# Eye on Washington

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# 2022 Year in Review: SECURE 2.0 and Other Tax Developments

The first year of the Biden presidency (2021) saw a number of very ambitious and far-reaching tax proposals introduced, though none were enacted as the massive and ever-shifting Build Back Better agenda was unable to garner the requisite majority in both houses of Congress. As a result, 2022 followed a more subdued legislative approach suitable to slim legislative majorities in an election year. Two notable pieces of legislation were ultimately successful, generous on the spending front though minimally disruptive on the tax side of the ledger.

Additionally, some fairly benign regulatory developments helpfully clarified tax rules, while inflation significantly impacted annually adjusted tax items for 2023. The November 2022 elections brought a slight shift in power in Washington, leaving a divided legislature unlikely to enact meaningful tax changes for the remaining two years of the current administration (though a sunset of the Tax Cuts and Jobs Act scheduled in 2026 will likely play a central role in any tax discussions for the foreseeable future).

## Legislative Activity

### SECURE 2.0

While no formal obstacles prevent Congress from convening to pass broadly bipartisan legislation during the course of the year, the “must-pass” end of year omnibus spending package acted as the fortunate impetus to include the long-awaited sequel to 2019’s SECURE Act, the Securing a Strong Retirement Act of 2022 (dubbed “SECURE 2.0”). Building on the retirement security reforms of the first bill, the latest changes continue the trajectory of incremental modifications to rules around retirement planning that most individuals and planners will find appealing. While not necessarily reducing complexity around retirement planning (effectively adding to rather than subtracting from existing laws), most provisions are generally deemed “taxpayer friendly.” The following provisions are included among the new reforms.

***RMD changes:***

- Increase in the age when required minimum distributions (RMDs) must begin:
  - Required beginning date (RBD) for those reaching age 73 (up from 72) starting in 2023 through 2032.
  - RBD will increase to age 75 starting in 2033.
  - Deferral in RMDs may allow certain individuals to avoid higher Medicare Part B and D premiums (based on income) and/or take greater advantage of Roth conversions.
- Effective starting in 2024, RMDs will not apply to participants in qualified Roth programs (such as Roth 401(k)s):
  - This provision equalizes RMD treatment to Roth IRAs (which do not have RMDs for participants).
  - Presumably, individuals taking RMDs from such accounts will no longer be required to do so starting in 2024.
- Also beginning in 2024, spousal beneficiaries of retirement accounts may elect to be treated as the deceased spouse for purposes of RMDs (including per the Uniform Life Table used by account owners):
  - Such provision will generally benefit individuals who inherit accounts from a younger spouse.
  - Beneficiaries of an account where the surviving spouse dies before RMDs begin will be treated as the original beneficiaries of the account as well.
- RMD relief for partial annuitization from individual accounts:
  - For IRAs and defined contribution plans, annuity payments are generally treated as satisfying the RMD for the annuitized portion, while the balance of the account must have a separately computed RMD.
  - Effective as of enactment, the new law directs the Treasury Department to amend its regulations to permit the RMD for the non-annuitized portion to be calculated based on the excess of the total account RMD over the annuity paid out.
    - For purposes of computing RMDs, the value of such annuity/ies will be included in the account value each year.

***Increased permissible contributions to retirement plans and more availability of Roth options:***

- Higher catch-up contributions for IRAs and qualified plans:
  - Inflation indexing of $1,000 IRA catch-up for those over age 50.
  - For those age 60-63, increases catch-up limit for qualified plans and SIMPLES to 1.5X the normal catch-up limit starting in 2025.
    - Note that catch-ups to qualified plans for employees with wages that exceed certain thresholds ($145,000 indexed for inflation starting in 2024) <u>can only be made</u> as Roth contributions (for plans that don't allow Roth contributions, no catch-up contributions would be available).
    - Note additionally that a drafting error in the bill would technically eliminate all catch-up contributions after 2024—a technical corrections bill should eventually correct the error, although political dynamics make the timing of such action uncertain.
- Allows employers to make matching retirement plan contributions for employees based on student loan payments (starting in 2024):
  - Student loan payments by an employee will be treated as elective deferral for matching (though not contribution) purposes for 401(k)s, 403(b)s, 457(b)s and Simple IRAs.
- Increased contribution limits by employers to SIMPLE plans, effective in 2024:
  - The additional contributions cannot exceed the lesser of (1) 10% of the employee's compensation or (2) $5,000 per participant (indexed for inflation) and must be established as a uniform percentage of compensation.
  - SIMPLE and SEP plan sponsors may also allow employees to elect to treat employer contributions to SIMPLE accounts as Roth contributions (beginning in 2023).
    - Note that Roth conversions of such amounts by employees have been previously available.

- Employer matches for Roth contributions (rather than all matches as pre-tax) are optionally permitted as well, effective in 2023.
- Enhancement of the Saver's Credit (now "Saver's Match") in the form of a tax credit payable directly to a retirement account (effectively a government match on savings for lower income individuals):
    - Note effective date of 1/1/2027.

***More annuity planning opportunities:***

- Increases the dollar limit for the acquisition of qualified longevity annuity contracts (QLACs) in retirement plans to $200,000 (with inflation adjustments) starting in 2023:
    - Notably, the lesser of 25% cap is eliminated as well.
    - QLACs generally permit RMD deferral through fixed annuity that may delay payments up to age 85.
- SECURE 2.0 also increases flexibility regarding commercial annuity pay-out options that previously conflicted with RMD rules.

***More charitable and special needs planning opportunities:***

- Inflation indexing of qualified charitable distribution (QCD) cap of $100,000 (beginning in 2024), plus one-time allowance of up to $50,000 gift (beginning in 2023) to charitable split interest vehicle that can benefit grantor or spouse (generally a charitable remainder trust [CRT] or charitable gift annuity [CGA]):
    - Note that the eligible age to make QCDs remains at 70 ½ (the pre-SECURE RMD age).
    - Note as well that CRTs eligible for the $50,000 transfer must be funded exclusively with QCDs, and all non-charitable distributions will be treated as ordinary income.
- Allows a special needs trust to be a qualified designated beneficiary of an IRA:
    - This permits the trust to receive distributions from the IRA over the beneficiary's life expectancy rather than under the 10-year rule.
    - Such special needs trusts may have a charitable remainder beneficiary notwithstanding the fact that such a beneficiary would normally accelerate required IRA distributions.

***Increased flexibility on use of 529 funds:***

- Increases eligible age applicable to 529 ABLE accounts from pre-26 disability to pre-46 (starting in 2026):
    - Such accounts were introduced in 2015 to provide a tax-preferred funding tool for the education, housing, transportation, employment, support, and health and wellness needs of disabled individuals and operate within the same general framework as 529 education plans as to contribution limits, etc.
    - Note that an individual will not need to be under age 46 by 2026 in order to be eligible, just disabled before age 46; starting in 2026, such individual will be eligible for an ABLE account if not otherwise eligible today.
- Allows rollovers of unspent funds in 529 plans to a Roth IRA (**in the name of the beneficiary of the 529**) starting in 2024:
    - 529 plan must be maintained for at least 15 years prior to any rollover, and rollovers limited to contributions and earnings made at least 5 years prior to rollover.
    - Rollovers likewise limited to the $6,000 annual contribution limit (adjusted for inflation and accounting for other IRA contributions – compensation rules apply as well) and lifetime limit of $35,000.
    - Notably, Roth income limits do not appear to apply.

***Relief from compliance penalties:***

- Permits penalty-free distribution from qualified plans and IRAs for "emergency" purposes (up to $1,000 every three years) starting in 2024.

- Starting in 2023, the penalty for failure to properly take RMDs is reduced from a 50% excise tax (on top of taxes assessed on the distribution) to 25%, or 10% in the case of timely corrections:
    - Timely corrections generally include withdrawals made before the end of the third calendar year when the tax is imposed, or the mailing of a deficiency notice if sooner.
- For individuals receiving penalty-free pre-age 59½ distributions from a retirement plan under the Series of Substantially Equal Period Payments (SEPP) rule, the receipt of additional funds through contributions or rollovers by such account will not be considered a modification to the SEPPs.
- Broadens the penalty-free access to retirement plans for those residing in presidentially declared disaster areas who sustained an economic loss as a result:
    - 180-day period to take up to $22,000 in penalty-free distributions for a given disaster.
    - Income recognized ratably over three years unless participant opts out.
    - Three-year repayment period on distributions permitted, as well as increase to $100,000 for plan loans (compared to $50,000 general limit).
- Permits a defined contribution plan to make penalty-free (though taxable) distributions up to $2,500 annually (inflation adjusted) for the purchase of a qualified long-term care insurance on an employee, his or her spouse, or a family member (starting in 2026).
- Lastly, the statute of limitations for the IRS to assess penalties on missed RMDs is now set to three years and excess contributions to six years:
    - Under prior guidance, the statute was potentially indefinite.

While SECURE 2.0 contains a number of additional provisions not described above, notably absent from the legislation was any attempt to restrict or eliminate the use of back-door Roth conversions, or any limits on the ability to accumulate and maintain large balances in so called "Mega-Roths." Both items were discussed extensively as potential changes to Roth planning during deliberations in 2021. Based on SECURE 2.0, however, the Magic 8 Ball points decidedly toward "outlook good" for additional Roth planning opportunities in the years ahead.

## Inflation Reduction Act

The somewhat conveniently titled Inflation Reduction Act was signed into law on August 16, 2022, as a vastly slimmed down (though still substantive) version of prior incarnations of the Build Back Better Act. A rose by any other name, the Inflation Reduction Act primarily focuses on health care initiatives and green energy spending and tax credits, paid for through narrowly tailored tax increases and notable non-tax revenue raisers. The legislation's passage caught a number of observers unaware, but the need for a legislative accomplishment in an election year may have proven to be a powerful lure for the conversion of a key Senate holdout.

***Primary spending provisions:***

- $369 billion dedicated to various climate and energy programs, including vastly expanded tax credits impacting consumers, developers, and manufacturers. Among them include:
    - Expanded energy efficient home improvement credits ($1,200 annual limit to replace $500 lifetime cap on various improvements).
    - Extended and expanded residential clean energy and clean (e.g., electric) vehicle credits.
    - Extension and modification of the Renewable Electricity Production and Energy Investment tax credits, as well as a host of other energy production and targeted fuel credits.
    - Increased authorization for Department of Energy Loan Programs focused on energy infrastructure projects.
- $64 billion for three-year extension of Affordable Care Act subsidies set to expire in 2023.

***Tax and revenue provisions:***

- While the Tax Cuts and Jobs Act of 2017 (TCJA) eliminated the corporate alternative minimum tax (AMT), the new legislation revives a scaled back version, imposing a 15% minimum tax on the financial statement earnings of companies with revenues in excess of $1 billion annually over prior three years.
    - Note that cash value growth and death proceeds from corporate owned life insurance can impact financial statement income subject to the AMT, although a credit against such tax in future higher tax years will likewise be available.
    - Green energy tax credits (which generally require a tax liability) may likewise compete with bonus depreciation (which does not count against AMT) in a given year when evaluating corporate tax planning opportunities.
- A 1% excise tax on the fair market value of stock repurchased by publicly traded US corporations applies to repurchases in 2023 and beyond.
    - The tax is reduced for stock issuances during the same taxable year.
- Among the Act's revenue provisions is claimed estimated savings of $288 billion from Medicare prescription drug pricing reforms and negotiations with pharmaceutical companies.
- Perhaps the most notable (and politically controversial) measure under the Act, however, is a significant outlay for IRS upgrades and enhanced enforcement.
    - The bill includes $80 billion for the IRS over the next 10 years, which increases the IRS budget by over 60% on average and is projected to generate $124 billion of additional revenue.
    - The funds would increase the IRS staff along with the hope of spurring improvements in customer service, responsiveness, and technology.
    - Of course, as a "revenue raiser," the IRS outlay is expected to significantly increase tax receipts and collections of perceived forgone tax revenue.
    - Commentators have wildly divergent views of which taxpayers will be impacted, although Treasury's stated intent is to target sophisticated tax schemes utilized by high income and high net worth individuals.
        - Per the Congressional Budget Office, higher overall audit rates can be expected for all income levels, although higher income individuals will see the highest audit rate increase.
        - Conversely, some members from the Joint Committee on Taxation have expressed concern that a disproportionate amount of revenue would come from taxpayers making less than $200,000 a year.
        - In all events, individuals would be well served to ensure that planning is properly undertaken and supported by adequate documentation. Increased scrutiny on certain transactions may encourage planners and high net worth individuals to adopt a more conservative approach to planning as well.

Apart from those operating in industries taking advantage of green energy initiatives, most individuals will likely feel little if any impact from the Inflation Reduction Act. Notably absent was any relief for the state and local income tax (SALT) deduction cap in spite of the best efforts of a number of Senators from high tax states. Also ending up on the cutting room floor was an extension of the holding period for carried interests to be eligible for the preferred long-term capital gains rate. The initial plan would have increased this to five years from the current three, but the current rule prevailed.

## Other Notable Developments in 2022

### *Further guidance on RMDs under the SECURE Act*

Proposed Treasury regulations issued in early 2022 confirmed prior IRS guidance that RMDs would be required for beneficiaries of inherited qualified plans and IRAs during the 10-year period where the participant had reached their required beginning date on or after death. Most commentators believed that the 10-year rule under the SECURE Act permitted beneficiaries to defer all distributions until the end of ten years. With the proposed regulations, however, the initial unofficial guidance (thought to be mistaken) was confirmed as the official position. Note that some commentators are hopeful that Treasury may yet reverse course when final regulations are issued, likely sometime in 2023.

It is likely that a good number of beneficiaries of IRAs and qualified plans failed to take RMDs in 2021 or 2022 based on the conventional understanding of the 10-year rule, a sentiment widely shared by the professional community as well. Failure to take RMDs can result in harsh penalties (50% of the amount that was not distributed); as a result, the IRS issued Notice 2022-53 on October 7, 2022, stating that no penalties would apply to individuals who failed to take RMDs as required under more recent guidance. Furthermore, any RMDs that were not taken would not be required to be withdrawn and reported (either in a prior tax year on an amended return, or prospectively). Effectively, the Service provides a "get out of jail free" card to those who acted in good faith in reliance on a sound interpretation of the SECURE Act (or were otherwise blissfully unaware). While this is welcome to many individuals, those who did in fact take RMDs and report the tax are not offered any specific opportunity to repay such distributions and recoup taxes paid. Whether such relief or opportunity will be offered in the near future is questionable. Anyone who reported any penalty taxes paid with respect to late distributions may apply for a refund.

Other clarifications under the proposed regulations include the following:

- A minor will cease to be an eligible designated beneficiary upon his or her 21st birthday (eliminates confusion on whether age 18 in some states would apply).
- An eligible designated beneficiary may elect to defer all distributions for 10 years if the participant died prior to reaching his or her RBD, or conversely begin RMDs based on their own life expectancy.

### *President Biden's student loan forgiveness plan:*

In an attempt to prove the might of the executive pen over the congressional sword, President Biden announced in late August of 2022 a plan to provide a large swath of student borrowers debt relief of up to $20,000 on student loan balances via executive order. Based on a generous interpretation of the HEROES Act of 2003, total estimates pegged the forgiveness at approximately $350 billion (with other estimates much higher). Legal wrangling predictably ensued, and the plan is currently on hold in the federal courts with an eventual stop at the US Supreme Court possible. In response, the Biden administration elected to extend the pause on student loans repayments in November until August of 2023, or sooner if the debt forgiveness litigation is resolved before (unlikely).

If the Biden plan is able to succeed on forgiveness, though, individuals should note that a discharge of indebtedness generally counts as taxable income. Under a provision of the American Rescue Plan Act (ARPA) of 2021, however, the forgiveness of student loan debt between 2021 and 2025 is not considered federal taxable income. Furthermore, a number of states follow federal treatment and likewise exclude debt forgiveness from own state income taxation (though not all states follow such rule).

### *Expiring tax provisions:*

Apart from the myriad energy tax credit provisions extended and modified under the Inflation Reduction Act, most other temporary tax provisions that expired at the end of 2021 and 2022 (many of which were COVID related) were left to expire.

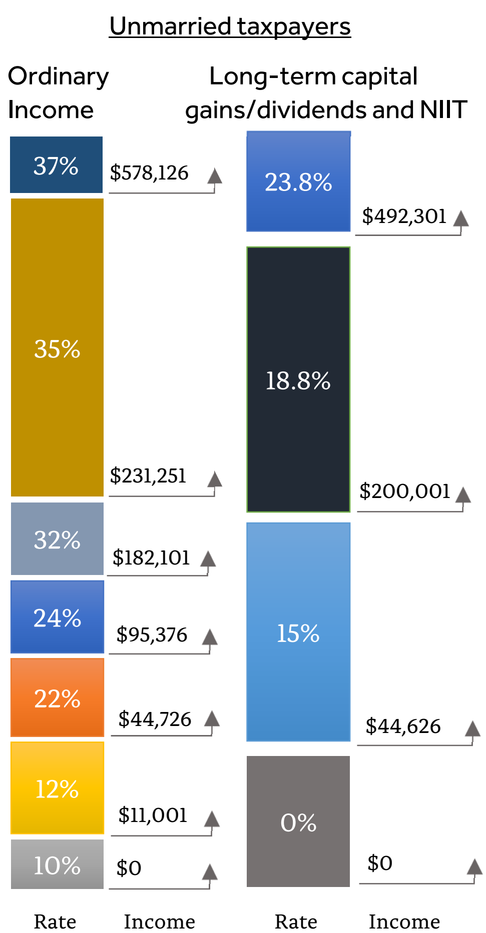
- Notably, the full deduction for business meals provided in a restaurant ended 12/31/22 and reverts to the 50% deduction in 2023.
- A number of Democrats had hoped to extend the child tax credit expansion (enacted for 2021 alone under the American Rescue Plan) retroactively in 2022 and beyond as part of the end of year omnibus spending bill but were unsuccessful.
- Lastly, it is important to note that the 100% bonus depreciation provision introduced with the TCJA begins to scale back starting in 2023. For 2017 through 2022, businesses could fully write off in the year of acquisition certain qualified property (depreciable assets with a recovery period of 20 years or less, such as vehicles, furniture, manufacturing equipment, and heavy machinery, as well as computer software, water utility property, and "qualified

improvements"). Starting in 2023, such depreciation is limited to 80% of cost, and will be reduced each year thereafter by 20% (reaching 0% in 2027).

## Moving Forward in 2023

***Inflation adjustments:***

While inflation was figuratively addressed in the Inflation Reduction Act, its effects were very evident when the updated inflation adjustments for various 2023 tax items were released in late 2022. Federal income tax brackets were adjusted by more than 7% heading into the new year, providing a minor measure of income tax relief for those not otherwise experiencing commensurate wage increases. Federal income tax brackets for 2023 are as follows:




Transfer tax exemptions and exclusions were likewise notably increased, with the exemption for gift, estate, and generation skipping transfer (GST) taxes increasing to $12,920,000 per person, up nearly $900,000 from 2022's $12,060,000. The annual gift tax exclusion also increased from $16,000 to $17,000.

***Impact of 2022 election:***

The 2022 mid-term election saw the Republican party assume a slim majority in the House of Representatives, while the Democrats maintained control of the Senate (even picking up a seat). As a result, the prospects for any meaningful tax legislation in 2023 or 2024 is very slim to non-existent. While the Treasury Department has its hands full with the implementation of rules for the bills from 2022, there is potential for increased regulatory activity around other tax items as well. Regulatory activity filled in for lack of action on the legislative front during the Obama administration and may yet serve as a template for team Biden (for example, regulations impacting valuation discounts in the estate planning context were proposed in mid-2016, though repealed by the Trump administration before they became effective). Time will tell whether and to what extent such activity is contemplated, but the recent Treasury priority guidance plan includes a (understandable) proposal to stipulate assets inside a grantor trust that are not otherwise includible in the grantor's estate do not receive a step-up in basis upon the grantor's death.

The likely lack of any activity on tax legislation in 2023 and 2024 will put the pending sunset of the TCJA front and center in the 2024 election. The vast majority of individual tax items under the TCJA will revert to pre-2018 law on January 1, 2026, including higher overall taxes through the brackets, elimination of the Section 199A Qualified Business Income tax deduction, lower standard itemized deduction and child tax credits, and reintroduction of many other deductions including a return of the unlimited SALT deduction. Additionally, sunset will cause the gift, estate, and GST exemption amount to be roughly cut in half from current levels, triggering a large increase in tax exposure for larger estates. The fate of sunset will rest heavily on the outcome of the 2024 election—but if recent history is any guide, neither party will walk away with large majorities or unified control, forcing some sort of compromise short of complete sunset or extension. One possibility would be the extension of many individual income tax items in exchange for some of the items from 2021 tax proposals, including higher tax rates at the upper income levels (including higher capital gains rates), higher overall corporate tax rate, broader application of net investment income tax, reduction in benefits under §199A at higher income levels, as well as expanded wealth transfer taxes, gain realization at death, and even possibly a form of accumulated wealth tax. Note that several states are currently coordinating on state level wealth tax proposals that would apply to high net worth individuals.

The remainder of the Biden term is unlikely to result in meaningful activity on additional tax changes, but changes are on the horizon nonetheless whether automatically via sunset or by the actions of Congress. Professional advisors and their clients would be well served to review planning to undertake in the meantime while the opportunity presents itself. As a famous golfer once said, "When a defining moment comes along, you define the moment, or the moment defines you."