KRAMER & JENSEN LLC
CERTIFIED PUBLIC ACCOUNTANTS

Contact Us:

Kramer & Jensen LLC
7430 E. Caley Ave. Suite 300E
Centennial, CO 80111
T 303-741-2253
F 855-330-4215
sjensen@kramerjensen.com

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Will the Recently Passed Pension Legislation Affect You?

On December 29, 2022, the President signed the Consolidated Appropriations Act, 2023, which is the "omnibus spending bill". That legislation also included the Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 Act, a.k.a. the SECURE 2.0 Act, that can significantly impact and augment your retirement planning strategies. The SECURE 2.0 Act incorporates provisions from proposed legislation that was passed by the House and another bill that was passed by the Senate that had not previously been reconciled.

So What's in the Legislation That May Affect You?

Included are over 300 pages of provisions affecting tax-favored retirement benefits that modify many provisions of the original SECURE Act enacted back in 2019. Some apply to individuals while others benefit businesses. The provisions of the SECURE 2.0 Act become effective over several years stretching out until 2026. This article includes the most significant provisions.

THOSE EFFECTIVE IN 2023

Here are the takeaways for those effective in 2023:

• **Required Minimum Distribution (RMD)** – To prevent an individual from investing in tax-deferred retirement plans, including Traditional IRAs, but never withdrawing from the plans, the account owner is required to begin taking RMDs in the year the IRA owner reaches the mandatory age set by Congress.

The policy behind the RMD rule is to provide that individuals spend their retirement savings during their lifetime and not use their retirement plans for estate planning purposes to transfer wealth to beneficiaries.

Originally RMDs had to begin at age 70½, until the original SECURE Act increased it to 72 beginning in 2020. Now the SECURE 2.0 Act is increasing it to age 73 in 2023 and age 75 in 2033, giving folks longer to accumulate their retirement savings.

• **Penalty for Not Taking an RMD** – For years, the penalty (technically an excise tax on "excess accumulation") for an individual failing to take the required minimum amount from their traditional IRA or retirement plan has been a draconian 50% of the amount that should have been withdrawn but wasn't for the year. The SECURE 2.0 Act decreases the penalty to 25% and further reduces it to 10% if corrected in a timely manner.

• **Excess Contribution or Distribution Penalty Statute of Limitations** – Individuals often are not aware of the penalty for excess contributions or not taking a required minimum distribution leading to an indefinite accumulation of interest and penalties. To provide finality

for taxpayers in the administration of these excise taxes, the SECURE 2.0 Act provides that a 3-year period of limitations begins when the taxpayer files an individual tax return (Form 1040) for the year of the violation, except in the case of excess contributions, in which case the period of limitations runs 6 years from the date Form 1040 is filed.

• **Nanny Retirement Contributions** – The act permits employers of domestic employees (e.g., nannies) to provide retirement benefits for such employees under a Simplified Employee Pension (SEP)plan. The reason these plans are referred to as simplified is the contributions are maintained in an IRA account of an employee and subject to normal IRA rules. SEP-IRAs require little administration on the part of the employer and contributions immediately vest for the employee.
The employer can decide what amount to contribute each year, anywhere from $0 to the maximum SEP-IRA contribution which is, 25% of compensation or $66,000 for tax year 2023, whichever is less.

• **Credit for Small Employer Pension Plan Start-up Costs** – SECURE 2.0 Act modifies the credit by creating a second category of employer – those with 50 or fewer employees – while leaving the original credit in place for employers with more than 50 employees but not more than 100.

Thus, for employers with 50 or fewer employees the maximum credit is increased from $500 to $1,000. In addition, the credit percentage is increased from 50% to 100% for the first-year expenses for starting a pension plan and for the next three years will be as shown here:

2nd Year	75%
3rd Year	50%
4th Year	25%

• **Military Spouse Retirement Plan Eligibility Credit for Small Employers** - Members of the military are transferred frequently and their spouses who move with them often do not remain employed long enough to become eligible for their employer's retirement plan or to vest in employer contributions. The SECURE 2.0 Act provides small employers (no more than 100 employees earning more than $5,000 per year) a tax credit with respect to their defined contribution plans if they:

1. Make military spouses immediately eligible for plan participation within two months of hire,
2. Upon plan eligibility, make the military spouse eligible for any matching or nonelective contribution that they would have been eligible for otherwise at 2 years of service, and
3. Make the military spouse 100% immediately vested in all employer contributions.

The tax credit equals the sum of:

1. $200 per military spouse, and
2. 100% of all employer contributions (up to $300) made on behalf of the military spouse.

This results in a maximum tax credit of $500. This credit applies for 3 years with respect to each military spouse.

• **Firefighter Retirement Distributions** – Under current law, an employee who withdraws funds from their retirement plan before age 59½ will pay a penalty (additional tax) of 10% of the taxable amount of the distribution. An exception to the penalty is if an employee terminates employment after age 55 and takes a distribution from a retirement plan. Further, there is a special rule that allows firefighters to substitute age 50 for age 55 for purposes of this exception from the 10% tax. The SECURE 2.0 Act extends the age 50 rule to private sector firefighters.

• **Penalty-Free Withdrawals for Domestic Abuse Victims** – The Act allows retirement plans to permit participants that self-certify that they experienced domestic abuse to withdraw a small amount of money and avoid the 10% early withdrawal penalty when they withdraw the lesser of:

- $10,000, or
- 50% of the present value of the nonforfeitable accrued benefit of the employee under the plan.

The distribution may be redeposited to the retirement plan at any time during the 3-year period beginning on the day after the date on which the distribution was received and avoid the tax on the distribution.

• **Qualified Charitable Distributions (QCDs) to Split Interest Entity** – Normally an individual at least age 70½ can annually transfer tax free up to $100,000 from their IRA to a qualified charity. That provision is expanded by the SECURE 2.0 Act to allow for a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts. Caution: Where a taxpayer made IRA contributions after reaching age 70½ there may be taxable ramifications; call this office before making a transfer.

• **Qualifying Longevity Annuity Contracts (QLACs)** - QLACs are generally deferred annuities that begin payment toward the end of an individual's life expectancy. Because payments start so late, QLACs are an inexpensive way for retirees to hedge the risk of outliving their savings in defined contribution plans and IRAs.

Tax regulations published in 2014 imposed certain limits that have prevented QLACs from achieving their intended purpose in providing longevity protection.
The Act addresses these limitations by:

- Repealing the 25% of the account balance limit that applies to the amount of premiums paid for the contract,
- Allowing up to $200,000 (indexed) to be used from an account balance to purchase a QLAC, and
- Facilitating the sales of QLACs with spousal survival rights – and clarifies that free-look periods are permitted up to 90 days with respect to contracts purchased or received in an exchange on or after July 2, 2014.

THOSE EFFECTIVE IN 2024

• **Tax Free Sec 529 Plan to Roth Rollovers** - Frequently individuals express concerns about funds being left over and stuck in 529 accounts when the beneficiary's higher-education expenses paid from the plan have turned out to be less than the account's value, leaving them no choice for getting access to the funds except taking a non-qualified withdrawal and assume a penalty.

The Act amends the tax code to allow for tax- and penalty-free rollovers from 529 accounts to Roth IRAs, under certain conditions.

- Beneficiaries of 529 college savings accounts would be permitted to roll over up to $35,000 over the course of their lifetime from any 529 account in their name to their Roth IRA.
- The 529 account must have been open for more than 15 years.
- These rollovers are also subject to the Roth IRA annual contribution limits (for example, an inflation-adjusted $6,500 in 2023), which means the $35,000 maximum rollover can't be done all in one year.

• **Additional Nonelective Contributions to SIMPLE Plans** - Currently employers with SIMPLE plans are required to make employer contributions to employees of either 2% of compensation or 3% of employee elective deferral contributions.
Beginning in 2024 an employer can make additional contributions to each employee of the plan in a uniform manner, provided that the contribution may not exceed the lesser of:

- Up to 10% of compensation or
- $5,000 (indexed)

• **Indexing IRA Catch-Up Contributions** - Currently the limit on IRA contributions is increased by $1,000 (not indexed) for individuals who have attained age 50. Beginning in 2024 catch-up contributions will be inflation adjusted in $100 increments.

• **Employers Can Make Matching Contributions Based on Student Loan Payments** - This new retirement plan twist is intended to assist employees who may not be able to save for retirement because they are overwhelmed with student loan debt, and thus are missing out on

available employer matching contributions for retirement plans.

The Act allows employees to receive matching contributions by reason of repaying their student loans and by permitting an employer to make matching contributions under a 401(k) plan, 403(b) plan, SIMPLE IRA or 457(b) government plan with respect to qualified student loan payments.

A qualified student loan payment is largely defined as a payment made on any indebtedness incurred by the employee solely to pay qualified higher education expenses of the employee.

• **Withdrawals for Certain Emergency Expenses** – Unless an exception applies, withdrawals from a 401(k) plan or a traditional IRA before attaining the age of 59½ are generally subject a 10% early withdrawal penalty.

Effective beginning in 2024, the Act provides an exception for certain distributions used for emergency expenses, which are unforeseeable or immediate financial needs relating to personal or family emergency expenses.

Only one distribution is permissible per year of up to $1,000, and a taxpayer has the option to repay the distribution to the plan within 3 years.

No further emergency distributions are permissible during the 3-year repayment period unless repayment occurs.

• **Emergency Savings Accounts -** According to a report by the Federal Reserve, almost half of Americans would struggle to cover an unexpected $400 expense resulting in many tapping into their retirement savings.

Congress reasoned that separating emergency savings from one's retirement savings account will provide participants a better understanding that one account is for short-term emergency needs and the other is for long-term retirement savings, thus empowering employees to handle unexpected financial shocks without jeopardizing their long-term financial security in retirement through emergency hardship withdrawals from their retirement plans.

Thus the Act provides employers the option to offer to their non-highly compensated employees pension-linked emergency savings accounts.

Employers may automatically opt employees into these accounts at no more than 3% of their salary, and the portion of an account attributable to the employee's contribution is capped at $2,500 (or lower as set by the employer).

The first four withdrawals from an emergency savings account each plan year may not be subject to any fees or charges. At separation from service, an employee may take their emergency savings account as a cash distribution or roll it into their Roth defined contribution plan (if they have one) or an IRA.

EFFECTIVE IN 2025

• **Increased Catch-Up Contributions for Those Aged 60 Through 63** - Employees who have attained age 50 are permitted to make catch-up contributions under a retirement plan more than the otherwise applicable limits. The limit on catch-up contributions for 2023 is $7,500, except in the case of SIMPLE plans for which the limit is $3,500.

Effective beginning in 2025, these limits are increased to the greater of $10,000 or 50% more than the regular catch-up amount beginning in 2025 for individuals who have attained ages 60, 61, 62 and 63. The increased amounts are indexed for inflation after 2025.

• **Automatic Enrollment** – Many Americans reach retirement age with little, or no savings simply because they are not offered an opportunity to save for retirement through their employers. Even for those employees who are offered a retirement plan at work, many do not participate.

The Act requires new 401(k) and 403(b) plans to automatically enroll participants in the respective plans upon becoming eligible (employees may opt out of coverage).

- The initial auto enrollment amount is a contribution by the employee of at least 3% but not more than 10% of their compensation.
- Each year thereafter that amount is increased by one percentage point until it reaches at least 10%, but not more than 15%.
- All current 401(k) and 403(b) plans are grandfathered (i.e., not required to have automatic enrollment).

The following employers are exempt from the mandatory enrollment requirement, including:

- Small businesses with 10 or fewer employees.
- Employers that have been in business for less than three years.
- Church Plans.
- Government Plans.

• **Long-Term Part-Time Employee 401(k) Participation** – The Act significantly lowers the bar for part-time employees to participate in 401(k) retirement plans. Employers maintaining a 401(k) plan must have a dual eligibility requirement under which an employee must complete:

- 1 year of service (with the 1,000-hour rule) or
- 2 consecutive years of service where the employee completes at least 500 hours of service per year (down from 3 consecutive years).

EFFECTIVE IN 2027

• **Enhancement and Modification of the Saver's Credit**

Current law provides for a nonrefundable credit for lower income individuals who make contributions to individual retirement accounts ("IRAs"), employer retirement plans (such as 401(k) plans), and ABLE accounts. The Act repeals and replaces the credit with respect to IRA and retirement plan contributions, changing it from a credit paid in cash as part of a tax refund to a federal matching contribution that must be deposited into a taxpayer's IRA or retirement plan.

The match is 50% of IRA or retirement plan contributions up to $2,000 per individual. Thus, the government's contribution will be a maximum of $1,000. Since the matching contribution is for lower- and middle-income individuals, the matching contribution is phased as indicated in the table.

SAVER'S MATCH MAGI PHASEOUT		
Filing Status	Phaseout Threshold	Fully Phased Out
Single, MFS	20,500	35,500
HH	30,750	53,250
MFJ, SS	41,000	71,000

MAGI = AGI plus add back of foreign and possession (Internal Revenue Code Sections 911,931 and 933) exclusions.

The preceding covers only some of the provisions in the new law. As the IRS develops further guidance and tax regulations more details will emerge of which we will keep you informed.

If you have questions or would like to schedule a retirement planning appointment, please give this office a call.

2023 Standard Mileage Rates Announced

As it does every year, the Internal Revenue Service recently announced the inflation-adjusted 2023 optional standard mileage rates used to calculate the deductible costs of operating an automobile for business, charitable, medical or moving purposes.

Beginning on Jan. 1, 2023, the standard mileage rates for the use of a car (or a van, pickup or panel truck) are:

- 65.5 cents per mile for business miles driven (including a 28-cent-per-mile allocation for depreciation). This is up from 62.5 cents for the last half of 2022;
- 22 cents per mile driven for medical or moving purposes unchanged from the last half of 2022; and
- 14 cents per mile driven in service of charitable organizations.

The business standard mileage rate is based on an annual study of the fixed and variable costs of operating an automobile. The rate for medical and moving purposes is based on the variable costs as determined by the same study. The rate for using an automobile while performing services for a charitable organization is statutorily set (it can only be changed by Congressional action) and has been 14 cents per mile for over 20 years.

Important Consideration: The 2023 rates are based on 2022 fuel costs. Due to the volatility of gas prices, it may be appropriate to consider switching to the actual expense method for 2023, or at least keeping track of the actual expenses, including fuel costs, repairs, maintenance, etc., so that the option is available for 2023.

Taxpayers have the option of calculating the actual costs of using their vehicle for business rather than using the standard mileage rates. In addition to the volatile fuel prices, the bonus depreciation as well as increased depreciation limitations for passenger autos may make using the actual expense method worthwhile during the first year a vehicle is placed in business service.

The standard mileage rates cannot be used if you have used the actual method (using Sec. 179, bonus depreciation and/or MACRS depreciation) in previous years. This rule is applied on a vehicle-by-vehicle basis. In addition, the business standard mileage rate cannot be used for any vehicle used for hire or for more than four vehicles simultaneously.

Employer Reimbursement – When employers reimburse employees for business-related car expenses using the standard mileage allowance method for each substantiated employment-connected business mile, the reimbursement is tax-free if the employee substantiates to the employer the time, place, mileage and purpose of employment-connected business travel.

The Tax Cuts and Jobs Act eliminated employee business expenses as an itemized deduction, effective for 2018 through 2025. Therefore, during these years employees may not take a deduction on their federal returns for unreimbursed employment-related use of their autos, light trucks or vans.

If you have questions related to the best methods of deducting the business use of your vehicle or the documentation required, please give this office a call.

Thank you for selecting our firm for your tax and accounting needs. We appreciate the confidence you have shown in us, and we remain ready to assist you at any time.

Scott Jensen
Kramer & Jensen, LLC

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Kramer & Jensen, LLC
sjensen@kramerjensen.com

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