Tax Tips & More

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Today's Presenter

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  - Mr. Pon has been in practice since 1986 and speaks regularly to tax professionals and financial advisors on the latest tax planning and preparation topics nationally.
  - Mr. Pon teaches Income Tax courses at College of San Mateo
  - Mr. Pon received his BS in Business Administration from UC Berkeley and MS in Taxation from Golden Gate University in San Francisco

Topics

- Still time to reduce client's 2022 taxes
- Portability- Estate Tax Planning
- SECURE 2.0 – What You Need to Know Now
- Expiration of TCJA

Still Time to Fund IRAs/HSAs

- October 16, 2023
  - California winter storms, flooding & mudslides
    - Except: Lassen, Modoc, & Shasta counties
  - Georgia & Alabama storm victims
    - GA: Butts, Henry, Jasper, Meriwether, Newton, Spalding & Troup counties
    - AL: Autauga & Dallas counties

Estate Tax

- Form 706 reports the value of a decedent’s estate
  - The property the deceased left to his or her heirs.
  - It shows the decedent’s assets, liabilities, and allowable deductions that combines to produce the estate’s taxable value
- Basic exclusion amount = $12,920,000 for 2023
  - Increased 2018-2025
  - Revert to pre-2018 amount in 2026

Estate Tax

- Basic exclusion increased by an deceased spousal unused exclusion amount (DSUE)
  - Permits surviving spouse an additional opportunity for sheltered gifts
- Annual exclusion = $17,000 for 2023
- Top estate tax rate = 40%
- Generation-skipping transfer (GST) tax exemption
  - $12,920,000 (2023)
- Top GST tax rate = 40%

Why Does This Matter?

- 2001 – estate exclusion = $675,000
  - 52,000 taxable estates
  - Collected $23.5 billion in taxes
- 2020 – estate exclusion = $11,580,000
  - 1,275 taxable estates
  - Collected $9.3 billion in taxes
- 2021 – estate exclusion = $11,700,000
  - 2,584 taxable estates
  - Collected $18.4 billion in taxes
  - 3,574 nontaxable returns

File 706 When First Spouse Dies

- For married couple to maximize the use of both of their exclusions at death
  - Executor of the first spouse to die must file an estate tax return
  - Check the box on the Form 706 for what is known as portability

Portability

- Take advantage of the deceased spouse's unused exemptions
- Add to their own exemption
- Protection against future tax changes
- Watch out for the timing

Portability Example

- First spouse passes away in 2022
  - His estate is $7,060,000
    - $12,060,000 - $7,060,000 = $5,000,000 for surviving spouse to add to her exemption amount
      - Her exemption = $12,060,000 + $5,000,000 = $17,060,000
  - After December 31, 2025, estate exemption drops to $5,000,000 (adjusted for inflation = $7,000,000?)
  - Surviving spouse dies in 2026 with estate of $12,000,000
      - With portability, total exemption = $7,000,000 + $5,000,000 = $12,000,000
        - Estate tax = $0
      - Without portability, exemption = $7,000,000
        - Estate tax = $2,000,000

Portability

- An executor can elect to transfer the decedent's unused exclusion (DSUE) amount to the surviving spouse by timely filing a complete Form 706
  - Return is timely if filed within nine months of death

Portability

- IRS can examine the 706 of the predeceased spouse to determine the appropriateness of the DSUE amount
  - Even though the statute of limitations for assessing estate or gift tax of the predeceased spouse has expired
  - If deceased spouse's estate includes hard-to-value assets or
  - If a valuation discount was taken
  - Increased risk in making the portability election

Rev Proc 2022-32

- Due date to file estate tax return to elect portability is nine months after the decedent's death
  - Plus six-month extension
- Rev Proc 2017-34
  - Simplified method for obtaining an extension of time to make the portability election beyond the due date
  - Available for two years after the decedent's death
    - Prior – Private Letter Ruling

Rev Proc 2022-32

- Rev Proc 2022-32 extends this relief to five years
  - IRS getting too many PLRs
- Requirements to be eligible
  - Decedent survived by a spouse
  - Decedent must be a citizen or resident of the US at the time of death
  - Not required to file Form 706 based upon value of gross estate
  - The executor must not have timely filed the estate tax return within nine months of death and extension due date
  - If it is later determined that the estate was required to file a return
    - Grant of relief will be null and void

IRS Audits of Portability

- There is no statute of limitations on the number of years the IRS can go back to audit and correct a DSUE reported by the estate of the spouse who died first.
- Important to document calculations
  - Appraisals
    - Hard-to-value assets
  - Account statements
  - Complete all sections of Form 706, Part 6

Why File for Portability?

- What will be the basic exclusion in the future?
  - Basic exclusion drops back to $5 million (adjusted for inflation) in 2026
    - $7 million?
  - Future legislation?
    - $3.5 million
- Gives surviving spouse protection in case estate exceed basic exclusion
- Malpractice protection

Advantages of DSUE Election

- 2nd basis step-up at death of surviving spouse
- Federal and state capital gains tax savings
- Spousal rollover of IRA/retirement assets
- Income subject to individual tax brackets vs. trust tax brackets
- Lower administrative expenses
- Avoid/reduce Net Investment Income Tax (NIIT)

Why Opt Out of Portability?

- A credit shelter trust can offer more creditor protection
- A credit shelter trust allows assets to appreciate freely outside of the estate
  - No step up in basis
- The "last deceased spouse" rule means that a spouse is only entitled to the exclusion of the last deceased spouse

What if client says no?

Dear Financial Professional:

Thank you for the information regarding the pros and cons of filing for Portability for my Deceased Spouse's Unused Exemption (Portability).

However, I do not want to file for Portability.

I will not hold you responsible for any estate tax due upon my death due to not taking advantage of Portability and none of my beneficiaries or any others can sue you.

Sincerely,

Cheap Widow

Last Deceased Spouse

- Most recently deceased person who was married to the surviving spouse at the time of that person's death
- Identity as of day of taxable gift or date of the surviving spouse's death
- Re-marriage does not alter the designation of last deceased spouse
  - Surviving spouse can apply DSUE amount to future lifetime gifts
  - However, death of the new spouse will reset the DSUE amount
    - Now be the most recent deceased spouse
- DSUE is always applied before the surviving spouse's basic exclusion amount

Portability Example

- Sam dies in 2011 with taxable estate of $2 million
  - His widow, Joanne, may add Sam's remaining $3 million ($5 million exclusion – $2 million) exemption to her exemption.
    - The $3 million DSUE will not be indexed for inflation
  - If Joanne remarries and the second husband predeceases her
    - Then Joanne cannot use Sam's unused exemption

SECURE 2.0

- On December 29, 2022, Congress passed the SECURE 2.0 (Act) adding over 90 new retirement plan provisions
- Intent of the Act is to expand retirement savings by mandating auto-enrollment for new plans
- Boost tax savings for small employers
- Providing more flexibility to those saving for retirement

529 Rollover to Roth IRA

- 529 plan must be open for at least 15 years
  - What happens if the 529 beneficiary is changed?
  - New 15 year period?
- $35,000 lifetime limit
  - Per 529 owner?
  - Per beneficiary?
    - Lucrative for a 529 owner with multiple beneficiaries
- Begins in 2024

529 Rollover to Roth IRA

- Roth IRA must be in the name of the beneficiary of the 529 plan
- Any contributions within the last 5 years (and earnings on those contributions) are ineligible to be moved to the Roth IRA
- Annual limit = IRA contribution limit for the year
  - Less any other IRA contributions
- Trustee to trustee
  - Plan to plan rollover

Sally’s 529 Plan

- Remaining balance in 529 Plan = $40,000
- 2024 Roth IRA contribution limit = $6,500
- Sally transfers trustee to trustee $6,500 from 529 Plan to her Roth IRA
  - No AGI limit
  - Earned income at least $6,500
  - Cannot make additional Roth IRA contributions that year
- Continue until $35,000 life time limit
  - Five years?

529 Rollover to Roth IRA

- Not subject to income limitations
- Tax planning consideration
  - Open 529 when child is born
    - Super 529
  - At age 16
    - Start moving funds to Roth IRA
    - Child will need earned income up to amount of IRA contribution limit
      - Summer job, part time job
    - Keep doing this until $35,000 lifetime transfer limit is reached

529 Rollover to Roth IRA

- 529 Plans
  - No federal deduction for contributions
  - Withdrawals are tax-free used to pay eligible education expenses
    - Tuition
    - Fees
    - Books
    - Supplies
    - Equipment
      - Computer, software and internet access
        - Not gaming computer
        - No software for games

529 Rollover to Roth IRA

- Eligible expenses
  - Room and board if student is enrolled at least half time
    - Students living and eating off campus can use 529 funds for rent and grocery bills
      - Up to limits that are often similar to the school’s charges for room and board
  - Typically cannot be used for transportation
    - Special-needs students can use them for a broad array of expenses that include transportation
  - Up to $10,000 can be used to pay student-loan debt for beneficiary
    - Also siblings and stepsiblings

529 Rollover to Roth IRA

- Eligible expenses
  - Graduate as well as undergraduate expenses
- Taxable withdrawals
  - If 529 distribution larger than total eligible expenses
    - Tax plus 10% penalty is due on the earnings
    - Earnings reported on Form 1099-Q

529 Rollover to Roth IRA

- Transfers
  - 529 owners can switch the beneficiary on an account without tax consequences if it is to a family member
    - Broadly defined
      - Spouses
      - First cousins
      - Descendants
      - Siblings
  - 529 owners can leave accounts to others at death
    - Account can exist in perpetuity
      - Unlike IRAs and HSAs
    - No RMDs
- See Publication 970 - Tax Benefits for Education

2022 Effective Changes

- If age 72 in 2022
  - Must begin Required Minimum Distributions (RMD)
- Age 73 age for RMD takes into effect in 2023

2023 Effective Major Changes

- RMD beginning age changed to age 73
  - If already drawing RMD under previous rules
    - Continue drawing in 2023
- Reduction in penalty for failure to take RMD
  - Was 50%
  - Beginning 1/1/2023, dropped to 25%
  - Could be 10%
  - Statute of limitations changed from unlimited to 3 years for failing to take an RMD

RMDs

- IRS Updates RMD FAQs (March 14, 2023)
- https://www.irs.gov/retirement-plans/retirement-plan-and-ira-required-minimum-distributions-faqs
- Designated Roth accounts in 401(k) & 403(b) plans are subject to RMDs for 2022 & 2023
  - Starting 2024
    - RMDs no longer required

RMDs

- 90% of individuals took distributions to satisfy their RMD
  - Deliberate non-compliance and inattention being part of the 10% gap
- IRS Form 5329 – Additional Taxes on Qualified Plans
  - Waive penalty with Reasonable Cause

Statute of Limitations

- SOL for missed RMDs and most excess contributions
  - Old law – Tax Court ruled in 2011 that for purposes of assessing IRA penalties
    - SOL does not begin until Form 5329 is filed
      - Indefinite SOL
  - SECURE 2.0 starts SOL clock on the filing of Form 1040
  - Penalty for RMD shortfall SOL is now 3 years
  - Penalty for excess contributions is 6 years

IRA Prohibited Transactions

- Beginning in 2023, when a prohibited transaction occurs within an IRA account, only that account is deemed distributed
  - Previously was deemed a full distributions from the IRA and a loss of its tax-favored status

How to Reduce Tax on RMDs

- Wait until RBD?
  - Take distributions before RBD
    - Build up nonqualified account
    - Capital gains tax rates
  - Roth conversions before RBD
    - Medicare IRMAA
      - Medicare Part B and Part D premiums
      - 2 year look back
- Delay taking RMD
  - Still working exception
    - <5% owner of the business sponsoring the plan

How to Reduce Tax on RMDs

- Qualified Charitable Distribution (QCD)
  - After turn age 70 ½ to satisfy charitable contributions
  - Fulfills RMD
    - Income excluded from AGI
    - Social security, Medicare IRMAA, medical deductions, etc.
  - Beginning in 2024, the QCD will be adjusted for inflation
    - Current limit = $100,000
  - One-time opportunity to use QCD to fund a split-interest entity
    - Beginning in 2023, one-time rollover to ~~CRUT, CRAT~~, or CGA
    - $50,000 – adjusted for inflation
    - Do not suggest CRUT or CRAT
    - Payments being <1 year after funding
    - Pays at least 5%

Start Tapping IRAs Early

- Mantra of retirement planning
  - Pull funds from taxable accounts first
    - Followed by tax-deferred accounts
    - Finally tax-free accounts
- Blending withdrawals can be more effective
- Pull funds in early 60s, not wait for RMD
  - Proportional approach

Start Tapping IRAs Early

- Journal of Financial Planning compared 15 methods of withdrawing funds from a $2 million portfolio with a 70-20-10 mix
  - Tax-deferred, taxable, and tax free assets
  - Over 30 retirement combinations
    - Couple would pay about $225,000 less in taxes by tapping the tax-deferred account first
      - Up to the level of one's taxable deductions
        - Then tapping a taxable account
          - Compared with withdrawing funds in the traditional manner

Roth Conversions

- Approaching or early in retirement, before RMDs begin
  - Shifting funds from tax-deferred accounts to tax-free accounts
- SECURE Act
  - Beneficiaries have 10 years to distribute the accounts
    - They may be in their own high-earning years
- Lost opportunity cost
  - Pay taxes upfront

Roth Conversions

- Couple has IRA valued at $100,000
  - Decide not to convert to Roth
    - Do not want to pay taxes upfront
  - IRA doubles to $200,000
    - 30% tax rate
    - Net = $140,000 ($200,000 - $60,000)
  - If convert to Roth
    - Tax upfront = $30,000
    - $70,000 left in Roth IRA
    - Doubles in value = $140,000
  - Same amount assuming same tax rates and investment rates
    - If tax rates increase, Roth has advantage

Life Insurance

- Proceeds from life insurance is tax free
- Use withdrawals from IRA to purchase permanent life insurance
  - Whole life or Universal life policy
    - $20,000+ to buy $1 million or more of life insurance?
  - Earlier you buy, the larger the death benefit for the same premium
- Assets inside life insurance policy grow tax-free
- Insurance can be left to a trust
- No RMDs

2023 Effective Major Changes

- New exception to the 10% early withdrawal penalty
  - In the event of a terminal illness
    - Result in death in 24 months or less
  - Earnings on excess contributions
- Roth accounts for SIMPLE and SEP retirement accounts

2024 Effective Changes

- Catch up contributions indexed for inflation
- 2 new 10% early withdrawal penalty exceptions
  - Emergency expenses
  - Domestic abuse
- SIMPLE plan limits increased in 2024
- 529 plan balances may be rolled into Roth IRAs

Victims of Domestic Abuse

- Withdraw up to the lesser of $10,000 (indexed for inflation) or 50% of their vested balance without incurring a 10% penalty
  - Distribution made from a defined contribution plan within the 1-year period after an individual has become a victim of such abuse
  - All or a portion of the distribution may be repaid in 3 years
  - Self certification that they qualify

Emergency Withdrawal Exception

- Taxpayer who experiences “unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses”
  - Limit individuals to no more than one such distribution per calendar year and to cap such distributions to a maximum of $1,000
  - Cannot take subsequent Emergency withdrawals until the earlier of the following
    - Prior distributions have been fully repaid
    - Regular deferrals and contributions total at least as much of the distribution
    - 3 years have passed since the previous Emergency withdrawal

2024 Effective Changes

- Student loan payments as elective deferrals and matching contributions
- High wage earners required to use Roth option for catch-up contributions
  - Only applies to those who have wages in excess of $145,000 (adjusted for inflation) DELAYED!
  - Not self-employed individuals

2025 Effective Changes

- Catch-up limit increased for older individuals
  - Greater of $10,000 or 50% more than the regular catch-up amount
  - For individuals aged 60 to 63

SECURE

- SECURE Act Regulations
  - Final still waiting to be issued
    - 10-year payment rule
      - Certain IRA beneficiaries have to take annual RMDs in years 1-9
        - Applies to beneficiaries who inherited from someone subject to RMDs
  - IRS Notice 2022-53
    - Waived excise tax from missed RMDs in 2021 and 2022
    - RMDs resume in 2023

Notice 2023-54

- IRS, for the second time, changed the applicability date of final RMD regulations
  - Will not apply until the 2024 distribution calendar year
- Notice 2022-53 – final RMD regulations will not apply until 2023 distribution year
  - No RMD penalty for amounts not paid in 2021 or 2022 for inherited IRAs and defined contribution plans
- No RMD in 2023 from accounts inherited in 2020 or later

Notice 2023-54

- Rollover relief
  - Extension of the 60-day rollover period to September 29, 2023 for any distribution made from a plan or IRA in the first half of 2023 that would have been an RMD and permits certain rollovers to IRAs
    - If started RMD at age 72
      - Erroneous RMD notices from financial institutions

NFTs and IRAs

- IRS Notice 2023-27 (March 21, 2023)
  - Nonfungible tokens (NFTs) in an IRA may be classified as “collectible”
    - NFT would be considered a prohibited IRA investment
      - Deemed distribution based on the cost of the NFT
        - Cost would be taxable
        - Subject to 10% early distribution tax if under age 59 ½
          - If in a Roth IRA
            - No tax or penalty if the distribution is “qualified”

NFTs and IRAs

- IRS Notice 2023-27 (March 21, 2023)
  - Not all NFTs will be considered a collectible
    - NFTs that link (or look through) to ownership or rights to a collectible such as
      - Work of art
      - Antiques
      - Gems
      - Certain coins, or
      - Other common collectibles
  - Avoid investing in NFTs
    - If NFTs decline in value in the IRS
      - Taxed on original cost
        - Even though substantial value may be lost

Expiration of TCJA (2026)

- State & local tax deduction
  - Current limit = $10,000
  - Push 2025 payment to 2026
- 2% Miscellaneous Itemized Deductions
  - Tax preparation fees
  - Unreimbursed employee business expenses
  - Home office for employees
  - Union dues
  - Uniforms
  - Investment advisor fees/asset management fees
  - Attorney fees

Expiration of TCJA (2026)

- Standard deduction
  - Reduced to ½ of current amounts
    - Single/MFS= $13,850
    - MFJ/QSS = $27,700
    - HOH = $20,800
  - Plan for itemized deductions
- Return of the 39.6% tax bracket
  - Current top rate = 37%

Future Sessions
Tax Talk With Larry
www.onefpa.org

- All at 1:00 PT, 4:00 ET
  - October 13, 2023 – Special guest
    - Gordon Stein – Cashflow Cookbook
  - December 22, 2023
  - January 19, 2024
  - February 16, 2024
  - March 15, 2024

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