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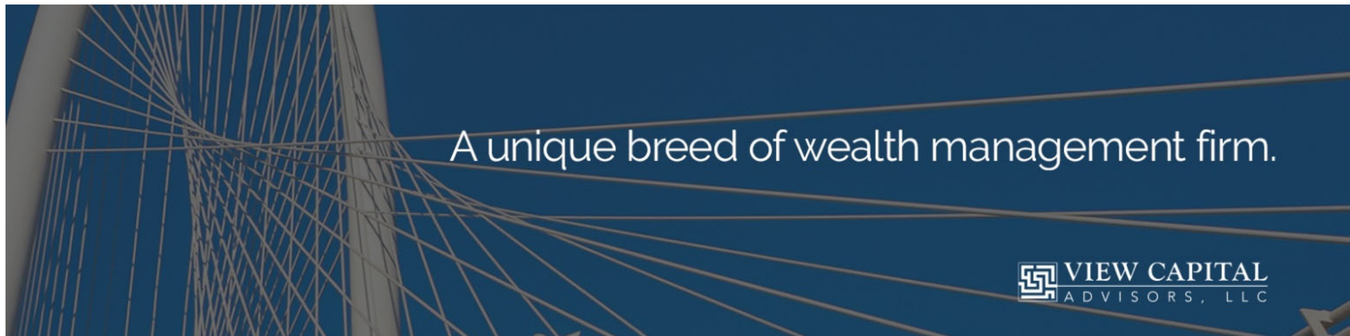

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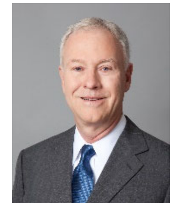

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RMD RULES CHANGE, AGAIN!

Required Minimum Distributions (RMDs) from qualified retirement accounts first appeared in the US tax law in the mid 1980's. The purpose behind the rule was to incentivize (with a penalty regime) retirement plan owners to begin taxable withdrawals from their plans that had been accumulating in value on a tax deferred basis for potentially decades. The initial rule set the date when RMDs were required to begin as the year in which an individual reached age 70 ½. That remained the necessary age for RMDs for more than 30 years until 2019, when the original SECURE Act increased it to age 72 starting in 2020.

Of course, an IRA owner can withdraw more than this minimum at any time, including the entire balance. One other penalty to watch out for though is the early withdrawal penalty – taking distributions before age 59 ½.

Congress passed Section 107 of SECURE Act 2.0 on December 29, 2022. This new law further extends the age at which RMDs must begin. The new law states that for individuals who attain age 72 after December 31, 2022, and age 73 before January 1, 2033, the applicable age is 73 for RMDs to begin.

Further, for individuals who attain age 74 after December 31, 2032, the applicable age is now 75. So, for individuals who turn 72 in 2023, RMDs will be pushed back by 1 year compared to the current age 72 rule and will begin at age 73. Age 73 will continue to be the age at which RMDs begin through 2032. Then, beginning in 2033, RMDs will be pushed back further, to age 75.

ROTH IRA CHANGES

The new SECURE Act 2.0 also includes a number of Roth-related changes for both individual Roth IRAs and Roth accounts in employer retirement plans. First, the SECURE Act 2.0 does not diminish or remove any of the benefits for Roth retirement accounts. Therefore, such retirement planning is still beneficial for individuals considering Roth retirement strategies for their personal retirement accumulation objectives. Since Roth strategies frequently involve the conversion of traditional tax deferred retirement savings accounts to Roth accounts, the likely motive to Congress for this rule change is to accelerate tax revenues to address continued Federal budget deficits.

Prior to the law change, Roth IRAs were not subject to RMDs during the owner's lifetime. But employer plan Roth accounts, were subject to the regular RMD rules, making them subject to RMDs beginning at age 72. However, such Roth distributions as and when taken are tax-free under the standard rules for Roth account withdrawals, but once withdrawn the earnings on those funds now become taxable. Beginning in 2024, Sec. 325 of SECURE Act 2.0 eliminates RMDs for Roth accounts in qualified employer plans. If the Roth owner does not need the money, it would make sense to never take money out of Roth accounts and continue the tax deferral as long as possible.

This disparity between the rules for Roth accounts in qualified employer plans with RMDs and Roth IRAs with no RMDs, encouraged rolling over plan Roth account assets into a Roth IRA for most individuals. Now, as a result of SECURE Act 2.0, plan Roth accounts and Roth IRAs will be on equal footing in terms of RMD requirements. So now the Roth rollover decision may have to be based on factors similar to those used by advisors to determine whether or not to roll over a pre-tax qualified plan into a traditional IRA.

Since the language of the new law appears to completely eliminate RMDs from plan Roth accounts beginning in 2024, those individuals with plan Roth accounts who have already been taking RMDs from those accounts should simply be able to stop taking them beginning in 2024.

IRS DELAYS 1099-K

In a prior Panorama newsletter, we announced a new IRS reporting regime intended to capture taxable services payments between individuals via electronic payment applications. The Internal Revenue Service recently announced a delay in reporting thresholds for third-party settlement organizations (TPSOs) set to take effect for the 2022 tax filing season. To be clear, it is the payment organizations, not the paying individuals, who have the IRS Form 1099-K filing requirement.

As a result of this delay, TPSO's (such as PayPal, Venmo and Zelle) will not be required to report tax year 2022 transactions on a Form 1099-K to the IRS or the payee for the lower, $600 threshold amount enacted as part of the American Rescue Plan of 2021. The TPSO is tasked with obtaining the payee's taxpayer identification number, reporting the number of payment transactions to the payee, and the dollar amount paid by month. If the payee is subject to backup withholding, then the TPSO will have to submit that withholding payment to the IRS on behalf of the payee.

As part of this reporting process, the IRS recently released guidance outlining that calendar year 2022 will be a transition period for implementation of the lowered threshold reporting for TPSOs that would otherwise have generated Form 1099-Ks for taxpayers.

The Acting IRS Commissioner explained that the IRS and Treasury heard a number of concerns (you think?) regarding the timeline of implementation of these changes under the American Rescue Plan. The IRS apparently understands that the magnitude of this new reporting deserves adequate time to ensure smooth transition for taxpayers, tax professionals and TPSOs. Accordingly, the IRS will delay implementation of the 1099-K changes. The additional time hopefully will help reduce confusion during the upcoming 2023 tax filing season and provide more time for taxpayers to prepare and understand the new reporting requirements.

The American Rescue Plan of 2021 changed the reporting threshold for TPSOs. The new reporting threshold for business transactions is $600 per year; changed from the previous reporting threshold of more than 200 transactions per year, exceeding an aggregate amount of $20,000. The law is not intended to track personal transactions such as sharing the cost of a car ride or meal, birthday or holiday gifts, or paying a family member or another for a household bill. Certain commercial payees appear to be able to provide information and become a "participating payee". Having looked at the reporting rules, I am still unclear how payments will be handled, for example, for one individual selling a personal item to another individual at a loss, or tagged as reportable or not.

Under the law, beginning January 1, 2023, a TPSO is required to report third-party network transactions paid in 2022 with any participating payee that exceed a minimum threshold of $600 in aggregate

payments, regardless of the number of transactions. TPSOs report these transactions by providing individual payee's an IRS Form 1099-K, Payment Card and Third-Party Network Transactions.

The change under the law is viewed as important to tax administration because reporting of taxable payments is higher when amounts are subject to information reporting, like the Form 1099-K. However, the IRS noted it must be managed carefully to help ensure that 1099-Ks are only issued to taxpayers who should receive them. In addition, it's important that taxpayers understand what to do as a result of this reporting, and tax preparers and software providers have the information they need to assist taxpayers.

The IRS will provide additional details as they develop along with additional information to help taxpayers and the TPSOs. For taxpayers who may have already received a 1099-K as a result of the statutory changes, the IRS is working to provide instructions and clarity so that taxpayers understand what to do.

The IRS also noted that the existing 1099-K reporting threshold of $20,000 in payments from over 200 transactions will remain in effect for tax year 2022.

THE “GOLDILOCKS” PARADOX

Over the past two decades, Congress has substantially increased the estate exemption amounts through law changes and annual inflation adjustments. At the current 2023 exemption levels of $12.92 million per person, or $25.84 million for married couples, most Americans may never be subjected to the US estate tax. But, tax laws can and do change, so you should not totally ignore this tax. The estate transfer tax has perpetually been viewed by Congress as an easy target for raising federal revenues, since those subjected to the tax are viewed as “rich” and comfortably capable of paying their fair share of taxes. Fortunately, the revenue raised from the estate tax accounts for less than 1% of total federal tax revenues, so changes to the estate tax laws are infrequent.

As recently as 2009, the estate tax exemption amount was $3.5 million per person, or $7 million for a married couple. So, a $10 million net worth couple could end up owing over $1 million in estate tax when the survivor died under 2009 rules. Given that numerous legislative bills have been introduced over the years to reduce the exemptions back down to the $3.5 million level, this would significantly increase the number of Americans potentially exposed to the tax.

An individual’s personal view of net worth is a subjective thing. Some may view $10 million of net worth as being fabulously wealthy. Others may view the same number as requiring a tightening of the belt to avoid running out of money before they die. So what estate plan is most appropriate for a family that is neither “too rich” nor “too poor” (the Goldilocks paradox)? If your wealth today is near or above the current estate exemption levels of almost $26 million for married couples, and you have at least

another 20 years of life expectancy without an extremely lavish lifestyle consuming your wealth, chances are you could be exposed to the estate tax.

If we could live in a country without an estate tax, then common sense objectives of leaving an inheritance to your children and grandchildren, either outright or protected in trusts, would be a simple and straightforward goal. But that is not our reality. Accordingly, the estate planning balancing act involves maintaining enough wealth for your immediate family's needs for your lives, but not so much wealth that it pushes your estate into the taxpaying category at death.

Traditional estate tax reduction planning addresses the obvious – use your exemptions and other lifetime wealth transfer planning strategies to minimize your future exposure to the tax. But using these strategies means you are irrevocably transferring ownership today of some portion of your net worth to your descendants or charity. Without a crystal ball, no one knows for sure how long they will live and whether gifts to children and grandchildren today could be premature and jeopardize outliving your money?

Two of the biggest hurdles to initiating a lifetime gifting program to take advantage of current exemptions are lack of control over the gifted assets and lack of access to income. But creative, and legal, strategies have evolved in the estate planning community to help address these concerns. For example, properly structured gifts to spousal lifetime access trusts (SLATs) can allow a husband and wife to each use their current law exemptions but still have indirect access to their property in both trusts. Another strategy involves establishing an irrevocable trust for descendants and then selling assets that are most likely to appreciate substantially over time to the trust. Income from the properties sold would be used by the trust to service the debt back to the seller.

Critical to all lifetime wealth transfer planning is the concept of valuing the property transferred. While the concept of valuing an asset sounds simple, it can be one of the biggest points of attack by the IRS (who are losing tax revenues due to this planning). Contested valuation issues most frequently surface around illiquid assets such as real estate or privately owned businesses. Ultra-cautious folks in the Goldilocks range of net worth may be hesitant to engage in planning that could result in an expensive fight with the IRS over the values of these assets. You could potentially lose an expensive battle in court and still owe more tax.

With today's generous estate exemptions, the estate planning community has shifted its planning focus to income tax reduction planning for their Goldilocks clients. Under current law, the cost basis of inherited assets is marked to fair market value as of date of death. The implication is that any unrealized gain from an asset purchased by the decedent is effectively erased and reset to the date of death value for the inherited asset. The maximum income tax rate today is 37%, which is fairly comparable to today's 40% for estate tax. But when you gift the asset during life, the donor's original purchase cost becomes the donee's cost basis, so property gifts received can come with substantial built in income tax liabilities when they are later sold.

On a final note, it's important to remember that the exemption is set to decrease to $5 million under current law, indexed for inflation, beginning in 2026. At that time, the estate planning community's definition of Goldilocks rich will capture many more people who will be subject to the federal estate tax.

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We seek to bring wealth planning best practices and a wide range of non-proprietary solutions to our clients. We also conduct our own research and diligence on world markets and investment alternatives.

For further information, please contact your investment representative or one of our wealth planning specialists:

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