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The Clock Is Ticking to Repay Coronavirus-Related Distributions

By Ed Slott, CPA

The Coronavirus Aid, Relief, and Economic Security (CARES) Act, passed in March 2020, made it easier for Americans who were negatively affected by the pandemic to access money in their IRAs and workplace retirement plans such as a 401(k), 403(b), and 457(b). Account owners could withdraw 100% of their vested balance, up to \$100,000 in 2020, without paying the 10% early-withdrawal penalty that normally applies before age 59½.

Taxpayers who took coronavirus-related distributions (CRDs) had the option of reporting the entire amount as taxable income in 2020 or spreading it evenly over three years to help manage the associated tax liability. Those who tapped into their retirement savings were also given three years to recontribute the funds and recover any taxes paid on the distribution.

If you are facing this important decision, you may want to consider the following details.

Recontribution Rules

Your deadline for repaying all or part of a CRD is three years from the day after you received the money. For example, if a CRD was taken on June 1, 2020, you have until June 2, 2023, to recontribute those funds.

Repayments do not have to go back into the retirement account from which the CRD originated, so you should think carefully about where and how you wish

Repaying a CRD presents an opportunity to put your retirement savings back to work.



to reinvest the money. If you took a CRD from your 401(k), the money can be returned to the same plan, to a new employer's plan (if permitted), or to an IRA. A CRD from an IRA can be returned to the same IRA or a different one. In fact, one or more repayments can be made to any retirement account into which the original distribution could have been rolled over.

Recontributions are considered direct rollovers or trustee-to-trustee transfers by the IRS — neither of which are taxable events. Moreover, the once-per-year rollover limitation does not apply to repayments, and they do not count toward annual contribution limits.

Tax Considerations

If you repay all or part of a CRD to an eligible retirement account before your three-year deadline, and the entire amount was included in your 2020 income, you can file an amended 2020 return and report recontributions on IRS Form 8915-E to claim a refund of the taxes paid. If you make a large repayment, your 2020 income might drop into a lower bracket and result in additional tax savings.

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If you have any questions about the topics in this newsletter or about your financial future, call us. We are available to help.

Three Stretch IRA Alternatives

The passage of the SECURE Act in 2019 effectively eliminated the stretch IRA, an estate planning strategy that allowed an inherited IRA to continue growing tax deferred, potentially for decades. Most nonspouse beneficiaries, including children and grandchildren, can no longer stretch distributions over their lifetimes. Moreover, proposed IRS regulations require most designated beneficiaries to take annual required minimum distributions (RMDs) within the 10-year distribution period if the original account owner died on or after his or her required beginning date. This shorter distribution period could result in unanticipated and potentially large tax bills for nonspouse beneficiaries who inherit high-value IRAs.

You may be looking for alternative ways to preserve your wealth and pass it on to your beneficiaries. Here are three options you might consider.

Roth Conversion

If you are willing to pay income taxes now instead of your beneficiaries paying them later, you could convert your IRA to a Roth IRA. Anyone can convert a traditional IRA to a Roth IRA. However,

you generally have to include the amount converted in your gross income for the year of conversion. Not only would you have to pay taxes on the amount converted, but the beneficiaries of your Roth IRA will generally have to liquidate the account within 10 years of inheriting it, although they won't pay federal income taxes on the distribution(s).

Life Insurance

You could take distributions from your IRA and use them to buy life insurance on your life. The beneficiaries you name in the life insurance policy will receive those proceeds tax-free at your death. The policy beneficiaries could use the tax-free proceeds of the life insurance to pay any income taxes they would owe on the balance of the IRA they inherit from you. Or, if you've been able to liquidate or spend down your IRA during your lifetime, the tax-free life insurance death benefit would replace some or all of the taxable IRA that otherwise would have been inherited by the beneficiaries.

Irrevocable Trust

You could create an irrevocable trust and fund it with non-IRA assets. An irrevocable trust can't be changed or

dissolved once it has been created. You generally can't remove assets, change beneficiaries, or rewrite any of the terms of the trust. Often, life insurance is used to fund the irrevocable trust. You can direct how and when the trust beneficiaries are to receive the life insurance proceeds from the trust after your death. In addition, if you have given up control of the property, all of the property in the trust, plus any future appreciation on the property, is removed from your taxable estate.

While trusts offer numerous advantages, they incur upfront costs and often have ongoing administrative fees. The use of trusts involves a complex web of tax rules and regulations. You should consider the counsel of an experienced estate planning professional and your legal and tax professionals before implementing such strategies.

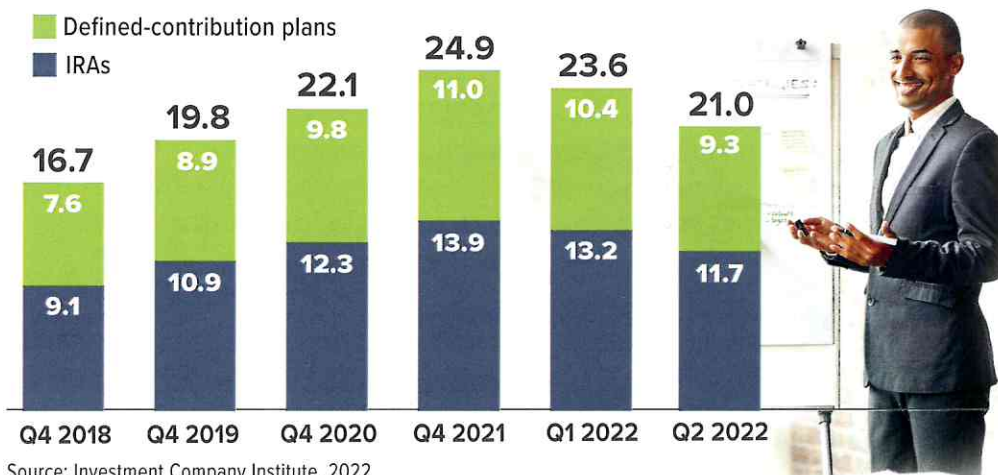
As with most financial decisions, there are expenses associated with the purchase of life insurance. Policies commonly have mortality and expense charges. The cost and availability of life insurance depend on factors such as age, health, and the type and amount of insurance purchased. In addition, if a policy is surrendered prematurely, there may be surrender charges and income tax implications. Any guarantees are subject to the financial strength and claims-paying ability of the insurer.

To qualify for the tax-free and penalty-free withdrawal of earnings, a Roth IRA must meet the five-year holding requirement, and the distribution must take place after age 59½ or due to the owner's death, disability, or a first-time home purchase (\$10,000 lifetime maximum). Under current tax law, if all conditions are met, the Roth IRA will incur no further income tax liability for the rest of the owner's lifetime or for the lifetimes of the owner's heirs, regardless of how much growth the account experiences.

Wealth Cache

Assets held in IRAs and defined-contribution plans such as 401(k)s dipped in the first half of 2022 to \$21 trillion. Even so, that total was up more than 25% from year-end 2018.

U.S. retirement assets, in trillions



Small Businesses Should Prepare for Stronger Tax Enforcement

The Inflation Reduction Act of 2022 is providing the IRS with an influx of about \$80 billion to modernize outdated technology and rebuild a depleted workforce, which is expected to improve enforcement to the tune of about \$200 billion over a decade. Treasury Secretary Janet Yellen directed the agency not to use additional resources to increase audit rates for taxpayers making under \$400,000 a year, but the tax returns of high-earning business owners are likely to face more scrutiny than they have in years past.¹

Higher audit rates won't appear overnight, but large investments to upgrade technology could eventually help the IRS develop more advanced enforcement methods. With that in mind, here are some tips to help you avoid unwanted attention from the IRS.

Understand the process. Tax returns are randomly selected, which means you might be audited even if you do everything by the book. However, when your tax return is processed, a computer program screens for anomalies and compares deductions to those of taxpayers with similar incomes. Your return is more likely to be chosen if there's a higher chance that it would result in the collection of additional taxes, but an audit can also be triggered by a red flag on your return or a simple mistake that leads to additional questions. If selected for a correspondence audit, you may be asked

to mail specific information to the IRS. A comprehensive field audit would be conducted at your home, place of business, or accountant's office.

Avoid common traps. Filing an incomplete tax return (with missing forms or schedules) and not making tax payments on time are surefire ways to attract unwanted attention from the IRS. Taking business deductions that are not in line with industry norms, not categorizing transactions consistently from year to year, having a high number of independent contractors relative to full-time employees, and reporting continuous losses are all situations that can look suspicious, even if they are valid.

Step up your record-keeping. Taxpayers are required to keep tax records for at least three years from the date the tax return was filed. Organizing and possibly digitizing your records could make it easier to respond to any requests for information that may come from the IRS — and not being able to provide a requested document could negatively impact your audit results.

A heightened focus on compliance means it may be more important than ever to consult an experienced tax professional for personalized guidance, especially if you receive any type of communication from the IRS.

1) U.S. Treasury Department, 2022

Audit Rates Over Time

IRS audit rates for individual, partnership, and S corporation income tax returns have fallen since 2010, a trend that could reverse as the IRS ramps up enforcement.

Individual returns by total positive income*	Tax year 2010	Tax year 2019
\$100,000 under \$200,000	0.8%	0.2%
\$200,000 under \$500,000	2.3%	0.2%
\$500,000 under \$1,000,000	3.6%	0.6%
\$1,000,000 under \$5,000,000	8.2%	1.3%
\$5,000,000 under \$10,000,000	13.5%	2.0%
\$10,000,000 or more	21.5%	8.7%
Partnership returns	0.5%	0.1%
S corporation returns	0.4%	0.1%

*Total positive income excludes losses
Source: Internal Revenue Service, 2022





Naming a Trusted Contact

When you open an account or update an existing account at a brokerage or a financial firm, you may be asked if you want to designate a “trusted contact.” This individual may be contacted in certain situations, such as when financial exploitation is suspected or there are other concerns about your health, welfare, or whereabouts. Naming a trusted contact is optional but may help protect your account assets.

The person you name as a trusted contact must be at least 18 years old. You’ll want to choose someone who can handle the responsibility and will always act in your best interest — this might be a family member, close friend, attorney, or third-party professional. You may also name more than one trusted contact.

Understandably, you might be concerned that the person you name could make transactions in your account, but that’s not the case. Your trusted contact will not be able to access your account or make financial decisions on your behalf (unless you previously authorized that person to do so). You are simply giving the financial firm permission to contact the person you have named.

Here are some examples of times when a financial firm might need to reach out to your trusted contact:

- To confirm current contact information when you can’t be reached
- If financial exploitation or fraud is suspected
- To validate your health status if the firm suspects you’re sick or showing signs of cognitive decline
- To identify any legal guardian, executor, trustee, or holder of a power of attorney on your account

A firm may only share reasonable types of information with your trusted contact. U.S. broker-dealers are required to provide a written disclosure that includes details about when information might be shared. Ask your financial firm or professional if you have any questions about the trusted contact agreement.

You may add, remove, or change your trusted contact at any time, and you need to keep your contact’s information up-to-date.

Be sure to notify the person you have chosen and make sure he or she is comfortable with the role and prepared to help if necessary.



Ed Slott is a professional speaker and the creator of several public television specials, including “Retire Safe & Secure! with Ed Slott.” He is the author of *The Retirement Savings Time Bomb...And How to Defuse It* and many other books about IRA planning.

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If you elected to spread your CRD income over three years, and you decide to repay some or all of it before the federal tax filing deadline (April 18, 2023, unless an extension is filed), you would exclude the repaid amount from the CRD income to be reported on your 2022 tax return, avoiding the associated taxes. Repayments that exceed the amount attributable to 2022 can be carried back and used to lower the CRD income reported for 2020 and/or 2021, and you would file an amended return with Form 8915-E to receive a refund of the taxes paid for those years. If you make a recontribution after the due date for 2022 tax returns — and before the aforementioned three-year deadline — you can choose how you want to amend downward the CRD income that was reported for 2020, 2021, and 2022, which may provide some helpful flexibility.

Repaying a CRD presents an opportunity to put your retirement savings back to work so you may benefit from any tax-deferred growth in the future. Plus, investing during a market downturn typically means you can buy more shares at lower prices. But if your emergency fund is dwindling, or you expect to need the extra cash for another purpose (college expenses or the down payment on a home purchase, for example), it might be preferable to keep the money in a less-restrictive savings vehicle.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.