1040 News Q1 2023

Quarterly news & tips for folks in every tax bracket

There are lots of changes to retirement account rules in the $1.7 trillion 2023 Consolidated Appropriations Act (signed into law 12/29/22).

The changes are too numerous to summarize in two pages (over 90 tax law changes). We'll cover the rules that will affect most folks. We'll also skip the detailed qualifiers (especially given that the IRS has not interpreted the new law).

Required Minimum Distributions (RMDs)

The age where distributions from retirement accounts becomes mandatory is increasing to 73 (from 72) starting 1/1/23. As such, those that will turn 72 in 2023 can delay their RMDs by one year. Those that turned 72 in 2022 (or earlier) fall under the old rules (so you can't skip RMDs for 2022 or future years).

The new law raises the RMD age again starting 1/1/33 (from age 73 to age 75).

Beginning in 2024, the RMD requirement for employer sponsored Roth plans will be eliminated. Individual Roth IRAs are already exempted from RMDs under current rules (unless inherited).

Beginning in 2023, the tax penalty for not correctly taking RMDs will decrease from 50% to 25% of the amount missed. There is also a provision to further reduce the penalty to 10% (if the error is corrected in a timely manner).

Catch-Up Contributions

Similar to the current rules, you will be able to contribute more to retirement plans when you reach age 50. The new bill will increase some catch-up contribution limits and require some of them to be post-tax (i.e. Roth) contributions. Here is the gist:

Beginning in 2024, the age 50 additional catch-up contribution amount for IRAs (traditional and Roth) will be indexed for inflation (it remains $1000 for 2023).

Beginning in 2025, taxpayers aged 60, 61, 62, or 63 will get an increase in the additional catch-up amount for most employer sponsored plans like 401(k), 403(b), etc. This amount will start at $10,000 (or 150% of the 2024 catch-up amount, if greater) and will be indexed for inflation in future years. If your employer plan is a SIMPLE IRA then the age 60-63 catch-up amount is $5000 (or 150% of the 2024 SIMPLE catch-up amount, if greater) and will be indexed for inflation in future years.

Beginning in 2024, catch-up contributions must be made in Roth accounts (if your income was greater than $145,000 in the prior year). The $145,000 income threshold will be indexed for inflation in 2025 and future years. Employers without a Roth option will presumably have to create one, or risk not allowing some employees to make catch-up contributions. Fortunately, the new law now allows the creation of Roth options for both SIMPLE and SEP IRAs starting in 2023.

Employer Matching Contributions to Roth

Beginning in 2023, employees may opt to have all or a portion of their employer's matching 401(k) contributions go into a Roth 401(k) (if available within the employer's plan). This rule also applies to employer sponsored 403(b) and 457(b) plans. If an employee opts for Roth, the employer's matching contributions will be taxable income.

Employer Match for Employee's Student Loan Payments

Beginning in 2024, employers will be allowed to make matching contributions to most types of retirement accounts based on an employee's student loan payments. Employers that choose to offer this benefit will be helping employees that can't afford to fund their retirement while paying off student loans.

Quicker Access to Employer Retirement Plan for Some Part-Time Workers

Beginning in 2023, the service requirement for some part-time workers will be lowered from 3 consecutive years down to 2 years (for employees with 500-999 hours of service in each consecutive year). Employees that work 1000+ hours per year already qualified to participate based on existing rules.

Automatic Enrolment in Employer Plan

Beginning in 2025, employers must automatically enroll eligible employees in 401(k) and/or 403(b) plans. The contributions will be taken from worker's pay and must range between 3% and 10% of compensation. Each year after 2025, the percentage of the contribution increases 1% (stopping at a maximum of 10% - 15%). Employees will be given a way to opt-out.

Employers in business for less than 3 years and those with fewer than 10 employees are exempted from the auto-enrollment requirement. There are also exemptions for church plans and government plans.

Turn the page for more.

Let's keep exploring some of the new rules for retirement accounts (again, skipping many of the detailed qualifiers).

Emergency Expense Distributions

Beginning in 2024, people will be allowed to take a limited (once per year, up to $1000) early distribution from a retirement account for unforeseeable or emergency needs.

A qualified distribution will be subject to tax (if applicable) but not penalty. Folks will be allowed to repay the retirement account within three years. However, if you don't repay then you won't be allowed another penalty-free emergency distribution for 3 years.

Distributions of Terminally Ill Individuals

Terminally ill people (physician certified) can now make penalty-free distributions from retirement accounts. Such distributions can also be repaid (with limitations).

Distributions in Cases of Domestic Abuse

Beginning in 2024, retirement plans can allow limited (lesser of $10,000 or half the amount in the account) distributions for participants who self-certify that they have experienced domestic violence within the last year. Such distributions can also be repaid (with limitations).

Federally Declared Disaster Distributions

The new law permanently establishes the hardship distribution and loan rules for taxpayers living in a federally declared disaster area. For federally declared disasters dating back to 1/26/21, you can take a qualified penalty-free distribution of up to $22,000 and spread the tax over three years. Such distributions can also be repaid (with limitations).

Additionally, qualified federal disaster loans are limited to $100,000 (max). You can also opt for a one-year extension of the plan's loan repayment period.

New Emergency Savings Accounts

Employers can create a new type of tax-advantaged saving account for non-highly compensated employees called Pension Linked Emergency Savings Accounts (PLESAs). Employers will be allowed to auto-enroll employees. Employees will be allowed to opt-out. The maximum annual contribution (and account balance) cannot exceed $2500. Contributions would qualify for employer matching.

The account is funded with post-tax wages, the earnings are sheltered from taxation, and up to four annual distributions are tax and penalty free. If the employee leaves the company they can cash out the account or roll it over to a Roth IRA.

Retirement Account Lost & Found

The new law gives the Department of Labor 2 years to create a searchable database of retirement accounts. This "lost & found" will help people find neglected or lost retirement savings.

Employer Incentives for Plan Participation

Beginning in 2023, employers will be allowed to offer small financial incentives (e.g. low-dollar value gift cards) to encourage employee participation in retirement plans. This was not allowed under previous rules.

Incentives for Small Employers Funding a New Retirement Plan

Beginning in 2023, there are generous incentives for small employers that contribute funds to new retirement plans. The details are complicated, but the maximum tax credit for the business can be up to $1000 per employee (excluding employees that make more than $100,000, as defined). The credit amount is based on a percentage of the employer's contributions to the new plan. The percentage starts at 100% (first two years) and reduces to 75% (year 3), 50% (year 4), 25% (year 5), and 0% thereafter. Employers with 50 employees (or fewer) qualify for the best credit (it gradually phases out for employers with 51-100 employees).

The new law also enhances an existing small business tax credit related to administrative costs of setting up a new retirement plan. This credit is currently available to businesses with fewer than 100 employees, and it pays 50% of the administrative costs (up to $5000 max). The enhanced credit now pays a higher percentage of administrative costs (100%, up to $5000 max) for businesses with 50 or fewer employees.

529 Plan Rollovers to Roth IRA

Beginning in 2024, money in a 529 plan (a type of education savings account) can be used to fund an annual Roth IRA contribution (with many limitations). Here are just a few of the qualifiers:

- The Roth IRA must be in the name of the beneficiary of the 529 Plan.
- The 529 Plan must be at least 15 years old.
- Contribution (plus earnings) made within the last 5 years cannot be rolled over.
- The annual maximum Roth contribution limit cannot be exceeded (including the 529 rollover).
- There is a lifetime cap for 529 to Roth rollovers of $35,000 .

Savers Credit for Low Income Taxpayers

Beginning in 2027, the Credit for Qualified Retirement Savings Contributions (a.k.a. the "Savers Credit") will be overhauled. The current non-refundable tax credit will be replaced with a government-funded matching contribution (max $2000, with income limitations) to an IRA. They've got a few years to figure out how that's actually going to be implemented. Stay tuned.

In Summary—These are just a few of the changes that will affect retirement savings for years to come. Ask for help to figure out how these and other changes will affect your specific situation.

Any Other Tax News? Yes! IRS Delays 1099-k Reporting Thresholds

Third party payment processors (like Venmo, PayPal, Cash App, etc.) are no longer required to issue form 1099-K for "goods and services" transactions exceeding $600. The IRS announced that the previous threshold of $20,000 (and 200 transactions) can be used "until further notice".

Thanks for reading.