July-September 2020 | V o l u m e 11 | Issue 3

The IRA Authority!

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

Appleby Retirement Consulting

Mark Your Calendar for These IRA Season Deadlines

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IRA Calendar Update

Due to an emergency declaration issued in response to the ongoing Coronavirus Disease 2019 (COVID-19) pandemic, many tax related deadlines have been postponed. They include the following:

- **2019 IRA Contribution Deadline Is July 15, 2020**
  The deadline for making regular contributions to traditional IRAs and Roth IRAs is the IRA owner's tax filing due date, which is generally April 15. This has been postponed to July 15 for 2019 IRA contributions.
- **Form 5498 Due Date Postponed**
  IRA owners who made any types of contribution- including recharacterizations and Roth conversions to an IRA for 2019, should be been sent IRS Form 5498- IRA contributions statement- by May 31, 2020. But, the deadline for issuing IRS Form 5498 for 2019 has been postponed to August 31, 2020.

September 30, 2020: Deadline for Removing Non-Designated Beneficiaries

If you have clients who inherited assets from IRAs and other retirement accounts during 2019, removing any non-designated beneficiaries by September 30, 2020 is critical for accounts with multiple beneficiaries. 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/definitions/qualifiedtrust 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 periods over which the other beneficiaries would be allowed to stretch distributions could be shorter than if the non-designated beneficiary had distributed its share by the September 30 deadline.

October 15, 2020:

The deadline by which recharacterizations of 2019 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 2019 tax filing deadline to do so.

Clients who filed their 2019 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, 2020.

The deadline to remove 2019 IRA excess contributions
An excess IRA contribution for 2019 must be corrected by removing the amounts by the 2019 tax filing deadline of the account owner, in order to avoid owing the IRS an excise tax of 6% of the excess amount. Similar to the deadline for completing recharacterizations of Roth conversions, clients who filed their 2019 tax return by the due date receive 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.

Reminder: RMDs Waived for 2020
The Coronavirus Aid, Relief, and Economic Security Act (CARES Act), waived RMDs for 2020. As a result, retirement account owners and beneficiaries need not take any amount that would have otherwise been RMDs for 2020.

A retirement account owners or spouse beneficiary who already distributed such an amount, may roll over all or a portion of the amount, as long as applicable rules and regulations are met.

This includes meeting the 60-day deadline, unless the individual qualifies for a waiver, and not breaking the one-per-year IRA-to-IRA rollover rule.

3 Essential 2020 Beneficiary Moves That Protect 2019 Beneficiaries from SECURE Act Limitations

The SECURE Act changed the options that are available to designated beneficiaries. But, for those who inherited IRAs and other retirement accounts in 2019, the year 2020 might be a last chance to hang on to the older and more beneficial beneficiary distribution options.

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One of the most impactful changes made under the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) is the elimination of the life expectancy distribution option for designated beneficiaries. These changes are effective for designated beneficiaries who inherit retirement accounts after 2019. Those who inherit retirement accounts in 2019 are the last set of designated beneficiaries to benefit from the *generally* more beneficial pre-SECURE Act life expectancy options; but for some, certain steps must be taken during 2020 to preserve that benefit.

Please note*: Because a spouse beneficiary has the option of moving an inherited retirement account to the spouse beneficiary's own retirement account, this article focuses on nonspouse beneficiaries.*

Starting with the Basics: Who is a Designated Beneficiary?

When it comes to retirement accounts, terminology matters. And, identifying who is a designated beneficiary is a prime example.

A nonperson- such as an estate or charity- can be designated as a beneficiary of a retirement account; so can an individual. However, only an individual may be a *designated beneficiary*.

A designated beneficiary generally has the option of taking distributions from an inherited retirement account over the designated beneficiary's life expectancy. A nonperson beneficiary cannot, as a nonperson beneficiary has no life expectancy.

Exception for Trust Beneficiaries: A trust is a designated beneficiary, if certain requirements are met. These are defined under Treas. Reg. §1.401(a)(9)-4, Q&A-5. If these requirements are met, the life expectancy of the oldest beneficiary of the trust may be used for required minimum distribution (RMD) purposes. Retirement account owners and beneficiaries should consult with an estate planning attorney, for assistance with determining whether a trust is qualified to be a designated beneficiary.

Continuing with the Basics: What is the Required Beginning Date (RBD)?

When determining the distribution options available to a beneficiary who inherited a retirement account before 2020, one must first determine if the retirement account owner died before the RBD. The RBD is the deadline by which a retirement account owner must start taking RMDs.

For beneficiaries who inherit retirement accounts before 2020, the RBD is April 1 of the year that follows the year in which the retirement account owner reached age 70 ½.

For employer sponsored retirement plans that permit deferral of RMDs past age 70 ½, the RBD is the later of:

- April 1 of the year that follows the year in which the participant reached age 70 ½, or
- April 1 of the year that follows the year in which the participant separated from service with the plan sponsor.

This means that April 1, 2020 would have been the RBD for retirement account owners who reached age 70 ½ in 2019. For retirement accounts under employer sponsored plans that permit the aforementioned RMD deferral, April 1, 2020 would be the RBD for those who separated from service with the employer in 2019 and were at least age 70 ½ in 2019.

Distribution Options for Designated Beneficiaries Who Inherit Retirement Accounts before 2020

A designated beneficiary who inherits a retirement account before 2020, is eligible to take distributions as follows:

A. If the retirement account owner died before the RBD:

(a) over the designated beneficiary's life expectancy; which is the default option under the regulations, or

(b) under the 5-year rule.

***5-year rule**: Under the 5-year rule, distributions are optional until December 31 of the 5th year that follows the year in which the retirement account owner died, at which time the entire remaining balance is the RMD and must be distributed.*

B. If the retirement account owner died on or after the RBD, the designated beneficiary may take distributions over <u>the longer of:</u>

(a) the decedent's remaining life expectancy, or

(b) the life expectancy of the designated beneficiary.

***Life expectancy rule**: When distributions are made under the life expectancy option, they must begin by December 31 of the year that follows the year in which the retirement account owner died.*

The life expectancy option could be limited by the provisions of the governing plan document or IRA agreement and when there are multiple beneficiaries of a retirement account. In those cases, a designated beneficiary might need to take action, to preserve the life expectancy option.

***Reminder:** For 2020, the Coronavirus Aid, Relief, and Economic Security Act waives RMDs for IRAs and defined contribution plans- for account owners and beneficiaries.*

Action Might Be Needed in 2020 to Preserve Designated Beneficiary Options for 2019 Beneficiaries

If a designated beneficiary is the sole primary beneficiary of a retirement account, and the IRA agreement or plan document defaults to the life expectancy option, then the life expectancy option is automatically preserved. But, if that is not the case, there are factors that could limit the designated beneficiary's options. The good news is, for 2019 beneficiaries, these limitations can be overridden if the appropriate action is taken in 2020.

The following is a high-level explanation of these limitations and how they can be overridden.

1. Limitation 1: When There Are Multiple Designated Beneficiaries

If there are multiple designated beneficiaries of a retirement account, the life expectancy of the oldest beneficiary is used for beneficiary RMD purposes. This puts younger beneficiaries at a disadvantage, as it forces them to take larger RMD amounts which depletes the account faster than if they were eligible to use their own life expectancies; thus, reducing the period over which eligible amounts may continue to grow tax-deferred.

Solution for 2019 beneficiaries: *Perform separate accounting by December 31, 2020*
If separate accounting occurs by December 31 of the year following the year of the account owner's death, each designated beneficiary may use his own life expectancy.

Please note: *Beneficiaries must contact the plan administrator or IRA custodian in advance of the deadline, for assistance with meeting the trustee or custodian's operational and documentation requirements for performing separate accounting.*

Example: Janet died in 2019. Her 65-year-old cousin Carl and her 25-year-old nephew Jonathan are the beneficiaries of her Roth IRA; to be shared equally.
Assuming a balance of $200,000, of which no more than RMD amounts are taken each year, and a rate of return of 5%, the total distribution amounts would be:

Scenario A: If separate accounting does not occur by December 31, 2020- then distributions would be made over Carl's life expectancy.

- Carl's total distributions would be approx. $173,596.29
- Jonathan's total distributions would be approx. $173,596.29

Scenario B: If separate accounting occurs by December 31, 2020, Carl's share would be distributed over Carl's life expectancy and Jonathan's share would be distributed over Jonathan's life expectancy.

- Carl's total distributions would be approx. $173,596.29
- Jonathan's total distributions would be approx. $561,608.37

2. Limitation 2: When There Are Multiple Beneficiaries That Include Individuals and Nonpersons

If there are multiple beneficiaries of a retirement account, and a nonperson is one of the beneficiaries, the account is treated as not having a designated beneficiary (except for certain trusts- See *Exception for Trust Beneficiaries* earlier).

This would require the inherited amounts to be distributed under the 5-year rule if the owner died before the RBD and over the remaining life expectancy of the decedent, if death occurred on/after the RBD. For Roth IRAs, the 5-year rule would apply regardless of the age of the owner at death.

Solution for 2019 beneficiaries: *Have nonperson beneficiaries take full distributions of their share by September 30, 2020*

The determination of whether a retirement account has a designated beneficiary is made by September 30 of the year that follows the year in which the retirement account owner dies. Any beneficiary that takes a full distribution or makes a full disclaimer of that beneficiary's share by this September 30th date, is disregarded for purposes of determining the period over which beneficiaries may take distributions. ***Reminder***: *Disclaimers must meet the requirements of IRC § 2518*

Example: 45-year-old Tom died in 2019. His 50-year-old brother Harry and his estate are the beneficiaries of his Traditional IRA; to be shared equally.

Assuming a balance of $1,000,000, of which no more than RMD amounts are taken, and a rate of return of 5%, the total distribution amounts would be:

Scenario A: If the estate's share remains in the account, both beneficiaries would be subject to the 5-year rule.

- Harry's total distributions would be approx. $638,140.79
- The estate's total distributions would be approx. $638,140.79

Scenario B: If the estate distributes its share by September 30, 2020- Harry would be able to take distributions over his life expectancy.

- Harry's total distributions would be approx. $1,281,891.98
- The estate's total distributions would be $500,000

3. Limitation 3: Plan Document or IRA Agreement Defaults to the 5-Year Rule

When a designated beneficiary inherits a retirement account from an owner who died before 2020 and death occurred before the RBD, the options are the life expectancy rule and the 5-year rule. For a Roth IRA, the options are the same regardless of the age of the account owner at the time of death.

However, while the regulations and the tax code default to the life expectancy rule, an IRA agreement or plan document may default to the 5-year rule.

Solution: *Override 5-year rule by making an election or moving the account by December 31, 2020*

The terms of a plan document or IRA agreement may permit a designated beneficiary to override the 5-year rule by making an election to do so. Such an election must be made by December 31 of the year that follows the year in which the retirement account owner died- which would be December 31, 2020 for accounts inherited in 2019.

The 5-year rule can also be overridden by moving the inherited account to one that permits the life expectancy distribution option. For instance, if a 401(k) plan requires beneficiaries to use the 5-year rule, a beneficiary who inherited a 401(k) account under such a plan in 2019 may avoid that limitation by moving the assets – **as a direct rollover** – to a beneficiary IRA that permits life expectancy distribution, by December 31, 2020. For inherited IRAs, the movement must be done as a nonreportable trustee-to-trustee transfer.

Moving Forward

Much ado is made about the changes to beneficiary options made by the SECURE Act- and rightfully so, as they limit the distribution period to the new 10-year rule for many designated beneficiaries.

But, for those who inherited retirement accounts in 2019, there are still opportunities to take distributions under the life expectancy method. When consulting with beneficiaries, advisors must determine whether the account was inherited before 2020, as that drives the distribution options.

IRS Waives 60-Day Rollover Deadline in PLR 202023007: IRA Owner Was Not Notified of Distribution Resulting from Resignation by IRA Custodian

The IRS waived the 60-day rollover deadline in private letter ruling (PLR) 202023007.

PLR Snapshot

The IRA custodian sent a letter to the IRA owner, notifying him that they had resigned as custodian of the IRA. This resignation resulted in a distribution of the IRA.

However, the letter of resignation was sent to the IRA owner's old address, causing a delay which resulted in the IRA owner missing the 60-day deadline.

The IRS approved the request for a waiver of the 60-day deadline, allowing the amount to be rolled over, providing there are no other reasons that would cause the amount to be ineligible for rollover

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