a little older - no medicare - would we be better to pro-rate it you think or do the last month rule? If they would each open an individual Health Savings can he do a move to both his and hers to get that extra 1,000 catch up? Or would that not be allowed and he would be better off doing one HSA and doing the max plus the one 1,000 catch up?

A-1A. If they are fairly confident that they will maintain the HDHP coverage until at least 12/31/2023, then they should use the last month rule for 2022. Their combined maximum contribution is $9,300 ($7,300 +$1,000 + $1,000).

If he would put $8,300 into his HSA, then she could put $1,000 into hers.

He would move the $8,300 from his IRA.

Q-1B. And these do not have any influence on their normal contributions for the year or is it one or the other?

A-1B. This IRA-to HSA contribution is considered to be an annual HSA contribution and is reported as an annual contribution in box 2 of the Form 5498-SA. A person's limit is as discussed. One does not get two contributions.

If either an employer or the individual has already made a partial HSA contribution this would reduce the amount the person may move from the IRA.

Email Guidance – Two RMD Situations

Q-1. We have a customer who is turning 72 this year. He currently has an Inherited IRA here for his deceased mother which he takes RMDs out of. Now, he needs to take his RMD. He is wanting to take his RMD amount out of his mother's Inherited IRA balance first, instead of his own IRA with us. Can that be done? It this a sort of alternative method and more a reporting issue with his tax preparer.

A-1. The IRS has a special rule allowing a person to aggregate RMDs from like-kind IRAs. A personal IRA and an inherited IRA are not like-kind IRAs for purposes of the RMD rules.

He must take his 2022 RMD from the inherited IRA by 12/31/2022.

He must take his 2022 RMD from his IRA and his deadline is 4/1/2023 because 2022 is his first RMD year.

He cannot satisfy his personal RMD by taking it from his inherited IRA or vice versa.

Two RMD Situations,
Continued from page 7

Q-2. I wanted to confirm that the federal and state tax withholding as part of an IRA distribution counts toward the RMD amount that is required to be distributed within the year?

An example would be if the RMD was $250,000 and we distributed $200,000 directly to the client but had $50,000 in tax withholding. Would this satisfy the IRS's RMD requirement? I believe that answer to be yes but was just looking for a confirmation.

A-2. Yes. I confirm. The individual is treated as having received any amount withheld for federal or state income tax purposes.

Email Guidance – Inherited IRAs for a Non-Spouse Beneficiary

An Immediate Lump Sum Distribution is Wanted

Q-1. I know we have discussed this topic before, but I have a couple of questions and would appreciate a refresher as I think I am confusing myself. "

The scenario is a parent passes away and has their 3 children as beneficiaries on the traditional IRA. The beneficiaries choose to each take their portion in money orders rather than keep the inherited IRA.

We discussed in the past not having to open an IRA for each of the beneficiaries if they were just going to close them out right away, but to code the final distribution from the mother's IRA as a death distribution. Is this still correct?

By coding the transaction this way and not opening up IRAs for the beneficiaries how does it get reported to the IRS they have inherited this money?

I believe we are missing a step, talking in circles, or just confused and would appreciate any assistance you can give.

A-1. The Form 1099-R must be prepared for any person who withdraws money from an IRA.

So, an IRA custodian is not required to set-up inherited IRAs. for the 3 children, but each child must receive a Form 1099-R for the amount he or she received.

Consequently, most banks set up the inherited IRA just so they can get the form 1099-R in the name of the beneficiary.

A Form 1099-R is <u>not</u> to be prepared for the deceased parent unless there was distribution prior to his/her dying.

The general tax rule, a beneficiary must include the withdrawn amount in their income and pay tax on it unless there would be basis within the IRA.

Remember, a non-spouse beneficiary has no rollover rights. So once a beneficiary receives the check it will be taxable.

Be Helpful by Transferring the Inherited IRA

Q-2. I have a customer who will be inheriting his mother's IRA as she recently passed away. He lives out of the area. He was wondering if it's possible to transfer the inherited IRA to his banking institution?

We have always had the customer "keep" their IRA with us or close it. I've never been asked about transferring. My gut says "no", but I thought I'd double check!

A-2. Your institution should assist this beneficiary with transferring the inherited IRA See our Form 56i.

A non-spouse beneficiary is ineligible to take a distribution and then make a rollover contribution. So, we suggest never distribute inherited funds to a non-spouse beneficiary unless the beneficiary acknowledges they have no rollovers rights. The distribution is taxable.

Keep your life simple. Your institution can transfer the entire amount and then he can handle the RMD topic with the successor IRA custodian.

If First State Bank was the successor IRA custodian, you would make the check payable to First State Bank, fbo John Doe as beneficiary of Mom's name IRA.