

2021 NATIONAL INCOME TAX WORKBOOK

CHAPTER 10: RETIREMENT,
INVESTING, AND SAVINGS



CHAPTER TOPICS/ISSUES

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LEARNING OBJECTIVES

P. 371

LEARNING OBJECTIVES

After completing this session, participants will be able to do the following:

- ✓ Understand who can participate in an I.R.C. § 403(b) plan and how contributions are made to the plan
- ✓ Know how to plan to maximize social security benefits
- ✓ Know how to plan to minimize tax on social security benefits
- ✓ Explain the tax consequences of the conversion of a traditional IRA to a Roth IRA
- ✓ Recognize prohibited transactions for a self-directed IRA
- ✓ Understand and report the deduction for contributions to a health savings account
- ✓ Know the requirements for an individual coverage health reimbursement arrangement
- ✓ Understand how stock options are taxed

ISSUE 1: I.R.C. § 403(B) RETIREMENT PLANS

P. 372

Tax exempt organizations [501(c)(3)s], public school, or church] can establish a 403(b) plan for employees.

Employees save in individual accounts.

Employers can also contribute to employee accounts.

These accounts are tax-deferred until distribution.

These plans can also be ROTH accounts with contributions taxed in the current year and tax-free distributions - including any earnings.

RMD rules apply.

PLAN PARTICIPATION

P. 372

Employees who are eligible:

- Employees of tax-exempt organizations
- Employees of public schools who are involved in day-to-day operations
- Employees of cooperative hospital service organizations
- Civilian faculty and staff of the Uniformed Services University of the Health Sciences
- Employees of public school systems organized by Indian tribal governments
- Certain ministers, including self-employed ministers

EMPLOYEES WHO CAN BE EXCLUDED

P. 372

- Employees who will contribute \$200 or less annually
- ☐ Employees who participate in a 401(k) or 457(b) plan or other 403(b) plan of the employer
- ☐ Nonresident aliens
- ☐ Employees who normally work less than 20 hours per week
- ☐ Students employed by the school

TYPES OF CONTRIBUTIONS

P. 373

Contributions may be the following:

- 1. Elective deferrals
- 2. Nonelective contributions, *i.e.* (Employer Contributions)
- 3. After-tax employee contributions
- Any combination of 1, 2, and 3

Employer reports contributions on W-2

Practitioner Note: Self-employed ministers deduct on line 15, Form 1040, Sch. 1

CONTRIBUTION LIMITS

P. 373

Limited to the lesser of:

- **The limit on annual additions;**
- The limit on elective deferrals (for **2021** - **lesser of** \$58,000 **or** 100% includable compensation) **(Increased to \$61,000 for 2022)**

Includable compensation= taxable wages; also includes; see *list* pg. 373

Includable compensation **does not include** any compensation received if the employer is **not** an eligible employer.

CONTRIBUTION LIMITS

P.374

Most Recent Year of Service:

The **employee's last full year of service**, ending on the last day of the employee's tax year that the employee worked for the employer that maintained a 403(b) account on his or her behalf.

*If the **employee's tax year is not the same as the employer's annual work period**, the **most recent year of service is made up of parts of at least two of the employer's annual work periods**.*

CONTRIBUTION LIMITS - CONTINUED

P. 374

Most Recent Year of Service**Examples**

- **10.1 Pg. 374** University's annual work period = Oct. through May. Jackson is a professor at ABC University. **Most recent year is academic year, January through May and October through December.**
- **10.2 Pg. 374** Hospital's annual work period = Jan. to December. Felicia works at the hospital. **Most recent year of service includes fraction from current year and prior years. (Figure 10.1)**

CONTRIBUTION LIMITS, CONT.

P. P. 375-376

(2021) Generally, limit on elective deferrals is \$19,500 (**increased to \$20,500 for 2022**) if taxpayer is under age 50

- Amount is reduced by contributions to other retirement plans

15-Year Rule – contribution limit may be increased (up to \$3,000)

Calculating yrs. of service= number of yrs. as full-time employee for employer maintaining the Sec. 403 (b) plan at end of yr.

Ex. 10.4, P. 375 & Fig.10.2, P. 376 illustrates this calculation.

CATCH-UP CONTRIBUTIONS

P. 376

Employee may make if employee is:

Age 50 by end of year;
Catch-up contributions are allowed under the Plan;
Maximum elective deferrals made to the plan have been made for the year.

Maximum annual catch-up contrib. is the lesser of \$6,500 (for 2021) or the excess of compensation for the year, over the elective deferrals that are not catch-up contributions.

DISTRIBUTIONS

P. 376

Distributions **taxed as ordinary income** and can be made when employee:

- Reach 59.5 years
- Severance from employment
- Dies
- Becomes disabled
- Financial hardship
- Qualified reservist distribution
- Qualified birth or adoption distribution
- Certain distributions of lifetime income investments

ISSUE 2: SOCIAL SECURITY PLANNING

P.P. 377

Definitions

- **Average Indexed Monthly Earnings (AIME)** Index workers earnings to reflect changes up to 35 years. Selects highest indexed earnings, sums, then divides by # months in those years.
- **Bend Points** \$ amounts of % of AIME used to calculate **PIA** changes
- **Full Retirement Age (FRA)** = birth Yr. 1937 & earlier, FRA = 65; '43-'55 FRA increases 2 mos. per year to age 66; 1960 & later, incr. 2 mos. per year until age 67
- **Indexed Earnings:** Earnings indexed to avg. wage level 2 yrs. prior to year of 1st eligibility
- **Primary Insurance Amount (PIA):** Benefit received at FRA w/o reduction in benefits
- **Retirement Age:** Age 62, with permanent reduction of benefits.

SOCIAL SECURITY CALCULATION

P.P. 377-378

PIA (Primary Insurance Amount) formula

For an individual who first becomes eligible for old-age insurance benefits or disability insurance benefits in 2021, or who dies in 2021 before becoming eligible for benefits, his/her PIA will be the sum of:

(a) 90 percent of the first \$996 of his/her average indexed monthly earnings (AIME), plus (b) 32 percent of his/her average indexed monthly earnings over \$996 and through \$6,002, plus (c) 15 percent of his/her average indexed monthly earnings over \$6,002.

Computation of 2021 bend points: First bend point: \$180 times 54,099.99 divided by 9,779.44 equals \$995.76, which rounds to \$996. Second bend point \$1,085 times 54,099.99 divided by 9,779.44 equals \$6,002.23, which rounds to \$6,002

SOCIAL SECURITY CALCULATION

P.P. 377-378

Ex. 10.5, P. 378 Retirement @ age 66. Retired 7/1/21 after earning \$45,000; AIME = \$6,000 based on top 35 years indexed annual earnings. PIA calc. using 2017 bend points (when she was 62). (\$45,000 earned **is less** than (\$50,520 2021 FRA limit) no reduction in benefits)

Fig. 10.3, P.378 PIA Calculation

2017 Bend Pts.	AIME	PIA %	PIA
0 through \$885	\$ 885	90%	\$ 796.50
> \$885 thro. \$5,336	\$4,451	32%	\$1,242.32
> \$5,336	<u>\$ 664</u>	15%	<u>\$ 99.60</u>
Total	\$5,000		\$2,320.40

ISSUE 2: SOCIAL SECURITY PLANNING FIG. 10.4

P.379

Year of Birth	Full Retirement Age	Mos. To FRA	@ Age 62 \$1,000 reduced	% Reduction
1943-1954.	66	48	\$750	25%
1955	66 + 2 Mos.	50	\$741	25.83%
1956	66 + 4 Mos.	52	\$733	26.67%
1957	66 + 6 Mos.	54	\$725	27.50%
1958	66 + 8 Mos.	56	\$716	28.33%
1959	66 + 10 Mos.	58	\$708	29.17%
1960 & Later	67	60	\$700	30%

Note: If delaying SS benefits, apply for Medicare benefits within 3 months of the 65th birthday to avoid increased cost of Medicare Part B and prescription drug coverage.

SPOUSAL BENEFITS & EARLY BENEFITS

PP. 379-380

- **Married indiv.** Both FRA benefits = > sum of indiv. benefits, or 150% of retirement benefits of spouse with higher benefit.
- **Example 10.6, P. 379 Spousal Retirement Benefits**
 - Bill and Mary retired in 2021 both at FRA. **Combined** benefit is \$2,100. (\$1400 X 150=2100). Bill's = \$700 which is greater than his \$600 benefit.
- **Example 10.7, P. 380 Early or Late Retirement**
 - **Figure 10.5, P.380** Sandy's benefits at ages 62, 66, 67. Assume Sandy's life expectancy is 18.80 more years @ age 70, and he will receive an annual benefit of \$46,740 if he waits to age 70 to take benefits as opposed to \$27,888 if he starts @ age 62. But see, the continuation Figure 10.5 next

COMPARISON EARLY OR FRA BENEFITS

P.380

Fig.10.5 and Ex. 10.7 Cont'd.

Age	Annual Payment	Total An. Payment	Total Benefits Received
62	\$2,324 X 12 =	\$27,888	\$153,384 (\$27,888 X 5.5)
66	\$3,113 X 12 =	\$37,356	\$56,034 (\$37,356 X 1.5)
70	\$3,895 X 12 =	\$46,740	\$0

Assume Sandy dies @ age 67.5:**Age 62 begins benefits, lives 5.5 years.** Total benefits received=\$153,384**FRA = 66, begins benefits, lives 1.5 years.** Total benefits rec'd = \$56,034

Benefits @ age 70 = \$0

WORKING BEFORE FRA

P. 381

- **Working before FRA & Receiving SS:** Excess of some or all benefits received must be repaid
 - 2021 **Under FRA** Annual earnings limit **\$18,960; (2022 = \$19,560)**
 - 2021 **FRA during year**, up to FRA, limit = **\$50,520; (2022 = \$51,960)**
 - **FRA before year**, no limit on earnings
- **Special Payments received after Retirement**
 - **Earned** before retirement, – can be excluded - ex. Wage earner vacation pay, severance pay, bonuses paid after retirement
 - SS benefit recipients before FRA- receiving earnings above limit can exclude, but **must notify SSA** of special payments received.

TAXATION OF SOCIAL SECURITY BENEFITS

P.P. 381-385

Figure 10.6 Form SSA-1099 Social Security Benefit Statement- **P.382****Figure 10.7 -P.383** Social Security **Tax Calculation Terms**

- Modified adjusted gross income
- Provisional Income
- Base amount
- Adjusted base amount

Example 10.8 P.P. 383-384-Provisional Income Exceeds Adjusted Base AmountMary and Jeff have \$20,000 social security benefits. **\$14,500 < \$17,000** (\$20,000 X .85) **\$14,500** is includable in income.See also **SSB Worksheet, Fig. 10.9- P. 385**

SOCIAL SECURITY BENEFITS PLANNING

P.P. 386-388

Qualified Charitable Distributions

- **Example 10.9, P. 386** Jeanne single, makes a \$10,000 QCD from RMD. None of her SSI is taxable. **Fig. 10.10**
- **See Planning Pointer:** Higher Income Yrs. Consider opting out of installment sale if beneficial to not spread sale over multiple years and increase AGI for those years if receiving SSI.

Planning for Spouses

- **Example 10.10, P. 387** Both Spouses below the Wage Base – no change in end result.
- **Example 10.11, P. 388** One Spouse above and One Spouse below the Wage Base – SS tax reduced. (Spouses form 50/50 P/S H shifts ½ his income to W whose income is above wage base) reduces their total SS tax. Shifting income depends on the **Average Indexed Monthly Earnings (AIME)** of each

Maximizing Social Security Benefits

- **Example 10.12, P. 388** Same Bend Points. Profit Shifting –decrease H AMIE- increases W AMIE same amt. offsets PIA amounts.
- **Example 10.13, P. 388** Different Bend Points- Profit shift- H AMIE decreases, but W increases.

ISSUE 3: IRA CONVERSIONS

P. 389

Conversions from a traditional IRA to a Roth IRA

No current deduction for contrib. to a Roth, but **Roth's have two advantages:**

- Distributions of regular and qualified distributions are tax free
- No RMD required during original owner's lifetime

2021 MAGI Phaseout amounts apply for contributions to a Roth IRA

- **Single & HOH** Individuals \$125,000 - \$140,000 **(\$129,000 - \$144,000 for 2022)**
- **Married filing jointly** \$198,000 - \$208,000; **(\$204,000 - \$214,000 for 2022)**
- **Married filing separately** \$10,000 **no change for 2022**
- **No income limit applies to conversions**

Practitioner Note: Defining Roth MAGI = AGI with some adjustments

ROTH IRA DISTRIBUTIONS

P. 389

Qualified distributions from a Roth IRA are not included in gross income if

1. Made on or after age of 59½
2. Made to a beneficiary (or estate) on or after the death of the individual
3. A payment made attributable to the individual's being disabled
4. A qualified special purpose distribution

Traditional IRA Contribution Limits. If more than 1 IRA, limit applies to total contrib. made to all traditional IRAs during the year

- \$6,000 per year or taxpayer's compensation
- \$7,000 per year with the "catch-up" amount if taxpayer is 50 or older

GENERAL CONVERSION RULES

P. 390

Taxpayer can receive a withdrawal from a traditional IRA and **within 60 days** reinvest the same assets into a Roth IRA

A conversion can be done as a **trustee-trustee transfer**

The **10% additional tax on an early distribution does not apply**

HOWEVER, **if** the traditional IRA was a **deductible IRA**, then all or part of the **distribution may be included in gross income and subject to ordinary income tax.**

Example 10.14 P.389 Conversion from a Traditional Deductible IRA

Part 6 2020 Conversions From Traditional, SEP, or SIMPLE IRAs to Roth IRAs	
Complete this part if you converted part or all of your traditional, SEP, and SIMPLE IRAs to a Roth IRA in 2020.	
16 If you completed Part 1, enter the amount from line 8. Otherwise, enter the net amount you converted from traditional, SEP, and SIMPLE IRAs to Roth IRAs in 2020.	24,000
17 If you completed Part 1, enter the amount from line 11. Otherwise, enter your basis in the amount on line 16 (see instructions).	0
18 Taxable amount. Subtract line 17 from line 16. If more than zero, also include this amount on 2020 Form 1041, 1041-SP, or 1041-PR, line 4b.	24,000

CREATING A BACKDOOR ROTH IRA

P. 391

Contribute to traditional nondeductible IRA then convert to Roth
Practitioner Note: Backdoor Strategy – TCJA conference report - footnote - Contribution to a traditional IRA, then convert it to a Roth IRA.

Example 10.15, P.391 Backdoor Roth IRA – Jason earns too much to make Roth IRA contribution. He contributes \$7,000 to nondeductible traditional IRA reports on F8606, takes a distribution from the traditional IRA, then rolls to it a Roth w/i 60-day time limit. Reports \$100 earnings on F 8606 & line 4 of F1040.

BASIS ALLOCATION WITH MULTIPLE IRAS

PP. 391-393

If the taxpayer has a traditional IRA with deductible contributions, the basis in a newly established IRA will be allocated among the new and any existing IRAs, increasing the amount of tax the taxpayer must pay when a conversion is executed.

Example 10.16- P.391 Multiple IRAs

See **Figure 10.12 P.392 –P. 393** for the calculation of **basis: \$5,829**

Taxable amount is \$5,929

Observation – P. 393 - IRA Basis and Value

It is important for the tax practitioner to obtain information about all the taxpayer's IRAs **because** basis is divided among all IRA's.

ISSUE 4: SELF-DIRECTED IRAS

P.P. 394-395

Broader investment choices but risk a prohibited transaction. Can invest in real estate, virtual currency, etc.

Self-directed IRAs are prohibited from investing in:

1. Works of art
2. Rugs or antiques
3. Metals or gems (certain bullion, such as stored at a bank, is allowed)
4. Stamps or coins (certain coins issued under state law are allowed)
5. Alcoholic beverages
6. Certain other tangible property

Gold, silver, platinum or palladium bullion in possession of a bank or Nonbank trustee (IRS approved) **are not** considered collectibles.

DISQUALIFIED PERSON

P. 395

Is defined under I.R.C. § 4975(e)(2) as **any of the following:**

1. Fiduciaries (discretionary authority or control of the IRA)
2. A person providing services
3. An employer whose employees are covered under the plan
4. An employee organization whose members are covered under the plan

Certain other persons and entities (see 5-9, pg. 395)

Example 10.17, P. 395 Disqualified Persons. Ray has a self-directed IRA. He owns 3 rental properties. Ray is owner & has discretion to make investment decisions. He is a DQP and cannot sell a rental property to the IRA or engage in any other prohibited transactions with the IRA.

PROHIBITED TRANSACTIONS

PP. 395-396

Examples of possible prohibited transactions: P.395

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

Thiessen v. Commissioner, 146 T.C. 7 (2016) T/p's used corp. owned by self directed IRA to acquire assets of a business. Corporation signed a promissory note for some of purchase & t/p's personally guaranteed the note. **Court held that the guarantees were indirect extensions of credit from the t/p to their IRAs and was a prohibited transaction.**

NOT PROHIBITED TRANSACTIONS

P. 396

A loan made by the plan to a disqualified person who is a participant or beneficiary of the plan is not a prohibited transaction **if the loan**

1. **is available to all such participants or beneficiaries,**
2. is **not** made available to highly compensated employees in an amount **greater than the amount made available to other employees,**
3. is made **in accordance with specific provisions** regarding such loans as **set forth in the plan,**
4. bears a **reasonable rate of interest,** and
5. is **adequately secured**

Practitioner Note: Prohibited Transaction Exemptions – Issued by DOL

REAL PROPERTY IN A SELF-DIRECTED IRA

PP. 396-398

A self-directed IRA **can purchase real property, but must avoid prohibited transaction rules must comply with the following:**

1. IRA cannot purchase property from the owner or a Disqualified Person
2. Must title the property in the name of the IRA
3. Purchase the property using IRA funds
4. Must be Nonrecourse financing and IRA owner or DQO **is not** borrower/guarantor

Financing Real Property

Example 10.18 P.396 - references ex. 10.17, pg. 395 – self directed IRA purchased rental prop. For \$125 k IRA has \$100 k, lender must finance \$25k with nonrecourse note, **c/n be guaranteed by Ray or his wife.**

Managing Rental Property – P. 397 can be done through an IRA owned LLC.

Rental income may be Unrelated Business Taxable Income (UBTI)/Unrelated debt financed Income (UDFI) – If >\$1,000 UDFI then file Form 990-T-pay tax @ trust & estate rate

REAL PROPERTY IN A SELF-DIRECTED IRA

P.P. 397-398

Taxation of Rental Income: @ Estates & Trusts rates **P.397**

- Unrelated Business Taxable Income (UBTI) > \$1,000, file F-990-T
- Unrelated Debt Financed Income (UDFI) > \$1,000, File F-990-T

Ex. 10.19, Pg. 397 Unrelated Debt-Financed Income

Rebecca's IRA has a \$100,000 balance, purchases rental prop. for \$125,000, IRA borrows \$35,000. Yr. 1 IRA collected \$11,400 rent, had \$3,000 property expense. Avg. adj. basis of the property or yr. 1 was \$120,000. UDFI for yr. 1 Ratio (debt to val. of prop.) is calculated: $\$30,000/\$120,000 = .25$

$.25 \times \$11,400 \text{ rent inc.} = \$2,850$. Rent Exp. = $.25 \times \$3,000 \text{ or } \750 . + \$1,000 specific deduction.

See Fig. 10.13 pg. 398 Form 990-T

RISK OF FRAUD WITH SELF-DIRECTED IRA

PP. 399-400

SEC issued Investor Alert: Self-Directed IRAs and Risk of Fraud (8/8/2018)

Summary:

- o **Custodial Responsibilities and Information Misrepresented**
- o **Avoiding Fraud**
 - o Verify Self-Directed IRA Account Statement Information
 - o Avoid Unsolicited Investment Offers
 - o Ask Questions
 - o Be Wary of Guaranteed Returns
 - o Consult a Professional
- o **Recourse for Fraud Victims**
 - o **See list p. 400**

ISSUE 5: HEALTH SAVINGS ACCOUNTS

PP. 401-403

Eligible taxpayers can claim an above-the-line deduction for HSA contributions.

- o **Setting up an HSA** – bank or insurance co.
- o **Qualifying for an HSA** – need a High Deductible Health Plan (HDHP) on Dec.1 for ex.
- o **Contributions** – 2021 annual limit \$7,200 **family**/\$3,600 **self-only**, plus \$1,000 catch-up over for > 55 indiv.
- o **Distributions** – tax free if used for **qualified** medical expenses
- o **Reporting Contributions** – **Form 5498- Pg. 403**. Employer contrib. = W-2, box 12
- o **Example 10.20 -P.402** Deduction for HSA Contribution
 - o Jamal contributed \$3,600, **see 5498-SA, Fig. 10.14, P.403**
 - o Reports deduction on **Form 8889 (Figure 10.15) – pg. 403**

FORM 5498-SA FROM EXAMPLE 10.20

P. 403

2727 <input type="checkbox"/> VOID <input type="checkbox"/> CORRECTED		OMB No. 1545-0047	
TRUSTEE'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone number		1. Employee or self-employed person's Archer MSA contribution made in 2021 and 2022 for 2021	
First Bank of Oregon 100 River Street Bend, Oregon 97701		\$	
TRUSTEE'S TIN XXX-XXXX-XXXX		2. Total contributions made in 2021 and 2022 for 2021	
PARTICIPANT'S TIN XXX-XX-XXXX		\$ 3,600	
PARTICIPANT'S name		3. Total HSA or Archer MSA contributions made in 2021 for 2021	
Jamal Wilson		\$	
Street address (including apt. no.)		4. Rollover contributions	
32 Penny Lane		\$	
City or town, state or province, country, and ZIP or foreign postal code		5. Fair market value of HSA, Archer MSA, or IRA MSA	
Bend, Oregon 97701		\$ 0.00	
Account number (see instructions)		6. HSA <input checked="" type="checkbox"/> Archer MSA <input type="checkbox"/> IRA MSA <input type="checkbox"/>	
Form 5498-SA		GSA No. 38487V www.irs.gov/Form5498-SA Department of the Treasury Internal Revenue Service	

FORM 8889 FROM EXAMPLE 10.20

P. 403

8889 Health Savings Accounts (HSAs)

Department of the Treasury
Internal Revenue Service

Use to report the plan's HSA for individuals and the total contributions.
OMB No. 1545-0047
Form 8889-20
2020

Before you begin: Complete Form 8889, Anchor MBAs and Long-Term Care Insurance Contracts, if required.

Part 1 HSA Contributions and Deductions. See the instructions before completing this part. If you are filing jointly and both you and your spouse each have separate HSAs, complete a separate Part 1 for each spouse.

1. Check the box to indicate your coverage under a high-deductible health plan (HDHP) during 2020.
☐ Self-only ☒ Family

2. HSA contributions you made for 2020 (or those made on your behalf, including those made from January 1, 2021, through April 15, 2021, that were for 2020). Do not include employer contributions, contributions through a cafeteria plan, or rollovers. See instructions.

3. If you were under age 55 at the end of 2020 and, on the first day of every month during 2020, you were, or were considered, an eligible individual with the same coverage, enter \$3,600 (\$7,300 for family coverage). All others, see the instructions for the amount to enter.

4. Enter the amount you and your spouse contributed to your Anchor HSA for 2020 from Form 8889, lines 1 and 2. If you or your spouse had family coverage under an HDHP at any time during 2020, also include any amount contributed to your separate Anchor HSA.

5. Subtract line 4 from line 3. If zero or less, enter -0-

6. Enter the amount from line 5. But if you and your spouse each have separate HSAs and had family coverage under an HDHP at any time during 2020, see the instructions for the amount to enter.

7. If you were age 55 or older at the end of 2020, married, and you or your spouse had family coverage under an HDHP at any time during 2020, enter your additional contribution amount. See instructions.

Add lines 6 and 7

8. Employee contributions made to your HSA for 2020

9. Qualified HSA funding distributions

10. Add lines 8 and 9

11. Subtract line 10 from line 6. If zero or less, enter -0-

12. HSA deduction. Enter the number of line 11 or the 12 from line 11 on Schedule A (Form 1040), Part 5, line 12. **Caution:** If line 12 from Form 1040 is 0, you may have to file a return. See instructions.

ISSUE 6: INDIV. COVERAGE HRA (ICHRA)

P.P. 404-405

I.R.C. § 105 allows for reimbursement of medical expenses under an **employer-sponsored health plan**. Fin. Reg. issued but not effective yet-(see Practitioner Note-Pg.404)

o As of Jan 1, 2020, regulations allow employers to establish **Individual Coverage Health Reimbursement Arrangement (ICHRA)s**.

o **Funded solely by employer**

o **Required Insurance**

o **Employees and dependents must be covered by health insurance (or Medicare A or B) to receive reimbursements from an ICHRA. Reimb. Can include premiums for indiv. Health coverage and Medicare.**

o Integration of an HRA can occur with individual health coverage –

o **See the list on page 405**

TAX SAVINGS

P. 405

ICHRA **reimbursements** for employee, employee's spouse, and dependents for medical care **are excluded from the employee's income and wages for federal income tax and employment tax.**

Example 10.21 P.405 ICHRA Tax Savings

H&W no children, their t.i. = \$200,000. W pays for her own indiv. Ins. coverage she paid 1200 per month. W's employer has a ICHRA and pays reimbursement up to \$12,000 per year. \$12,000 is excluded from W's income, which can provide a federal income tax savings \$2,880 (24% rate). The exclusion is also exempt from FICA and state income tax.

SUBSTANTIATION

P. 405

Employers must require that employees - To enroll in ICHRA plan, **Employee covered by the plan**, must **1)** prove enrollment in eligible health care (including Medicare) coverage for employee, spouse, and dependents for each month covered. **And** **2)** for reimbursement, employee must prove eligible individual was covered by health care, during month medical care expense incurred.

IRS Sample attestation forms @www.irs.gov/pub/irs-uttl/health-reimbursement-arrangements-faqs.pdf.

NONDISCRIMINATION

P. 406

Employers can offer group health plans to one class of employees, and an ICHRA to another class of employees. **See list of allowed classes. Pg. 406**

Minimum class size rules may apply.

Employer with fewer than 100 employees, minimum class size is 10

New versus grandfathered current employees may have different options.

Can offer increased amounts for older workers & those with more dependents.

Age class cannot discriminate in favor of highly-compensated employees.

IMPACT ON THE PREMIUM TAX CREDIT

P.P. 406-407

ICHRAAs will provide tax-advantaged savings for many employees purchasing of health care insurance or services.

However, for some employees, an ICHRA could increase their costs because an offer of an affordable ICHRA makes recipient ineligible for a premium tax credit.

Cross-Reference to 2020 NITW for calculation of affordability-pg. 395

Employers must provide a **written notice at least 90 days prior to offer of ICHRA** - impacts of an ICHRA on the employee's premium tax credit eligibility.

SAFE HARBORS: APPLICABLE LARGE EMPLOYERS P.P. 407-408

ALEs have an average of 50 or more Full Time Equivalent Employees (FTEs) in the preceding calendar year-

- o **Location Safe Harbor**
 - o Where employee's **employment is located** instead of residence- whether offer is affordable
- o **Look-Back Month Safe Harbor**
 - o Employer-use **any calendar month** to determine employees required contribution
- o **Household Income Safe Harbor**
 - o **W-2; federal poverty line**
- o **Example 10.21, P.408** Application of the **Safe Harbors**
 - o Use applicable premium in **work location**
 - o January 2020 is **lookback month**
 - o \$2,000/month using **rate-of-pay safe harbor**

ISSUE 7: STOCK OPTIONS

PP. 409-410

Statutory stock options are incentive stock options (ISOs) under I.R.C. § 422 and options granted under an employee stock purchase plan (ESPP) described in I.R.C. § 423.

- o **Exercise of the Option**
 - o Generally, no income inclusion
- o **Disposition of the Stock**
 - o If stock from an ISO is held 2 years from granting, and 1 year from exercise then capital gain/loss
 - o If holding period not met, ordinary income

NONSTATUTORY STOCK OPTIONS

P. 410

A **nonstatutory stock option** Employee or independent contractor can purchase the employer's stock. Generally, there are no tax consequences for the employer or the employee on the grant of a nonstatutory stock option in connection with the performance of services if the option does not have a readily ascertainable FMV.

- o **Exercise of the Option**
 - o Employee has ordinary income
- o **Risk of Forfeiture**
 - o If risk exists, then the compensation not included in the employee's income
- o **Section 83(b) Election**
 - o Recipient can elect to include the FMV of stock in income in year transferred

NONSTATUTORY STOCK OPTIONS

P. 411-413

Section 83(f) Deferral

- o Allows qualified employees of privately held corps to defer paying income tax for up to 5 years on the exercise
- o Qualified stock options and restricted stock units

See Notice 2018-97 for additional guidance

EXAMPLES

P. 414

10.23 pg. 414 Restricted Nonstatutory Options – No Election

Emilio doesn't include in income until vested

\$100,000 income

10.24 pg. 414 Restricted Nonstatutory Options – With Election

Emilio makes 83(b) election to include at exercise

\$50,000 income

Questions?
