Federal Tax Changes 2023 and 2024: What You Should Know

As we usher in the new year, it is time to review legislative changes that influence the documentation individuals must compile for their income tax returns. While no significant shifts in federal tax policy were passed in 2023, changes enacted in prior years will impact 2023 and 2024 tax returns.

Energy Efficiency Credits for Residential Properties

In August 2022, the *Inflation Reduction Act* dramatically changed the home improvements for which individuals may receive tax credits, renamed it the *Residential Clean Energy Credit*, and extended the credit through 2034.

This non-refundable credit worth up to 30% of the cost of eligible property (which now includes qualified battery storage technology) can be carried forward indefinitely and used for any residential home – primary or secondary - in the US (either existing or being constructed). Since there is no requirement that the taxpayer own the property, a tenant who installs qualified energy efficient equipment such as solar electric, solar hot water, geothermal heat pumps, or small wind energy may qualify.

Another credit, the *Energy Efficient Home Improvement Credit*, can be used exclusively for the taxpayer's residence. Qualified improvements include exterior doors; exterior windows (including skylights); insulation materials or systems; natural gas, propane, or oil water heaters; electric or gas heat pump water heaters; electric or natural gas heat pumps; natural gas, propane, or oil furnaces or hot water boilers; central air conditioners; and more. This credit can also be applied toward home energy audits. The lifetime limit of $500 for this credit was eliminated. While there are limits on each of these categories (i.e. $600 credit for exterior windows and $250 per exterior door), the annual limit for building "envelope" improvements is $1200 with a separate $2000 annual limit for water heaters, heat pumps, and boilers.

Clean Energy Vehicle Credits

The *Inflation Reduction Act* increased the number and types of vehicles that qualify for an energy credit. Previously, the credit could only be claimed for the first 200,000 electric vehicles sold by a manufacturer. The new legislation eliminates the manufacturer production limit on the number of cars and instead places limits on the vehicle itself: manufacturer's suggested retail price (MSRP), battery (must be at least 7 kW and externally charged), and country of origin for materials and manufacturing of electric vehicle and its components. This non-refundable credit for new electric vehicles has two $3750 components – one for the battery and another for "critical materials" – with no carryforward allowed. The list of qualified vehicles is available at https://www.fueleconomy.gov.

New for tax years beginning with 2023 is a non-refundable credit for the purchase of a preowned clean energy vehicles. The tax credit is the lesser of $4000 or 30% of the vehicle cost and the sales price must be $25,000 or less (Including taxes and fees, but before trade-in allowances, etc.). The vehicle must be 1) at least two model years earlier than the calendar year (2021 or earlier models qualify for 2023 credit) and 2) plug-in hybrid, all-electric, or hydrogen fuel cell vehicle, and 3) purchased from an authorized dealer.

Both the pre-owned vehicle credit and the new *Clean Energy Vehicle Credit* may be transferred to the dealer for sales taking place in 2024, but the taxpayer is required to file Form 8936 to reconcile the credit and may have to repay a portion if their Modified Adjusted Gross Income (MAGI) exceeds the threshold. However, taxpayers may choose to use either their current year income or the year immediately preceding the year of purchase for the application of the MAGI limitations.

IRAs, Inherited IRAs, RMDs and RMD Penalties

The *SECURE 2.0 Act* passed in December of 2022 was a follow-up bill to the *SECURE Act* enacted on Jan 1, 2020. SECURE stands for “Setting Every Community Up for Retirement Enhancement” and both acts made significant changes to retirement plans such as IRAs, 401ks, etc. Most of these retirement plans are tax deferred, not tax exempt. Many of the new regulations change <u>when withdrawals need to be made</u> (and therefore taxes are paid).

Prior to 2020, the Required Beginning Date (RBD), or the date at which individuals are required to take distributions from their retirement accounts, was April 1 of the year after they turned 70.5. If a taxpayer born June 10, 1948, turned 70.5 on Dec 10, 2018, they were required to take their first Required Minimum Distribution (RMD) by April 15, 2019.

The *CARES Act of 2020* allowed individuals to not take their RMDs in 2020. This included taxpayers who turned 70.5 in 2019 if they did not take a distribution in 2019. Subsequently *SECURE* 1.0, changed the RBD to age 72 for those born after July 1, 1949. Then SECURE 2.0 extended the RBD to 73 for those turning 72 after Dec 31, 2022; and to 75 for those turning 74 after Dec 31, 2032.

Prior to 2020, beneficiaries of retirement accounts generally had to take RMDs over their lifetime, even if they were the beneficiary of an inherited IRA and had not reached retirement age. If the lifetime of the beneficiary could not be determined (i.e. the named beneficiary of the account was the decedent’s estate instead of an individual), the account had to be distributed within 5 years after the year in which the original owner died.

The *SECURE Act of 2019* created two types of designated beneficiaries of inherited IRAs. Eligible Designated Beneficiaries (EDB) (which would be surviving spouse, disabled child, minor child, etc.) can still choose to have distributions based on their lifetime (also called a “stretch IRA”). However, if the beneficiary is not an EDB, then the entire account balance must be distributed within 10 years. If a beneficiary is not named, the old rules still apply, and the IRA must be distributed to the estate within 5 years. The beneficiary distribution requirements apply to both IRAs and ROTH IRAs.

Shortly after the *SECURE Act of 2019* took effect, many taxpayers (and tax professionals) believed that if the IRA funds were exhausted within 10 years, no other distributions were required. In 2022, the IRS released guidance: If the original IRA owner already started taking RMDs, the required minimum distributions based on the original owner's age must continue to be taken. However, the beneficiaries will not be subject to penalties for missed RMDs in 2020 through 2023 on inherited IRAs but may incur penalties for missed RMDs in 2024.

The changes to the RMDs are not retroactive. If a taxpayer inherited an IRA prior to 2020, their RMD is based on their lifetime (i.e. it is a "stretch IRA"). But future successors to that inherited IRA will be using the 10-year distribution rules if they are a non-eligible designated beneficiary.

Prior to *SECURE 2.0*, the penalty or excise tax for not having taken an RMD was 50% of the amount that was supposed to have been withdrawn. That meant that if the RMD was $50,000, there was a $25,000 penalty for not taking the withdrawal. The only way to avoid the excise tax was to take corrective action (i.e. take out the RMD, even if it is late) and file Form 5329 to request penalty abatement. The 2022 legislation lowered the excise tax to 25% of the RMD amount not withdrawn, which is reduced to 10% if the oversight is corrected in a timely manner.

Since IRAs are intended to be used for retirement, there is generally a 10% additional tax if an individual withdraws money from their traditional IRA before they reach the age of 59.5. However, there are certain exceptions, such as using the funds for a first-time home purchase, higher education costs, or health insurance if you are unemployed. *SECURE 2.0* added several new exceptions, including: if the taxpayer lived in a federally declared disaster area, experienced domestic violence, are qualified public employees, had unforeseeable emergency expenses, or are certified to have a terminal illness. Each exception may have a different effective date, varying details (i.e. regarding certification, timing, repayment, and distribution limits), and be applicable only to specific types of retirement accounts (i.e. to IRAs but not 401ks).

Note: RMDs are not required for ROTH IRA accounts during the original owner's lifetime. Until 2024, RMDs were required to be taken from ROTH 401k accounts, even though the distributions are not taxable. *SECURE Act 2.0* modified the RMD requirements for ROTH 401k accounts to be consistent with ROTH IRA accounts. However, beneficiaries are required to take distributions from inherited retirement accounts – whether they are ROTH or traditional.

529 Plans and Planning for Retirement

SECURE 2.0 changed not only the rules regarding withdrawals and penalties, but also contributions and the establishment of retirement accounts.

Many of the new contribution provisions apply only to employer-sponsored plans but may apply to SEPs (Simplified Employee Plans) for self-employed individuals or other small business owners. The legislation includes improved coverage for part-time employees and spouses of active military as well as incentives and credits for small businesses to establish retirement plans. Employers may now make "matching" contributions to a 401k plan for employees who are making student loan payments. There are also new provisions enabling employers to make ROTH contributions to employee retirement plans (not only traditional pre-tax contributions), including to SEP and SIMPLE accounts. Employers can also create emergency savings plans tied to defined retirement contribution plans. This last provision allows employers to encourage their non-highly compensated employees to save for retirement AND set aside funds for emergencies.

Congress also is allowing 529 accounts to be dual purpose – saving for college and for retirement. Beginning in 2024, taxpayers can rollover 529 funds into a ROTH IRA, provided certain conditions are met, including: the 529 account must have been open at least 15 years, the distributions (including earnings) cannot exceed the most recent 5 years of contributions, the taxpayer must have taxable income equal to or more than the rollover amount, the rollover must be a trustee-to-trustee transfer and counts toward the taxpayer's annual ROTH Contribution (currently limit is $6500), and the lifetime rollover limit is $35,000. This new dual purpose encourages families to continue contributing to 529 accounts even if they are uncertain whether the beneficiary will be attending college or will have all their educational expenses covered by scholarships and grants.

1099-Ks

Statistics show that taxpayers are more likely to report their income when they receive a tax information reporting document such as a 1099, 1098 or W2. The *American Rescue Plan of 2021* lowered the reporting threshold for 1099-Ks from $20,000 to just $600, with no minimum number of transactions. The new, lower reporting requirements were originally scheduled to be implemented for 2022, and then for 2023. However, as of Dec 31, 2023, the IRS announced that for 2023, the reporting requirements will remain at $20,000 and 200 transactions, and that 2024 will be a transition year with a threshold of $5000.

1099-Ks are required to be issued by third party payment processors, such as credit card processing companies as well as payment apps (Paypal, Venmo, CashApp, etc.) and online marketplaces (Etsy, Poshmark, etc.). (Note: Zelle does not consider themselves to be a third-party processor and does not issue 1099-Ks.) These information reporting documents are only required to be issued if goods were sold or services were provided. Therefore, many of these processors have an option to check whether goods or services were provided.

The receipt of a 1099-K does not change the taxability of the income. If an individual sold an item as part of their business, it should be reported as self-employment income. If a taxpayer sold some artwork they make as a hobby, then it would be reported as hobby income. If an extra pair of tickets to an event were sold, then how the income is reported will depend on whether there was a gain or loss on the sale. These types of income should be reported on the individual's tax return, whether the income was reported to the IRS on a 1099-K or not – but need to be reported if the tax document was issued, even if no tax is due.

Since the IRS computer systems are becoming more efficient at flagging taxpayers with income documents that are not reported on the tax return, it is important that taxpayers go online to identify whether a 1099-K (or other information reporting document such as 1099-INT or 1099-NEC) was issued and provide that information to their tax preparer.

Corporate Transparency Act

While not tax legislation, the *Corporate Transparency Act* will likely impact many taxpayers – including self-employed individuals and rental property owners.

On January 1, 2021, the *Corporate Transparency Act* (CTA) was signed as part of the *Anti-Money Laundering Act of 2020*. This legislation is a follow-up to the *Bank Secrecy Act of 1974* which required banks and other financial institutions to identify and verify beneficial owners. The purpose of the CTA is to help law enforcement detect, prevent, and punish terrorism, money laundering and other misconduct by requiring business entities to report their beneficial owners directly to the federal government. It is also meant to bring the U.S. into compliance with international anti-money laundering standards.

Starting January 1, 2024, "reporting companies" may register directly with FinCEN (Financial Crimes Enforcement Network), which is a division of the U.S. Treasury. "Reporting companies" must submit a Beneficial Ownership (BOI) Report which includes the full legal name, current residential address, date of birth, and a unique identification number (i.e. driver's license or passport number) for each beneficial owner of the company.

Most small businesses formed at the state level, including LLCs and S-Corporations, must file a BOI report. Exempt from filing are large operating entities, defined as companies that 1) employ more than 20 full time employees 2) have a physical office in the U.S., and 3) file a federal income tax return reporting more than $5 million in gross receipts or sales. There are also exemptions for publicly traded companies, banks and domestic credit unions, securities broker-dealers, insurance companies, tax-exempt entities, and inactive businesses. Therefore, most individuals or partnerships that created an LLC for their self-employment income or rental property will need to file.

The civil penalty for not filing the required information with FinCEN is up to $500 per day, and criminal penalties of up to $10,000 and up to 2 years imprisonment can be applied.

Business entities that were in existence on Dec 31, 2023, have until Jan 1, 2025, to file their initial BOI report. Entities that are created in 2024 have 90 days to file their initial BOI report, and newly created entities in 2025 or later will have 30 days to register. If previously reported beneficial ownership information has changed, the entity will have 30 days to update the information with FinCEN.

Looking forward

While no significant tax legislation was passed in 2023, the federal budget for the 2023-2024 fiscal year still has not been approved. Congress often includes tax policy changes in the various appropriations bills, and sometimes include retroactive provisions. Some of the proposals which may be retroactive include expensing research and development costs, higher bonus depreciation, increasing the state and local tax caps for itemized deductions, and an expanded child tax credit. None of these will likely alter which documents taxpayers need to provide to their preparer but may significantly impact the tax return. So, don't be surprised if this tax season tax professionals are encouraging their clients to delay filing to take advantage of the latest changes.

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