July to September | V o l u m e 12 | Issue 3

The IRA Authority!

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

Annual IRA Calendar

Please mark your calendar with the following deadlines:

September 30, 2021: Deadline for Removing Non-Designated Beneficiaries

If you have clients who inherited assets from IRAs and other retirement accounts during 2020 and share primary beneficiary status with other beneficiaries, removing any non-designated beneficiaries by September 30, 2021 might determine the distribution options for all the beneficiaries.

The Reason: Any beneficiary that is a non-person, such as an estate, charity or nonqualified trust, is a non-designated beneficiary. An exception applies to a trust beneficiary that meets certain specific requirements. Visit www.retirementdictionary.com for a definition of a qualified trust. If a non-designated beneficiary is one of multiple beneficiaries and fails to distribute its share by September 30, the distribution options for all beneficiaries would be those that apply to non-designated beneficiaries.

As an advisor, you will need to help your clients determine the distribution options that are available to them.

October 15, 2021:

The deadline by which recharacterizations of 2020 IRA contributions must be completed

Clients who want to recharacterize a Roth IRA contribution to a Traditional IRA contribution or vice versa, have until their 2020 tax filing deadline to do so. Clients who filed their 2020 tax returns or filed for extensions by the due date received an automatic six-month extension from the original return due date, to complete recharacterizations. For calendar year tax filers, the automatic six-month extension ends on October 15, 2021.

The deadline to remove 2020 IRA excess contributions

An excess IRA contribution for 2020 must be corrected by removing the amounts by the 2020 tax filing deadline of the account owner, in order to avoid owing the IRS an excise tax of 6% of the excess amount.

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Similar to the deadline for completing recharacterizations of Roth conversions, clients who filed their 2020 tax return by the due date received an automatic six-month extension from the original return due date to correct the excess IRA contribution.

Recharacterizations and return of excess contributions must include any net income attributable (NIA) to the amount. The NIA can be earnings or losses. Some IRA custodians will calculate the NIA. If you are working with a client whose custodian does not calculate the NIA, the instructions provided in IRS Publication 590-A can be used .

New Rules for Correcting IRA Excess Contributions - Gary Lesser Explains

"*The IRS, the Code, and regulations thereunder, have always been clear, at least until recently: An individual has up until his or her return deadline, including extensions, for the year in which the excess IRA contribution was made to distribute the excess to avoid the amount distributed from being treated as a taxable distribution and subject to the 6 percent tax on excess IRA contributions.*

The IRS has indicated a desire to change the determination of the year in which an excess is treated as made and hence the due date of the year in which it must be corrected in (or by) to avoid the 6 percent tax on excess contributions. And it appears that this change has already been implemented. The new interpretation would treat all excesses made for a contribution year as having been incurred during that contribution year (the year 'for which' it is made) rather than the year 'in which' the actual contribution giving rise to the excess was made."

Gary Lesser

EXECUTIVE SUMMARY:

The IRS, the Code, and regulations thereunder, have always been clear, at least until recently: an individual has up until his or her return deadline, including extensions, for the year ***in which*** the excess IRA contribution was made to distribute the excess to avoid the amount distributed from being treated as a taxable distribution and subject to the 6 percent tax on excess IRA contributions.[i]

The IRS has indicated a desire to change the determination of the year in which an excess is treated as made and hence the due date of the year in which it must be corrected in (or by) to avoid the 6 percent tax on excess contributions.[ii] And it appears that this change has already been implemented. The new interpretation would treat all excesses made for a contribution year as having been incurred during that contribution year (the year "for which" it is made) rather than the year "in which" the actual contribution giving rise to the excess was made.

COMMENT:

Thus, for an excess contribution made in 2022 for the prior year (2021), a correcting distribution would have to be made on or before the 2021 tax return due date as described above to avoid the 6 percent tax on excess contributions. The IRS's new interpretation treats all excess IRA contributions made *for a year* (including contributions of excess amounts made after the end of the year) as being contributed during the same (earlier) tax year for correction purposes (see Note 1).

If formally adopted, the proposed (but not yet issued) rule might also have the effect of shortening the statute of limitations in favor of the taxpayer, but accelerating the year by which the excess would have to be corrected. It

should be noted that the instructions to Form 8606, *Nondeductible IRAs (2020)*, have recently been modified, and in the authors opinion, prematurely, to reflect the "for which" year interpretation (see Note 2). Similarly, the instructions to Form 5329, *Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts (2020)*, were also recently modified and now state: "The total contributions to your traditional IRAs for the tax year ***for which*** the excess contributions were made weren't more than the amounts shown. …" (see page 5). {Emphasis added.}

On the other hand, for example, the 1994 version of Publication 590, Individual Retirement Arrangements (IRAs), stated:

You will not have to pay the 6% tax if you withdraw an excess contribution ***made during a tax year*** *and* interest or other income earned on it by the date your return *for that year* is due, including extensions. {*Emphasis added.}*

This interpretation continued through the 2019 version of Publications 590-A, *Contributions to Individual Retirement Arrangements (IRAs)*, which also uses the phrase "made during a tax year" in describing the timely withdrawal of excess IRA contributions (see page 33). However, the 2020 version of the publication now states:

In general, if the excess contributions **for a year** aren't withdrawn by the date your return **for the year** is due (including extensions), you are subject to a 6% tax" (see page 33). {Emphasis added.}

The IRS does not provide any example of an excess IRA contribution being made after the end of the year or explain how a correcting distribution is to be reported to the taxpayer and the IRS. The 2020 version of Publication 590-A also states:

You must complete your withdrawal by the date your tax return for ***that year*** is due, including extensions." {Emphasis added.}

As a practical matter, the IRS's "for which" interpretation makes sense. It also comports to the IRA contribution timing rule in Code Section 219(f)(3) which states, "For purposes of this section, a taxpayer shall be deemed to have made a contribution to an individual retirement plan on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof)." While IRS publications may be instructive for purposes of setting forth IRS policies and interpretations of tax law, they are not binding precedent and are generally not given meaningful weight by courts.[iii] The IRS does not usually take litigation positions in conflict with its published materials. Thus, for tax years before 2020, it could still be argued (based on IRS publications) that an excess IRA contribution made after the end of the year that is treated as made for the prior year would not be taxable, nor subject to the 6 percent penalty, if distributed by the due date, including extensions, for that (later) year.

Note 1. The timely distribution must still include the earnings (or loss) attributable to the returned contribution. No change is being proposed to the rule that earnings are "includible in gross income for the taxable year in which the contributions were made." [Treas. Reg. §1.408A-6, Q&A-1(d) (T.D. 8816, 64 Fed. Reg. 5597-5611, Feb. 4, 1999)]

Note 2. Code Section 408(d)(4) reads as follows:

(4) Contributions returned before due date of return—Paragraph (1) does not apply to the distribution of any contribution ***paid during a taxable year*** to an individual retirement account or for an individual retirement annuity if—

(A) such distribution is received on or before the day prescribed by law (including extensions of time) for filing such individual's return ***for such taxable year***,

(B) no deduction is allowed under section 219 with respect to such contribution, and

(C) such distribution is accompanied by the amount of net income attributable to such contribution.

In the case of such a distribution, for purposes of section 61, any net income described in subparagraph (C) shall be deemed to have been earned and receivable in the taxable year in which such contribution is made. Emphasis added.

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[i] I.R.C. §§ 408(d)(4), 4973(a), Treas. Reg. § 1.408-4(c)(2)(i).

[ii] See Treasury/IRS RIN 1545-BL99 (NPRM REG-107302-14); Fall 2018 Unified Agenda of Regulatory and Deregulatory Actions, available at *https://www.reginfo.gov/public/do/eAgendaMain#* (select "Department of the Treasury" in drop down menu); *see* "Reporting Change for Some Excess IRA Contributions" (Vol. 29, Issue 3), *IRA Plus* (PenServ Plan Services, Oct. 2018) and "Continuation of the "In Which/For Which" Saga The New Rules for Correcting IRA Excesses in 2018" (Vol. 28, Issue 1), *IRA Plus* (PenServ Plan Services, Aug. 2017), available through https*://www.penserv.com*; Susan Diehl, "The New Rule for Correcting IRA Excesses in 2018," *National Tax-Deferred Savings Association* (NTSA), available at *https://www.ntsa-net.org/new-rule-correcting-ira-excesses-2018* (visited on May 10, 2021).

[iii] *Bobrow v. Comm'r*, T.C. Memo. 2014-21 (2014).

Gary Lesser has over 45 years of experience in ERISA and is nationally recognized as a leading expert in the field. Gary is the principal of **GSL Galactic Publishing, LLC**, a pension and retirement benefit consulting practice. He has strong technical and marketing experience with qualified and non-qualified deferred compensation plans, programs, and products, especially those used by individuals and smaller business owners. Mr. Lesser is a former IRS Tax Law Specialists with the Employee Plans Division.

Gary is a contributing author and technical editor of the *Health Savings Account Answer Book*, *Roth IRA Answer Book*, *SIMPLE, SEP, and SARSEP Answer Book*, and the *457 Answer Book*. He was also a contributing author and technical editor of Aspen Publishers *Quick Reference To IRAs*, and the *Life Insurance Answer Book For Qualified Plans and Estate Planning*, in addition to the CPA s *Guidebook to Retirement Plans for Small Businesses*, the *Adviser s Guide to Health Savings Accounts*, as well as several continuing professional education (CPE) programs for the American Institute of Certified Public Accountants (AICPA). Along with his father, he wrote and published *Basic Accounting Simplified*.

5 Key Facts That Clear up Any Confusion about the New 10-Year Rule for IRA Beneficiaries under the SECURE Act

One of the most significant changes made by the SECURE Act limits the distribution period to 10 years for designated beneficiaries. An example provided by the IRS in Pub. 590-B has led to some confusion.

The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) was signed into law on December 20, 2019 as part of the Further Consolidated Appropriations Act, 2020. One of the more significant changes made by the SECURE Act repealed the provision that allowed designated beneficiaries to take distributions over their life expectancies. Now, designated beneficiaries who inherit IRAs after 2019 must distribute

these IRAs within 10-years. An example of this new 10-year rule in IRS Pub. 590-B-*Distributions from Individual Retirement Accounts (IRAs)* for use in preparing 2020 returns (Pub. 590-B) has raised questions about how it works, making it necessary to review some key facts.

Background

A designated beneficiary is a person or trust that meets certain specific requirements and named as beneficiary of an IRA.

If a designated beneficiary inherited an IRA before 2019, her distribution options are as follows:

- *If the owner died before the RBD*:* The 5-year rule or over her single life expectancy.
- *If the owner died on or after the RBD*: Over the longer of her life expectancy or the remaining life expectancy of the decedent.

Note: **The required beginning date (RBD), is April 1 that follows the year in which the IRA owner reached age 70 ½ (72 for IRAs inherited after 2019).*

Under the 5-year rule, distributions are optional until December 31 of the 5th year that follows the year in which the IRA owner died; at which time the entire balance must be distributed.

The SECURE Act changed the rules for IRAs inherited after 2019 by upgrading the 5-year rule to 10 years effective for IRAs inherited after 2019 and removing the option that allowed designated beneficiaries to take distributions over their life expectancies. Changes were also made for successor beneficiaries, some of which are also highlighted in this article.

Pub 590-B includes an example that suggests that designated beneficiaries would take distributions over their life expectancies, despite being subject to the 10-year rule. Word through the IRA grapevine is that the IRS has since admitted that the example used in the explanation was not intended to convey such a message, and will clear up any confusion in proposed RMD regulations that will be issued soon. In the meantime, the following 5 facts should be helpful.

1. **The Age of IRA Owner at Death is Immaterial for a Designated Beneficiary**

   Whereas the 5-year rule was an option for a beneficiary that inherited an IRA before 2020 only if the IRA owner died before the RBD, the 10-year rule applies to a designated beneficiary regardless of the age at which the IRA owner dies.

   As a result, it is no longer necessary to determine the age of the IRA owner at the time of death for distribution purposes if the IRA owner died after 2019 and the beneficiary is a designated beneficiary.

2. **Distributions Are Optional Until the End of Year 10**

   As explained above, where the 5-year rule applies, distributions are optional until the end of the 5th year that follows the year of the IRA owner's death. The only change that the SECURE Act made to the 5-year rule was to extend it to 10 years for designated beneficiaries. Therefore, for designated beneficiaries who are subject to the 10-year rule, distributions are optional until December 31 of the 10th year that follows the year in which the IRA owner dies.

   Did the IRS Get it Wrong?

Pub. 590-B includes the following example:

> "Your father died in 2020. You are the designated beneficiary of your father's traditional IRA. You are 53 years old in 2021, which is the year following your father's death. You use Table I and see that your life expectancy in 2021 is 31.4. If the IRA was worth $100,000 at the end of 2020, your required minimum distribution for 2021 would be $3,185 ($100,000 ÷ 31.4)."

This example is incorrect because it states that the *"required minimum distribution for 2021 would be $3,185 ($100,000 ÷ 31.4)"*, which means that the beneficiary must distribute $3,185 in 2021. If the beneficiary was an eligible designated beneficiary taking distributions over her life expectancy (see Fact Number 4 below), this example would be accurate. But for a designated beneficiary, distributions for an IRA inherited in 2020 would be optional for 2021 and therefore not an RMD. The IRS made this rule clear in more than one instance in the same issue of Pub 590-B, including where they stated the following:

> "Don't use any of the tables if either the 5-year rule or the 10-year rule…applies".

It is therefore clear that the IRS knows that no calculation is required when the distribution option is the 10-year rule.

3. The 10-Year Rule Applies to a Successor Beneficiary of a Pre-2020 Beneficiary Taking Distributions over Her Life Expectancy and Dies after 2019

If a designated beneficiary inherited an IRA before 2020 and was taking distributions over her life expectancy, her successor beneficiary would take distributions over what remained of her- the designated beneficiary's- life expectancy. However, this option to take distributions over what remained of the designated beneficiary's life expectancy applies only if the designated beneficiary died before 2020. If such a designated beneficiary dies after 2019, the successor beneficiary is subject to the 10-year rule. This 10-year period starts the year that follows the year in which the designated beneficiary dies.

4. The 10-year Rule Applies to the Successor Beneficiary of an Eligible Designated Beneficiary Taking Distributions over Her Life Expectancy

Eligible designated beneficiary is a new category of beneficiary that was created under the SECURE Act and applies only to IRAs inherited after 2019. These beneficiaries are:

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 of the previous categories (**A** to **D**) who is not more than 10 years younger than the IRA owner.

An eligible designated beneficiary is eligible to take distributions over her life expectancy, and in doing so, her successor beneficiary would then be subject to the 10-year rule. This 10-year period starts the year that follows the year in which the eligible designated beneficiary dies.

5. **An IRA Inherited by a Beneficiary Who is a Minor Would Later be Subject to the 10-Year Rule**

   If the eligible designated beneficiary is a minor child of the IRA owner, he is eligible to take distributions over his life expectancy. As stated above under Fact Number 4, a minor child of the IRA owner would be an eligible designated beneficiary and his successor beneficiary would be subject to the 10-year rule upon his death. However, this applies only if the minor child dies before reaching the age of majority- as defined under State law.

   There is an added layer for a beneficiary who is a minor child of the IRA owner, where the distribution option is switched from the life expectancy option to the 10-year rule when the minor child reaches the age of majority as defined under State law.

Advisors Will Need to Amend Their Beneficiary Checklists

Beneficiaries who fail to take RMDs by the applicable deadline will owe the IRS a 50% excess accumulation penalty of any RMD shortfall. This includes those who are subject to the 10-year rule and fail to fully distribute the account by the end of the 10-year period.

Advisors should update their beneficiary questionaries to ensure that the answers provided clearly show whether a beneficiary is a designated beneficiary, an eligible designated beneficiary or a successor beneficiary. And, for successor beneficiaries, advisors will also need to know whether the primary beneficiary was eligible to take distributions under the life expectancy option and was doing so.

This article certainly does not address all of the applicable factors. But it is a good place to start. When issued, the proposed RMD regulations should provide answers to some of the questions that are still outstanding.

IRS and Legislative Updates

IRS Corrects 10-Year Rule Explanation in Pub 590-B

Publication 590-B, published in March 2021, included an example that incorrectly suggested that an annual distribution is required under the 10-year rule. This 10-year rule applies to designated beneficiaries that inherit IRAs and other retirement account after 2019.

The IRS has since issued an updated version explaining that the annual distribution requirement applies only to eligible designated beneficiaries. However, they still neglected to use the proper term ‘eligible designated beneficiary’, and to indicate that the example is for an eligible designated beneficiary and not a designated beneficiary.

The IRS Might be Splitting Form W-4P into Two Forms- W-4P and W-4R: Withholding of less than 10% Might be an Option

The IRS published draft versions of the new forms for 2022:

- W-4P: -Withholding Certificate for Periodic Pension or Annuity Payments and
- W-4R: -Withholding Certificate for Nonperiodic Payments and Eligible Rollover Distributions

On the draft versions of the new forms, IRA owners may elect to have an amount of less than 10% withheld effective 2022. That was never an option before, for nonperiodic payments. This could be problematic for IRA

custodians whose systems are hardcoded to withhold zero, 10% or greater than 10%; if they don't have the time and resources to have the changes made for 2022.

We will keep you posted.

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