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ALSO IN THIS ISSUE –

UBIT - IRA Duties, *Page 2*

Important Form 1099-R Rules for
an IRA Custodian to Follow and
Observations, *Page 3*

Reporting Roth IRA Distributions
on the 2022 Form 1099-R, *Page 4*

Completing the 2022 Form
1099-Q (Payments for a
Coverdell -ESA, *Page 7*

Email Guidance – Correcting
Excess HSA Contributions, *Page 9*

IRS Penalty Relief for Taxpayers
Filing Form 1099-R for 2019 and
2020, *Page 10*

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The IRS Admits to be Making a Mistake Affecting IRAs

On page 2 there is an ARTICLE discussing the IRA Custodian's/Trustee's duty to file Form 990-T when applicable. The IRS posted on its website certain information from the completed forms for 120,000 IRAs.

Form 990-T is titled, Exempt Organization Business Income Tax Return. That is, this form is the tax return for the applicable tax exempt entity. An IRA is one type of tax exempt/deferred entity. Most IRAs do not owe current income tax. Some do owe current income tax.

Any tax exempt entity, including an IRA which is operating an active business (e.g. flipping real estate) is required to pay income taxes as a normal business must.

There is a second purpose to filing Form 990-T. An IRA which has invested in a RIC (regulated investment company/mutual fund) has the right to file this form requesting a refund of the applicable portion of income tax which has been paid by the IRA by the RIC on undistributed long term capital gains. The RIC pays income tax on the total undistributed long term capital gains but since an IRA is a tax deferred entity, it does not owe the tax. The refund must be requested by the IRA custodian/trustee from the IRS. Some/many IRA custodians/trustees on behalf of the IRA owners do not request the refund from the IRS.

In general, most tax return information of individuals, corporations and tax

exempt organizations is not to be available to the general public. This rule is supposed to be sacrosanct. There are to be few exceptions.

One exception is - although certain information about a charity is to be open to the public, other information (size of gross income and net income) are not to be disclosed.

The IRS explanation for why the error occurred - our personnel “coded” it incorrectly.

The confidential tax information made available - name of the taxpayer (e.g. First Federal Bank as custodian/trustee IRA fbo Jane Doe), contact information and basic tax return information.

An IRS representative has stated that the incorrect files were quickly removed from the website. and that they will be replaced with the correct files in the near future.

The reality is - the IRS is starting to have problems with the intentional leaking of certain tax return information and the IRS is having an increase in human errors. This was most likely a case of human error, but one tends to think less of the IRS when such errors are made.

UBIT - IRA Duties

UBIT is the acronym for unrelated business income tax. An IRA trustee of a trust IRA or an IRA custodian of a self-directed IRA has the responsibility to determine if the IRA is required to file Form 990-T and pay any applicable tax liability. The title of Form 990-T is Exempt Organization Business Income Tax Return (and proxy tax under section 6033(e)).

If an IRA holds certain IRA investments and has related income of \$1,000 or more from such investments, then there is a duty to file the Form 1099-T. The fact the Form 990-T must be filed does not necessarily mean there is a tax liability. There is a tax liability only if there is taxable income from the business activity.

Code sections 511-514 (the unrelated business taxable income tax rules) were enacted in 1950 long before the IRA tax laws were enacted in 1974. The IRA laws did not set forth any discussion how the unrelated business income tax laws applied to IRAs, if at all. Therefore, the IRS adopted an administrative position to explain how the two laws interrelated. The IRS ruled there are times when an IRA or a 401(k) plan will be subject to the unrelated business income tax laws. In general, if the IRA investment is a passive investment such laws do not apply. However, if the IRA investment is an operating business or there is debt financing such laws will apply and the IRA must pay taxes on this businesses' taxable income.

With the growth in self-directed IRAs and hard to value IRAs more questions are arising regarding the unrelated business income rules. The IRS, of course, is always looking for tax areas where it can collect additional income tax revenue.

It is the IRA trustee who must decide if an IRA has unrelated business income, if the Form 990-T must be prepared and filed and must pay any tax which is owed.

The IRA trustee may ask the individual and the individual's accountant for assistance, but the IRA trustee should have its own staff or accountant perform the required tasks. An IRA trustee should charge reasonable fees for doing these tasks.

The IRA trustee must make the determination on an annual basis whether an IRA has any unrelated business

income. Often it is not clear if an IRA has unrelated business income.

The IRS position is, an IRA investment activity produces unrelated business income if it meets three requirements:

1. it is a trade or business,
2. it is regularly carried on, and
3. it is not substantially related to furthering the exempt purpose of the organization.

The Internal Revenue Service has defined the owning of any active trade or business as being unrelated to the IRA's tax exempt purpose.

The following types of income when paid to an IRA will generally not be unrelated business income:

1. dividends,
2. interest,
3. royalties,
4. rent from real estate, and
5. the sales proceeds from the sale of real estate as long as the facts do not show that there is a pattern of selling real estate.

The bank as the IRA trustee is in a difficult situation because there will be times when it is not clear if there is unrelated business income so the Form 990-T must be filed.

The conservative approach for the bank/IRA trustee is to prepare the Form 990-T (or partially prepare it) and attach a note to the tax return explaining why the IRA trustee believes there is no unrelated business income and request that the IRS make the determination that no tax is owed because there is no UBIT.

Another possible course of action, have the IRA owner furnish an opinion letter from an attorney or an accountant (and acknowledged by the individual) stating the law is unclear and that if the IRS would conclude otherwise that the IRA trustee is authorized to pay from the IRA the tax liability plus any interest and penalties.

A primary purpose of an IRA or a 401(k) plan is to have the plan assets earn income. The goal is to prudently maximize earnings. The more income earned means there will be more funds to be used for retirement purposes. The IRS' argument that an IRA which

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PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.				1 Gross distribution \$		OMB No. 1545-0119 <div style="font-size: 2em; font-weight: bold;">2022</div> Form 1099-R		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.			
				2a Taxable amount \$							
				2b Taxable amount not determined <input type="checkbox"/> Total distribution <input type="checkbox"/>							
PAYER'S TIN		RECIPIENT'S TIN		3 Capital gain (included in box 2a) \$		4 Federal income tax withheld \$		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the 2022 General Instructions for Certain Information Returns.			
RECIPIENT'S name				5 Employee contributions/ Designated Roth contributions or insurance premiums \$		6 Net unrealized appreciation in employer's securities \$					
Street address (including apt. no.)				7 Distribution code(s) <input type="checkbox"/> IRA/ SEP/ SIMPLE		8 Other <input type="checkbox"/> %					
City or town, state or province, country, and ZIP or foreign postal code				9a Your percentage of total distribution %		9b Total employee contributions \$					
10 Amount allocable to IRR within 5 years \$		11 1st year of desig. Roth contrib.		12 FATCA filing requirement <input type="checkbox"/>		14 State tax withheld \$		15 State/Payer's state no.		16 State distribution \$	
Account number (see instructions)				13 Date of payment		17 Local tax withheld \$		18 Name of locality		19 Local distribution \$	

Form **1099-R** Cat. No. 14436Q www.irs.gov/Form1099R Department of the Treasury - Internal Revenue Service

Important Form 1099-R Rules for an IRA Custodian to Follow and Observations

- #1. An IRA includes all investments under one IRA plan agreement. File only one Form 1099-R no matter how many distributions have been made from the investments of the same IRA plan agreement during one year unless different reasons codes apply. Example, Jane Doe is paid a death distribution (reason code #4) from her former spouse's IRA (she did not treat this IRA as her own) and she is also paid a distribution from her only IRA. She is age 65 (reason code #7). One Form 1099-R must be filed for all distributions with a reason code 4 and a Form 1099-R must be filed for all distributions with a reason code 7.
- #2. The Form 1099-R and the Form 5498 are per plan agreement forms. If a person, age 65, has two traditional IRA plan agreements and takes a distribution from each IRA, he or she must be furnished two 1099-R forms each having a reason code 7 in box 7. The IRA custodian could be fined \$260.00 times 2 if it only created one Form 1099-R. The IRA custodian must file Form 1099-R using the same name and EIN/TIN used to deposit any tax withheld and to file Form 945, Annual Return of Withheld Federal Income Tax.
- #3. The IRS wants an IRA custodian to prepare a Form 1099-R for every distribution, even those less than \$10.00.
- #4. If an IRA custodian is required to file a Form 1099-R, then it must furnish a statement (i.e. a copy of the 1099-R form) to the recipient.
- #5. An account number must be used on a Form 1099-R when a recipient has more than one IRA plan agreement and you are required to file multiple Form 1099-R's. However, the IRS encourages an IRA custodian to designate an account number for all Form 1099-Rs which it files.
- #6. Never enter a negative amount in any box on Form 1099-R.
- #7. Use the name and TIN of the individual or entity which receives funds from the IRA. Normally, this will be the IRA accountholder. However, if you make a distribution to a beneficiary (whether an individual, trust or estate), then the 1099-R is prepared using the name and TIN of the beneficiary. You do not use the name of the decedent for payments after his or her death.

Continued on page 4

1099-R Rules,
Continued from page 3

- #8. An IRA custodian has a duty to correct a Form 1099-R that it knows was prepared incorrectly. The correction must be made as soon as possible. See the IRS instructions as a 2015 law does allow the IRA custodian to not correct an incorrect Form 1099-R in some limited situations.
- #9. For a distribution from a traditional IRA boxes 1 and 2a are to be completed with the same amount unless an exception applies.
- #10. For a distribution from a Roth IRA, box 2a is to be left blank unless an exception applies.
- #11. An IRA custodian will generally check box 2b, taxable amount not determined. There will be times when it is not checked - withdrawal of an excess or current year contribution before the due date, a recharacterization and rolling funds from an IRA into an accepting employer plan.
- #12. The total distribution box is also found in 2b. An "X" is to be entered in this box when the amount shown in box 1 is a total distribution. The instructions for the total distribution section of box 2b are not as clear as they should be. It is doubtful if this box applies to IRA distributions; but the instructions are unclear, and an IRA custodian should complete the box pursuant to the instructions. In order for a person to use the favorable 10 year averaging or capital gain treatment he or she must receive a total distribution. Such treatment does not ever apply to any type of IRA distribution. If this box is not checked, the IRS will question any individual's attempt to use 10 year averaging. A total distribution is one or more distributions within one tax year in which the entire balance is distributed. This means if two or more nonperiodic distributions occur in more than one year, then there is no total distribution and the box does not need to be checked. For example, a person with an IRA balance of \$30,000 withdraws \$10,000 in 2021 and the remainder in 2022 has not had a total distribution. Exception. If periodic or installment payments are made in more than one year, this box is to be marked for the year in which the final payment is made.
- #13 For a distribution of contributions plus earnings from an IRA under **section 408(d)(4)**, report the gross distribution in box 1, only the earnings in box 2a, and enter Code 8 or P, whichever is applicable, in box 7. Enter Code 1, 2, 4 or 7, if applicable.
- #14. For a distribution of contributions without earnings after the due date of the individual return, under section **408(d)(5)**, leave box 2a blank, and check the "Taxable amount not determined" check box in 2b. Use Code 1 or 7 in box 7 depending on the age of the accountholder.
- #15. For a distribution from an IRA that is payable to the trustee of, or is transferred to, an employer plan, or for an IRA recharacterization, enter 0 (zero) in box 2a.
- #16. In box 7 indicate the distribution code and enter an "X" in the **IRA/SEP/SIMPLE check box** if the distribution is from a traditional IRA, SEP IRA, or SIMPLE IRA. Do NOT check the box for a distributing from a Roth IRA or for an IRA recharacterization.
- #17. **Roth IRAs.** For a distribution from a Roth IRA, report the total distribution in box 1 and leave box 2a blank except in the case of an IRA revocation or account closure and a recharacterization. Use Code J, Q, or T as appropriate in box 7. Use Code 8 or P, if applicable, in box 7 with Code J. Do not combine Code Q or T with any other codes.

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

Reporting Roth IRA Distributions on the 2022 Form 1099-R

The general preparation rule is – a Roth IRA custodian is to report the total distribution amount in box 1 and 2a (taxable amount) is to be left blank. Note the instruction to leave box 2a blank does not mean to insert "0.00" on the copy furnished to the individual.

When box 2a is left blank, the IRS instructions for box 2b suggest that box 2b (taxable amount not determined) is to be checked. The IRS instructions do not expressly state this. Since a Roth IRA custodian does not know if a specific Roth IRA distribution is taxable or not because

Continued on page 5

Roth IRA,
Continued from page 4

of the ordering rules applying to Roth IRA distributions, CWF believes that box 2b is to be checked.

There are, of course, some exceptions when box 2a is to be completed with an amount and is not to be left blank. This in turn means box 2b is not checked.

Exception #1. There has been the withdrawal of current year contribution including a true excess contribution. Only the earnings are to be reported box 2a. If there has been no earnings, then report 0.00.

Exception #2. If there has been a deemed recharacterization withdrawal from the Roth IRA, then report 0.00 as a recharacterization is a nontaxable transaction.

Box 7 is comprised of two boxes. The “second” box is for IRA/SEP/SIMPLE. This box is not to be checked when the distribution is from a Roth IRA.

In the “first” box, the proper Code must be entered to describe the distribution from the Roth IRA. Unlike with traditional IRA distributions where two Codes are often used, with Roth IRAs as discussed later, two Codes are only used in two situations.

Code Q – to be used if the custodian knows the 5-year time period has been met and the recipient is either the Roth IRA owner who has reached age 59½ or is disabled, or is an inheriting beneficiary. Note that for purposes of determining if the 5-year time period requirement has been met the Roth IRA custodian only considers the time the Roth IRA has been at the Roth IRA custodian. That is, the time the individual may have had the same Roth IRA funds with another custodian is not considered. No other Code is ever used with Code Q.

Code T – to be used if the custodian knows the 5-year time period has NOT been met and the recipient is either the Roth IRA owner who has reached age 59½ or is disabled, or is an inheriting beneficiary. Note that for purposes of determining if the 5-year time period requirement has been met, the Roth IRA custodian only considers the time the Roth IRA has been with the Roth IRA custodian. That is, the time the individual may have had the same Roth IRA funds with another custodian is not considered. No other Code is ever used with Code T.

Code J – to be used when Code Q or Code T is NOT used. In general, the use of Code J means there has been an early (i.e. before age 59½) distribution from the Roth IRA. For example, Jane Doe has not yet attained age 59½. Regardless of whether she has met the 5-year time period requirement, Code J is to be used.

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PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Gross distribution \$	OMB No. 1545-0119 2022 Form 1099-R		Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.
		2a Taxable amount \$	2b Taxable amount not determined <input type="checkbox"/> Total distribution <input type="checkbox"/>		
PAYER'S TIN	RECIPIENT'S TIN	3 Capital gain (included in box 2a) \$	4 Federal income tax withheld \$	Copy A For Internal Revenue Service Center File with Form 1096.	
RECIPIENT'S name		5 Employee contributions/ Designated Roth contributions or insurance premiums \$	6 Net unrealized appreciation in employer's securities \$	For Privacy Act and Paperwork Reduction Act Notice, see the 2022 General Instructions for Certain Information Returns.	
Street address (including apt. no.)		7 Distribution code(s) IRA/SEP/SIMPLE <input type="checkbox"/>	8 Other \$		
City or town, state or province, country, and ZIP or foreign postal code		9a Your percentage of total distribution %	9b Total employee contributions \$		
10 Amount allocable to IRR within 5 years \$	11 1st year of design. Roth contrib. <input type="checkbox"/>	12 FATCA filing requirement <input type="checkbox"/>	14 State tax withheld \$	15 State/Payer's state no.	16 State distribution \$
Account number (see instructions)		13 Date of payment \$	17 Local tax withheld \$	18 Name of locality \$	19 Local distribution \$

Form 1099-R Cat. No. 14438Q www.irs.gov/Form1099R Department of the Treasury - Internal Revenue Service

The two situations where two Codes are used to report a Roth IRA distribution are as follows.

Use Code J8 when there has been the withdrawal of a current year Roth IRA contribution, including a true excess contribution, when the contribution is made one year (could either be 2016 or 2017) and is withdrawn the same year (2016 or 2017). The 8 informs the individual and the IRS that the income, if any, is taxable for the year in which the contribution was made.

Use Code JP when there has been the withdrawal of a current year Roth IRA contribution, including a true excess contribution, when the contribution is made in 2016 but withdrawn in 2017. The P informs the individual and the IRS that the income, if any, is taxable for 2016 since the contribution was made in 2016.

Code N – to be used if a Roth IRA contribution was made during 2017 and it was also recharacterized (deemed to have been withdrawn from the Roth IRA) in 2017 to be a traditional IRA.

Code R – to be used if a Roth IRA contribution was made during 2016, but it was recharacterized (deemed to have been withdrawn from the Roth IRA) in 2017 to be a traditional IRA.

Code 2 – to be used when the withdrawal was due to an IRS levy (not a state revenue department) or the withdrawal was pursuant to a substantially equal periodic payment schedule. These are early distributions, but an exception is known so the individual and the IRS is told

Roth IRA,
Continued from page 5

that the 10% additional tax is not owed. The general IRS instructions for box 2a still apply, box 2a is to be checked indicating that the custodian does not know the taxable amount.

Code 5 – to be used when a prohibited transaction has occurred. Code 5 means the account is no longer a Roth IRA. The general IRS instructions for box 2a still apply, this box is to be checked indicating that the custodian does not know the taxable amount.

The Codes as discussed above are the only Codes to be inserted in box 7 for a Roth distribution. Note that no other Codes are never used to report a distribution from a Roth IRA.

Code B reports a distribution of Designated Roth funds to a person from a 401(k)/403b/457b plan and is never used to report a distribution from any IRA, including a Roth IRA.

Note that Code J is not used with any other code except it is to be used with the Code 8 or Code P, as applicable. Code J1 is never used. The current IRS approach does not inform the individual or the IRS that if the recipient is under age 59½ that he or she owes the 10% if there is any taxable income being distributed.

Special Reporting When Roth Distribution Is Due to Revocation By the Individual or By the Custodian For CIP Reasons -

If a Roth owner revokes (7-day rule) a regular Roth IRA contribution or if the custodian for CIP reasons closes the Roth IRA after the making of a regular Roth IRA contribution, but there are no earnings, then the gross distribution is entered in box 1, enter 0.00 in box 2a, box 2b is not checked and Code J is used in box 7. Note this is true even if the individual is older than age 59½ or is disabled.

The above reporting will also be done for any conversion contribution which is revoked by the individual or closed by the custodian for CIP reasons.

If a Roth owner revokes (7-day rule) a regular Roth IRA contribution or if the custodian for CIP reasons closes the Roth IRA after the making of a regular Roth IRA contribution, and there are earnings, then the gross distribution is entered in box 1, enter the amount of earnings in box 2a, box 2b is not checked and Code J8 is used in box 7. Note this is true even if the individual is older than age 59½ or is disabled.

The above reporting will also be done for any conversion contribution which is revoked by the individual or closed by the custodian for CIP reasons.

If a Roth owner makes a rollover contribution (or a transfer contribution) from another Roth IRA and then revokes (7-day rule) or if he or she makes a rollover contribution (or a transfer contribution) from another Roth IRA and the custodian for CIP reasons closes the Roth IRA after such rollover or transfer, then the gross distribution is entered in box 1, box 2a is to be completed with the same amount as in box 1 and Code J is used in box 7. Note this is true even if the individual is older than age 59½ or is disabled.

CWF Observation/Comment. We do not understand why the IRS wants the taxable amount box completed with the same amount as the gross distribution from the revoked or closed Roth IRA. When the individual withdrew the funds from the original Roth IRA, the Form 1099-R for that distribution would be prepared with box 2a being blank. We do not understand the rationale requiring the new custodian to report the distribution of the closed or revoked Roth IRA as being taxable. This make sense for a distribution from a traditional IRA, but not a distribution from a Roth IRA.

If a Roth owner has made a rollover contribution into his or her Roth IRA from a qualified plan and then revokes (7-day rule) it or the custodian for CIP reasons closes the Roth IRA after such rollover and there are no earnings, then the gross distribution is entered in box 1, enter 0.00 in box 2a, box 2b is not checked and Code J is used in box 7. Note this is true even if the individual is older than age 59½ or is disabled.

If a Roth owner has made a rollover contribution into his or her Roth IRA from a qualified plan and then revokes (7 day rule) it or the custodian for CIP reasons closes the Roth IRA after such rollover and there are earnings, then the gross distribution is entered in box 1, enter the earnings in box 2a, box 2b is not checked and Code J is used in box 7. Note this is true even if the individual is older than age 59½ or is disabled.

In conclusion, the IRS has detailed rules and procedures to be followed by the custodian to report Roth IRA distributions. Remember, the IRS may assess a \$260 per form fine for each improperly prepared Form 1099-R. Until the IRS furnishes additional guidance explaining more definitively that a person who receives a Form 1099-R with a reason Code Q in box 7 need not mention it on his or her federal income tax return, an individual will want to explain on the return that the distribution is qualified and is not taxable.

UBIT,
Continued from page 2

owns a business is not substantially related to furthering the exempt purpose of the IRA is not a strong argument.

The general tax rule applying to an IRA is - the income earned by the IRA is not presently taxed. In the case of traditional IRAs, SEP-IRAs and SIMPLE IRAs, the individual will include such income in his or her income when it is withdrawn from the IRA. This is true even though there is no distinction between withdrawing contributions versus withdrawing income. In the case of Roth IRAs, the individual is able to withdraw the income on a tax-free basis if the distribution is a qualified distribution. With a Roth IRA when the distribution is a non-qualified distribution there is a distinction between withdrawing contributions versus earnings.

The IRS' has adopted the tax position that - it is right to require an IRA to pay tax on income earned by a business-owned and operated by an IRA. However, there is no express statutory provision supporting this IRS position. And there is no statutory rule providing that the income earned within or by an IRA is subject to being taxed if the income arises from non-passive types of investments whereas passive income will not be taxed. The IRS has a fundamental belief - all income is taxable **unless** there is statutory support that it is not to be taxed.

Additional discussion of UBIT:

It appears that as long as rent is paid directly to the IRA and not through some passive entity, then such rent is not unrelated business income.

Selling one piece of real estate most likely would not be found to be a business and most likely would not be a business regularly carried on. However, if the person's IRA holds property primarily for sale then one could expect the IRS will argue this activity is a business so that it would owe the unrelated income tax.

In order to for UBIT to exist, there must be a trade or a business and it must be carried on regularly. If the business is not carried on regularly, the UBIT will not exist. The IRS has adopted "hobby" rules for when a person's activities do not rise to the level of being a business.

Presumably, this concept should carryover to IRAs. The IRA activity is not regular so there is no unrelated business income.

It should be clear to the IRS and Congress that Con-

gress needs to rethink these tax rules and make needed changes. Until then, IRA trustees will need to adopt procedures to administer these IRAs to comply with existing laws. We at CWF lean towards more disclosure versus no disclosure.

Completing the 2022 Form 1099-Q (Payments from a Coverdell ESA)

As with other IRS tax reporting forms, the Form 1099-Q is used by an individual to prepare his or her tax return and it is used by the IRS to make a basic determination if the individual has properly determined and reported the CESA transactions on his or her tax return.

A CESA custodian/trustee must file the 2018 Form 1099-Q to report every distribution from a Coverdell ESA. Completing the Form 1099-Q is similar to completing the Form 1099-R for IRA distributions, but there are many differences. The IRS instructions on reporting distributions from CESAs would certainly be improved if the IRS would clarify some of the instructions.

3131 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		1 Gross distribution OMB No. 1545-1760 Form 1099-Q (Rev. November 2019) For calendar year 20__		Payments From Qualified Education Programs (Under Sections 529 and 530)
2 Earnings \$		3 Basis \$		
PAYER'S/TRUSTEE'S TIN	RECIPIENT'S TIN	4 Trustee-to-trustee transfer <input type="checkbox"/>		Copy A For Internal Revenue Service Center File with Form 1096. For Privacy Act and Paperwork Reduction Act Notice, see the current General Instructions for Certain Information Returns.
RECIPIENT'S name		5 Distribution is from: • Qualified tuition program— Private <input type="checkbox"/> or State <input type="checkbox"/> • Coverdell ESA <input type="checkbox"/>		
Street address (including apt. no.)		6 Check if the recipient is not the designated beneficiary <input type="checkbox"/>		
City or town, state or province, country, and ZIP or foreign postal code				
Account number (see instructions)				
Form 1099-Q (Rev. 11-2019) Cat. No. 32223J www.irs.gov/Form1099Q Department of the Treasury - Internal Revenue Service Do Not Cut or Separate Forms on This Page — Do Not Cut or Separate Forms on This Page				

The Form 1099-Q is prepared using the name and social security number of the CESAs designated beneficiary. This is the person whom the CESA is intended to benefit.

On the Form 1099-R, box 7 must generally be completed with one distribution code. If more than one distribution code applies to a person, a separate Form 1099-R must be prepared. On the Form 1099-Q, the CESA custodian may, but is not required to include a distribution code in the blank box below boxes 5 and 6. This means only one Form 1099-Q is required to be prepared to report all of the CESA Distributions.

**Form 1099-Q,
Continued from page 7**

However, the IRS does ask that in at least three cases, separate forms be prepared. First, the IRS would like the CESA custodian/trustee to prepare a separate Form 1099-Q if an excess contribution was made and withdrawn. Secondly, the CESA custodian/trustee should file a separate Form 1099-Q for any (each) transfer.

An IRA custodian is not required to prepare a Form 1099-R if the annual distribution amount for person is less than \$10. Although there probably should be the same rule for a CESA distributions, there is no \$10 limit for CESA Distributions. All CESA distributions must be reported.

If a CESA custodian prepares more than one Form 1099-Q for the same recipient, then the CESA must complete the account number box with a unique account number for that person. As with IRAs, the IRS would like the custodian/trustee to insert an account number in the account number box even though it is not mandatory.

And unlike with IRAs where a transfer distribution is not reported on the Form 1099-R, a transfer distribution must be reported on the Form 1099-Q.

Box 1 reports the gross distribution amount paid to the designated beneficiary or a beneficiary. The distribution may be made with cash or with some property. This amount will be the sum of the account's basis (see box 3) and the earnings. (box 2).

Box 3 shows the basis within the CESA if the CESA custodian has elected to report such basis. However, the IRS has given the CESA custodian the option of leaving box 3 and box 2 blank.

If this option is elected, and most financial institutions elect this option, the custodian must report the fair market value (FMV) as of the end of the year in the blank box below boxes 5 and 6. The amount must be labeled FMV. It will then be the designated beneficiary and his or her accountant that determine what portion of the distribution is basis and earnings.

Box 2 is used to report the earnings if the CESA custodian has elected to report such earnings. However, the IRS has given the CESA the option of leaving box 2 blank as discussed above and most custodians have elected this option. Box 2 is generally left blank. And then it will be up to the designated beneficiary and his

or her accountant to determine what portion of the distribution is basis and earnings.

The distribution of earnings may or may not be taxable. Earnings used to pay qualified education expenses will be tax-free. Earnings withdrawn and used for reasons other than paying the qualified education expenses of the designated beneficiary will be taxable and possibly subject to the 10% penalty tax. Earnings are NOT subject to backup withholding.

If the CESA has incurred a loss (i.e. negative earnings) and the CESA is not closed this year, then enter 0.00 in box 2. Also enter 0.00 if you know that there has been no earnings.

If the CESA has incurred a loss and the CESA is closed this year, then enter a loss in box 2.

There is one time when the IRS asks the CESA custodian to not leave boxes 2 and 3 blank. This is when an excess contribution is withdrawn along with the related earnings.

Box 4 contains a checkbox and this box is to be checked to indicate that there has been a trustee-to-trustee transfer. It is to be checked if the CESA distribution is made directly to another CESA (section 530) or to qualified tuition program (section 529). There is no similar box on the Form 1099-R. Box 4 is to be left blank if the CESA custodian does not have records showing that the gross distribution was a trustee-to-trustee transfer.

It appears that if there has been a change in the designated beneficiary, but the new beneficiary is a member of the former beneficiary's family and he or she is under age 30, then this change is not to be reported as a transfer on the Form 1099-Q.

It also appears that if there has been a change is the designated beneficiary, but the new beneficiary is a member of the former beneficiary's family but he or she is age 30 or older, then this change is to be reported as a transfer on the Form 1099-Q and the recipient will need to include the income in his or her income.

It also appears that if there has been a change into the designated beneficiary, but the new beneficiary is NOT a member of the former beneficiary's family, then this change is to be reported as a transfer on the Form 1099-

Form 1099-Q,
Continued from page 8

Q and the recipient will need to include the income in his or her income.

Box 5 reports the type of plan. check the CESA box. The other two boxes related to the two types of qualified tuition programs.

Box 6. This box must be checked if the distribution was made to a person other than the designated beneficiary. Normally, this will be the case if the funds are paid to a beneficiary who is not a family member of the deceased designated beneficiary. Such family members are: his or her spouse; children, stepchildren, foster children, and their descendants; parents, their siblings, ancestors; stepparents; in-laws; and the spouses of such individuals and any first cousin of the designated beneficiary.

The recipient of a CESA distribution will in some cases have to report the CESA distribution on his or her federal income tax return. The IRS instructions to the recipient do state that "nontaxable" distributions from CESAs, including rollover, are not required to be reported on the individual's tax return. See Pub. 970.

Email Guidance – Correcting Excess HSA Contributions

Q-1. We have a HSA customer that has contributed \$8050.00 YTD to her HSA account. She is over age 55, so would be allowed the catch up contribution. I just spoke to her and she informed me that she has single coverage and has had for last year and this year. Last year, her YTD contribution was \$4954.87. As of today, she has a balance in her HSA account of \$659.17. I told her she couldn't contribute any more money to this account if she has single coverage and encouraged her to speak with her tax person. In your opinion, what do we do with this account when she doesn't have enough money in it to even return it as an excess?

In speaking with her, she clearly does not understand HSA accounts!

A-1. Your customer's HSA excess contribution situation illustrates that the IRS should create some "practical" safe harbor for correcting and reporting HSA excess contribution situations.

I will be discussing 2021 and 2022. Her contribution

limit for 2021 was \$4600. Her contribution limit for 2022 is \$4650.

I will first discuss 2022.

To avoid the 6% excise tax for 2022 she wants to withdraw her excess contribution amount of \$3300 .. Whether she (or the bank) knew it some of her withdrawals which now are coded as normal distributions actually were the withdrawal of the excess contribution. As a practical matter the parties involved will spend a fair amount of time correcting this situation even though she owes no income taxes. No income tax is owed and the 6% excise tax is not owed when a person withdraws the excess contribution.

I will discuss two approaches for 2022. She has contributed an excess amount of \$3300 (\$8050-\$4650). The HSA owner and the bank can decide on the course of action.

Course of Action #1. This is the simplest and best approach.

She withdraws \$659.16 as an excess contribution. The remaining .01 is to keep the HSA open. You would discuss with her. She would agree that she (and her tax preparer) will handle the situation and that the bank (CWF) need not do any special reporting for the transactions which have previously occurred in 2022. The entire contribution amount will be reported in box 2 on her 2022 Form 5498 and her previous distributions will be reported as normal HSA distributions. She will be furnished two 1099-SA forms for 2022. One will report the normal distributions and one will report the withdrawal of the excess contributions we will need to prepare her Form 8889 to show that she had made an excess HSA contribution and that she has corrected the excess situation by withdrawing such excesses. She may want to add a note to her tax return to explain some other distributions which the bank described as normal actually were the withdrawal of an excess contribution. I expect earnings have been very minimal and so I suggest box 2 on the Form 1099-SA for the excess would be completed either with \$0.00 or \$1.00. There is no good reason to try to calculate the actual income earned by the excess contributions.

She informs the bank of her excess contribution situation and that she wants previous distributions re-coded

Continued on page 10

Excess HSA,
Continued from page 9

from being normal distributions to being the withdrawal of an excess. Any distribution she withdrew after withdrawing \$4650 was the withdrawal of an excess. The tax forms would be prepared to report the proper amounts.

As a practical matter she (her tax preparer) will still need to prepare her Form 8889 to show that she had made an excess HSA contribution and that she has corrected the excess situation by withdrawing such excesses. She may want to add a note to her tax return to explain some of her distributions which the bank described as normal actually were the withdrawal of an excess contribution. I expect earnings have been very minimal and so I suggest box 2 on the Form 1099-SA for the excess would be completed either with \$0.00 or \$1.00.

This approach obviously is not the simplest approach. I don't believe you are obligated to discuss that she has this option, but it is your decision.

Now I will discuss 2021. Her excess contribution amount for 2021 was \$304.87. If this amount was still in her HSA as of 12/31/2021, it was withdrawn sometime in 2022 before 4/15/2022. She withdrew it so she does not owe the 6% excise tax and no income tax is owed.

She must discuss with her tax adviser. She might decide as a practical matter not to file an amended tax return for 2021. She owes no tax, but she would inform the IRS that she had made an excess contribution and that she had corrected it. Form 5329 would be filed.

As under Approach #2 for 2022, if she requests the bank to change the IRS reporting forms, you should do it, but only if requested. I don't think she will request it.

In summary, there can be substantial work involved when a person makes an excess HSA contribution and then withdraws it.

IRS Penalty Relief for Taxpayers Filing Form 1099-R for 2019 and 2020

Has or might the IRS impose a penalty on your institution for failing to timely comply with the requirements for filing/providing the 2019 or 2020 IRS reporting forms? We, of course, at CWF are primarily concerned with IRA and HSA reporting forms.

The IRS has recently issued Notice 2022-36. It grants relief from certain failure to file penalties, certain penalties related to foreign persons and certain information return penalties with respect to certain 2019 forms and certain 2020 forms. Such forms could have been submitted on paper or electronically.

This article discusses the relief for the certain information returns for 2019 and 2020. Remember that the tax filing deadline was changed for both 2019 returns and 2020 returns. The tax filing deadline for 2019 was changed to July 15, 2020. The tax filing deadline for 2020 was changed to May 17, 2021. That filing deadline is also the contribution deadline for traditional IRAs, Roth IRAs and HSAs. At the time the IRS granted limited relief to taxpayers, but the IRS failed to discuss comprehensively if and how the filing deadline for some of the information returns was affected.

Notice 2022-36 grants relief for Forms 1099-R, 1099-SA and 1099-Q. It does not grant relief with respect to the 2019 or 2020 Form 5498, Form 5498-SA and Form 5498-ESA.

The revised deadline for imposing penalties for certain forms for 2019 is August 1, 2020.

The revised deadline for imposing penalties for certain forms for 2020 is August 1, 2021.

If a filer submitted or furnished their forms by the August 1, then any penalties imposed will be removed and no penalties will be imposed.

With respect to tax year 2019, relief is provided for an information form which was filed on or before August 1, 2020 if the original due dates were - January 31, 2020, February 28, 2020 (if filed on paper) or March 31, 2020 (if filed electronically; or March 15, 2020.

With respect to tax year 2020, relief is provided for an information form which was filed on or before August 1, 2021 if the original due dates were - January 31, 2021, February 28, 2021 (if filed on paper) or March 31, 2021 (if filed electronically; or March 15, 2021.

With respect to the 2019 Form 5498, Form 5498-SA and Form 5498-ESA, the IRS had in Notice 2020-35 postponed the deadline to be August 31, 2020.

With respect to the 2020 Form 5498, Form 5498-SA and Form 5498-ESA, the IRS had in Notice 2021-21 postponed the deadline to be June 30, 2021.