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ALSO IN THIS ISSUE –

Collin W. Fritz and Associates, Inc.,
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A SEP-IRA Plan is an Alternative to a State Mandated IRA/Retirement Program Inform Your Business Customers

The number of states adopting or considering adopting state mandated IRA/retirements plans has recently increased. Some of these plan are in effect now and others will become effective later in 2023, 2024 or 2025. Minnesota recently enacted a new law to go into effect in 2025.

These states with mandated IRA/retirement plans are primarily states controlled by the Democrats or the so called blue states. Minnesota is such a state. Most of the state laws require certain employers (must have 5 or more employees) who don't currently sponsor any type of retirement plan to make contributions or to give an employee the right to make a contribution to an IRA.

The following states presently mandate some version of a state mandated IRA or retirement program. Some of the mandates are in effect now and others such as Minnesota become effective in 2025.

1. California
2. Colorado
3. Connecticut
4. Hawaii
5. Illinois
6. Maine
7. Maryland
8. Minnesota
9. New Jersey
10. New York
11. Oregon
12. Vermont.
13. Virginia

Some states have enacted a law creating a state run retirement program which allows an employer to participate in the program. It is not mandated.

1. Massachusetts
2. New Mexico
3. Washington

Why have many states adopted laws requiring an employer if it wants to do business in the state to sponsor some sort of retirement plan?

These states apparently believe an employer has or should have the duty to force an employee to receive some portion of his or her compensation in the form of retirement plan compensation. That is, these states want to mandate that an employee must save for retirement rather than using the funds for other purposes regardless of how worthy those other purposes are. Each state plan has its own rules. These rules can be complicated.

An employer doing business in many states will have to comply with rules of each state. This can and will be an administrative nightmare.

Many of these state plans are based on an employee having to establish an IRA. Sometimes the money is held by a state entity and sometimes by a local financial institution.

<u>The point of this article is, an employer who has established and maintains a SEP-IRA plan is exempt from having to</u>

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comply with any state mandated IRA and other retirement type program. A state may not like it that a business has a legal right and a way to not follow their mandate, but many businesses will appreciate knowing of this alternative.

The easiest and most inexpensive method to be exempt is to establish a SEP-IRA plan. An employer is also exempt if it establishes a 401(k) plan, a profit sharing plan, a SIMPLE-IRA plan or other plans.

There is a lot of money in SEP-IRAs without the changes which will come as more states adopt these state mandated plans. Many SEP-IRAs are established for a one-person business. However, there certainly are many SEP-IRA plans having multiple participants. A SEP-IRA plan in 2023 authorizes a person with large compensation to have a SEP-IRA contribution of $66,000.

ERISA as passed in 1974 expressly states that federal law preempts any state law on the subject of retirement plans. ERISA authorizes retirement plans and IRAs. A SEP-IRA plan is an ERISA plan. The blue states do not like the reality of this preemption and they have tried to craft their state mandates to comply with ERISA. Even the Democratic leaning Department of Labor has had to inform these Democratic controlled states that federal law preempts state law.

Are there problems needing to be solved by these state mandated plans? It has been estimated that 60% of businesses do not sponsor a retirement plan and that 50-60% of individuals have an inadequate retirement program. So there may be problems to be solved (more people should save more), but these state mandated retirement programs will not resolve the problems.

Every working person is eligible to have their own retirement plan. It is called an Individual Retirement Account (IRA). An IRA is easy to establish. For whatever reasons many individuals fail to establish IRAs. A person should have a will but many people do not. It is the same with IRAs.

ERISA sets forth the authority for any individual who is working to establish and fund their own retirement account, it is called an IRA. Federal law since 1975 has allowed any employee to fund their own retirement plan by funding a traditional IRA and later a Roth IRA. The approach of federal law is to bestow various tax benefits on a person who establishes and contributes to their IRA. An individual is given the right to have the IRA earn tax deferred income, some individuals are able to claim a tax deduction for their contribution and some individuals qualify to claim a tax credit.

The approach of federal law is to create tax incentives for a business to establish a retirement plan for its employees, but it does not mandate that an employer sponsor a retirement plan. Many employers establish retirement plans as a way to attract high performing individuals. And many employers don't. They decide to pay higher levels of direct compensation.

We at CWF agree with the approach of the current law. There is one federal law (ERISA) and not many individual state laws. Let employers and employees decide what approach is best for themselves. Mandates are unnecessary. An employee has the right to make their own IRA contribution and there is no need to force an employer or an employee to do so. It may be if federal income tax rates and state income tax rates were not so high more individuals would have the funds to be making more IRA contributions and saving more.

An employer will solve the problems created by a stated mandated retirement program by sponsoring a SEP-IRA plan.

Why do small or modest sized employers (1-100 employees) like SEP-IRA plans and why will they like them in the future because of these new state mandated plan rules?

1. Each year an employer has the flexibility or discretion to decide what percentage of a participant's compensation will be contributed. Every eligible employee must receive the same percentage. The maximum percentage is 25%. An employer is not required to make any contribution for a certain number of years. An employer must be able to defeat any claim or assertion the SEP-IRA plan has been terminated. Not making a contribution for one year does not mean an employer has terminated its SEP-IRA plan.
2. An employer is able to not make contributions for a good number of employees because they will not have met the eligibility requirements. The law permits an employer to not make a SEP- IRA contribu-

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tion if the employee has not attained age 21. The law permits an employer to not make a contribution if an employee has not performed any work in at least 3 of the previous 5 years. The law permits an employer to not make a contribution if an eligible employee does not earn at least $750 (2023) during the current year.

Again, the states may not like the fact that contributions are not required for these individuals, but that is what federal law allows.

Many state plans will require an employer make contributions for employees which are not entitled to receive a contribution under the SEP-IRA plan.

3. Employers and employees like to make and receive SEP-IRA contributions because these contributions are exempt from all taxes, including Social Security and Medicare taxes. An individual is free to withdraw their SEP-IRA funds, but any distribution will be subject to income tax, including the pre-age 59½ tax of 10%.
4. New reason. An employer which has a SEP-IRA plan is exempt from having to comply with any state mandated plan.

Conclusion. Many small business will choose to establish a SEP-IRA plan in order to be exempt from the many state mandated retirement programs. Financial institutions want to be ready to service these employers and their employees. Communicate and inform. A financial institution which offers SEP-IRA services to its business customer will be furnishing a tremendous services. It may see its SEP-IRA contributions and balances increase dramatically as a result of the state mandates.

The IRS Grants Two Years Relief For Certain 401(k) Plans and Participants and Provides Some Clarifications

In Notice 2023-62 the IRS grants relief for two years for certain 401(k) plans and participants and provides some clarifications. The IRS expressly states the guidance is not intended to provide comprehensive guidance.

The current 401(k) law is that a participant has the right to make a standard elective deferral contribution under a profit sharing plan allowing participants to make elective deferral contributions. The current law does not require a sponsor of a 401(k) to authorize a participant to designate an elective deferral contribution as a designated Roth contributions.

Section 603 of the SECURE 2.0 Act requires that commencing in 2024 an individual with a high income who makes catch-up elective deferrals must have these catch-up elective deferrals be designated as Roth contributions. A participant will be limited to having his or her catch-up elective deferrals be designated as Roth contributions if his or her wages from the employer as defined in section 3121(a) for the preceding calendar year exceed $145,000. The $145,000 is subject to statutory adjustment under section 414(v)(7)(E). This guidance postpones it so this new mandate is effective for 2026 rather than for 2024. So, a participant exceeding the compensation threshold may continue to make standard catch-up elective deferrals for 2024 and 2025.

401(k) plan documents will need to be amended to comply with the requirement mandated by section 603.

Note, the rule of section 603 does not apply to participants of SIMPLE-IRA plans or SEP-IRA plans.

SECURE 2.0 Act has special rules for SIMPLE-IRA plans and SEP-IRA plans. These are discussed in a separate article set forth on page 4.

The IRS clarifies that if there is one participant whose elective deferral must be a designated Roth, then all eligible participants must have the right to make a designated Roth contribution regardless of his or her income.

The IRS also clarifies that a person who initially make a standard catch-up elective deferral because he or she

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understood that their compensation was such that he or she was not required to make a designated Roth contribution has the right to undo the making of that catch-up elective deferral.

The IRS believes if a person is a participant of two 401(k) plans that the $145,000 limit is determined on a per employer basis and the individual is not required to aggregate his or her income from the two employers.

Somewhat surprisingly, the IRS is also proposing that the $145,000 limit would not apply to a participant who did not have wages for purposes of FICA such as is the case for self-employed individuals or partners.

The IRS is requesting the public to submit comments. Comments should be submitted in writing on or before October 24, 2023, and should include a reference to Notice 2023-62. Comments may be submitted electronically via the Federal eRulemaking Portal at www.regulations.gov (type "IRS-2023-0039" in the search field on the Regulations.gov home page to find this notice and submit comments). Alternatively, comments may be submitted by mail to: Internal Revenue Service, Attn: CC:PA:LPD:PR (Notice 2023-62), Room 5203, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044.

The Treasury Department and the IRS will publish for public availability any comment submitted electronically or on paper to its public docket.

Special New Roth Rules for SIMPLE-IRAs and SEP-IRAs

Section 601 of SECURE 2.0 authorizes SIMPLE and SEP Roth IRAs. Previously the law did not allow any SIMPLE-IRA or SEP-IRA to be treated as a Roth type account.

The new law authorizes a SEP-IRA participant to have his or her SEP-IRA contribution treated either as a regular contribution or as a Roth contribution. If a person elects to have the employer's contribution as a Roth then such contribution is not excludable from the participant's income. That contribution is taxable.

The new law authorizes a SIMPLE-IRA participant to have his or her SIMPLE-IRA contributions treated either as a regular contribution or as a Roth contribution. This new rule applies to both the participant's elective deferral contributions and the contribution made by the employer. If a person elects to have the employer's contribution as a Roth then such contribution is not excludable from the participant's income.

The new laws are effective now in 2023. However, the IRS has furnished no additional guidance as of August 31, 2023.

The new law imposes substantial new accounting requirements on an employer. There must be income tax withholding and the payment of social security and Medicare taxes on the SEP-IRA Roth contributions and on the SIMPLE-IRA Roth contributions.

With respect to these new election rights, the statutory law does provide "at such time and in such manner as the Secretary may provide." Is a SEP-IRA participant or SIMPLE-IRA participant unable to make the election now in 2023 because the IRS has not yet issued the guidance?

It is unclear and unsettled if the Secretary has not or does not provide any guidance then a SEP-IRA participant or SIMPLE-IRA participant may not make such an election. We don't believe so. Hopefully, the IRS gives guidance soon. Making such an election should not be complicated. Financial institutions servicing SEP-IRAs and SIMPLE-IRAs will need to be ready to service the "SEP Roth IRA" accounts and the "SIMPLE Roth IRA" accounts.

Email Guidance – Assisting Customers with ESOP Distributions

Q-1. I came into the office today to a note on my desk that a customer has an ESOP and he wants to roll it over into an IRA. I have never worked with ESOPs so I am unsure if there are certain rules or way this would need to be done, if any. Would you also be able to provide me some information on what is needed on both the customers and on my side? ·

A-1. I will be writing a newsletter article in the next 1-3 months on ESOPs distributions. ESOP is the acronym for Employee Stock Ownership Plan. Such a distribution is more complicated that a standard distribution from a 401(k) or profit sharing plan.

If the person is receiving "cash" then the distribution is like any distribution from a 401(k) or profit sharing plan and the person can instruct to have a direct rollover to an IRA.

An ESOP means that some or quite a bit of the plan's assets were comprised or invested in employer stock. Some ESOP plans provide that a separating participant will be distributed primarily stock and not cash.

Sometimes the separating participant will sell their stock back to the plan and receive cash.

Sometimes the plan will require the separating participant to sell their stock to the plan.

Sometimes the plan will not require the separating participant to sell their stock to the plan, but the administrator or the corporate officers give the idea that such a sale is required.

Some separating participants will want to be distributed the stock. Such stock can be rolled in an IRA, but often it is not a good idea to rollover such stock. All distributions from an IRA are taxed as ordinary income. There is no capital gain treatment.

Or, such stock can be distributed to the separating participant. If the stock has appreciated in value it is many times best to be distributed the stock because the person includes in income only the cost basis of the stock and not its current value. When the stock is sold in the future it is entitled to capital gain treatment if certain requirements are met.

The person should talk with their tax adviser before deciding - take the cash or take the stock.

Email Guidance – Inherited IRAs

Q-1. We have a twice inherited IRA and are trying to figure out the beneficiary's options based on the new rules.

It was first Dorothy's IRA (passed away in 2019), then Neal's (passed away 2023), now Janet's. Neal was Janet's spouse and he was taking annual RMD distributions from this inherited IRA.

Would her options be the 10-year rule, lump sum, or annual RMD distributions over the course of her lifetime?

A-1. The IRA accountholder died before 2020 so the first beneficiary (Neal) is defined to be an EDB.

Upon the death of an EDB (Neal), the beneficiary of the EDB (Janet) continues the divisor schedule applying to the EDB (Neal), but the 10-year rule applies.

Janet continues the schedule being used by Neal, but also must close this inherited IRA by 12/31/2033. For this situation there are no special spouse rules.

Janet must take at least her RMD for years 2024-2032 and she must close this inherited IRA by 12/31/2033. She can take more than her RMD each year. For income tax reasons she may wish to take approximately 10% each year. She has the right to take a lump sum at ant time as long as Neal did not restrict her from doing so.

Q-2. I'm wondering if the owner of an IRA is allowed to designate their Trust as their Payable On Death Beneficiary?

A-2. Yes a person may designate their trust as their beneficiary.

Hopefully, the customer is acting on the advice of a good advisor, because may times the income taxes to be paid when the funds are distributed to the trust will be at a much higher marginal tax rate than if the distribution was made to a person.

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One wonders if the customer might be thinking, I have this trust where my beneficiaries are already designated, I will just name the trust rather than completing an IRA beneficiary designation form. There are tax reasons it is generally best to name the individuals on an IRA beneficiary designation form.

Q-3. We are running into an issue we have a new customer wanting to open up an IRA and they have 10 beneficiaries and our Jack Henry system only has 7 beneficiary spots. Jack Henry informed us that they can make a new screen with 8, 9, and 10 fields but they said it would not print on the IRA application so they said we would need to create a freeform and add the beneficiaries info onto that. We are wondering if that would be in compliance with all the rules and regulations and if you had a form that you would suggest we use in this case? Otherwise we thought an option would be doing an IRA application with the 7 and then do another application with the other 3?

A-3. I like your idea of having two IRAs.

I also suggest as a consideration - don't list any of the beneficiaries on the Jack Henry system. Such a list is not needed for any IRS reporting reasons. You will need to review the IRA plan document to see if their form allows an IRA accountholder to furnish a special beneficiary designation form.

There would be a special note that the IRA accountholder has designated 10 beneficiaries on a special designation of beneficiaries form and that this form controls.

Q-4. We have a customer that has an inherited IRA. His father passed away in 2014 and the son has been taking a distribution each year since 2015 but does he have to have it closed within 10 years or what are the rules since it was inherited prior to 2020?

A-4. The son has been taking annual distributions (RMDs) since 2015 using the life distribution rule. Under the new laws he is authorized to continue to use that same schedule because he was grand-fathered. That is, the new laws were written so a beneficiary of an IRA who died before 2020 is not required to use a new distribution rule.

The new 10-year rule does <u>not</u> apply to him.

The IRS has stated that the original divisor used for 2015 is to be reset using the applicable divisor from the new single life expectancy table. His divisor should be reset.

Unless the IRA owner had imposed a restriction the son is allowed to take out more than his RMD. He will owe the 10%/25% excess accumulations tax on his missed RMD if he fails to take out 100% of his an annual RMD.

Upon the son's death, I understand his beneficiary will be allowed to continue the son's schedule, but his beneficiary will be subject to the 10-year rule. The IRS needs to make this more clear in its final regulation.

Is it Still Possible to Establish a SIMPLE-IRA Plan for 2023?

Yes, if the sponsoring business has never sponsored a SIMPLE-IRA Plan before and if the business has not made any contributions for 2023 to another type of retirement plan (e.g. profit sharing plan or SEP).

A person or business can set up a SIMPLE-IRA plan effective on any date between January 1 and October 1 of a year, provided it did not previously maintain a SIMPLE-IRA plan. This requirement does not apply if there is a new employer that comes into existence after October 1 of the year the SIMPLE-IRA plan is established. A new business must set up a SIMPLE-IRA plan as soon as administratively feasible after it comes into existence. If it previously maintained a SIMPLE-IRA Plan, it can set up a SIMPLE-IRA plan effective only on January 1 of a year. A SIMPLE-IRA plan cannot have an effective date that is before the date you actually adopt the plan.

SIMPLE-IRA Fees May be Charged Good Notices and Timing are Needed

The IRS has written two model SIMPLE-IRA forms. One (Form 5305-SIMPLE) provides for a designated financial institution and other (Form 5304-SIMPLE) does not.

An employer may choose to complete Form 5305-SIMPLE because it allows the employer to designate a particular financial institution to which all SIMPLE-IRA contributions will be made. This right greatly reduces the employer's administrative tasks of having to make contributions at multiple financial institutions. An employer which sponsors a SEP does not have such a right. Each employee can have his or her SEP-IRA set up with the financial institution of its choice. These requirements must be met in order for there to be a designated financial institution:

1. The employer and the financial institution must agree in writing the financial institution will be the designated financial institution (DFI).

2. Upon a participant's request his or her SIMPLE-IRA balance will be transferred without cost or penalty to another SIMPLE-IRA or to any IRA once 24- months have elapsed since the date of the first SIMPLE- IRA contribution.

3. Each participant must be furnished a notice explaining the procedures which must be used in order that the SIMPLE-IRA balance will be transferred without cost or penalty.

If a financial institution is not a DFI, then it is free to impose a reasonable fee with respect to transferring funds from the SIMPLE-IRA to another SIMPLE-IRA or any IRA if the 2-year requirement has been met.

The general rule is – if a financial institution is a DFI, it is unable to impose any fee and/or cost for transferring funds from the SIMPLE-IRA to another SIMPLE-IRA or any IRA if the 2-year requirement has been met. Code section 408(p)(7) states this requirement. "A transfer is deemed to be made without cost or penalty if no liquidation, transaction redemption or termination fee, or any commission, load (whether front-end or back-end) or surrender charge, or similar fee or charge is imposed with respect to the balance being transferred.

Note that this rule does not prevent the imposition of fees for any non-transfer transaction. For example, if the SIMPLE-IRA accountholder wanted to take a distribution, the SIMPLE-IRA custodian could impose a distribution fee, or if the SIMPLE-IRA accountholder would close his or her SIMPLE-IRA, the financial institution could impose a closing fee. This restriction of fees applies once the employee has notified the custodian the he or she will be exercising their rights under the transfer policy.

The DFI will need to settle on its fee policies and write a notice explaining such policies and procedures. The DFI should furnish this notice to both the employer and the employees. It could be an attached summary description which the DFI furnishes the employer.

In 1998 in Notice 98-4 the IRS created and announced some major exceptions to this no fee for transfers requirement. There are four significant exceptions where the SIMPLE-IRA custodian has the right to charge a reasonable transfer fee. We discussed these four exceptions in our September 2019 issue.

In summary, many financial institutions performing SIMPLE-IRA services wrongly believe that fees cannot be charged on SIMPLE-IRAs The only time there is a legal restriction on fees for SIMPLE-IRAs is when the employer has chosen one financial institution to act as the designated financial institution. And then the restriction applies only to certain transfers. As discussed above, the IRS has created a number of exceptions allowing for fees to be charged in some transfer situations.

Who Pays U.S. Individual Income Tax?

The population of the United States in 2020 was estimated to be 331.0 million. The population of the world in 2020 was 7.79 trillion. The population of China was 1.42 trillion. The population of India was 1.34 trillion. As a percent of the world's GDP, the U.S. has a share of 25.06% and China had a share of 17.48%.

The IRS has released individual income statistics for 2020 in Publication 1304. It was revised in October of 2020. have been released. It contains 417 pages of statistics. IRS data shows who pays the individual income taxes. This publication does not address other taxes such as social security, medicare or corporate taxes. Individual income taxes account for approximately 48%, corporate income taxes account for 11.5%, social security accounts for 25%, Medicare accounts for 8.5% and the remaining 7% comes form other minor excise taxes.

The purpose of this article is to illustrates two facts - married individuals pay a large share of the income taxes as do individuals with very high incomes.

There were 164,358,792 income tax returns filed for 2020 as follows:

Filing Status	Number of Filed Returns	%	Tax Revenue	% Tax Revenue
Single	83,652.916	50.90%	$416,008,121,000.	22.82%
Head of Household	21,463,538	13.06%	$92,115,009,000.	5.05%
Married Filing Jointly	55,322,922	33.66%	$1,266,316,696,000.	69.47%
Married Filing Separately	3,919,416	2.38%	$48,421,908,000.	2.66%
Total	164,358,792	100.00%	$1,822,861,734,000.	100.00%

2. Total individual income tax revenue was 1.83 trillion dollars.

3. The total number of individuals filing a tax return is 219,681,714 (164,358,792 + 55,322,922) when both spouses of the married joint filers are considered.

4. Married individuals pay 72.13% of all tax revenues even though they file only 36.04% of all tax returns. The average amount paid by those filing a married joint return is $26,117.

5. Single filers and head of household filers total 105,116,454 or 63.96% of the filers. Together these two groups pay 27.87% of the taxes.

6. There were 127,413,288 tax returns filed for 2020 showing some taxable income and 36,945,504 returns showed no taxable income.

Filing Status	Number of Filed Returns	%	Tax Revenue	Average
Single	59,008,898	46.31%	$416,008,121.	$7,049.92
Head of Household	16,583,862	13.02%	$92,115,009.	$5,554.50
Married Filing Jointly	48,486,977	38.05%	$1,266,316,696.	$26,116.60
Married Filing Separately	3,333,551	2.62%	$48,421,908.	$14,525.62
Total	127,413,288	100.00%	$1,822,861,734.	$14,306.68

7. The table below shows the U.S. tax system is very progressive. A small number of taxpayers (25%) pay 88.5% of the income taxes and the top 50% of taxpayers pay 97.7% of the taxes. In general, the top 50% of taxpayers are those with AGI of $50,000 or more.

AGI Range	Taxes Paid	% Paid	Accumulated % Paid	Average Taxes Paid
Top 1%	$772,732,000,000.	42.3%	42.3%	$458,894
Top5%	$1,071,681,000,000.	20.4%	62.7%	$136,091
Top 10%	$1,258,335,000,000.	10.0%	73.7%	$79,897
Top 25%	$1,511,786,000,000.	14.8%	88.5%	$38,396
Top 50%	$1,668,410,000,000.	9.2%	97.7%	$21,187
51-99%	$39,671,000,000.	2.3%	100.0%	$504
Total	$1,708,081,000,000.	100.0%	100.0%	$10,845

8. The top 1 % pay 42.3% which is $773 billion or $458,894 per return.

9. The top 5% pay 62.7% which is $1,071 billion or $136,091 per return.

10. The top 10% pay 73.7% which is $1,258 billion or $79,897 per return.

11. The top 25% pay 88.5% which is $1,151 billion or $38,396 per return.

12. The top 50% pay 97.7%. These are returns showing income of $50,000 or more.

The United States is very fortunate that 25% of tax filers are willing to pay most of the income taxes collected by the U.S. Treasury. Married individuals obviously are to be valued for the large tax amounts they pay to the U.S. Treasury.