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The Pension Digest

ALSO IN THIS ISSUE –

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

Business Opportunities Related to SEP-IRAs and Roth SEP-IRAs

There are business opportunities related to SEP-IRAs and IRA custodians/ trustees should be making business decisions as to what SEP-IRA services, if any, will it render.

A financial institution wants to have a basic understanding of its customer base Who wants to make SEP-IRA contributions and who might make SEP-IRA contributions.

The tax benefits associated with SEP-IRAs are great. Fairly often in this newsletter we have explained or indicated the average annual SEP-IRA contribution is in excess of $15,000. The maximum SEP-IRA contribution for 2024 is $69,000 and is $70,000 for 2025. A bank or other financial institution wants to service those small businesses which do or will consider making SEP-IRA contributions. Servicing one-person SEP plans is so simple every institution should do it. With respect to small businesses having employees, servicing them can also be simple. The small business must understand that the SEP-IRA plan is a retirement plan and it must be administered. A financial institution may decide that it will provide the administrative services, but that is not required.

The purpose of this article is to argue - there are business customers who have SEP-IRAs who will want to exercise the new right to have the employer's SEP contribution go into a Roth SEP-IRA versus a standard SEP-IRA. A person who has a successful business may not want the complexity of a 401(k) plan. A person who has a successful business many times will be ineligible to make a Roth IRA contribution because their income is too high. These individuals somehow want to get money into a Roth account. Participating or having a Roth SEP-IRA gives them that opportunity. This opportunity first became available in 2023 because of a law change made by SECURE 2.0.

CWF can assist you with the plan documents and other forms which a business must execute to be able to make Roth SEP-IRA contributions. You may and should charge a reasonable fee to a customer. By offering this service you can acquire new businesses as your customers. Again, there are successful individuals who want to make "Roth" contributions. You want to help them make such contributions.

The IRS has issued guidance that an employer with a SEP-IRA will need to decide if their plan will be amended giving any participant the right to decide to have the employer contribution go into a Roth SEP-IRA account or a standard SEP-IRA account or both. The SEP-IRA custodian/trustee will have to perform "separate accounting" for Roth SEP-IRA contribution. The SEP-IRA custodian/trustee does have a new duty to perform when a participant designates their contribution as a Roth IRA SEP contribution. For IRS reporting purposes, their contribution is treated as if a Roth conversion has occurred, A Form 1099-R must be prepared to report this deemed conversion distribution because it is taxable.

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Tax Rules for Selling One's Home

This article discusses a subject which is not an IRA, HSA or pension topic, but it is an important tax and planning topic. For most US residents their wealth is comprised on their home and their retirement funds in IRAs and other retirement plans.

A person who meets certain rules is able to exclude the first $250,000 of gain when he or she sells his or her home. This amount increases to $500,000 if a person is married and files a joint income tax return.

The general rule is - a person is eligible to exclude any gain on the sale of their home if he or she meets a residence requirement, an ownership requirement and a look back requirement. One meets the residence requirement if the person owned the home and used it as their residence for at least 24 months of the previous 60 months (5 years). The use need not be consecutive. One meets the look-back requirement if he or she did not sell another home during the 2-year period before the date of the sale. One is eligible to take the exclusion only once during a 2-year period. One meets the ownership requirement if he or she has owned the home for at least 24 months out of the last 5 years before the closing date. If a person is married and a joint income tax return is filed, then only one of the spouses must meet the ownership requirement.

There are two special rules for surviving spouses.

Rule #1. Even if a surviving spouse will not be filing a joint income tax return because their spouse died in a prior year, she or he may still be able to exclude $500,000 and not $250,000. The following requirement must be met:

1. The home must be sold within 2 years of the deceased spouse's death.
2. The surviving spouse has not remarried.
3. Neither the surviving spouse or the deceased spouse had used this rule within the previous 2-years and
4. The 2-year ownership and residence requirements were met by one spouse or both spouses.

Rule #2. A surviving spouse who doesn't meet the 2-year ownership and residence rule is able to use the time when the deceased spouse did to meet the requirements as long as the surviving spouse has not remarried.

The IRS has issued Publication 523. There are many special rules and a surviving spouse and his or her adviser will want to review it.

A person is eligible to receive this tax benefit more than once in his or her lifetime.

How Was The Financial Condition of Social Security Changed by COVID-19?

A study conducted by the National Bureau of Economic Research was recently released and it indicates the financial condition of the Social Security system improved by $205 billion as a result of COVID-19.

It has been estimated or determined that COVID-19 caused 1.7 million deaths between 2020 and 2023.which otherwise would not have occurred. The 1.7 million deaths were premature or excess deaths among those age 25 and older.

Because of these premature deaths the Social Security Fund will NOT need to pay retirement benefits of $294 billion. This gain is partially offset by $58 billion because those who died (and their employers) will no longer be paying social security taxes. This gain is also partially off-set by $32 billion because payments now must be paid to surviving spouses and children.

Note the Social Security Administration did not release this report. For whatever reason the trustees of Social Security and the Social Security Administration have been unwilling to provide an analysis of how COVID-19 impacted the Social Security Fund.

The Social Security Administration estimates that it will pay benefits of $1.6 trillion in 2025 to 69 million Americans.

SEP-IRAs and Roth SEP-IRAs,
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We at CWF are here to assist you if you wish to offer any Roth SEP-IRA services or any standard SEP-IRA services. Call us with your questions or email us.

A small business has until the tax filing deadline (including an extension) to establish and contribute to a Roth SEP-IRA or a standard SEP-IRA.

Email Guidance – Must an IRA Trustee Perform the DOL's Rollover Analysis Before Accepting a Direct Rollover?

Q-1. When we are transferring IRAs I have heard so much conflicting information that I want to get your opinion.

Are we currently required to perform an analysis with the client for a transfer of an IRA or 401(k)to us?

A-1. The IRS does not require it.

The Biden DOL tried to require it, but 2 federal courts in Texas issued stays covering the entire nation. I understand these stays are still in effect. Those 2 courts stated that their Initial determination was the DOL rules were an unconstitutional overreach with respect to IRAs because IRAs are not subject to Title I of ERISA.

I am biased, but the Biden DOL rule went too far as discussed by the 2 courts.

It is unclear to me what the banking regulators are saying. The banking regulators may have implemented the DOL's new rule. They should not have. In my opinion until the law is clarified by the Trump administration, a banking regulator should not be stating that such an analysis is required.

I don't believe such an analysis should ever be required for an IRA to IRA transfer or rollover. movement. Existing law (IRS and DOL) does not require it.

Are other institutions claiming they will not release or transfer the IRA funds until they are shown that an analysis has been made? As long as the individual instructs to have the transfer or rollover that transaction should occur regardless of any analysis by one or both financial institutions.

The SEC and FINRA have rules requiring such an analysis. I do not understand well - if and how these rules (Best Interest) apply to a bank rather than a securities firm. Presumably, these SEC and FINRA rules too will be changed by the Trump administration. But the existing regulations will need to be changed and it will take time.

Q-1A. But what if it is a 401(k) to IRA transfer?

A-1A. One needs to wait to see what President Trump wants done and what his new DOL head actually gets done. Until then, I don't believe that special analysis is required. Again, I have no idea of the position of the banking regulators.

The DOL regulation mandating the analysis has not yet been formally rescinded, but it is no longer the governing law.

Are there some or many 401(k) plans and the related investment firms saying they won't allow a person to have a direct rollover to an IRA unless there has been that analysis? That is, they want an excuse for holding onto the account for a certain period of time.

Those employees at the DOL who used to be in control truly believed that the professional investors of the 401(k) plan would achieve higher earnings than individuals would if they moved the funds into their own IRAs.

Email Guidance – Does Google Misunderstand the RMD Rules?

Q-1. We have a customer that is turning 73 In May; they would like to take their RMD next week. In the manual we purchased from Colin Fritz & Associates it states that it can be taken any time after January 1 in the year they turn 73. If we Google it, it states that they cannot take a distribution before their birthdate and have it satisfy the RMD.

Can you please clarify for us?

A-1. Yes. We all make mistakes. This time it is Google which is wrong.

I understand Google is saying that a person who takes a distribution prior to their age 73 birth date cannot use that distribution or distributions to satisfy their RMD. If there was such a law it would nearly be impossible for the IRS to administer the RMD rules and the rollover rules. The IRS would need to know everyone's birth date.

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Google,
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The RMD rules are not based on every individual's birth date. The RMD rules are based on an individual's required beginning date. An individual's required beginning date is April 1 of the year following the-year the person attains age 73. Under the RMD rules every person attaining age 73 in 2025 has the same required beginning date of April 1 of 2026.

A person who attains age 73 in 2025 and who takes a distribution on or after January 1, 2025 must use that distribution to first satisfy their 2025 RMD. The law is very clear that an RMD is never eligible to be rolled over. Never is never. In order that the rollover laws may be applied and administered the IRS has adopted a regulation providing that a person is eligible to rollover a distribution only if the person has satisfied their RMD requirement for the current year.

See IRS Publication 590-B. I admit the IRS does not expressly discuss this birthdate topic. On the other hand the is no IRS discussion supporting the Google position. The RMD rules and the rollover rules could not be administered effectively if they were based on an individual's birth date.

Email Guidance – Recharacterizing an Excess Roth IRA Contribution and Then Converting it

Q-1. I have a customer who made Roth Contributions in the amount of roughly $700.00 dollars in 2024, she just went to file her taxes and her accountant informed her she is ineligible to make Roth contributions because she has chosen to file Married Filing Separately while living with her spouse and her AGI is over $10,000.00 (this part I understand).

Can we recharacterize in 2025 the Roth Contributions made in 2024 as Traditional IRA Contributions? Her accountant has also suggested a loophole that allows her to convert the funds to Roth funds after recharacterizing to Traditional. Can she do this even though she is ineligible to make. Roth Contributions? I spoke with the accountant and he said this is how high earners are able to make Roth IRA contributions.

So my question is two-fold, has the accountant found the loophole of all loopholes, and how do I clean this up in the best way for my customer?

A-1. Yes she may recharacterize her Roth IRA contribution to be a traditional IRA contribution.

I understand she would treat this contribution as non-deductible. If she has no "taxable" funds in a traditional IRA with ABC or another bank, then yes she can convert that $700 into a Roth IRA

However the conversion transaction is not that simple if she has any taxable funds in any traditional, SEP or SIMPLE-IRA with ABC or another IRA custodian.

Example. Jane Doe has a traditional IRA with Bank 2 with a balance of $15,000. It is assumed these funds are all taxable because she claimed tax deductions for her contributions. She then makes a $700 non-deductible contribution to her IRA with Bank 1 in 2025. Set forth below are the tax consequences if she converts $700.

The prorata taxation rule applies. Sometimes people are unaware of this prorata rule. One is not allowed to withdraw the non-deductible funds ahead of the taxable funds. A portion of the $700 is taxable and a portion is not taxable. The law provides a prorate formula applies.

Taxable portion $15,000/ $15,700 x $700 = $668.79

Non-taxable portion $700/ $15,700 x $700 =$31.21

In this situation a person will probably not convert the $700 because 91% of it is taxable. She will probably decide to withdraw the excess contribution and not recharacterize it. Or, she may recharacterize it and not convert it. She benefits because the non-deductible funds within the IRA will earn tax deferred income.

If she converts the $700 now the conversion occurs in 2025. It is not done in 2024. If there has been some earnings by the $700 and those earnings are also converted the earnings will be taxable.

She should act on the advice of her accountant.

Q1-A. In this case the customer has a 401(k) through her employer, but no other Traditional, SEP or SIMPLE-IRAs with any other custodian.

At this very moment after speaking with her accountant personally we are planning to re-characterize, and then discuss the Roth Conversion at a later date, how-

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Roth IRA Contribution,
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ever, I told him I would be reaching out to my advisor to counsel me on the situation since it was unfamiliar territory.

When I recharacterize is this done as a withdrawal from the Roth IRA, and then a subsequent deposit to the new Traditional IRA?

A-1A. The IRS is to be informed of the following three recharacterization transactions.

The 2024 Form 5498 for the Roth IRA is to report the 2024 contribution into the Roth IRA in box 10.

A 2025 Form 1099-R will report the recharacterized withdrawal from the Roth IRA. The reason code in box 7 is to be an "R". Box 2a is to be completed with 0.00. No tax is owing when there is a recharacterization.

A 2025 Form 5498 will report the recharacterization contribution into the traditional IRA in box 4.

If the customer makes the conversion in 2025, then the IRS is to be informed of the following two conversion on transactions

A 2025 Form 1099-R will report the withdrawal from the traditional IRA. Box 1 and 2a are to be completed and box 7 will depend on her age. If she is under age 59½ it will be a "2" and it will be a 7 if she is age 59½ or older She will need to complete Form 8606 for two reasons and she must complete her tax return to explain that the $700 is not taxable because she had made a $700 non-deductible contribution. The earnings will be taxable but will not be subject to the 10% additional tax. Part I and Part II on the 2025 Form 8606 should be completed. Her accountant will need to decide if Part I of the 2024 Form 8606 should be completed.

A 2025 Form 5498 for the Roth IRA will show in box 3 that she made a $700+ earnings Roth IRA conversion contribution.

The sooner she and the accountant decide whether she will do the conversion the better. Any earnings after she has made the conversion will presumably one day be tax-free. However, she will need to include in her income any earnings prior to the conversion.

Email Guidance – Opening a New SEP-IRA Plan and Roth SEP-IRA Contributions

Q-1. We have a customer inquiring about establishing a SEP-IRA with our bank. It has been several years since we have opened up a new SEP-IRA.

Can you refresh my memory on these types of IRAs - what forms would be required for us to open up a new SEP-IRA?

A-1. It is easy and very easy if the employer has no employees. The customer will complete IRS Form 5305-SEP. The bank does not sign this form. The employer does.

If the employer has any employees a copy of the signed form should be given to each eligible employee.

On the CWF IRA FormSystem this form is CWF702.

This SEP form was written in 2004 and the IRS has not updated. The limits in the form are adjusted by a COLA.

A person may make a very large contribution as the maximum contribution is 25% of compensation up to $69,000 for 2024 and $70,000 for 2025.

Q-2. We have a customer asking about Roth SEP-IRAs. What can you tell me about Roth SEP-IRAs?

A-2. This topic is discussed on page 1.

Email Guidance – Is Your Institution Considering Offering HSAs?

Q-1. Would you be able to get me a synopsis on HSAs? How complicated are HSAs to manage? What forms are used? What happens at tax time?

A-1. To service HSAs a bank will basically perform the same duties that it performs for IRAs, but a little less.

The HSA owner must complete a Form 8889 and explain the tax consequences of their contributions and distributions. Most distributions are ''normal'' and the

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Consider HSAs,
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individual informs the IRS if the distribution was used to pay a qualified medical expense or not used to pay a medical expense.

The bank will need HSA forms. These are on our IRA Formsystem. There is an additional charge of $150.

There must be annual IRS reporting by the bank of contributions and distributions on Forms 5498-SA and 1099-SA. We at CWF will do that for the same per account fee applying for IRAs.

The bank must decide what type of account it will offer the HSA owners? A savings account, a checking account, debit card, time deposit, etc;,

With HSAs there will be many more distributions made by the HSA owner than with IRAs. The HSA plan agreement is written so that almost all distributions are processed as normal distributions and the HSA owner must instruct in those other cases. The bank has legal duty or right to monitor why an HSA takes a distribution. That is the responsibility of the HSA owner.

I suggest the bank attend our basic HSA webinar on HSAs. Let us know if you want to do so. We can arrange a special time for the webinar at your convenience.

An HSA has more tax benefits than IRAs. A person is able to claim a deduction for any contribution they make (or excluded from income when the employer makes the contribution) and any distribution used to pay a medical expense is tax-fee.

Email Guidance – HSA Mistakes If and How to Process Corrections

Q-1. It was brought to our attention when our customer received his tax forms for 2024 that his employer deposited his payroll into his HSA account in error on 12/20/24 and then they reversed it the same day. What would you suggest as our steps to assist this customer?

A-1. What question is being asked by the person? Is the customer thinking because it was immediately reversed there should be no IRS reporting for these transactions? That is, it is permissible to treat the 2 transactions as if they never occurred. The employer and the accountant probably believe this mistake is easily corrected, but being a tax subject it is not.

I agree that the IRS should furnish and have procedures allowing this type of mistake to be easily corrected. However, HSAs are a tax subject and the IRS probably won't adopt rules for making an easy correction.

The standard rule is - as with IRAs the HSA custodian is required by law to report all HSA contributions and all HSA distributions.

The "excess" contribution would be reported and the withdrawal of an excess would be reported. I understand the bank prepared the Form 1099-SA showing this distribution amount.

I believe the customer should be informed what the IRS procedure is, the bank must report all contributions and distributions and he or she has the duty to explain the tax consequences of the contributions and the distributions on their tax return.

The employer's mistake does create various issues for the employee. Has the employer or the accountant furnished the employee any type of written explanation of its mistake and offer to assist.

It appears the bank allows an employer to make its HSA contributions by ACH and it allows ACH withdrawals. The bank should consider modifying its procedures for HSAs where the ACH withdrawal would not automatically be permitted.

The bank should be aware once a contribution is made that the owner of the funds switches from the employer to the individual. An individual may certainly consent to having certain funds returned to the employer but an employer under the law does not have the automatic right to reclaim the funds. IRS rules permit an employer to recover an HSA contribution in only 2 situations. First, the person has already met his or her contribution limit for the year and second, the person was never eligible for an HSA.

Q-2. We have a customer that opened an HSA account at one of our branches. This account was opened in error by the employee. The customer does not qualify for the HSA. She is on Medicare, retired and does not have a HDHP. To close the HSA and return the funds, would we treat this as an excess contribution or a prohibited transaction? The account was opened yes-

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HSA Mistakes,
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terday, so they have not made any additional contributions.

A-2. She needs to withdraw the amount contributed as an excess HSA contribution.

Q-3. We had an HSA Owner take out $25,000 from his HSA for an investment opportunity. Now he wants to return it?

A-3. There are times we all learn tax lessons the hard way. This may be such a situation for your customer. He will need to act on the advice of his tax adviser.

Like with IRAs, an HSA custodian by law is required to report to the IRS the contributions made by the HSA owner and the distributions withdrawn. The HSA custodian reports the total amount of contributions and distributions The individual or the tax preparer reports the tax consequences on his or her tax return by completing Form 8889.

When an HSA owner withdraws HSA funds and does not use the withdrawn amount to pay a qualified medical expense the amount withdrawn ($25,000) must be included in his income plus he owes a 20% penalty tax.

Your customer now wants to somehow return to his HSA the $25,000 he withdrew. He has raised the subject of a mistaken distribution. The fact that he was unaware of the tax rules for this situation is not a mistaken distribution as that term has been defined for HSA purposes. For HSA purposes a mistaken distribution is one which a person takes because he reasonably believe he needs to pay medical expense because his HDHP is not going to pay it. However , the HDHP does pay it. When he gets paid or refunded by the HDHP he is allowed to put these funds into his HSA The re-contribution is not reported and the original distribution is not to be reported.

Your customer does not have a mistaken distribution as the IRS has defined that term for HSA situations. He did not withdraw the $25,000 because he believed the HDHP was not going to pay a medical expenses.

The bank is unable to treat his withdrawal as a mistaken distribution for IRS reporting reasons. The facts do not support it.

Additional Comment. The IRS has never said that an HSA owner who misses the 60-day rollover requirement is able to use the Late Rollover certification procedure. He may need to discuss wit the IRS.

Q-4. We have a customer that by mistake had cut up the wrong debit card and was using her HSA debit card in error. She has 10 transactions on her HSA account that are personal expenses. She wants to transfer money from her personal account to cover the expenses. Do we do a Distribution Reversal for the transactions? Do we need to post each amount back separately or can I do one lump sum?

A-4. She may have learned a tax lesson the hard way. She must talk with her tax adviser. Any distribution not used for medical reasons must be included in income and the 20% penalty tax is also owed. You did not mention the total of these transactions.

She could rollover one of the distributions. The other contributions would count towards her annual limit.

HSAs are a tax subject. Often a person cannot correct what they think they should be able to correct.

I realize the bank wants to help the customer, but the bank does not want the customer's problem to become the bank's problem. That is what could happen if the bank decides to not report to the IRS the distributions and you would allow a lump sum re-contribution which is not reported. These transactions would be coded as transfers or some code that does get reported.

The IRS does not ask the bank to determine the tax consequences. You report the contributions and the distributions to both the IRS and the customer. It is up to the HSA owner/customer on Form 8889 to report/explain the tax consequence of the contributions and the distributions. The HSA Owner has the duty and ability to explain the tax consequences of her HSA distributions on her tax return.

Q-4A. Could you explain the second statement about rollover one of the distributions & the other contributions would count toward her annual limit?

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HSA Mistakess
Continued from page 7

If she wants the dollar amount in the account to stay the same, could she make a regular contribution as long as she has not reached her yearly limit?

Another question is if they have a distribution from a medical provider and then are refunded with a check from that provider how do we code this contribution?

A-4A. She could rollover the largest distribution. Then she does not include that amount in her income and she does owe the 20% on that amount.

Yes, she can use these funds to make a regular contribution as long as she has not met her yearly limit.

Your last question asks - has a mistaken distribution occurred as defined by the IRS. The IRS defines a mistaken distribution as - the HSA owner withdraws funds from her HSA because she has reason to believe the HDHP will not pay the medical expense, but then the HDHP does pay it so she is refunded the amount of her prior payment. If this occurs - the original distribution is not reported on the Form 1099-SA and the re-contribution is not reported on the Form 5498-SA.

When one uses the wrong debit card - that is not a mistaken distribution as defined by the IRS.

Q-5. A customer's accountant is positive an HSA customer and her spouse have a limit of $9,300 for 2024.

A-5. The combined maximum HSA contributions for 2024 are $10,300 ($9,300 + $1,000) and for 2025 are $10,550 ($9,550 + $,1000).

On Page 7 of the 2024 IRS Publication 969 it clearly states the maximum contribution for a married couple is $10,300. But to reach that limit the couple must have two HSAs. The $1,000 contribution allowed a person age 55 or over must be contributed to that spouses HSA.

You may show this email to your HSA customer and her accountant. If the accountant has something in writing indicating their contribution is limited to $9,300. I will certainly review it.

Page 7 of IRS Publication 969:

Rules for married people. If either spouse has family HDHP coverage, both spouses are treated as having family HDHP coverage. If each spouse has family coverage under a separate plan, the contribution limit for 2024 is $8,300. You must reduce the limit on contributions, before taking Into account any additional contributions, by the amount contributed to both spouses' Archer MSAs. After that reduction, the contribution limit is split equally between the spouses unless you agree on a different division.

CAUTION: The rules for married people apply only if both spouses are eligible individuals.

If both spouses are 55 or older and not enrolled in Medicare, each spouse's contribution limit is increased by the additional contribution. If both spouses meet the age requirement, the total contributions under family coverage can't be more than $10,300. Each spouse must make the additional contribution to their own HSA.

Q-6. We have a customer who has an HSA and turned 65 in January. He is on Medicare. Can he use his HSA to help pay Medicare premiums? Also when his wife turns 65, can they use the HSA to help pay her Medicare premiums? Any information you can provide on this would be greatly appreciated. Thanks!

A-6. Yes, he is able to reimburse himself from his HSA for his Medicare premiums which he is considered to have paid since the Social Security Adm. reduces his monthly SS benefit by this amount He could put that amount into a checking account or into a savings account or he could write a check to himself. Paying the Medicare premiums is defined to be a qualified medical expense.

He will be able to reimburse himself from his HSA for her Medicare premiums as long as she does not do so from her own HSA if she has an HSA.

Q-6A. I was wrong in my first email; it is the wife's HSA and she is not 65 years old. The husband is on Medicare but is currently not drawing social security. Can they still use this to help pay for his Medicare premium? She also wants to know if they can use the HSA to help pay for supplemental premiums?

A-6A. She must act on the advice of her tax adviser.

See Publication 969 for HSAs. The general rule is - paying insurance premiums is not a qualified medical expense for an HSA owner unless one of four exceptions applies. There is an exception that applies for Medicare coverage if the HSA owner is age 65 or older. She is not. So, she may NOT withdraw funds from her HSA to pay his Medicare premiums even though he is older than age 65.