New IRA Rules: Is Your Firm Ready?

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REGIONS
PRIVATE WEALTH MANAGEMENT

The Basics

Why have an IRA?

Retirement Savings

- Provide retirement funds in addition to Social Security
- Annual Contributions
- Rollovers From ‘Qualified Plans’
- Earnings From Investments
- Required Distributions (sometimes)
- Distribution strategies may be planned to take advantage of tax planning

Tax Breaks

- Tax Deductions For Traditional IRA Contributions (maybe)
- Non-taxable ‘Rollovers’ From Qualified Plans
- Tax Deferred/Free Investment Earnings

The Basics

Two Main Types of IRAs

Traditional

- Established by Employee Retirement Income Security Act of 1974
- Contributions <u>may</u> be tax deductible
- MAGI phase-out for tax deductible contributions
- Annual Contributions up to $6,000 or $7,000 (age 50 or older)
    - Or eligible compensation
- Funding possible by rollovers from Workplace Retirement Accounts
- Tax Deferred Earnings
- Required Minimum Distributions begin at age 72
- Distributions usually taxable

The Basics

Two Main Types of IRAs

Roth

- Established by the Taxpayer Relief Act of 1997
- Annual Contributions up to $6,000 or $7,000 (age 50 or older)
    - Or eligible compensation
- MAGI phase-out for contributions
- Contributions are <u>not</u> tax deductible
- Tax Free Earnings
    - Roth IRA Distribution Rules
- Funding possible by rollovers from Workplace Retirement Accounts
- Funding possible by Roth Conversions from “pre-tax” Retirement Accounts
- Named after Senator William Roth
- No Required Minimum Distributions
- Distributions usually not taxable

The Basics

Types of “Work-Related” IRAs

Simplified Employee Pensions (SEP)

- Funding by employer’s SEP Plan (Form 5305-SEP)
- Employee Contributions
- Contribution limits are higher than Traditional/Roth Annual Contributions
- Traditional IRA Distribution Rules

Savings Incentive Match Plan (SIMPLE)

- Funding by employer’s SIMPLE Plan (Form 5305-SIMPLE or 5304-SIMPLE)
- Employee Payroll Withholding
- Contribution limits are higher than Traditional/Roth Annual Contributions
- Traditional IRA Distribution Rules

The Basics

Inherited IRAs

Inherited Traditional
- Required Distributions
- 10-Year Rule
- 5-Year Rule
- “Ghost” RMD Rule
- Distributions may be taxable (depending on source)

Inherited Roth
- Required Distributions
- 10-Year Rule
- 5-Year Rule
- Distributions may be <u>tax</u> and <u>penalty</u> free
  - Roth IRA Distribution Rules

The Basics

Funding IRAs Through Workplace Retirement Plan Rollovers

- Usually when plan participant retires
- Sometimes the plan document provides for “In-Service” withdrawals
- Often large balances are rolled over
- Clients are usually looking for additional investment options and personalized services from advisors
- Any rollover recommendation should be made in the “Best Interest” of the plan participant
- IRS Form 1099-R will be produced by the plan provider
- Entry on IRS Form 5498 for the IRA will verify to the IRS that a rollover was made
- Tax preparer will report distribution and rollover on client’s tax return

The Basics

Funding IRAs Through Roth Conversions

- Taxes are paid when converting “pre-tax” Traditional IRA funds
- After-tax Traditional IRA funds are not taxable when converted
- No Modified Adjusted Gross Income limitation
- Roth “5-Year Rules”
- If Roth Rules are followed, tax free earnings can be withdrawn
- Beware of the “Back Door” Roth
- If IRA owner is under age 59 ½, tax withholding should not be made

The Basics

Prohibited Transactions

Generally, a **Prohibited Transaction** is any improper use of an IRA account or annuity by the IRA owner or beneficiary or any disqualified person.

- Disqualified persons include the IRA owner, their fiduciary, and members of the IRA owner's family (spouse, ancestor, lineal descendant, and any spouse of a lineal descendant)

Examples

- Borrowing money from it
- Selling property to it
- Using it as security for a loan
- Buying property for personal use (present or future) with IRA funds

The Basics

Effect of Prohibited Transaction

On the IRA account

Generally, if the IRA owner or other disqualified person engages in a prohibited transaction in connection with the IRA account at any time during the year, the account stops being an IRA as of the first day of that year.

On the IRA owner or beneficiary

If the account stops being an IRA because the IRA owner or disqualified person engaged in a prohibited transaction, the account is treated as distributing all its assets at their fair market values on the first day of the year.

Result: Distribution from the IRA and usually a Taxable Event

The Basics

Prohibited Investments

If an IRA invests in collectibles, the amount invested is considered distributed in the year invested. The IRA owner may have to pay the 10% additional tax on early distributions.

Collectibles

- Artworks
- Rugs
- Antiques
- Metals
- Gems
- Stamps
- Coins
- Certain other tangible personal property
- Alcoholic beverages

Exception. The IRA can invest in one, one-half, one-quarter, or one-tenth ounce U.S. gold coins, or one-ounce silver coins minted by the Treasury Department. It can also invest in certain platinum coins and certain gold, silver, palladium, and platinum bullion.

The Basics

Penalty for making excess contributions

In general, if the excess contributions for a year are not withdrawn by the date the IRA owner's tax return for the year is due (including extensions), the IRA owner is subject to a 6% tax. They must pay the 6% tax each year on excess amounts that remain in the IRA at the end of the tax year. The tax cannot be more than 6% of the combined value of all IRAs as of the end of the tax year.

Penalty for taking early distributions

Generally, if the IRA owner is under age 59 $^{1/2}$, they must pay a 10% additional tax on the distribution of any assets (money or other property) from the IRA. Distributions before age 59 $^{1/2}$ are called early distributions.

The 10% additional tax applies to the part of the distribution that is included in gross income. It is in addition to any regular income tax on that amount. **(Some exceptions apply)**

The Basics

Penalty for allowing excess amounts to accumulate (Failing to take RMD)

The IRA owner must begin receiving distributions by April 1 of the year following the year in which they reach the age of 72. The required minimum distribution for any year after the year in which they reach age 72 must be made by December 31 of that later year.

- **<u>50% Excise Tax</u>** on undistributed amounts
- Paid by IRA owner on Form 5329 when 1040 is filed or as a ‘stand-alone’ form.

The Basics

Court Rulings and Regulatory Issues

Bobrow v. Commissioner

- Limits IRA rollovers to once per year (365 days) per taxpayer (IRA owner)

U.S. Supreme Court Ruling – No Bankruptcy Protection For Inherited IRAs

- Traditional & Roth protected up to approximately $1.3 million
- SEP and SIMPLE IRAs protected
- Rollover IRAs from Work Related Plans protected
- Inherited IRAs are <u>not</u> protected
    - Not considered retirement funds for beneficial owner
    - Spouse beneficiary IRA may be protected

Best Interest Standards (Making Recommendations in the Client's Best Interest)

- Department of Labor Fiduciary Rule
- Breakout Session – Wednesday 1:00 PM

The Basics

IRA Distributions

Traditional, SEP, and SIMPLE IRAs

- Calculated when IRA owner reaches age 72
- Uniform Lifetime or Joint Life and Last Survivor Tables can be used
- <u>**First**</u> RMD must be taken by April 1 in the year <u>after the year</u> the IRA owner attained age 72 (Required Beginning Date)
- Early Distribution Penalty if distributions taken before age 59 ½

Roth IRAs

- No Required Distributions

Inherited Traditional or Inherited Roth IRAs

- Single Life Table is used for annual RMD calculations
- For original IRA owner deaths prior to January 1, 2020
    - "Old" Rules apply
- For original IRA owner deaths after December 31, 2019
    - SECURE Act Rules apply

The Basics

What is Required Beginning Date? (RBD)

- April 1 of the year after the year IRA owner reaches age 72

- First RMD can be delayed until April 1 in year <u>after the year</u> the IRA owner reaches age 72. All future RMDs due by 12/31

- Original IRA owner death <u>before</u> or <u>on or after</u> RBD
    - Effects beneficiary options
    - Distribution Rules are different for each type of beneficiary
    - More discussion later in review of SECURE Act and new IRS Regulations

The Basics

Qualified Charitable Distributions

- QCD Requirements and Tax Reporting
  - IRA Distribution paid directly to charity
  - Must be a qualifying charity
  - Can be used to satisfy RMD
  - Limited to $100,000 annually
  - Can be used to reduce AGI rather than taking deduction on Schedule A
  - Reported on 1099-R as a Distribution to IRA owner, although paid to charity
  - CPA will 'adjust' 1099-R amount on client's Form 1040 on Lines 4a and 4b
- IRA owner must be at least age 70 ½
- Inherited IRA owner, although may have RMD at any age, must be at least age 70 ½
- More QCDs are <u>expected</u> in the future as tax legislation (Tax Cuts and Jobs Act) increased Standard Deduction amounts

The Basics

Look Through Trusts

Look Through Rules

- Trust must be valid under state law
- Trust be irrevocable or become irrevocable at IRA owner's death
- Trust beneficiaries must be identifiable from the trust document
- Trust document must be provided to IRA sponsor
- Trust beneficiaries should be individuals

RMD Calculations are similar to calculations as if inherited by an <u>individual</u>

Distributions are death distributions made to a trust where trustee determines amount paid to trust beneficiaries

- Trusts may be Conduit or Accumulation
- Special distribution rules apply for QTIP Trusts

Trust Deposits are made according to trust governing document, state law or UPIA

Secure Act

H.R.1994 – SECURE Act
Part of H.R. 1865 - Further Consolidated Appropriations Act, 2020

Setting Every Community Up for Retirement Enhancement Act of 2019
IRA Provisions

TITLE I--EXPANDING AND PRESERVING RETIREMENT SAVINGS
(Sec. 106) The bill treats stipends and non-tuition fellowships as compensation for purposes of the retirement savings tax deduction.
(Sec. 107) The prohibition on contributions to a traditional Individual Retirement Account (IRA) by an individual who has reached age 70-1/2 is repealed.
(Sec. 113) The bill permits penalty-free withdrawals from retirement plans for expenses related to the birth of a child or adoption.
(Sec. 114) The bill increases from 70-1/2 to 72 the age for mandatory distributions from retirement plans.
TITLE IV--REVENUE PROVISIONS
(Sec. 401) The bill modifies required minimum distribution rules with respect to defined contribution plans and IRA balances upon the death of the account holder. All distributions must be made by the end of the 10th year after death, except for distributions made to certain eligible designated beneficiaries. Depending on age of original IRA owner at death.

Secure Act

Inherited IRA Distributions before SECURE Act

Original IRA Owner Deaths Before 2020

- “Old” Rules Apply
- Stretch was available to most beneficiaries
- Two types of Beneficiaries
  - Designated Beneficiaries
    - Stretch RMDs Based on Single Life Expectancy
  - Non-Designated Beneficiaries
    - 5-Year Distribution Rule
    - “Ghost” Distribution Rule

Secure Act

Inherited IRA Distributions Affected by SECURE Act

SECURE Act Rules for Original IRA Owner Deaths <u>After</u> 2019

- Three types of Beneficiaries
  - Eligible Designated Beneficiaries
    - Can still use the “Stretch”
    - EDBs
      - Surviving Spouse
      - Beneficiary with Disabilities
      - Chronically ill Beneficiary
      - Beneficiary not more than 10 years <u>younger</u> than IRA owner
      - Minor child of IRA owner (until they reach age of majority)
  - Designated Beneficiaries
    - Beneficiaries who are not EDBs
    - 10-Year Rule (must “empty IRA within 10 years after original IRA owner’s death)
      - <u>May</u> have annual RMDs during the 10-Year period
  - Non-Designated Beneficiaries
    - 5-Year Rule (must “empty” IRA within 5 years after original IRA owner’s death)
    - “Ghost” Distribution Rule

Secure Act

IRS Proposed Regulations – Selected IRA Sections

- Clarifying 10-Year Rule and 5-Year Rule
  - Original IRA owner death before RBD, no annual RMDs
  - Original IRA owner on or after RBD, annual RMDs
- Age of majority for minor children of IRA owner is age 21
- Provided guidance for Inherited IRAs owned by trusts
  - Retains the concepts of Conduit and Discretionary (a.k.a. Accumulation) trusts
  - Trust beneficiaries who can be disregarded when determining the post-death payout period
- Provided a definition of '10 years younger' for determining Eligible Designated Beneficiary
- Provided the requirements for determining if beneficiary is Chronically ill or person with disabilities

Secure Act 2.0

Securing a Strong Retirement Act of 2022

- Increases Required Beginning Date from 72 to 75
  - Gradually over a period of years

Increased Risk for IRA Custodians/Trustees

- "An alarming amount of money is being taken out of retirement accounts. The constant outflows from Defined Contribution Plans, which totals $4.61 trillion between 2011 and 2020, are mostly due to rollovers and cash outs." – Morningstar March 1, 2022.

- Increased rollovers from Workplace Retirement Plans created increased regulatory oversight to "protect retirement investors".

- Rollover recommendations should be made by considering the best interest of the retirement investor.

- SECURE Act and IRS Regulations increased compliance risks

- Several types of risk have <u>increased</u> for financial institutions.

Increased Risk for IRA Custodians/Trustees

Definition of Risk

Fiduciary Risk

Fiduciary Risk is the possibility that an agent will not act in the client's best interest. This does not necessarily include foul play or fraud. It could simply mean that the agent is not handling the client's funds in the best possible way.

SECURE Act and IRS Proposed IRS Regulations

- Risks are increased
- More expertise required
- More risk

Types of Risk

- Compliance
- Operational
- Regulatory
- Reputational
- Financial

Controlling Risk for IRAs

- Develop a 'Robust' Compliance Management System
  - Methodology to stay updated on IRA rules
- Develop Policies, Procedures and Operational Guides
- Develop 'Regulatory Awareness' for associates
- Consult internal and external legal/tax professionals
- Create an 'IRA Department' or 'IRA Subject Matter Expert'
- Participate in IRA 'groups'
- Attend IRA compliance conferences and training
- Training employees
  - Client facing associates
  - IRA operational positions
  - Compliance and Risk Control associates

Nationally Famous IRA Experts

Quiz: Match the numbers below to the pictures above.

1. Nerd's Eye View
2. www.irahelp.com
3. www.ataxplan.com

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