April to June | V o l u m e 12 | Issue 2

The IRA Authority!

IRA & Employer Plan Rules, News & Tips in Plain Language

Annual IRA Calendar

Please mark your calendar with the following deadlines:

May 31, *IRA Contribution Information* (Form 5498)- Likely to be extended

May 31 is the deadline by which IRA custodians are required to issue Form 5498, IRA Contribution Information (Form 5498) to IRA owners, unless the custodian files for an extension. Form 5498 can be used as an audit tool for IRA contributions, allowing interested parties to determine whether the IRA custodian properly reported the transactions.

The following are some of the transactions that are reported on Form 5498: -

- Box 1: Traditional IRA participant contributions for 2020. This includes contributions made January 1, 2020 to December 31, 2020 for 2020, and January 1, 2021 to May 17, 2021 (postponed from April 15) for 2021.
- Box 2: Rollover contributions made to the IRA during 2020.
- Box 3: Roth IRA conversions to Roth IRAs during 2020.
- Box 4: Recharacterized contributions and recharacterized conversions between Roth IRAs and non-Roth IRAs during 2020.
- Box 8: SEP IRA contributions received by the IRA custodian during 2020, regardless of the year for which the employer makes the contribution.
- Box 9: SIMPLE IRA contributions received by the IRA custodian during 2020, regardless of the year for which the employer makes the contribution.

Table of Contents

- Box 10: Roth IRA participant contributions for 2020. This includes contributions made January 1, 2020 to December 31, 2020 for 2020, and January 1, 2021 to May 17, 2021 (postponed from April 15), for 2020.
- If none of these transactions were made to the IRA, and the IRA custodian already reported the December 31 fair market value to the IRA owner by January 31, Form 5498 is not required to be issued for the IRA for the year.

RMD Indication

The IRA custodian is also required to indicate if the IRA owner is required to take an RMD for the 2020 calendar year. If an RMD is required, Box 11 should be checked. This does not apply to Inherited/Beneficiary IRAs.

A complete list of the information reported in each box of Form 5498 is available in the 2020 version of the IRS instructions, which is available here https://www.irs.gov/forms-instructions

IRA Successor Beneficiary Options under the SECURE Act: A Case Study

The SECURE Act shortened the distribution period for designated beneficiaries of retirement accounts. For successor beneficiaries the distribution period is less than 10 years.

The required minimum distribution (RMD) regulations allowed a designated beneficiary to distribute an inherited IRA over his life expectancy if the IRA owner died before 2020. This meant being able to accumulate tax-deferred growth on non-RMD amounts for many years for young designated beneficiaries. If that designated beneficiary died before 2020, his successor beneficiary could continue taking distributions over what remained of the designated beneficiary's life expectancy.

The Setting Every Community Up for Retirement Enhancement (SECURE) Act – which became law in December 2019, severely limited these benefits for IRAs inherited after 2019.

Background– Back to Basics

To begin to understand the distribution rules that apply to beneficiaries, one must first understand some basic beneficiary related definitions:

Designated Beneficiary: An individual who inherits an IRA and is not limited by any extenuating circumstances that would cause him to lose his designated beneficiary status. This definition applied before the SECURE Act and continues to apply under the SECURE Act.

Eligible Designated Beneficiary: A designated beneficiary who is:

A. the surviving spouse of the IRA owner

B. a child of the IRA owner who has not reached the age of majority, as defined under state law. Once the child reaches the age of majority, that child becomes a regular designated beneficiary and has 10 years (after reaching the age of majority) to distribute the inherited IRA

C. disabled- which generally means meeting the social security administration's definition of disability

D. chronically ill - subject to meeting certain specific requirements, or

E. an individual not described in any previous categories (A to D) who is not more than 10 years younger than the IRA owner.

This definition is new and was introduced under the SECURE Act effective for years after 2019.

Successor Beneficiary: A beneficiary that inherits an IRA from a designated beneficiary or an eligible designated beneficiary.

Distribution Options for Designated Beneficiaries

If a designated beneficiary inherited an IRA from an owner who died before 2020 and the terms of the IRA agreement did not dictate otherwise, the designated beneficiary would be eligible to take distributions over his single life expectancy.

Exception: If the IRA owner died after RMDs were required to begin from the IRA, the beneficiary could take distributions over the longer of his life expectancy or the decedent's remaining life expectancy.

Whichever life expectancy applied to the designated beneficiary would continue to apply to his successor beneficiary after his death.

For example: If John inherited an IRA at 30 years old, he would be eligible to distribute the IRA over his life expectancy period of 52.4 years, which would begin the following year when he reaches age 31. If John dies at age 32, his successor beneficiary would be eligible to continue taking distributions over John's remaining life expectancy of 51.4 years.

Under the SECURE Act, the distribution periods for designated beneficiaries and successor beneficiaries are now much shorter. Let's take a look at a case study:

	IRA Owner-Mary	Original beneficiary (nonspouse) Dick-designated beneficiary	Successor beneficiary -Harry
Date or year of birth	05/08/1950	1956	1964
Date or year of death	10/06/2017	2019	N/A

When Mary died, Dick- who reached age 62 the following year, was eligible to take distributions over his single life expectancy of 23.5 years beginning by December 31, 2018.

When Dick died in 2019, he had a remaining life expectancy of 22.5 years. His successor beneficiary, Harry, was eligible to continue taking distributions from the IRA over that remaining 22.5 years.

Harry's real age is never factored into the analysis because he is merely a successor beneficiary.

Assuming a rate of return of 5% and no more than RMDs were taken each year, the total distributions would have been $1,234,549; a significant income to the beneficiary, which would be compounded if the IRA was a Roth, as no income tax would be due on the amount.

Now, let's change the date of the designated beneficiary's death to after 2019 to see how the SECURE Act affects the distributions.

	IRA Owner-Mary	Original beneficiary (nonspouse) Dick-designated beneficiary	Successor beneficiary -Harry
Date or year of birth	05/08/1950	1956	1964
Date or year of death	10/06/2017	2021	N/A

When Mary died, Dick was eligible to take distributions over his single life expectancy of 23.5 years, beginning by December 31, 2018.

When Dick died in 2021, Harry was subject to the new 10-year rule under the SECURE Act. Here, Harry's distributions are optional until December 31, 2031, at which time the entire balance must be distributed.

Assuming a rate of return of 5% and that no more than RMDs were taken each year, the total distributions would have been $1,121,344- a difference of $113,205 ($1,234,549-$1,121,344), which would have been even more significant if the designated beneficiary was younger.

The Exception for Eligible Designated Beneficiaries

While the life expectancy option is no longer available to a designated beneficiary who inherits an IRA after 2019, it applies to an eligible designated beneficiary.

When an eligible designated beneficiary dies, the successor beneficiary is then subject to the 10-year rule.

IRA Savvy Advisors Can Help to Ensure Accurate Application of the Rules

With the changes made under the SECURE Act, interested parties must be even more vigilant when determining which distribution options apply to designated beneficiaries and successor beneficiaries. Failing to apply the rules accurately could result in beneficiaries taking less than their RMDs, and any RMD shortfall would be subject to an IRS assessed 50% excess penalty.

This is a high-level overview. Many more rules apply to inherited IRAs. These include the special rules that apply to spouse beneficiaries and other eligible designated beneficiaries. Working with an advisor who understands these rules can help to avoid mistakes.

Q&A: Correcting Excess Salary Deferral to a Roth 401(k)

My 55-year-old client participates in a 401(k) and a 403(b) IRA plan.

For 2020 he made the following salary deferral contributions:

- $20,500 to the 401(k) plan and
- $8,000 to his 403(b) IRA

I know that he is limited to $19,500, plus $6,500 catch-up as salary deferral.

Are these limits separate? Or has he exceeded his salary deferral limit for the year?

Answer:

Your client is limited to $19,500, plus $6,500 catch-up contributions.

The $19,500 can be split between the 401(k) and the 403(b). Therefore, the total salary deferral between both cannot exceed $19,500.

The $6,500 can be split between the 401(k) and the 403(b) IRA. Therefore, the total catch-up between both cannot exceed $6,500.

Your client should notify the employers about the excess contribution.

The deadline to remove the excess is April 15. If your client misses this deadline, the amount will remain in the 401(k), until she is eligible to make a withdrawal from the plan (for example, reaching age 59 ½ or separation from the employer).

Distributions of that excess amount might be taxable, resulting in double taxation. That's the cost of missing the deadline.

Disclaimer

Appleby Retirement Consulting Inc.
253 Silvertop Drive,
Grayson, GA 30017
Telephone: 973-313-9877
Fax: 888-524-3120

help@irapublications.com
www.applebyconsultinginc.com
www.iraeducationcenter.com

Writer: Denise Appleby, MJ, CISP, CRC, CRPS, CRSP, APA
Editor: Marjorie Wellington, MBA

Please do not hesitate to contact us with any questions and/or comments about the content.