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## SECURE 2.0 Makes Changes to RMD and Excess Contribution Penalties

Penalties can happen to anyone. Just ask Bruce Springsteen. A few years ago, he was performing one of his famous marathon concerts in Foxborough, Massachusetts. The show ran too late, and "The Boss" ended up with a five-figure, concert-curfew fine. The same is true for retirement account owners.

Despite our best efforts, sometimes rules are violated, and penalties will ensue. Two common penalties that occur with IRAs are the required minimum distribution (RMD) penalty and the excess contribution penalty. SECURE 2.0 makes some big changes to both.

### RMD Penalty Changes

When retirement account owners reach their required beginning date (RBD), RMDs must be withdrawn. The due date for most RMDs is December 31. However, account owners have extra time to receive their first RMD. That deadline is April 1 of the year following the first RMD year (under SECURE 2.0, the age 73 year). Beneficiaries, including Roth IRA beneficiaries, are also subject to RMDs. Some have annual RMDs while others must follow the 10-year or 5-year payout rules. For those beneficiaries subject to either the 5- or 10-year rule, the RMD is whatever remains in the account at the end of that period.

Missing an RMD deadline is consequential as it can result in a significant fine.

For years, the penalty for a missed RMD has been 50% of the amount not taken. SECURE 2.0 changes things beginning in tax year 2023. The missed RMD penalty is reduced from 50% to 25%. Additionally, the penalty can be further reduced to 10% if the missed RMD is withdrawn during a correction window. For most people, correction must be made by the end of the second tax year following the year for which the RMD was missed. The RMD would need to be taken and the 10% penalty paid during this window.

**Example 1:** Bruce Springsteen will celebrate his 74<sup>th</sup> birthday on September 23, 2023. He may be "born to run," but he cannot outrun his RMDs. He will have an RMD from his IRA for 2023 that he must take by December 31, 2023. If he fails to take this RMD, he will owe a 25% penalty on the amount not taken. However, this penalty will be reduced to 10% if he takes the 2023 RMD and pays the penalty by December 31, 2025.

While the changes to the RMD penalty are mostly good news for account holders who miss RMDs, there are still potential issues. SECURE 2.0 leaves intact previous rules which allow an individual

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## Executive Summary

### SECURE 2.0 Makes Changes to RMD and Excess Contribution Penalties

- The missed RMD penalty is reduced from 50% to 25% and can be further reduced to 10% if the RMD is withdrawn during a correction window.
- SECURE 2.0 leaves intact previous rules which allow an individual who missed an RMD to take the distribution and then use Form 5329 to request a waiver of the penalty.
- SECURE 2.0 directs the IRS to expand its Employee Plans Compliance Resolution Program (EPCRS), which previously only covered employer plan errors, to also cover IRA errors.
- A three-year statute of limitations is established for missed RMDs.
- SECURE 2.0 exempts earnings on excess contributions from the 10% early distribution penalty if under age 59½.
- SECURE 2.0 establishes a six-year statute of limitations on excess IRA contributions that starts to run with the tax-filing deadline (not including extensions) for the year for which the excess occurs.

### Unsolved Mysteries of SECURE 2.0

- SECURE 2.0 contains several unintended drafting errors and a number of unanswered questions.
- Congress inadvertently deleted a provision of the tax code which effectively bars any employee from making any catch-up contributions (pre-tax or Roth) starting in 2024.
- SECURE 2.0 is not clear as to whether a fresh 15-year waiting period is required for a Roth rollover when someone changes 529 beneficiaries.
- Certain high-paid 401(k) participants will be required to have age-50-or-over catch-up contributions made to Roth accounts. *But what if the plan does not already offer Roth accounts?*
- SECURE 2.0 is unclear if Roth employer contributions apply only when contributions are fully vested or if they can apply to the partially-vested portion of a contribution.

### New Laws Add More Sparkle to Health Savings Accounts

- Recent federal legislation allows improved insurance benefits while still permitting taxpayers to fund an HSA as a virtual "healthcare IRA" to cover medical expenses during a future retirement, tax-free.
- There is no annual "use it or lose it" feature, so HSA owners might be able to enjoy years of HSA accumulation, then pay medical bills with never-taxed dollars. (As a possible additional tax benefit, HSA contributions made through salary deferrals reduce the wage amount subject to income, Social Security, and Medicare taxes.)
- Another provision of SECURE 2.0 might have an indirect impact: leading high-income workers to contribute more to HSAs than in the past because of the "Rothification" of catch-up contributions to employer sponsored retirement such as 401(k)s.
- Without having ample untaxed HSA funds, retirees might wind up paying higher taxes on sizable RMDs, fail to get an offsetting tax deduction, and fall into expensive IRMAA territory.

who missed an RMD to take the distribution and then use [Form 5329](#) to request a waiver of the penalty. In the past, the IRS has been agreeable to granting these waivers. But it is unknown whether the IRS will continue their waiver policy now that SECURE 2.0 has reduced the penalty. Additionally, requesting a waiver may take some time, and the window could potentially close on the deadline

to reduce the penalty from 25% to 10%. Some individuals may decide it is simpler to just pay the 10% penalty and be done with it. In the end, the penalty for a missed RMD may be smaller, but more retirement savers may end up paying it.

SECURE 2.0 also directs the IRS to expand its [Employee Plans Compliance Resolution Program](#)

[\(EPCRS\)](#), which previously only covered employer plan errors, to also cover IRA errors. This provision of SECURE 2.0 does not include a great amount of detail. However, it does specifically mention that the expansion of EPCRS could be used to exempt a missed RMD from the penalty. How EPCRS will dovetail with the missed RMD correction process is still unclear.

Another change to the RMD penalty, effective upon the enactment of SECURE 2.0, is the establishment of a three-year statute of limitations for missed RMDs. That limitations period starts with the tax-filing deadline (not including extensions) for the year for which the RMD is missed. For those who do not file, the deadline would be the deadline for their return had they filed.

Before SECURE 2.0, because Form 5329 is considered a stand-alone tax return, the statute of limitations did not start to run until that form was actually filed. This meant the IRS could potentially go back many years to assess a penalty for missed RMDs. Now, the IRS will be limited to a three-year look back period.

**Example 2:** Bruce Springsteen's bandmate Stevie Van Zandt took a wrong turn and just kept going. In 2023, he never took an RMD from his IRA. The statute of limitations on this missed RMD will start to run on the due date for filing his 2023 tax return. After three years, the IRS can no longer assess the penalty on the missed RMD.

A question that remains is exactly when the new statute of limitations for missed RMDs is effective. SECURE 2.0 says that it is "effective upon enactment." It is unclear whether this means that missed RMDs from years prior to 2022 would be subject to the new statute of limitations. (This same question arises with respect to the six-year statute of limitations for excess IRA contributions.)

**Example 3:** Wendy was "born in the USA" on March 1, 1948. Beginning for 2018, she was required to take RMDs from her IRA. Wendy failed to take her 2019 RMD. *Does the statute of limitations on this missed RMD expire in 2023? Or can the IRS assess the penalty after this date because Form 5329 should have been filed starting*

*in a year before SECURE 2.0 was enacted?* The answer is currently unclear.

### Excess Contribution Penalty Changes

When it comes to IRA contributions, you can have too much of a good thing. If too much is contributed, penalties can be avoided by correcting the excess contribution in a proper and timely manner. Excess contributions can be removed or recharacterized without penalty if done by October 15 of the year following the year of the contribution.

To properly correct the contribution by removal, any net income attributable (NIA) must also be removed. These earnings will be taxable. However, SECURE 2.0 exempts these earnings from the 10% early distribution penalty if under age 59½. This rule is effective in 2023.

**Example 4:** On January 7, 2023, Mary, age 43, made a \$6,000 prior year contribution for 2022 to a new Roth IRA. She later discovered that her 2022 income was too high for her to contribute to a Roth IRA. On February 10, 2023, when her Roth IRA balance is \$6,300, she decides to correct the excess amount by withdrawing it. To avoid the 6% excess contribution, she must also withdraw the NIA.

When Mary takes the \$6,300 distribution of the excess contribution, the amount of the excess contribution (\$6,000) is not taxable. Only the amount of the NIA (\$300) will be included in her income for 2023. However, it will not be subject to the 10% early distribution penalty due to SECURE 2.0's elimination of the penalty on distribution of NIA when correcting an excess contribution.

If the October 15 deadline is missed, the excess can still be corrected by withdrawal.

However, a 6% penalty will apply each year the excess remains in the account on December 31. SECURE 2.0 establishes a six-year statute of limitations on excess IRA contributions.

This change was effective upon the enactment of SECURE 2.0. The statute of limitations starts to run with the tax-filing deadline (not including extensions) for the year for which the excess occurs. Prior to SECURE 2.0, as with the RMD penalty, the statute of limitations was not considered to start until Form 5329 was filed. That meant the IRS could have potentially assessed penalties on excess contributions at any time. Now, the IRS will be limited to the most recent six years.

**SECURE 2.0 establishes a six-year statute of limitations on excess IRA contributions.**

**Example 5:** Rosalita made a Roth IRA contribution for 2023. Unfortunately, she was ineligible because her income was too high. The statute of limitations on this excess contribution will start to run on the due date for filing her 2023 tax return. After six years, the IRS can no longer assess the penalty on the 2023 excess contribution.

The 6% penalty on excess contributions is a penalty that applies each year that the excess contribution remains in the IRA. An excess contribution from years ago will continue to be subject to the penalty each year. However, the IRS will only be able to go back six years to assess the penalty under the new SECURE 2.0 statute of limitations.

**Example 6:** Jake made a \$7,000 IRA contribution for 2022. However, he was retired and no longer had any taxable compensation. Jake does not correct this excess contribution



and it remains in his IRA. If the IRS decides ten years later in May of 2032 to assess the 6% penalty on this excess contribution, they will only be able to assess it for years 2026, 2027, 2028, 2029, 2030, and 2031.

There is a creative exception to the six-year statute of limitations for certain excess contributions. SECURE 2.0 specifically says that no statute of limitations applies in the case of an excess contribution that is "attributable to acquiring property for less than the fair market value."

This language allows the IRS and the Tax Court to continue to use the rules for excess contributions to shut down abusive Roth IRA schemes indefinitely as they have in the past.

Such was the approach the IRS took, and the Tax Court approved, in the [Paschall](#) and [Swanson](#) cases. In these abusive IRA cases, the Tax Court said that because Form 5329 was never filed, the statute of limitations never started to run. The IRS was permitted to go back many years to assess penalties based on excess contributions to Roth IRAs. SECURE 2.0 does not

change this indefinite look-back ability in bargain sale situations.

### The Takeaway

While retirement account penalties are best avoided, mistakes do happen, and those mistakes could lead to penalties. SECURE 2.0 brings some welcome relief to those who face penalties due to missed RMDs or excess IRA contributions. The reduced penalties and the shorter time frame for IRS enforcement do come with some limitations and unknowns, but they are, overall, good news for retirement savers. ■

## Unsolved Mysteries of SECURE 2.0

The [SECURE 2.0 Act of 2022](#), signed into law on December 29, 2022, includes over 90 new IRA and retirement plan changes and covers 357 pages. So, it should be no surprise that the new legislation contains several unintended drafting errors and a number of unanswered questions.

### Drafting Errors

There are at least three drafting errors that will have to be fixed, either by Congress in "technical corrections" legislation or by the IRS.

The first drafting error was discussed last month in the [February 2023 issue of Ed Slott's IRA Advisor](#). SECURE 2.0 raises the age that IRA owners must start taking required minimum distributions (RMDs) from age 72 to age 73 for anyone born on or after January 1, 1951, and before January 1, 1960. It further delays the RMD age to 75 for those born on or after January 1, 1959. The effect of these changes is that someone born during 1959 will have two "first" RMD ages: 73 and 75. This will need to be corrected, likely to provide a 73 RMD age for those born in 1959. The good news is

that there is plenty of time for this to be fixed.

A more pressing drafting glitch concerns the rule that requires higher-income 401(k) participants to make age-50-or-over catch-up contributions on a Roth basis, starting in 2024. By adding that change, Congress inadvertently deleted a provision of the tax code. That deletion effectively bars any employee (higher-income or not) from making any catch-up contributions (pre-tax or Roth) starting in 2024. Of course this will need to be corrected, and soon.

**The effect of these changes is that someone born during 1959 will have two "first" RMD ages: 73 and 75.**

Another pressing drafting error occurred when Congress added the provision allowing SEP and SIMPLE IRA contributions to be made on a Roth basis. The drafters mistakenly removed tax code language that prevented any SEP and SIMPLE contributions from counting against the Roth IRA annual contribution limit.

### 529-to-Roth IRA Rollovers

Besides these unintentional errors, there are a number of unresolved issues in SECURE 2.0 that require clarification by the IRS. One change that has drawn significant attention permits a 529 account owner, starting in 2024, to do a tax-free rollover of up to \$35,000 of unused 529 funds to a Roth IRA. The new rollover has several restrictions, one of which is that the 529 plan must have been open for more than 15 years. However, SECURE 2.0 is not clear as to whether a fresh 15-year waiting period is required when someone changes 529 plan beneficiaries. *Can the new beneficiary use the existing time that the 529 account has been open, or does the clock reset?* This is unknown.

**Example 1:** Selina is the owner of a 529 plan established in 2009 for her son John. John has now graduated from college, and there is \$50,000 of unused funds in the 529 plan. Selina would like to change the 529 beneficiary to herself and do a series of rollovers totaling \$35,000 (each annual rollover equaling no more than the Roth IRA contribution limit) starting in 2024 to her own Roth

IRA. If John's 15-year waiting period could be carried over to Selina as the new 529 beneficiary, then Selina could qualify to start the rollovers in 2024. If not, then she would have to wait until 2039.

Another question that has arisen is whether the \$35,000 limit applies per 529 owner or per 529 beneficiary. SECURE 2.0 seems to say "per beneficiary," but it is not crystal clear.

**Example 2:** Selina, from Example 1, also owns an IRA for her daughter Jade that she set up in 2015. Jade has received a scholarship, so there is \$75,000 remaining in her plan. If the rollover rule applies per beneficiary (not per owner), then Jade could do her own series of rollovers (totaling \$35,000) starting in 2030 to her Roth IRA. Jade can do this even though Selina is also rolling over the other 529 plan that Selina owns.

### New Exceptions to the 10% Penalty

Last month's issue of *Ed Slott's IRA Advisor* also discussed a bevy of new exceptions to the 10% early distribution penalty created by SECURE 2.0. These include withdrawals for federally-declared disaster expenses (retroactively effective to January 26, 2021); for terminal illness (effective in 2023); for victims of domestic abuse and for emergency expenses (both effective in 2024); and for long-term care premiums (effective December 29, 2025).

It appears that plans are not required to offer withdrawals for any of these exceptions. If offered, withdrawals for these exceptions (except possibly for terminal illness) will allow employees to access their accounts earlier than usually allowed under the tax code. The code generally bars in-service withdrawals of pre-tax and Roth employee contributions before age 59½ (except in case of hardship).

However, as SECURE 2.0 now reads, distributions that would qualify for the exception to the 10% penalty for terminally ill employees would not be available for in-service withdrawals before age 59½. It's not clear whether Congress intended the new rule to be so limited.

**Example 3:** Peter participates in Acme Technology's 401(k) plan. At age 45, Peter becomes terminally ill but is able to continue working. Apparently, Peter cannot take an in-service distribution on account of his terminal illness. But if Peter leaves his job with a terminal illness, he will not be subject to the 10% penalty — *even if that occurs before the year he turns age 55.*

Effective for 2023, SECURE 2.0 eases the 10% exception for certain public safety employees so that it applies after 25 years of service "under the plan" — *even if that is before age 50.* By using the words "under the plan," it seems that Congress intended the rule to require at least 25 years with the same employer, but that should be clarified.

**Example 4:** Bruce is a firefighter with the Gotham City Fire Department. He has worked for Gotham City for 20 years. Previously, Bruce had worked for 5 years with the Metropolis Fire Department. Bruce is age 44 and would like to take his pension plan lump sum distribution without paying the 10% penalty.

Under SECURE 2.0, it appears that Bruce cannot use his Metropolis service to satisfy the 25-year rule, and he must wait until he has 25 years with Gotham City to take a penalty-free withdrawal.

### Other Unresolved Issues

**Qualified Charitable Distributions:** SECURE 2.0 allows individuals to make a one-time \$50,000 qualified charitable distribution (QCD) through charitable gift annuities,

charitable remainder unitrusts or charitable remainder annuity trusts. It is not clear whether the \$50,000 one-time distribution is subject to the overall annual \$100,000 (as indexed) QCD limit.

### Roth Catch-Up Contributions:

As discussed, beginning next year, certain high-paid 401(k) participants will be required to have age-50-or-over catch-up contributions made to Roth accounts.

*But what if the plan does not already offer Roth accounts?* SECURE 2.0 does not answer that question. One possibility is the plan must begin offering Roth accounts to accommodate the mandatory treatment of catch-ups. Or, it may be that the plan can continue not to offer Roth accounts, but in that case, it could not offer catch-ups for anyone. Or, maybe the "required Roth catch-up" could simply be directed to the pre-tax portion of the plan when there is no Roth plan option.

Yet another unresolved issue concerns which employees are required to have catch-up contributions deposited into Roth accounts. SECURE 2.0 says that this only applies to those whose "wages" exceed \$145,000 (as adjusted) in the prior year. But many self-employed persons, including sole proprietors, do not have "wages"; instead, they have business income. Read literally, the Roth requirement would not apply to high-income self-employed individuals who don't earn wages.

**Yet another unresolved issue concerns which employees are required to have catch-up contributions deposited into Roth accounts.**

**Roth Employer Contributions:** Another SECURE 2.0 provision

## New Laws Add More Sparkle to HSAs

allows for 401(k) and 403(b) employer contributions to be made to Roth accounts. Up until now, those contributions had to be made to pre-tax accounts (even if it was a match to a Roth employee contribution).

Many plans use vesting schedules for employer contributions. SECURE 2.0 makes clear that only vested employer contributions can be converted to Roth accounts. What's less clear is whether this means that Roth treatment cannot apply until contributions are *fully* vested or can apply to the *partially*-vested portion of a contribution.

**Example 5:** Natasha participates in a 401(k) plan which provides that matching contributions are 20% vested after two years of service, 40% vested after three years, and so forth, with 100% vesting after six years. Starting in 2024, the plan permits employees to elect to have the match made on a Roth

basis. Natasha is only 40% vested in her Roth matching contribution account. *Can she direct the plan to have her 40% vested portion converted to a Roth account, or will she need to wait until she is 100% vested?*

**What's less clear is whether this means that Roth treatment cannot apply until contributions are *fully* vested or can apply to the *partially*-vested portion of a contribution.**

If an employer contribution is made on a Roth basis, employees will be taxed on the contribution. The IRS must confirm that taxation occurs in the year the contribution is made — *even if made with respect to the prior year*. Guidance is also needed on whether the

taxable amount should be reported to employees as a distribution on [Form 1099-R](#) or as W-2 wages. Also, it is not clear how the tax treatment of Roth employer contributions will work for sole proprietors.

### Conclusion

It is not unusual for new retirement legislation to have drafting errors and unanswered questions. What makes SECURE 2.0 so unique is the sheer number of new provisions that throw off so many unsettled issues. Although some of the provisions are not effective until 2024 or later, the IRS has a tall task ahead. (Consider that over three years after the original SECURE Act became law, we still do not have final regulations.) Until there is guidance, advisors will need to exercise caution with any interpretations of unanswered questions. ■

## New Laws Add More Sparkle to Health Savings Accounts

### Guest IRA Expert



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For years, Health Savings Accounts (HSAs) have been the most compelling choice for tax-efficient retirement preparation. Recent federal legislation allows improved insurance benefits while still permitting taxpayers to fund an HSA as a virtual "healthcare IRA" to cover medical expenses during a future retirement, tax-free.

The newly-passed SECURE 2.0 Act allows healthcare plans to offer

first dollar coverage for telehealth services. Earlier in 2022, the [Inflation Reduction Act](#) allowed healthcare plans to provide preventive care for chronic medical conditions (including insulin for individuals with diabetes) prior to meeting the deductible.

These changes are modest but they will greatly help patients with diabetes and those who enjoy the convenience of telehealth, while not affecting their ability to fund HSAs. If the rules had not been passed, health insurance plans might not have been able to offer these benefits to plan participants without jeopardizing the high-deductible status that is needed for HSA contributions.

### Bountiful Benefits

As mentioned, individuals and families must have high-deductible

health insurance in order to open and contribute to an HSA. With high-deductible coverage, people may incur more frequent healthcare expenses but they'll benefit from lower premiums as well as protection from catastrophic costs.

With an HSA, participants' contributions are tax-deductible. Indexed to inflation, the 2023 limits are \$3,850 for self-only coverage and \$7,750 for family plans. Individuals age 55 and older can contribute an extra \$1,000 so a senior married couple might be able to deduct as much as \$9,750 moved into an HSA this year.

Inside the HSA, any investment growth is untaxed. Distributions for qualified expenses also are untaxed. Moreover, there is no annual "use it or lose it" feature, so HSA owners might be able to enjoy years of HSA accumulation,



then pay medical bills with never-taxed dollars. (As a possible additional tax benefit, HSA contributions made through salary deferrals reduce the wage amount subject to income, Social Security, and Medicare taxes.)

According to Devenir Research, as recently as 2014 nearly 87% of HSA assets were invested in short-term savings accounts, where the money could be used to pay current healthcare bills, pre-tax. Estimates for 2023 show a reduced 68% of HSA assets in savings while 32% is invested, possibly for long-term growth to cover future expenses, tax-free.

**Moreover, there is no annual “use it or lose it” feature, so HSA owners might be able to enjoy years of HSA accumulation, then pay medical bills with never-taxed dollars.**

## Looking Ahead

Indeed, at our firm we are seeing an increased interest in HSAs, especially as a vehicle to build up a tax-free source of funds to pay for healthcare costs in retirement. Many people had previously appreciated the basic tax benefits of being able to contribute to HSA savings accounts on a pre-tax basis and currently take tax-free distributions for qualifying medical expenses.

Now they are becoming more aware that one of the biggest benefits of an HSA is the tax-free growth of any earnings, inside the account, if those funds eventually are distributed for qualifying expenses. Those tax-free distributions can come at the time when they are needed the most: in retirement!

## The Roth Response

Another provision of SECURE 2.0 might have an indirect impact: leading high-income workers to contribute more to HSAs than in the past because of the “Rothification” of catch-up contributions to employer sponsored retirement such as 401(k)s. Starting in 2024, catch-up contributions to 401(k)s for participants earning more than \$145,000 must be made as Roth 401(k) or other after-tax contributions.

Some high-earning taxpayers have been maximizing their 401(k) contributions, rather than max their HSAs. As of 2024, it will make more sense to choose HSAs for those catch-up contributions. Switching to the HSA will deliver a similar pre-tax benefit to what they have enjoyed until now, except that subsequent distributions for qualifying medical expenses will be tax-free.

Some high earners probably should have been contributing more to the HSA all along, because of that potential for untaxed distributions. Tax-free is always better after getting an upfront tax deduction for the same dollars.

## Winning the Match Game

Beyond catch-up contributions, growing awareness of their tax advantages moves HSAs up the list of retirement account selections. One strategy calls for making sure of full eligibility for any employer matching contribution to a 401(k) or similar account. Free money shouldn't be overlooked.

Once the full employer match is secured, the next dollars for retirement could go into the HSA, up to the annual limits, as described above. If still more money is to be saved for retirement, that amount might go into an unmatched 401(k) or an IRA.

*Why this progression?* Beyond any match, putting money into a regular 401(k) means contributing tax-deferred dollars. In 2023, seniors can put as much as \$30,000 into a 401(k).

**Example:** 57-year-old Adam gets a 100% match on the first 6% of his \$100,000 salary.

*Does it really make sense to put \$30,000 into a traditional 401(k), of which \$24,000 is unmatched?* All of that contribution, including any investment growth, will be fully taxed on withdrawal, from the 401(k) or from an IRA after a rollover, at whatever tax rates might be in the future.

## Piling on the Pain

The last thing our hypothetical Adam would want is to be stuck using “tax infested” traditional IRA or traditional 401(k) funds to pay doctors and hospitals. If someone is required to tap tax-deferred accounts for medical expenses in retirement, that adds tax pain to those outlays.

What's more, using any kind of offsetting tax deduction for those bills is increasingly chancy. It always has been a challenge to deduct itemized medical expenses, which must:

- A. Exceed 7.5% of adjusted gross income; *and*
- B. Be large enough to make it worthwhile not to take the standard deduction. Since 2018, the standard deduction has become so large that fewer taxpayers receive a benefit from itemizing, especially married couples.

A further reason to choose funding an HSA is that the other path, loading up pre-tax retirement accounts, could eventually make required minimum distributions (RMDs) enormous. The resulting taxable income could increase to the point where Medicare

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is a monthly publication sold for \$150 annually by:

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ISSN 1531-653X

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*Double trouble:* Without having ample untaxed HSA funds, retirees might wind up paying higher taxes on sizable RMDs, fail to get an offsetting tax deduction, and fall into expensive IRMAA territory. Many retirees will be thankful they planned ahead and accumulated as much as possible inside their HSAs.

### A Matter of Timing

Although the idea of using an HSA as a healthcare IRA may be logical, not all HSA owners are on this track. As the statistics cited earlier in this article indicate, many people use HSAs to cover current medical bills, tax-free. Considering that tax rates are scheduled to rise in 2026, with even higher rates down the road a possibility, maximizing the power of a tax-favored HSA through long-term use seems most appropriate.

Of course, this assumes that the taxpayer has other resources from which to pay ongoing medical expenses. If an HSA owner's cash flow needs change, the money in the HSA will be available for untaxed medical outlays at any time, at any age. Even prior expenses that have not been reimbursed from HSA funds in the past can be reimbursed in a later year, tax-free, if they haven't already been deducted on a tax return as an itemized deduction. HSA owners should keep their receipts!

### Advisor Action Plan

- Review clients' tax returns to see if they include IRS Form 8889. Checking to see if HSA contributions are being maximized and/or pre-retirement distributions are being taken is a great value-add to offer.
- If someone has been taking distributions on IRS Form 8889, suggest that he or she might stop those withdrawals and let the

funds build up, tax-free, for future use.

- Make sure that clients with HSAs do not take distributions from those accounts if they also are getting a tax deduction for the same expenses. Self-employed taxpayers receive the "self-employed health insurance deduction" for health insurance premiums they pay, including outlays for Medicare Parts B and D as well as long-term care insurance. If withdrawals for these expenses are taken from HSA funds, that deduction would be lost or reduced.
- Urge self-employed taxpayers to consider making HSA distributions for medical expenses that do not qualify for this deduction, such as deductibles and co-pays. ■

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# 2023 Health Savings Account (HSA) Chart

## HSA Contribution Eligibility

- Must be enrolled in a high deductible health plan (HDHP) to contribute
- Generally cannot have other health insurance that is not an HDHP
- Cannot be enrolled in Medicare or Tricare
- Can't have received care from the Veteran's Administration within the last 3 months (other than preventive care for all veterans or VA hospital care and medical services for veterans with a service-connected disability)
- Cannot be eligible to be claimed as a dependent on someone else's tax return

## HDHPs: Minimum Deductibles and Maximum Out-of-Pocket Expenses\*

Year	Self-Only HDHP Minimum Deductible	Self-Only HDHP Maximum Out-of-Pocket Expenses	Family HDHP Minimum Deductible	Family HDHP Maximum Out-of-Pocket Expenses
2022	\$1,400	\$7,050	\$2,800	\$14,100
2023	\$1,500	\$7,500	\$3,000	\$15,000

\*Confirm with the health insurance company that the plan is an HDHP.

## HSA Contribution Limits

Year	Self-Only HDHP under age 55	Self-Only HDHP age 55+	Family HDHP under age 55	Family HDHP age 55+
2022	\$3,650	\$4,650	\$7,300	\$8,300
2023	\$3,850	\$4,850	\$7,750	\$8,750

Contributions are generally pro-rated for the number of months the individual is enrolled in an HDHP. Contributions can be made by the individual, the employer or anyone, but the annual contribution limit above applies. The contribution deadline is the tax-filing deadline, not including extensions (i.e., April 15th).

## HSA Tax Benefits & Advantages

Control	Owned and controlled by the individual, not the employer.
Death of HSA Owner	Spouse beneficiary automatically treated as new HSA owner. Non-spouse beneficiary must include HSA value at death as taxable income, but no 20% penalty.
Distributions	Tax-free for qualified medical expenses of the individual, spouse or dependents. Distributions not used for qualified medical expenses are taxable as ordinary income plus a 20% penalty unless due to death, disability, or age 65+.
Employee/Individual Contributions	Tax deductible as an above-the-line deduction (reduces AGI), regardless of individual's tax-filing status or income.
Employer Contributions	Tax deductible to employer and must be "comparable." Employees do not include employer HSA contributions in income.
Investment Gains	Tax-free, if used for qualified medical expenses.
Portability between HSAs	HSA funds can be rolled over or transferred to another HSA (once-per-year rule and 60-day rule applies to rollovers).
Portability from an IRA	IRA funds cannot be rolled over or transferred to an HSA. There is a one-time exception for a qualified HSA funding distribution (QHFD). HSA funds can never be rolled over to an IRA.
Qualified HSA Funding Distribution	A QHFD is a tax-free direct transfer from an IRA to an HSA. It is a one-time only transfer from an IRA that is limited to an individual's maximum HSA contribution for the year. Only pre-tax IRA funds can be transferred (exception to the IRA pro-rata rule). Does not apply to ongoing SIMPLE or SEP IRAs. After a QHFD, individual must remain HSA eligible for a 1-year testing period to avoid taxes and penalties.
Use-It-Or-Lose-It Rule	N/A - Unused HSA funds continue to belong to the owner.