

The IRA Authority!

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



Annual IRA Calendar

Please mark your calendar with the following deadlines:

Missing deadlines for IRA transactions can result in missed opportunities to take advantage of tax and retirement related benefits. It could also cost clients in the form of IRS assessed penalties. In this issue, we provide reminders of some of the upcoming deadlines, and include background explanations where possible.

October 1: Deadline to establish a new SIMPLE IRA

Small business owners can establish a savings incentive match plan for employees of small employers (SIMPLE) IRA plan for this year, if the plan is established by October 1. In general, *establishing* the SIMPLE IRA plan means that the employer completes the documentation required to set-up the SIMPLE IRA plan, and provides the required notification to employees. The financial institution with which the plan will be maintained should be consulted about their documentation requirements. In most cases, the financial institution will provide the business owner with a kit that includes all the required paperwork and notices.

An exception to the deadline applies to businesses which start up after October 1. Under this exception, the SIMPLE IRA must be established as a soon as it is administratively feasible.

October 15: Deadline for Completing Recharacterizations

October 15 is the deadline by which recharacterizations of Roth contributions for last year must be completed. We strongly recommend submitting the paperwork to the custodian earlier, so as to help ensure that the transaction is processed by the deadline.

There have been instances where the paperwork was delivered to the custodian by October 15, but the IRS determined the deadline was not met because the actual transaction was not processed by October 15.

Tip: *if your client's request was submitted by October 15, but was not processed by then, ask the custodian to process the recharacterization 'as of' October 15 or earlier, to prevent any discrepancies with the IRS. The method by which this 'as of' transaction can be accomplished varies among custodians. For your client, the key is to be able*

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to provide documented proof to the IRS if needed. **Note:** Bear in mind that not every custodian is willing to accommodate such a request.

October 31: Deadline for providing trust documentation to IRA custodian for IRAs inherited last year

If a trust meets certain requirements, it is eligible to be treated as a designated beneficiary for distribution purposes. This means that distributions would be permitted to be taken under the life-expectancy method, just as if an individual was the designated beneficiary. In such cases, the life expectancy of the oldest beneficiary under the trust is used. A trust that meets these requirements is considered a *qualified trust*.

The requirements which must be met, in order for a trust to be considered a 'qualified trust', includes providing the trust documentation to the IRA custodian by **October 31 of the year following the year-of the IRA owner's death**.

November 1: Deadline for providing summary description (for SIMPLE IRAs) to employees

For every year that an employer intends to continue maintaining a SIMPLE IRA plan, employees must be notified of the opportunity enter into a salary reduction agreement for the calendar year, or to modify a prior agreement for the SIMPLE IRA Plan, (including reducing the amount subject to this agreement to \$0).. This must be provided immediately before the employee's 60-day election period, which is November 2 to December 31.

If applicable, this notification must disclose an employee's ability to select the financial institution that will serve as the custodian of the employee's SIMPLE IRA.

The notification must also include the summary description. The IRA custodian may need to provide the employer with the summary description before the 60-day period – no later than **November 1**, so as to allow the employer to meet its deadline

The summary description must include information such as:

- a) The name and address of the employer and the custodian.
- b) The requirements for eligibility for participation.
- c) The benefits provided with respect to the SIMPLE IRA.
- d) The time and method of making employee elections with respect to the SIMPLE IRA.
- e) The procedures for, and effects of, withdrawals (including rollovers) from the SIMPLE IRA.

Employers should check with the IRA custodian to determine the terms of their agreement, as it relates to these requirements.

The employer should also include information about the employer contribution that will be made to employees' SIMPLE IRAs; that is, where the employer will be making a reduced matching contribution or a nonelective contribution in lieu of a matching contribution.

December 31: Deadline for separate accounting

With a few exceptions, beneficiaries who are taking distributions under the life-expectancy method are allowed to use their own life-expectancies. One exception is when there are multiple designated beneficiaries of the same IRA. In this case, each designated beneficiary is required to use the life expectancy of the oldest designated beneficiary, unless separate accounting occurs by December 31 of the year that follows the year in which the IRA owner dies. As

such, if you have a client who is one of multiple designated beneficiaries, and she is not the oldest beneficiary; remind her of the importance of segregating her share into a separate account by December 31.

December 31: Deadline for Roth IRA conversions

One of the ways in which a Roth IRA can be funded is by converting funds from other retirement accounts, such as traditional IRAs, SEP IRAs, SIMPLE IRAs, as well as from employer plans, such as 401(k), 403(b) and governmental 457(b) plans. For clients who want to have a conversion done for this year, the amount must leave the account from which the conversion is being done by December 31.

Be sure to notify clients of these deadlines early, in order to allow them sufficient time to submit their instructions.

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. 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 🍎

2021 is Last Opportunity to Override 5-Year Rule and Stretch Distributions for 401(k)s Inherited in 2019

Designated beneficiaries who inherit retirement accounts in 2019 get a one-year extension to override the 5-year rule. The deadline is extended from December 31, 2020, to December 31, 2021.

Clients who inherited assets held in an employer plan in 2019 and are required to fully distribute the account within 5 years might be able to override that limitation and stretch distributions over their life expectancies. To do so, they must take action by December 31, 2021. For this purpose, employer plans include qualified plans such as 401(k) and pension plans, 403(b) plans and Governmental 457(b) plans.

Background

If a beneficiary inherited assets that are held in an employer plan before 2020 and the owner died before the required beginning date (RBD), the beneficiary generally has two options for distributing the inherited account. The 5-year rule and the life-expectancy rule. The terms of the plan document determine whether both or one of the two options are available.

The following are some key terms that are relevant to this article:

- *Plan document:* The set of rules that dictate the terms of the employer plan under which the inherited the retirement account or benefit (account) is held.
- *The RBD:* The RBD is April 1 of the year that follows the year in which the account owner (participant) reached age 70-½. If permitted under the employer plan, the RBD can be deferred past that date until April 1 of the year that follows the year in which the participant separates from service with the plan sponsor (employer).
- *The 5-year rule:* Under the 5-year rule, the beneficiary chooses whether to take any distributions in years one through four. But the entire account balance must be distributed by the end of year five. This is extended to six years for accounts inherited in 2015 to 2019 because a recent law – The Coronavirus Aid, Relief, and Economic Security (CARES) Act, provides that 2020 is not counted when counting the 5-year period.
- *The life-expectancy rule:* Under the life expectancy rule, the designated beneficiary would take distributions over their life expectancy every year beginning by December 31 of the year that follows the year the participant died. The life expectancy would be determined based on the Single Life Expectancy Table published by the IRS. As above, the CARES Act waived these distributions for 2020.
- *Designated beneficiary:* Only a designated beneficiary is eligible to use the life expectancy rule when the participant died before the RBD. Generally, a designated beneficiary is a person who inherits a retirement account. A trust can also be a designated beneficiary if certain specific requirements are met.

Whether a beneficiary is a designated beneficiary for an account inherited in 2019 would have been determined as of September 30, 2020. A beneficiary who is unsure about whether she is a designated beneficiary should consult with her tax advisor or attorney.

Limited scope: The rules that apply if the participant died on or after the RBD are different and are not discussed in this article as they are irrelevant to the strategy being discussed. Additionally, the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019 changed the distribution options for accounts inherited after 2019 and these are also not covered herein.

The Tax Impact of the 5-Year Rule vs. The Life Expectancy Rule

A designated beneficiary who inherited a significant amount under a retirement account might find that it is

| Year | Balance | LE | Distribution | Total Distributions |
|------|--------------|------|--------------|---------------------|
| 2020 | \$500,000.00 | | \$0.00 | \$0.00 |
| 2021 | \$525,000.00 | 33.2 | \$15,813.25 | \$15,813.25 |
| 2022 | \$534,646.09 | 34.2 | \$15,632.93 | \$31,446.18 |
| 2023 | \$544,963.82 | 33.2 | \$16,414.57 | \$47,860.75 |
| 2024 | \$554,976.71 | 32.2 | \$17,235.30 | \$65,096.05 |
| 2025 | \$564,628.48 | 31.2 | \$18,097.07 | \$83,193.12 |
| 2026 | \$573,857.98 | 30.2 | \$19,001.92 | \$102,195.04 |
| 2027 | \$582,598.86 | 29.2 | \$19,952.02 | \$122,147.06 |
| 2028 | \$590,779.18 | 28.2 | \$20,949.62 | \$143,096.68 |
| 2029 | \$598,321.04 | 27.2 | \$21,997.10 | \$165,093.78 |
| 2030 | \$605,140.14 | 26.2 | \$23,096.95 | \$188,190.73 |
| 2031 | \$611,145.35 | 25.2 | \$24,251.80 | \$212,442.53 |
| 2032 | \$616,238.23 | 24.2 | \$25,464.39 | \$237,906.92 |
| 2033 | \$620,312.53 | 23.2 | \$26,737.61 | \$264,644.53 |
| 2034 | \$623,253.67 | 22.2 | \$28,074.49 | \$292,719.02 |
| 2035 | \$624,938.14 | 21.2 | \$29,478.21 | \$322,197.23 |
| 2036 | \$625,232.93 | 20.2 | \$30,952.13 | \$353,149.36 |
| 2037 | \$623,994.84 | 19.2 | \$32,499.73 | \$385,649.09 |
| 2038 | \$621,069.87 | 18.2 | \$34,124.72 | \$419,773.81 |
| 2039 | \$616,292.41 | 17.2 | \$35,830.95 | \$455,604.76 |
| 2040 | \$609,484.53 | 16.2 | \$37,622.50 | \$493,227.26 |
| 2041 | \$600,455.13 | 15.2 | \$39,503.63 | \$532,730.89 |
| 2042 | \$588,999.08 | 14.2 | \$41,478.81 | \$574,209.70 |
| 2043 | \$574,896.28 | 13.2 | \$43,552.75 | \$617,762.45 |
| 2044 | \$557,910.71 | 12.2 | \$45,730.39 | \$663,492.84 |
| 2045 | \$537,789.34 | 11.2 | \$48,016.91 | \$711,509.75 |
| 2046 | \$514,261.05 | 10.2 | \$50,417.75 | \$761,927.50 |
| 2047 | \$487,035.47 | 9.2 | \$52,938.64 | \$814,866.14 |
| 2048 | \$455,801.67 | 8.2 | \$55,585.57 | \$870,451.71 |
| 2049 | \$420,226.91 | 7.2 | \$58,364.85 | \$928,816.56 |
| 2050 | \$379,955.16 | 6.2 | \$61,283.09 | \$990,099.65 |
| 2051 | \$334,605.67 | 5.2 | \$64,347.24 | \$1,054,446.89 |
| 2052 | \$283,771.35 | 4.2 | \$67,564.61 | \$1,122,011.50 |
| 2053 | \$227,017.08 | 3.2 | \$70,942.84 | \$1,192,954.34 |
| 2054 | \$163,877.95 | 2.2 | \$74,489.98 | \$1,267,444.32 |
| 2055 | \$93,857.37 | 1.2 | \$78,214.48 | \$1,345,658.80 |
| 2056 | \$16,425.03 | 1 | \$16,425.03 | \$1,362,083.83 |

more tax favorable to take life expectancy distributions than having to fully distribute the account within 5 years. This is because the life expectancy distributions would *generally* require smaller amounts to be included in income each year.

Consider the following example:

401(k) participant profile

- Date of birth: 01/01/1958
- Date of death: 01/01/2019

Designated Beneficiary profile

- Date of birth: 01/01/1970
- Date of death: N/A

Assumed rate of return: 5%

The total distribution amounts under each option would be:

Life expectancy distributions: Assuming distributions are taken under the life expectancy option and that no more than RMDs are taken each year, the total distributions would be about: \$1,362,000. The amount distributed each year would range from about \$15,000 to \$78,000.

These smaller amounts could help to keep the beneficiary in a lower tax bracket than taking larger amounts within five years, thus reducing the tax impact. Additionally, amounts that remain after RMDs would continue to grow on a tax-deferred basis. Finally, all distributions would be tax-free if the account is a Roth.

The following is the annual RMD amounts, using the profile above:

Calculator used: Brentmark Distributions Live @

<https://www.brentmark.com> . With permission from Nicole Maholtz, CEO

5-year rule: Assuming no distributions taken until the end of the 5-year period, the total distributions would be about \$638,000.

How to Override the 5-Year Rule

If a beneficiary inherited a qualified plan account in 2019, the terms of the plan might default to the 5-year rule. In such cases a designated beneficiary is generally required to take action by December 31, 2020 to

be eligible to take distributions over her life expectancy. However, the deadline was postponed to December 31, 2021. The following are the two scenarios that could apply.

1: The Plan Document Permits the Participant to Choose

The terms of a plan document may permit the participant or a designated beneficiary to choose between the 5-year rule or the life-expectancy rule. This election is generally required to be made by December 31 of the year that follows the year the participant died.

Example: John, a 401(k) participant whose date of birth is January 1, 1958, died in 2019. His beneficiary is his sister Lupita.

Under the terms of the 401(k)-plan document, Lupita must elect the 5-year rule or the life expectancy rule by December 31, 2020.

Postponed Deadline: The SECURE Act allows the plan to be amended to allow Lupita – and other beneficiaries in the same category, to make the election by December 31, 2021.

2: The Only Option is the 5-year Rule

The terms of a plan document may provide that the 5-year rule is the only option available when the participant died before the RBD. If an inherited account is subject to this limitation, a designated beneficiary of such an account can override it and use the life expectancy option by rolling over the balance to a beneficiary IRA that allows life expectancy distributions. Such a rollover must be done as a direct rollover (paid directly to the beneficiary IRA) by December 31 of the year that follows the year the participant died.

Example: Jackie, a 401(k) participant whose date of birth is January 1, 1959, died in 2019. Her beneficiary is her brother, Ray.

Under the terms of the 401(k)-plan document, Ray is subject to the 5-year rule. Ray may override the 5-year rule by moving the amount via a direct rollover to a beneficiary IRA that allows life expectancy distributions by December 31, 2021 (extended from December 31, 2021 under the SECURE Act.).

Advisor Action Plan

As you meet with clients during 2021, be sure to ask them if they inherited any retirement accounts in 2019, and if so, determine whether the 5-year rule applies. The plan administrator should be able to provide information about the distribution options that apply to the beneficiary. Ideally such information should be provided in writing in an official plan related document like an explanation of the distribution options or a summary plan description.

Those who want to use the 5-year rule may do so by distributing the entire balance December 31, 2025. This is an option even if the life-expectancy rule is available under the plan.

But if a designated beneficiary wants to use the life expectancy rule and it is not the default option under the plan, the plan administrator should be contacted to ensure any required action- whether it is an

election or performing a direct rollover to a beneficiary IRA that permits life expectancy distributions- is taken by December 31, 2021. 🍎

Q&A RMD Aggregation Rule: Own IRA and Beneficiary IRA

Question: My client owns a traditional IRA that she funded herself. She also has a beneficiary traditional IRA that she inherited from her brother. Can she take the total RMD due for both from the inherited IRA?

Answer: No. Taking RMDs for multiple accounts from one or more of those accounts is referred to as RMD aggregation. RMDs cannot be aggregated for one's own IRA with a beneficiary IRA.

Q&A: 10-Year Rule- Annual RMD Requirement

Question: My client inherited an IRA in 2020 from her friend. She is a designated beneficiary and subject to the 10-year rule. Is she required to take an annual RMD over the ten-year period?

Answer: No. Under the 10-year rule, distributions are optional until December 31 of the 10th year that follows the year of the IRA owner's death. Therefore, she can choose whether to take distributions at any time, as long as the entire balance is distributed by December 31, 2030.

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