2020
NATIONAL INCOME TAX WORKBOOK
CHAPTER 8: RETIREMENT AND INVESTMENT ISSUES
CHAPTER TOPICS

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Recently passed legislation made changes to tax laws affecting retirement taxation and planning.

The SECURE Act, which is part of the Further Consolidated Appropriations Act, 2020, has provisions that were passed to encourage retirement savings and to make it easier for employers to offer retirement plans to employees.

The CARES Act, which was passed to help American taxpayers impacted by COVID-19, makes short-term changes to RMDs and access to retirement funds.

This chapter also discusses the taxation of various investment options.
SECURE Act increases the age to 72 for RMDs

- April 1 of the calendar year following the later of the calendar year in which the employee turns 72, or the calendar year in which the employee retires

- If account owner dies, and the spouse inherits account, distributions do not have to begin before the date the employee would have turned 72
RMD SCHEDULE

- Attain age 70 ½ in 2019 - RMD by 4/1/2020
- Attain age 70 ½ in 2020 - No RMD
- Attain age 72 in 2022 - RMD 2021 by 4/1/2023
RMD can be postponed until April 1 of the following year
The individual must take **two RMDs** in this second year
Exception - if the individual continues to work
The RMD is delayed until retirement occurs - defined benefit plans only (not IRA’s)
POLLING QUESTION

Do you plan to retire within the next 3 years

1. Yes
2. NO
The SECURE Act repeals the maximum age for traditional IRA contributions (tax years after December 31, 2019)

- This change does not affect the age when an individual can make a **qualified charitable** deduction using an IRA - 70 ½.
- If both an IRA qualified contribution and an IRA deduction is taken, the qualified contribution is reduced by the IRA deduction amount.
Taxable compensation for pursuing graduate or postdoctoral studies is income for the purpose of determining IRA eligibility.

- Applies to tax years that begin after December 31, 2019.
Penalty for failing to take an RMD is 50%
  ◦ IRS can waive penalty for reasonable cause: illness, old age, memory problems, etc.

The CARES Act waives the requirement to take an RMD in 2020.
Individual turns 72 in 2020, no RMD required by April 1, 2021
Required beginning date April 1, 2021, then no RMD required
Death of Owner - individual who dies, and the account must be distributed within 5 years, (2020 doesn’t count)
(If death in 2018, 5-year period ends in 2024, not 2023)
CALCULATING RMDs

RMDs - use the Joint Life and Last Survivor Expectancy Table (Table II) if sole beneficiary of the account is the spouse, and the spouse is more than 10 years younger than the account owner.

If spouse is not the beneficiary - Uniform Lifetime Table (Table III) or if the spouse is not the only beneficiary or if the spouse is not more than 10 years younger.

Example 8.1 Calculating the RMD
EXAMPLE 8.1

Faye (unmarried) celebrated her seventy-third birthday on 10/5/2020. All her retirement savings are in her three IRAs, which have a combined value of $255,000.

Faye will be age 73 at the end of 2020, so her distribution period from Table III (Figure 8.1) is 24.7.

Her RMD is $10,324 ($255,000 ÷ 24.7).

At 74 the factor would be 23.8 (as we get older the factor gets higher due to a shorter life expectancy and to ensure that the account get distributed).
Beneficiary can be any person or entity the account holder chooses.

Prior to the SECURE Act, beneficiaries could withdraw amounts from inherited accounts over the course of the beneficiary’s lifetime.

The SECURE Act phases down the allowed time period for withdrawal of an inherited IRA.
DESIGNATING THE SURVIVING SPOUSE  

If the surviving spouse inherits a traditional IRA, there are 3 choices

1. Treat the IRA as beneficiary’s own and become the account owner

2. Treat the IRA as beneficiary’s own and roll it over to a traditional IRA or other deferred tax retirement plan (see list on Page 266)

3. Treats him/herself as the beneficiary rather than treating the IRA as the beneficiary’s own
SPOUSAL ELECTION

Surviving spouse may elect to treat the spouse’s entire interest as a beneficiary in an individual’s IRA (the decedent) as the spouse’s own IRA

- Extends RMD until age 73
- Example 8.2 Later RMD Start Date
  - Jennifer dies in 2020, she was 68. Melissa, Jennifer’s wife was designated beneficiary and is 60 years old
SPOUSAL ELECTION: LONGER DEFERRAL PERIOD  PP. 266-267

The spousal election allows the surviving spouse to use Table III, (longer deferral period)
  ◦ Example 8.3 Longer Deferral Period
  ◦ Frank elects to treat inherited IRA from his wife as his own, therefore, his RMD is $6,818 as compared to $11,811 if he treated the IRA as if he was the beneficiary.
Requirements for Election: Sole beneficiary, unlimited right to withdraw

- Early distribution penalty applies if the surviving spouse treats IRA as his/her own and the surviving spouse is under 59½ years old

Making the Election

- Redesignate the inherited account in the name of the surviving spouse, or if
  - The amount in the IRA is not distributed within the RMD time period (is considered an election)
  - The surviving spouse makes a contribution to the IRA
SPOUSAL ROLLOVER PP. 267-269

If the surviving spouse receives a distribution (other than an RMD) it can be rolled into the surviving spouse’s IRA

- Must be done within 60 days (See discussion on page 268)
- May postpone RMDs

Example 8.4 Estate as Sole Heir
Spouse as Beneficiary

- Begin RMDs by the later of
  - 12/31 of the year following the year in which the decedent died, or
  - 12/31 of the year in which the decedent would have attained age 72 had he or she lived

Example 8.5 Distributions over Surviving Spouse’s Life Expectancy
SECURE Act - requirement that if an employee or IRA owner dies before the distribution of the retirement account

The account must be distributed to beneficiaries within 10 years of date of death
• Surviving spouse of the employee or IRA owner
• Child of the employer or IRA owner who has not reached majority (age 18)
• Disabled within the meaning of I.R.C. § 72(m)(7)
• Chronically ill individual
• Individual who is not more than 10 years younger than the employee or IRA owner.
• Example 8.6 Death of Eligible Designated Beneficiary
For noneligible designated beneficiaries, the qualified retirement account or IRA must be distributed in total within 10 years of the DOD of the owner.

Note: A trust is a “see-through trust,” and the beneficiaries are generally treated as designated beneficiaries if four items are met:

1. Trust is a valid trust under state law
2. Trust is irrevocable or became so upon owner’s death
3. Beneficiaries of the trust are identifiable
4. Trustee of the trust provides the plan administrator with documentation required
OTHER ISSUES TO CONSIDER PP. 271-272

What if ……No Designated Beneficiary
Entire account must be distributed within 5 years of death if owner had not started distributions, or life expectancy of decedent if owner had started distributions
POLLING QUESTION

Do you plan on utilizing the new RMD age of 72
1. Yes
2. No
ISSUE 3: EARLY DISTRIBUTIONS

PP. 272-273

General Rule

◦ If under 59 ½ years old - 10% penalty applies (unless there is an exception)
◦ Example 8.7 Arnold (age 52) pays both income tax and the 10% penalty on the distribution
◦ If ROTH, then no penalty if contributions were withdrawn after 5 years
Coronavirus-Related Distributions

◦ CARES Act waives 10% penalty for early withdrawals
  Up to $100,000 for COVID-related withdrawals
  (1/1/2020 to 12/31/2020)
  ◦ Diagnosed with COVID-19
  ◦ Spouse or dependent is diagnosed with COVID-19
  ◦ Experiences adverse financial consequences (Cross-Reference Notice 2020-50 for others)
  ◦ Included ratably over 3-tax years (unless elect out)
IRA EARLY DISTRIBUTION EXCEPTIONS PP. 273-274

Beneficiary  Higher-Education Expenses
Disabled       First-Time Homebuyer
Substantially Equal Payments  Qualified Reservist
IRS Levy       Birth or Adoption of a Child
Unreimbursed Medical Expenses
Medical Insurance for Unemployed Person
continued
QUALIFIED PLAN EXCEPTIONS

Beneficiary
Disabled
Substantially Equal Payments
IRS Levy
Unreimbursed Medical Expenses
Qualified Reservist
Birth or Adoption of a Child
Only for qualified plans (not IRAs)
- Distribution made after employee separation and employee is 55 or older (50 if public safety employee)
- Distribution made to alternate payee under a QDRO
- Distribution of dividends from employee stock ownership plan
Several acts, beginning in early 2017, address disaster relief and allow distributions, exempt from the 10% penalty, up to $100,000.

Distributions are included in taxable income over 3 years.

Or, plan participants may repay the distribution back to the plan within 3 years; the repayment is treated as a trustee-to-trustee transfer.
The penalty for early withdrawal is 10%. The taxpayer uses IRS Form 5329, Part 1 to make the calculation. The penalty is in addition to any income tax on the withdrawal.

Example 8.9 Early Distribution Penalty with Exception

- Barbara, 40, returns to school to finish her degree.
- She withdraws $8,400 from her IRA. Barbara pays $6,000 of tuition remaining after a scholarship and buys a car with the remaining $2,400.
A qualified charitable distribution (QCD) is a distribution that is transferred directly from an IRA to a qualified charity.

Satisfies the RMD requirement.

Owner must be at least 70 ½ years old (up to $100K) from the IRA to the charity without paying income tax on the distribution.

No charitable contribution deduction (no double dipping).

See list of 6 benefits of a QCD.
QUALIFIED CHARITABLE ORGANIZATION  PP. 276-277

Community chest, other organizations or trusts for charitable, religious, scientific, literary, or educational purposes, prevention of cruelty to kids or animals, national or international amateur sports [501(c)(3) orgs]

War veterans’ orgs

Domestic fraternal societies, orders and associations (if nonprofit purpose)

Certain nonprofit cemetery companies or corporations

The United States, any state, District of Columbia, a political subdivision of a state or US possession, or an Indian tribal government or any of its subdivisions (with funds used for public purposes)
PROCEDURE TO DONATE A QCD

Owner of the IRA requests the IRA trustee to make the QCD

Trustee writes a check to the qualified organization

Owner will receive a 1099-R and reports the distribution on 1040, line 4a and writes “QCD” beside line 4b and reports $0

Note, married couples, filing jointly, may exclude up to $100,000 each.

Example 8.10 Claiming the QCD
Traditional IRAs where the owner has basis, because the deduction was disallowed in the year of the contribution also are eligible.

ROTH IRAs are eligible (limited to earnings).

SEPs and SIMPLE IRAs are not eligible for a QCD.

Example 8.11 Nondeductible IRAs
When the stock market is volatile, investors may look elsewhere to diversify their investment holdings to mitigate risk. This issue discusses alternative investments and how these are taxed, and the reporting of taxable income generated by these investments.
Banks, credit unions and others use Form 1099-INT to report interest to the owner of the account.

Partnerships, LLCs and Sub-s corporations may report pro rata interest earnings on business accounts to the owners on Schedule K-1.

Schedule B is used if the taxpayer received over $1,500 of interest income (and in 7 other instances).
1. The taxpayer is claiming the interest exclusion under the Education Savings Bond Program
2. The taxpayer received interest from a seller financed mortgage, and the buyer used the property as a home
3. The taxpayer received a Form 1099-INT for US savings bond interest that includes amounts he or she reported in a previous tax year
4. The taxpayer received, as a nominee, interest that belongs to someone else

5. The taxpayer received a Form 1099-INT for interest on frozen deposits

6. The taxpayer received a Form 1099-INT for interest on a bond that he or she bought between interest payment dates

7. The taxpayer is reporting original issue discount (OID) in an amount less than the amount shown on Form 1099-OID
A CD is a federally insured savings account paying a premium interest rate with a fixed date of withdrawal.

If the CD is withdrawn prior to the maturity date a penalty typically is imposed.

If CDs pay interest annually or more frequently, the taxpayer reports the income when received.
US SAVINGS BONDS

US Savings Bonds are low risk savings instruments

Generally the owner reports the interest when the bonds are cashed in

Bond owners using the accrual method of accounting report each year’s interest as it accrues.

Types of Savings Bonds

- HH, no longer issued, but last ones will mature in 2024
  (interest paid 2x /yr. direct deposit)
US SAVINGS BONDS

- EE Bonds - issued at face value, interest paid upon redemption (penalty for early cashing out)
- I Bonds - inflation indexed bonds, face value plus interest at maturity, (penalty for early cash out)

Interest on Series EE and Series I bonds is payable when the taxpayer cashes the bond
Two methods allowed for reporting of income
1. At the time the bond is cashed or disposed of, or the year of maturity, or
2. Elect to report increase in value annually
The same method must be used for all Series EE and Series I bonds

Practitioner Note regarding exclusion for education savings
Changing Reporting Method

- IRS allows, without asking for permission, a change from method 1 to method 2
- IRS requires permission for changing from method 2 to method 1
  Permission is usually granted automatically if a statement is attached with 5 required items

Child as Owner

- Interest on US savings bond bought for and registered in the name of a child is the income of the child.
- Example 8.13 Children as Owners of Bonds – Method 2
## JOINT OWNERSHIP OF US SAVINGS BONDS

### FIGURE 8.3 Who Pays the Tax on Savings Bond Interest Income

<table>
<thead>
<tr>
<th>Ownership</th>
<th>Who Owes the Tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>The purchaser is the only owner of the bond</td>
<td>The purchaser</td>
</tr>
<tr>
<td>The purchaser purchases a bond and puts it in the name of the purchaser and the co-owner</td>
<td>The purchaser</td>
</tr>
<tr>
<td>The purchaser purchases a bond and puts it in someone else’s name as the only owner</td>
<td>The person who is named as the owner</td>
</tr>
<tr>
<td>The purchaser and another person buy a bond together and are both named as co-owners</td>
<td>Each purchaser reports interest in proportion to the amount he or she paid for the bond</td>
</tr>
<tr>
<td>The purchaser and his or her spouse live in a community property state, buy a bond that is community property, and file separate tax returns</td>
<td>Each spouse reports one-half the interest</td>
</tr>
</tbody>
</table>

Source: [www.treasurydirect.gov/indiv/research/indepth/ebonds/res_e_bonds_eetaxconsider.htm](http://www.treasurydirect.gov/indiv/research/indepth/ebonds/res_e_bonds_eetaxconsider.htm)
If Series EE or Series I bonds are purchased but then reissued to the beneficiary or spouse subject to a divorce, all interest earned must be included in the taxpayer’s gross income.

**Example 8.14 Transfer Incident to a Divorce**

Transfer to a Trust – must include in income (unless owner of the trust)

Decedents – surviving owner can wait to cash

**Example 8.15 Inherited Bond – No Election to Include**

**Example 8.16 Inherited Bond – Election to Include**
When a US savings bond is cashed, the bank or other payer redeeming the bond must issue a 1099-INT if the accrued interest is $10 or more.

Box 3 of Form 1099-INT shows the interest as the difference between the amount received and the amount paid for the bond.

There may be 5 reasons for the 1099-INT showing more interest than the taxpayer needs to include:

- See list on PP. 283-284
Mutual funds allow investors to pool money with other investors to purchase a portfolio of stocks, bonds, and other securities. Mutual funds generally provide lower risk by creating investment diversity.

Mutual fund returns are generally paid out as:
- Dividends: ordinary and qualified
- Capital gain income
### FIGURE 8.4 Qualified Dividends Maximum Tax Rates For 2020 Taxable Incomes

<table>
<thead>
<tr>
<th>Maximum Tax Rate</th>
<th>Single</th>
<th>Married Filing Jointly</th>
<th>Married Filing Separately</th>
<th>Head of Household</th>
<th>Estates and Trusts</th>
</tr>
</thead>
<tbody>
<tr>
<td>0%</td>
<td>Not over $40,000</td>
<td>Not over $80,000</td>
<td>Not over $40,000</td>
<td>Not over $53,600</td>
<td>Not over $2,650</td>
</tr>
<tr>
<td>15%</td>
<td>$40,001–$441,450</td>
<td>$80,001–$496,600</td>
<td>$40,001–$248,300</td>
<td>$53,601–$469,050</td>
<td>$2,651–$13,150</td>
</tr>
<tr>
<td>20%</td>
<td>Over $441,450</td>
<td>Over $496,600</td>
<td>Over $248,300</td>
<td>Over $469,050</td>
<td>Over $13,150</td>
</tr>
</tbody>
</table>
Mutual funds will report on Form 1099-DIV. Taxpayers will use Schedule B if ordinary dividends are more than $1,500.

- January Dividends: declared in October, November, or December are considered received on December 31 of the year, even if actually paid in January of the following year
- Partnerships, LLCs and S corporations may pass through dividends on Schedule K-1
Determining basis is important to calculate gain or loss on sale of mutual fund shares.

- **Purchased Stock:** Initial purchase plus any sales load, commission, or fees
- **Inherited Stock:** generally FMV on the DOD (or alternate valuation date)
- **Gifted Stock:** generally the carryover basis of the donor, if FMV is less at time of gift, the FMV is used to calculate a loss on disposition by the donee
EXAMPLE 8.18

Adjusted basis of $10,000
FMV at the time of the gift of $9,000
Rhonda sells the property for $9,500
Her basis for calculating a gain is $10,000, which results in a $500 loss
Her basis for calculating a loss is $9,000, which results in a $500 gain
Rhonda does not have a gain or loss
Dividend Reinvestment – must still report as income
Undistributed Capital Gains – also included in income
Calculating Gain on the Sale of Mutual Fund Shares
  • Can use cost basis or average basis
### FIGURE 8.5 Record of Purchases

<table>
<thead>
<tr>
<th>Date</th>
<th>Action</th>
<th>Price per Share</th>
<th>Number of Shares</th>
<th>Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 15, 2018</td>
<td>Purchase</td>
<td>$10</td>
<td>1,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>December 15, 2018</td>
<td>Reinvestment</td>
<td>$12</td>
<td>100</td>
<td>$1,200</td>
</tr>
<tr>
<td>July 15, 2019</td>
<td>Purchase</td>
<td>$10</td>
<td>1,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>December 15, 2019</td>
<td>Reinvestment</td>
<td>$8</td>
<td>200</td>
<td>$1,600</td>
</tr>
</tbody>
</table>
AVERAGE BASIS

Requirements

Acquires identical Shares at various times

Left share on deposit kept by custodian or agent

Averaging basis of all shares (regardless of holding period)

DRP and non-DIRP are not identical to shares in a non DRP account
Using Average Basis - Shares are sold on a **FIFO** basis

- Example 8.20 Average Basis

**FIGURE 8.6 Andy’s Average Basis Calculation**

<table>
<thead>
<tr>
<th>Step</th>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Total adjusted basis of all shares owned in the fund before the sale</td>
<td>$4,800</td>
</tr>
<tr>
<td>2.</td>
<td>Total number of shares owned in the fund before the sale</td>
<td>300</td>
</tr>
<tr>
<td>3.</td>
<td>Divide the amount on line 1 by the amount on line 2</td>
<td>$16</td>
</tr>
<tr>
<td>4.</td>
<td>Enter the number of shares sold</td>
<td>150</td>
</tr>
<tr>
<td>5.</td>
<td>Multiply the amount on line 3 by the amount on line 4</td>
<td>$2,400</td>
</tr>
</tbody>
</table>
INVESTMENT EXPENSES

General rule allows for ordinary and necessary expense deductions
   ◦ Reasonable amounts
   ◦ Proximate to the production of income
   ◦ Management, conservation, and maintenance

Fees for investment counsel, custodial fees, clerical help may be deductible as a miscellaneous itemized deduction if greater than 2% of AGI

For tax years 2018 – 2025 these deductions are eliminated
INVESTMENT INTEREST

Investment interest is deductible subject to limitations
◦ Allocation of interest expense to the investment debt
  ◦ Example 8.23 Allocation of Investment and Personal Interest
◦ When to deduct Investment Interest
  ◦ Cash when paid, accrual when accrued
◦ Limit on Investment Interest Deduction (net investment income – expenses)
To deduct investment interest expenses, the taxpayer must itemize deductions on Schedule A and attach Form 4952.

**FIGURE 8.9 Schedule A (Form 1040)**

| Interest You Paid |  
|--------------------|------|
| a. Home mortgage interest and points reported to you on Form 1098. See instructions if limited. | 8a   |
| b. Home mortgage interest not reported to you on Form 1098. See instructions if limited. If paid to the person from whom you bought the home, see instructions and show that person’s name, identifying no., and address. | 8b   |
| c. Points not reported to you on Form 1098. See instructions for special rules. | 8c   |
| d. Mortgage insurance premiums (see instructions). | 8d   |
| e. Add lines 8a through 8d. | 8e   |
| 9. Investment interest. Attach Form 4952 if required. See instructions. | 9     |
| 10. Add lines 8e and 9 | 10    |
THE FUTURE NIB
From Barron’s - Bipartisan Bill

Raise RMD to age 75
Require most 401(k), 403(b) & SIMPLE plans to auto enroll participants
with an initial savings amount of at least 3% to a max of 10% of salary
(increasing 1% each year)

Increase incentives for small businesses
Increase and streamline Savers Credit
Treat 403(b) plans like 401(k) plans
POOLING QUESTION

Do you have a saving bond that has matured but not cashed in
1. Yes
2. No
3. Not Sure
QUESTIONS?