

FINANCIAL EXPERTS

NETWORK

Form 5329:
Exceptions to Early Distribution
Penalty

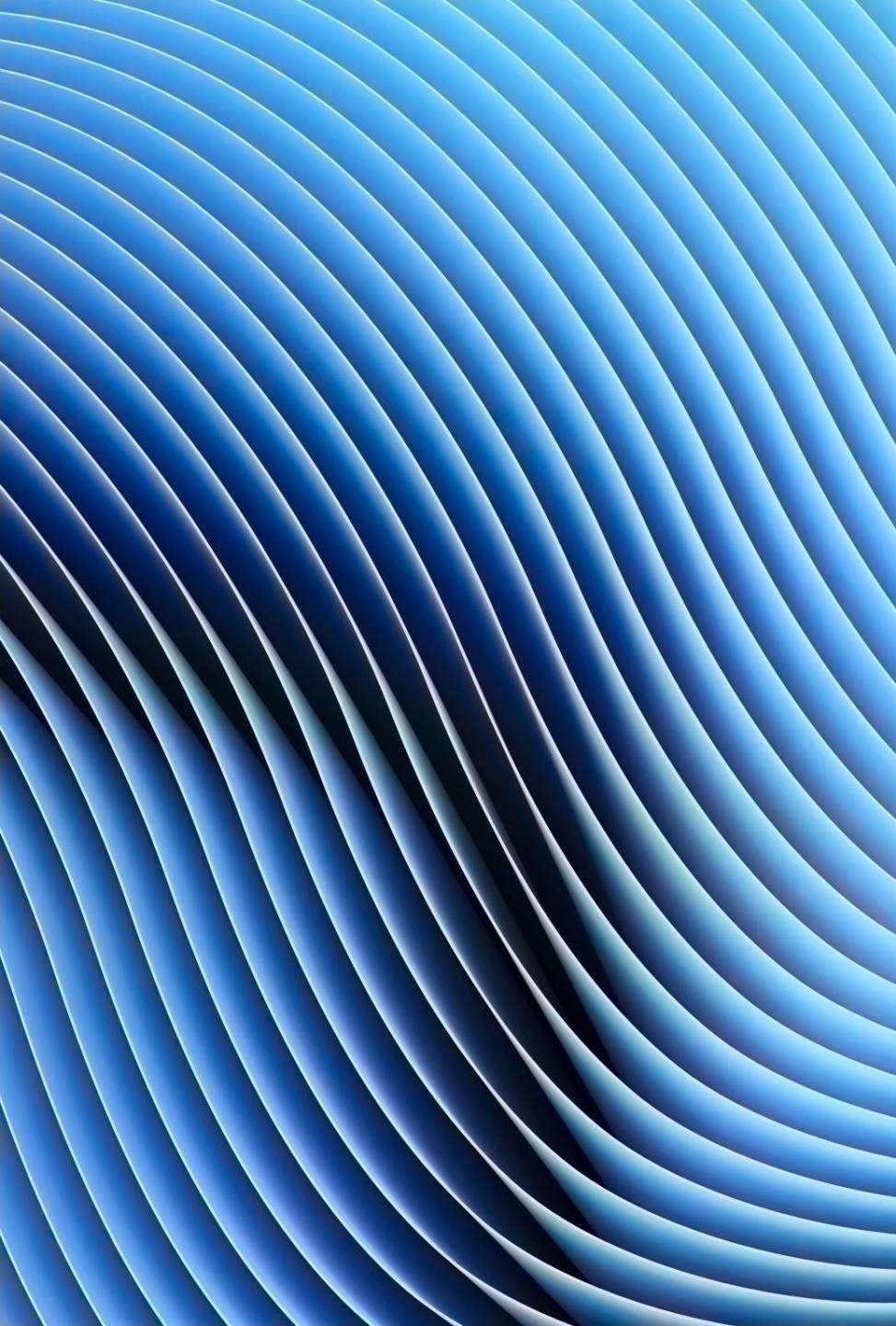
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Today's Presenter

Lawrence Pon

- Lawrence Pon is a Certified Public Accountant, Personal Financial Specialist, Certified Financial Planner, Enrolled Agent, United States Tax Court Practitioner, and Accredited Estate Planner in Redwood Shores, CA
- Mr. Pon has been in practice since 1986 and speaks regularly to tax professionals on the latest tax planning and preparation topics throughout California and nationally.
- Mr. Pon received his BS in Business Administration from UC Berkeley and MS in Taxation from Golden Gate University in San Francisco



Today's Topics

Form 5329:
Additional Taxes
on Qualified Plans

Exceptions to
early distribution
penalties

Form 5329

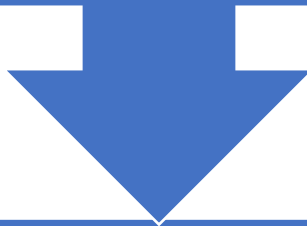
- Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts
 - Part I: Additional Tax on Early Distributions
 - Part II: Additional Tax on Certain Distributions From Education Accounts and ABLE Accounts
 - Part III: Additional Tax on Excess Contributions to Traditional IRAs
 - Part IV: Additional Tax on Excess Contributions to Roth IRAs
 - Part V: Additional Tax on Excess Contributions to Coverdell ESAs
 - Part VI: Additional Tax on Excess Contributions to Archer MSAs
 - Part VII: Additional Tax on Excess Contributions to Health Savings Accounts (HSAs)
 - Part VIII: Additional Tax on Excess Contributions to ABLE Account
 - Part IX: Additional Tax on Excess Accumulation in Qualified Retirement Plans (Including IRAs)

Additional Tax on Early Distributions

- If took a taxable distribution before reaching age 59 ½ from a qualified retirement plan (including IRA) or modified endowment contract
 - Other than a qualified disaster distribution
 - Form 8915-E & Form 8915-F
 - Complete this part to indicate qualify for an exception.
- Line 1 = early distributions includible in income.
 - Form 8606
- Additional tax = 10%
 - If SIMPLE IRA, additional tax = 25%
 - If received within 2 years from the date of first participation in SIMPLE

How To Avoid Additional Tax on Early Distributions

Rollover within 60 days of receiving distribution



Any amount not rolled over subject to 10% additional tax on early distributions


Once every 12 months

Rollover (aka convert) from a qualified retirement account to Roth IRA

- Not subject to 10% additional tax on early distributions
- Report on Form 8606

In-plan Roth rollover

- 10% additional tax on early distribution does not apply



Additional Tax on Early Distributions

- Does not apply to:
 - Qualified disaster distribution
 - Including 2020 coronavirus-related distribution
 - Form 8915-F
 - Qualified distributions from Roth IRAs
 - Five-year rule(s)
 - Over age 59 ½
 - First time purchase of home (\$10,000)

Additional Tax on Early Distributions

- Does not apply to:
 - Birth or adoption of child of up to \$5,000
 - Made during the 1-year period beginning on the date child was born or adopted
 - Attach a statement
 - Name, age, and TIN of child or adoptee
 - If child died before obtaining a TIN, then write that the child died and include copy of birth certificate, death certificate, or hospital records
 - Eligible adoptee has not reached the age of 18
 - If adult
 - Physically or mentally incapable of self-support
 - Qualified HSA funding distribution from an IRA

60-Day Waiver Request

- PLR 202033008
 - The IRS has the authority to waive the 60-day deadline, where “failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement”
 - Whether deadline was missed to due errors committed by a financial institution, and
 - The use of the amount of was distributed
 - Check cashed
 - Funds were in use at the time the rollover was required to be completed
 - On the advice of real estate agent, took IRA distribution
 - Intend to roll over distribution after the sale of home
 - Home was not sold in time
 - IRA custodian refused to accept rollover after 60-day deadline

60-Day Waiver Request

Reason for waiver request

- Failure to meet the deadline was caused by the failure of the real estate agent
- IRA custodian did not inform him of the 60-day rollover deadline

IRS Denial

- No one is required to tell IRA owner about deadline
 - No such requirement for IRA custodians
 - Unlike qualified plans which is subject to IRC §402(f) notice requirement
- The failure of the realtor and financial institution to provide this information does not rise to the level of financial institution error
- This was loan
 - Short-term interest-free loan
- Did not meet Congressional intent
 - Facilitate movement of assets between retirement accounts
 - Not loan to cover personal expenses

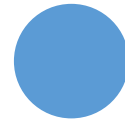
Self-Certification Rollover List

- Revenue Procedure 2020-46
 - 60-Day Rollover Deadline
 - Distributions not taxable if properly rolled over
 - 60-day deadline
 - Waived under certain circumstances
 - Automatic waiver
 - Self-certification
 - Private ruling



Self-Certification Rollover List

- Revenue Procedure 2016-47 provides list of reasons
- Revenue Procedure 2020-46 adds more reasons
 - Conditions for self-certification
 - No prior denial by the IRS
 - Reason for missing 60-day deadline is on the list
 - Contribution as soon as practicable
 - 30 day safe harbor



Rev Proc 2020-46

- Reasons
 - Error committed by financial institution
 - Check was misplaced and never cashed
 - Deposited into wrong account
 - Taxpayer's principal residence was severely damaged
 - Member of taxpayer's family died
 - Taxpayer or member of taxpayer's family seriously ill
 - Taxpayer was incarcerated
 - Restrictions imposed by a foreign country
 - Postal error
 - Distribution made to state unclaimed property fund

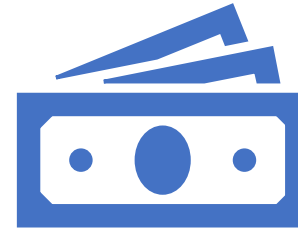
Rev Proc 2020-46



More reasons

Distribution made on account of IRS levy and proceeds returned

Party making the distribution delayed providing information that the receiving plan or IRA required to complete the rollover despite reasonable efforts to obtain information



Reporting on Form 5498

IRA trustee accepts a rollover contribution after 60-day deadline

Knowledge Check #1

When does the early distribution tax apply?

- a. When the owner takes a distribution from an IRA before age 59 ½
- b. When the distribution is qualified disaster distribution
- c. When the distribution is rolled over another IRA within 60 days
- d. When the distribution is rolled over into a Roth IRA.

Knowledge Check #2

What is the amount of the early distribution tax?

- a. 10%
- b. 2.5%
- c. 25%
- d. 6%



Exceptions

- 01 - Qualified retirement plan distributions, not apply to IRAs.
 - Separation from service on or after age 55
 - Age 50 for qualified public safety employees
- 02 – Substantially equal periodic payments made at least annually for life (or life expectancy) or the joint lives (or the joint life expectancies) of owner and designated beneficiary
 - If from an employer plan, payments must begin after separation from service
- 03 – Distributions due to total and permanent disability

Exceptions

- 04 – Distributions due to death
- 05 - Up to the amount paid form unreimbursed medical expenses minus 7.5% of AGI
- 06 – Made to an alternate payee under a qualified domestic relations order
 - Does not apply to IRAs
- 07 – IRA distributions made to certain unemployed individuals for health insurance premiums

Exceptions

- 08 – IRA distributions made for qualified higher education expenses
- 09 – IRA distributions made for the purchase of a first home, up to \$10,000
- 10 – IRS levy
- 11 – Reservists while serving on active duty for at least 180 days
- 12 – Other
 - Enter this code if more than one exception applies

Exceptions

- Other
 - Distributions incorrectly indicated as early distributions by code 1, J, or S in box 7 of Form 1099-R
 - Include on line 2 the amount received when 59 ½ or older.
 - Distributions from a §457 plan
 - Which are not from a rollover of a qualified retirement plan
 - Qualified birth or adoption distributions
 - Attach a statement that provides the name, age, and TIN of the child or eligible adoptee.
 - See instructions for more.

Rollover Can Lose Death Exception

- Catania v. Commissioner (TC Memo 2021-33)
 - Rollover from a Qualified Plan to IRA Lost Exemption to 10% Early Distribution Penalty
 - Rule of 55
 - Taxpayer retired at age 55 and therefore eligible for the age 55 exception for his 401(k)
 - Rolled over 401(k) to his IRA
 - Took \$57,000 distribution from IRA at age 57
 - Tax Court ruled Age 55 exception does not apply to IRAs



Unreimbursed Medical Expenses Exception

- Deduction for medical expenses on Schedule A (Form 1040)
- Do not need to itemize expenses to claim this exception

Medical Insurance Exception

- Amount paid for medical insurance for taxpayer, spouse, and dependents
 - Lost job
 - Received unemployment compensation under any federal or state law for 12 consecutive weeks because of lost job
 - Receive distributions during either the year received unemployment or the following year
 - Receive distributions no later than 60 days after reemployed

Disabled Exception

A physician must determine condition can be expected to result in death or to be of long, continued, and indefinite duration.

Furnish proof that cannot do any substantial gainful activity because of physical or mental condition

Substantially Equal Period Payments Exception

IRS approved
distribution method
(§72(t))

- Required minimum distribution method
 - Exact amount to be distributed, not the minimum amount
- Fixed amortization method
- Fixed annuitization method

Watch out of
recapture tax for
changes in
distribution method
under equal
payment exception

- Receive payments for at least 5 years

One-time switch

- To the required minimum distribution method

IRS Notice 2022-6

Replaces Rev. Rul. 2002-62 and Notice 2004-15

- For any series of payments commencing on or after January 1, 2023
- May be used for series of payments commencing in 2022

Using updated tables from RMD method

- Not treated as a impermissible modification of the payment stream

Interest rates

- Fixed amortization method or fixed annuitization method, rate can be no more than the greater of:
 - 5% or
 - 120% of the federal mid-term rate for either of the 2 months immediately preceding the month in which the distribution begins

Interest Rate

January, 2022

- 120% of applicable Federal mid-term rate = 1.57%

February, 2022

- 120% of applicable Federal mid-term rate = 1.69%

March, 2022

- 120% of applicable Federal mid-term rate = 2.09%

Use the higher rate from the two months prior to the month when the schedule began



Example – Pre Notice 2022-6

- Sally, age 50, \$1 million IRA
 - 120% Mid-term AFR = 1.69%
 - RMD Method
 - Single life table = \$27,624
 - Uniform life table = \$20,619
 - Fixed Amortization Method
 - Single life table = \$37,156
 - Uniform life table = \$30,375
 - Fixed Annuitization Method
 - Annuity factor (single life) = \$36,978

Example – Notice 2022-6

- Sally, age 50, \$1 million IRA
 - 120% Mid-term AFR = 1.69% or 5%
 - RMD Method
 - Single life table = \$27,624
 - Uniform life table = \$20,619
 - Fixed Amortization Method
 - Single life table = \$60,312
 - Uniform life table = \$55,177
 - Fixed Annuitization Method
 - Annuity factor (single life) = \$59,308





Higher Education Expenses Exception

- Qualified higher education expenses paid to eligible educational institution
- Education for taxpayer, spouse, children, or grandchildren
- Do not include expenses paid with:
 - Tax-free distributions from Coverdell education savings account
 - Tax-free part of scholarships and fellowships
 - Pell grants
 - Employer-provided educational assistance
 - Veterans' educational assistance
 - Any other tax-free payments received as educational assistance
 - Not gifts or inheritance

Higher Education Expenses Exception



- Qualified higher education expenses
 - Tuition
 - Fees
 - Books
 - Supplies
 - Equipment
 - Special needs services
 - If at least half-time student
 - Room and board are qualified higher education expenses



Education

Higher Education Expenses Exception

- Eligible educational institution
 - College
 - University
 - Vocational school
 - Postsecondary educational institution eligible to participate in the student aid programs administered by the US Dept of Education

First Home Exception

- Buy, build, or rebuild a first home
- Used to pay qualified acquisition costs before the close of the 120th day after the date it was received
- Who is any of the following
 - Taxpayer
 - Spouse
 - Child
 - Grandchild
 - Parent or ancestor



A close-up photograph of a hand holding a set of keys. The keys are silver and include a standard house key. Attached to the keychain is a silver-colored metal charm shaped like a house with two windows and a door. The background is a soft-focus outdoor scene with greenery and a blue sky.

First Home Exception

- Limit = \$10,000 each
- Qualified acquisition costs
 - Costs of buying, building, or rebuilding a home
 - Any usual or reasonable settlement, financing, or other closing costs
- First-time homebuyer
 - No present interest in a main home during the 2-year period ending on the date of acquisition of the home which the distribution is being used to buy, build, or rebuild.
 - If married, spouse must also meet this no-ownership requirement

Qualified Reservist Distributions Exception

- Distribution made no earlier than the date of the order or call to active duty and no later than the close of the active duty period.



Storing IRA Gold at Home

- Andrew McNulty v. Commissioner (157 TC No. 10)
 - Scheme promoted on radio and internet ads
 - Touting the benefits of using IRA assets to buy gold and silver coins
 - Store them at home or in a safe-deposit box
 - Investing in alternative assets must follow strict rules against self dealing
 - Used an LLC to invest in a condominium and gold and silver coins.
 - Tax Court ruled taxpayer had “unfettered control” of the coins.
 - Should have been held by a third-party fiduciary
 - Taxes of \$270,000 on \$730,000 of IRA assets
 - Plus accuracy related penalty of \$54,000



Knowledge Check #3

What is the amount of the early distribution tax for SIMPLE IRAs?

- a. 10%
- b. 2.5%
- c. 25%
- d. 6%



Resources



- Form 5329
 - <https://www.irs.gov/pub/irs-pdf/f5329.pdf>
 - <https://www.irs.gov/pub/irs-pdf/i5329.pdf>
- IRS Publication 590-A – Contributions to Individual Retirement Arrangements (IRAs)
 - <https://www.irs.gov/pub/irs-pdf/p590a.pdf>
- IRS Publication 590-B – Distributions from Individual Retirement Arrangements (IRAs)
 - <https://www.irs.gov/pub/irs-pdf/p590b.pdf>

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