2023 Tax Update

IRA Owners Get More Tax Relief and Other “Fixes”

If your head is spinning from all the changes to IRA rules in the last few years, you’re not alone. On December 20, 2019, Congress passed a sweeping retirement reform bill known as the SECURE Act, which changed the rules for retirement accounts in several important ways, including:

1. Modifying the withdrawal rules for post-2019 *inherited* IRAs; and
2. Delaying the age at which *Required Minimum Distributions (RMDs)* must be taken from retirement accounts from age 70½ to 72, as of 2020, and then to age 73 effective in 2023, and age 75 in 2033.

A few months later, in March 2020, Congress passed the CARES Act in response to the COVID-19 pandemic, which allowed certain special tax exceptions for tax year 2020, including the suspension of all RMDs for 2020 and extending the time for rollovers of funds withdrawn from IRAs in that year. On top of that, the IRS proposed new SECURE Act regulations in 2022 and, in 2023, Congress passed a second iteration of retirement reforms called “SECURE 2.0.”

The flurry of changes is why your head might be spinning, but we’ll unpack some of the key changes and the impacts to you and your retirement savings.

Inherited IRAs: RMDs and the 10-Year Rule

The SECURE Act introduced what is called the “10-year rule” for inherited IRAs. This rule states that unless an IRA was inherited by a spouse or another qualifying beneficiary, an inherited IRA must be fully drawn down by the end of the 10th year following the owner’s death.[1] When the rule was first enacted, it seemed plain and simple—10 years. However, two years later, in February 2022, the IRS issued proposed regulations that would require RMDs to be withdrawn from an inherited IRA if the deceased owner died on or after their Required Beginning Date—which is April 1 following the year in which the owner attained age 72 (now age 73 as of Jan. 1, 2023).

The new regulation immediately spread confusion because it was widely thought the new statutory rule was a simple 10 years. To address the hardship caused by the confusion, the IRS announced in 2022 that the 50% penalty for not taking an RMD on time would be waived for 2021 and 2022 for affected IRAs (i.e., where the owner died after Dec. 31, 2019).[2] On July 14, 2023, the IRS issued a second notice extending this relief to tax year 2023 as well.[3]

SECURE 2.0 – Age for RMDs Goes from 72 to 73 and IRS Allows Rollover of Early Withdrawals in 2023 for Anyone Born in 1951

In 2023, a second issue with RMDs resulted from the enactment of SECURE 2.0. As mentioned, effective in 2023, the SECURE 2.0 Act increased the age at which RMDs must be taken from 72 to 73. So now, as of January 1, 2023, anyone born in 1951, i.e., anyone who turns 72 in 2023, would not be required to take an RMD in 2023. However, this news did not reach everyone in time and many people who thought they needed to take their first

[1] Under the SECURE Act, if a retirement account owner dies after Dec. 31, 2019, the designated beneficiary must withdraw all assets from the account within 10 years instead of taking RMDs over the beneficiary’s lifetime as permitted under prior law. This change eliminated the so-called “stretch IRA”. Exceptions to the 10-year rule apply for spouses, minor children, disabled and chronically ill persons, and for beneficiaries not more than 10 years younger than the owner. These categories of beneficiaries are not subject to the 10-year rule.
[2] The waiver does not apply if the decedent died before January 1, 2020. Note that RMDs were suspended entirely for 2020 by the CARES Act.
[3] IRS Notice 2023-54.

RMD in 2023 actually didn't because the new age was just increased to 73. But, what if they did already take an RMD? Can they put the funds back in the IRA? The answer is "yes."

In an effort to minimize the hardship associated with mistakenly taking a withdrawal from an IRA earlier than necessary, the IRS announced on July 14, 2023, that anyone born in 1951 who took what they thought was an RMD before July 31, 2023, may roll that amount back into their IRA by September 30, 2023. In doing so, they may avoid the tax on the withdrawal. Note: if income taxes were withheld on the distribution, the withheld amount would also have to be rolled over to the IRA in order to complete the rollover of the full amount withdrawn. To do that, you must use other funds since the taxes withheld won't be available to the IRA owner until after filing a 2023 income tax return in 2024.

Penalty Relief

Failing to take an RMD when required is a tax code violation and triggers a hefty tax penalty. Until 2023, the penalty was 50% of the missed RMD. However, a waiver of the penalty was possible if you requested it and had a reasonable explanation. (See IRS Form 5329.) Starting in 2023, SECURE 2.0 reduced the penalty to 25% and, if you correct the missed RMD within two years, the penalty rate is reduced to only 10% of the unpaid RMD amount.

It is unclear how lenient the IRS will be with waiving the penalties on RMD violations in the future. However, since there is widespread confusion as a result of multiple changes in the law, it may be worth seeking a waiver if you find yourself in this situation, especially if you have corrected the violations. As always, we recommend that you consult with your attorney and tax advisor about any tax questions you may have.

What's next? More "Fixes"

SECURE 2.0 is a massive piece of legislation with over 357 pages of legalese, and it covers a wide range of retirement account issues. It is no surprise that there are a few drafting errors among the pages. One example relates to catch-up contributions to an employer-sponsored plan, such as a 401(k) or 403(b). SECURE 2.0 meant to limit how catch-up contributions could be made by higher earners (i.e., those making $145,000 or more a year) by requiring that, starting in 2024, catch-up contributions must go into a Roth instead of a traditional 401(k) or 403(b) plan. However, as drafted, the legislation doesn't allow anyone to make catch-up contributions starting in 2024, which is contrary to congressional intent. There are also major practical issues with implementing this change for many large employee retirement plans. The big question is whether Congress can get its act together and pass a technical corrections bill, which has traditionally been its course of action in similar situations.[4] Another question is whether the IRS can fix this (at least temporarily) on its own. Both remain to be seen.

Other "fixes" to the retirement rules have been floated along the way, such as ending "back-door" Roth contributions, limiting what kind of investment can be held in a retirement account, and forcing RMDs out of "very large" IRAs. These types of changes are not on the table at the moment, but could come in the future. We will continue to monitor the situation and keep you updated of any new developments. As always, your team at 1919 is ready and available to answer any specific questions.

[4] See Article by Anne Tergesen, "High-Earning Retirement Savers Are Losing Some of Their 401(k) Tax Break," in The Wall Street Journal (July 16, 2023). Link: https://www.wsj.com/articles/retirement-tax-breaks-401k-contributions-2868ffdc

WARWICK M. CARTER, JR
Principal, Senior Wealth Advisor

Warwick M. Carter, Jr. is a Principal at 1919 Investment Counsel based in New York. As a Senior Wealth Advisor, his primary focus is generational wealth planning for high net worth individuals and families. He also advises on philanthropic planning. When giving advice, Warwick takes a comprehensive approach to assessing all aspects of a client's tax, financial and family situation. Warwick works closely with Portfolio Managers and Client Advisors in all of our offices to integrate wealth strategies with a client's investments. He regularly meets with outside advisors to devise appropriate solutions that will help grow wealth in a tax-aware way over the long term.

Warwick is a graduate of Denison University and the Columbus School of Law at The Catholic University of America. He also holds a master's in taxation from Georgetown University. He is admitted to the bar in New York and the District of Columbia. Warwick is also a member of the New York State Bar Association and the Society of Trust and Estate Practitioners (STEP).

Email address: wcarter@1919ic.com

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