# 2023 NATIONAL INCOME TAX WORKBOOK

CHAPTER 5: RETIREMENT TAX ISSUES

PART 2

Land Grant University Tax Education Foundation

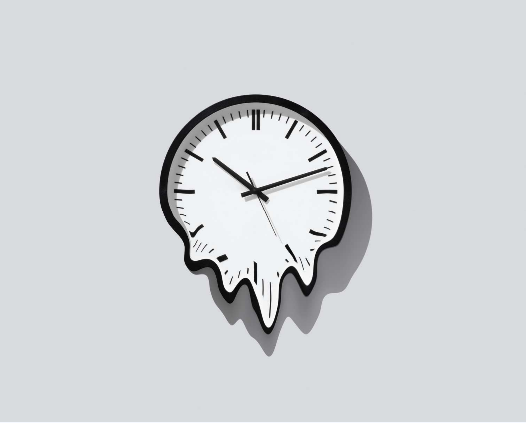
## ISSUE 2: EARLY DISTRIBUTIONS FROM QUALIFIED PLAN P. 177

Generally, 59 ½ years is age to avoid 10% additional tax assessment

Sec. 72(t)(2) lists exceptions

SECURE 2.0 adds

- Terminally ill person,
- Victims of domestic violence
- And $1,000 for emergency expenses



Difference between employer-sponsored plans and IRA are covered in Figure 5.3    This section covers the calculation as well.

# ISSUE 2: EARLY DISTRIBUTIONS FROM QUALIFIED PLAN P. 177

**Early Distribution Exceptions (cont.)** No additional tax

**Substantially Equal Periodic Payments** [Editor: retirement]

Payments over life expectancy or with designated beneficiary's joint lives.

At least, yearly a distribution must be made. An IRS-approved method must be used.

The payment cannot be made from the trust for employer's stock bonus program, pension or profit-sharing plan unless the payments are made after the employee has separated from service. Certain annuities are also going to be subject to the 10% additional tax

# ISSUE 2: EARLY DISTRIBUTIONS FROM QUALIFIED PLAN

## FIGURE 5.3 EXCEPTIONS TO 10% ADDITIONAL TAX ON EARLY DISTRIBUTION

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| Exception | IRA, SEP, SIMPLE | Other Qualified Plans |
|---|---|---|
| Beneficiary | X | X |
| Disability | X | X |
| Substantially equal payments | X | X |
| Separation from service | | X |
| Employer securities (ESOP) | | X |
| IRS levy | X | X |
| Unreimbursed medical expenses | X | |
| QDRO | | X |
| Medical insurance for unemployed | X | |
| Higher-education expenses | X | |
| First-time homebuyer | X | |

# ISSUE 2: EARLY DISTRIBUTIONS FROM QUALIFIED PLAN P. 180

**Early Distribution Exceptions (cont.) Table of Exceptions Figure 5.3**

| | | |
|---|---|---|
| Qualified reservist | X | X |
| Birth or adoption | X | X |
| Emergency expenses | X | X |
| Domestic abuse | X | X |
| Terminally ill | X | X |

Both IRA and Qualified Plans can have these provisions (Editor: Be aware that the qualified plans can have individual requirements and qualifying early distributions. Check with administrator if questions arise.) Example 5.7 on next page.

# ISSUE 2: EARLY DISTRIBUTIONS **EXCEPTIONS (CONT.)** P. 181

Practitioner Note **Long Term Care Contracts**

After 12/31/2024, SECURE 2.0 allows $2,500 per year for premiums for certain specified long-term care insurance. It will not be subject to the additional 10% tax.

**Disaster Relief**

Secure 2.0 makes permanent the rules on use of retirement funds for any federally declared disaster to a maximum of $22,000. The amount can be included as gross income over 3 years.

Repayment of this withdrawal can be made. Rules for prior purchase of a home and additional loans and repayment period can also be impacted.

# ISSUE 3: HARDSHIP DISTRIBUTION

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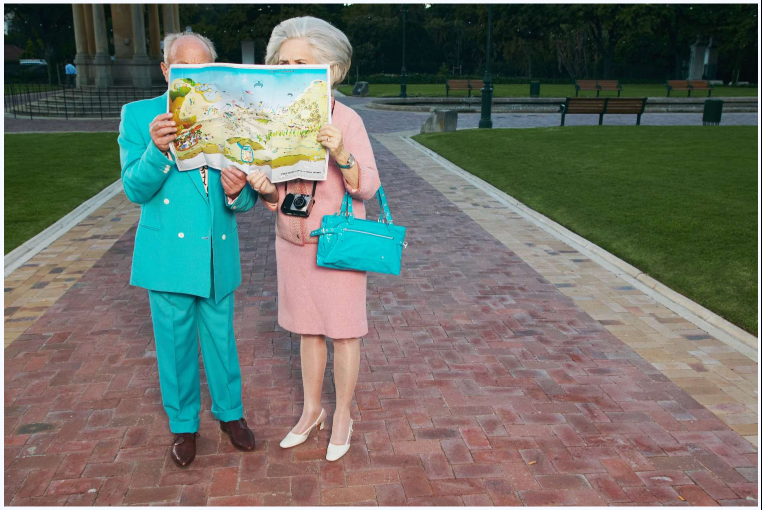
Generally, emergency withdrawals are permitted, but subject to tax and additional tax of 10% if before 591/2.

If the withdrawal exceeds the loan amount, it will be taxable. The 401(k) and 403(b) plans do not have to have hardship provisions. (They are written into the plan.)



Governmental plans under Sec. 457 can allow withdrawals for specified emergencies.

## ISSUE 3: HARDSHIP DISTRIBUTION -10% PENALTY P.182

**Taxation of Hardship Distributions**
If the withdrawal is an early distribution, 10% additional tax will apply unless one of the exceptions applies.

Sec. 457 emergencies are subject to tax, but no 10% penalty applies. This will permanently reduce the employee's balance.

# ISSUE 3: HARDSHIP DISTRIBUTIONS

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**401 (k) Plan Requirements**

If allowed, requirements include

1. Document defines what qualifies as a hardship.
2. Rules must apply to all participants in a non-discriminatory manner.
3. Amount is limited to elective contributions of the employee.
4. Hardship must have caused a heavy and immediate financial meet which cannot be met from other sources.
5. Distribution is limited to the hardship plus tax and penalty costs.

**Plan Document**

The plan has specific criteria. It can include for only medical or funeral expenses. The plan may exclude home purchase and education. It must be specific and non-discriminatory and objective standards.

# ISSUE 3: HARDSHIP DISTRIBUTIONS



**Nondiscrimination**

The plan must consider the facts and circumstance of the operation of the plan. Each participant must be treated uniformly.

**Amount of Distribution**

The balance as of the date of distribution includes the regular pretax contributions plus Roth contributions, and the catch contributions.

It does not include and gain or loss of the fund. But does include

1. Contributions to profit-sharing or stock bonus plan
2. Qualified nonelective contributions – correction of error
3. Qualified matching contributions – See T.D. 9875
4. Earnings on 1, 2, and 3

## ISSUE 3: HARDSHIP DISTRIBUTIONS

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**Hardship – (These factors must be considered by employer who is granting payout)** Need must be immediate and heavy per facts and circumstances

1. Medical care due primary beneficiary under the plan
2. Cost directly related to purchase of residence excluding mortgage
3. Education related expenses for 12 months of post-secondary education for family or beneficiary
4. Prevent eviction of employee’s residence or foreclosure on mortgage
5. Burial or funeral expenses for family or beneficiary
6. Damage to principal residence due to traditional casualty loss rules
7. Expense & losses due to Federally Declared Disaster provided residence or principal place of employment is in the area

# ISSUE 3: HARDSHIP DISTRIBUTIONS

P. 183-4

**Financial Need**

Qualify If employee does not have resources to meet the need.

Employee must obtain all other currently available distributions including
Deferred compensation, qualified and nonqualified

The amount cannot be in excess of the need. But the amount can include taxes or penalties which may result from the distribution.

The need may have been foreseeable or voluntarily incurred. It still would qualify.

# ISSUE 3: HARDSHIP DISTRIBUTIONS

P. 184

**Self-Certification**

Secure 2.0 allows employee to make a written certification of hardship.

Employer can rely on certification that

1. Need is immediate and heavy financial need
2. Distribution is not in excess of the amount to satisfy the financial need
3. Employee has no alternative means reasonably available to satisfy such need

Administrator can accept certification unless the person has actual knowledge that is contrary to the employee’s certification.

# ISSUE 3: HARDSHIP DISTRIBUTIONS

P. 184

**IRC § 403 Plan Hardship Distributions**

Currently 403(b) plans only allow contributions without earnings to be distributed.

After 12/31/2023, SECURE 2.0 conforms the Sec. 403(b) plans to conform to the 401(k) rules

# ISSUE 3: HARDSHIP DISTRIBUTIONS

P. 184

**IRC § 457 Plan Requirements include defining unforeseeable emergency**

Severe financial hardship of the participant or beneficiary from
1. Illness or accident of family
2. Loss of property due to casualty not covered by insurance
3. Extraordinary and unforeseeable circumstances beyond the control of the participant or beneficiary.

The eviction from residence, medical expenses and funeral expenses are considered to be beyond the employee's control. However, purchase of home and education or not emergencies.

Rules for other sources are the same as 401(k) and only reasonable payouts are allowed.

# ISSUE 3: HARDSHIP DISTRIBUTIONS

P. 185

**IRC § 457 Self-Certification (Same rules as 401(k))**

Employer can rely on certification that

1. Need is immediate and heavy financial need
2. Distribution is not in excess of the amount to satisfy the financial need
3. Employee has no alternative means reasonably available to satisfy such need

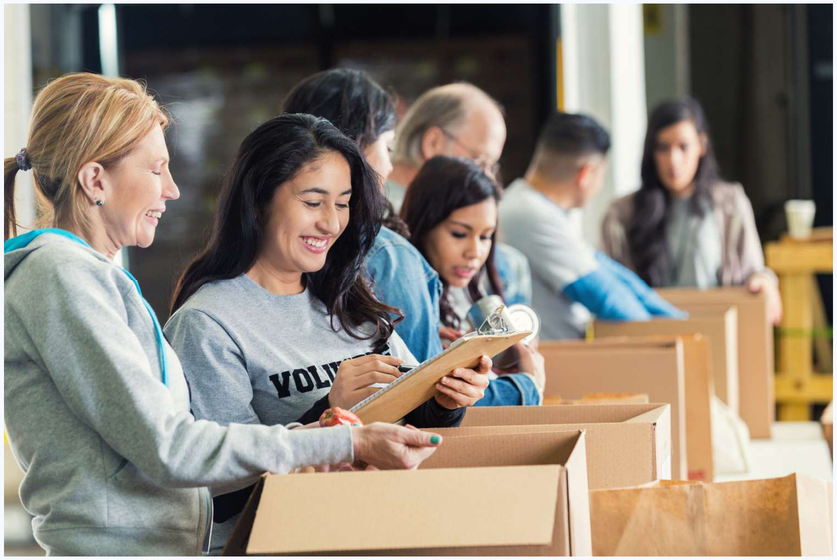
Administrator can accept certification unless the person has actual knowledge that is contrary to the employee’s certification.

**HARDSHIP Distribution from IRA** – May still have additional 10% tax, but not for education expenses or $10,000 for new home purchase

## ISSUE 4: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD) P. 186

QCD is nontaxable distribution paid directly from trustee to charitable organization. The owner must be **70 ½** when the distribution is made. The owner must have substantiation under the rules of charitable contributions.

Maximum annual excludable amount is $100,000 per individual. Joint return can have two.



## ISSUE 4: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD) P. 186

QCD is limited to the amount which would have been included in income for the current year.

If the IRA contains non-deductible contributions, distributions are first paid out of otherwise taxable income. QCD if paid first in any year, are considered meeting the RMD.

# ISSUE 4: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD) P. 186

**Example 5.9 Distribution is Partial QCD**

Beau Buckley, age 75, requested his trustee to make distribution by paying $25,000 directly to the local food bank. Beau's IRA has a balance of $30,000. Only $20,000 is from contributions & related earnings. $10,000 is nondeductible contributions or basis.

Beau meets the age test. The organization qualifies & the money is paid directly to the food bank.

# ISSUE 4: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD) P. 186

**Example 5.9 Distribution is Partial QCD**

| | | |
|---|---|---|
| **QCD** | **20,000** | **Previously taxed** |
| Balance | 5,000 | Schedule A |
| Total | 25,000 | Paid, not subject to state tax either |

The QCD is limited to his contributions with earnings of $20,000.

The balance of $5,000 is treated like previously taxed income and would be allowed as a schedule A contribution based upon AGI limits.

# ISSUE 4: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD) P. 186

**Offset of QCDs by IRA Contributions**

As of 1/1/2020, the QCD is reduced by excess aggregate IRA contribution since 701/2 over the amount IRA contributions were used to reduce the excludable amount of QCDs in earlier years. (The limit is necessary because making an IRA contribution & QCDs in the same year is like having your cake and eating it too.)

**Example 5.10 Contributions Offset QCDs**

| Lucas D'Angelo | Year | Contributed to IRA | QCD | Allowed QCD |
|---|---|---|---|---|
| | 2021 | $5,000 | - | |
| | 2022 | $5,000 | $6,000 | 6,000-10,000=(4,000) None |
| | 2023 | | $6,500 | 6,500 -4,000=2,500 excludable |
| | Total | $10,000 | | |

# ISSUE 4: QUALIFIED CHARITABLE DISTRIBUTIONS (QCD) P. 186

**QCD One-Time Election**

After 12/31/2022, TP can elect to make a one-time distribution of up to $50,000 from IRA to charities through a charitable remainder trust, charitable remainder unitrust or charitable gift annuity funded only by QCDs.

After 2023, this $50,000 one-time election and the $100,000 annual charitable distribution limit will be adjusted annually for inflation.

# ISSUE 5: SECURE 2.0 SUMMARY BY EFFECTIVE DATE P. 187

| SECURE 2.0 Citation | Title | Summary | Effective Date |
|---|---|---|---|
| 111 | Application of credit for small employer pension plan startup costs to employers that join an existing plan | Ensures the startup tax credit is available for 3 years for employers joining a multiple-employer plan (MEP), regardless of how long the MEP has been in existence. | Tax years beginning after December 31, 2019 |
| 331 | Special rules for use of retirement funds in connection with qualified federally declared disasters | Permanent rules allow up to $22,000 to be distributed from employer retirement plans or IRAs for affected individuals.<br>Distributions are not subject to the 10% additional tax and are taken into account as gross income over 3 years.<br>Distributions can be repaid to a tax preferred retirement account. | Disasters occurring on or after January 26, 2021 |

# FIGURE 5.4 SECURE 2.0 SUMMARY CON'T 12/29/22 ADMIN ISSUES

P. 187

| | | | |
|---|---|---|---|
| 204 | Elimination of a penalty on partial annuitization | If a tax-preferred retirement account also holds an annuity account, the owner can elect to aggregate distributions from both portions of the account for purposes of determining minimum distributions. | December 29, 2022 |
| 301 | Recovery of retirement plan overpayments | Allows retirement plan fiduciaries the latitude to decide not to recoup overpayments that were mistakenly made to retirees.<br>If plan fiduciaries choose to recoup overpayments, limitations and protections apply. | December 29, 2022 |
| 305 | Expansion of Employee Plans Compliance Resolution System | Expands the Employee Plans Compliance Resolution System to (1) allow more types of errors to be corrected internally through self-correction, (2) apply to inadvertent IRA errors, and (3) exempt certain failures to make required minimum distributions from the otherwise applicable excise tax. | December 29, 2022 |

# ISSUE 5: SECURE 2.0 SUMMARY CON'T 12/29/22 P. 188

| | | | |
|---|---|---|---|
| 323 | Clarification of substantially equal periodic payment rule | The exception to the additional tax on an early withdrawal for substantially equal periodic payments continues to apply after a rollover of the account, an exchange of an annuity providing the payments, or an annuity that satisfies the RMD rules. | Transfers, rollovers, and exchanges after December 31, 2023, and annuity distributions on or after December 29, 2022 |
| 604 | Optional treatment of employer matching or nonelective contributions as Roth contributions | Allows defined contribution plans to provide participants with the option of receiving matching contributions on a Roth basis. | December 29, 2022 |
| 112 | Military spouse retirement plan eligibility credit for small employers | Provides small employers a tax credit for defined contribution plans if they (1) make military spouses immediately eligible for plan participation within 2 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. | Tax years beginning after December 29, 2022 |
| 118 | Tax treatment of certain nontrade or business SEP contributions | Permits employers of domestic employees (e.g., nannies) to provide retirement benefits for such employees under a SEP. | Tax years beginning after December 29, 2022 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS AFTER 12/29/22 P. 188

| | | | |
|---|---|---|---|
| 128 | Enhancement of 403(b) plans | Permits 403(b) custodial accounts to participate in group trusts with other tax-preferred savings plans and IRAs. | After December 29, 2022 |
| 302 | Reduction in excise tax on certain accumulations in qualified retirement plans | Reduces the penalty for failure to take RMDs from 50% to 25%. Further, if a failure to take an RMD from an IRA is corrected in a timely manner, the excise tax on the failure is further reduced to 10%. | Tax years beginning after December 29, 2022 |
| 113 | Small immediate financial incentives for contributing to a plan | Enables employers to offer de minimis financial incentives, not paid for with plan assets, such as low-dollar gift cards, to boost employee participation in workplace retirement plans. | Tax years beginning after December 29, 2022 |
| 312 | Employer reliance on employee certifying that deemed hardship distribution conditions are met | Under certain circumstances, employees are permitted to self-certify that they have had an event that constitutes a hardship for purposes of taking a hardship withdrawal. | Tax years beginning after December 29, 2022 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS AFTER 12/29/22 P. 188-9

| | | | |
|---|---|---|---|
| 311 | Repayment of qualified birth or adoption distribution limited to 3 years | Distributions from a retirement plan for qualified birth or adoption expenses must be recontributed within 3 years. | Distributions made after December 29, 2022, and retroactively to the 3-year period beginning on the day after the date on which such distribution was received |
| 326 | Exception to additional tax on early distributions from qualified plans for individuals with a terminal illness | There is an exception to the additional tax on early withdrawals for a distribution to a terminally ill individual. | Distributions made after December 29, 2022 |
| 102 | Modification of credit for small employer pension plan startup costs | The small employer pension plan startup credit is increased from 50% to 100% for employers with up to 50 employees.<br>Except in the case of defined benefit plans, an additional credit is provided. | Tax years beginning after December 31, 2022 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS - CHECK DATES

P. 189

| | | | |
|---|---|---|---|
| 107 | Increase in age for required beginning date for mandatory distributions | The required beginning date for RMDs is increased to 73 starting on January 1, 2023, and increased to 75 starting on January 1, 2033. | January 1, 2023 |
| 601 | SIMPLE and SEP Roth IRAs contributions | Allows SIMPLE IRAs to accept Roth contributions and allows employers to offer employees the ability to treat employee and employer SEP contributions as Roth (in whole or in part). | Tax years beginning after December 31, 2022 |
| 339 | Recognition of tribal government domestic relations orders | Adds tribal courts to the list of courts authorized under federal law to issue qualified domestic relations orders. | Effective to domestic relations orders received by plan administrators after December 31, 2022, including any such order that is submitted for reconsideration after that date |
| 116 | Allowance of additional nonelective contributions to SIMPLE plans | Permits an employer to make additional contributions to each employee of the SIMPLE plan in a uniform manner, provided that the contribution may not exceed the lesser of up to 10% of compensation or $5,000 (indexed). | Tax years beginning after December 31, 2023 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS – 12/31/23



| | | | |
|---|---|---|---|
| 117 | Increase of contribution limit for SIMPLE plans | Increases the annual deferral limit and the catch-up contribution at age 50 by 10%, as compared to the limit that would otherwise apply in the first year this change is effective, in the case of an employer with no more than 25 employees.<br>An employer with 26 to 100 employees can provide higher deferral limits, but only if the employer either provides a 4% matching contribution or a 3% employer contribution. | Tax years beginning after December 31, 2023 |
| 325 | Roth plan predeath distribution rules | Eliminates the predeath distribution requirement for Roth accounts in employer plans. | Tax years beginning after December 31, 2023.<br>Does not apply to distributions that are required for years beginning before January 1, 2024, but can be paid on or after that date |
| 327 | Surviving spouse election to be treated as employee | A surviving spouse can elect to be treated as the deceased employee for purposes of the RMD rules. | Calendar years beginning after December 31, 2023 |
| 603 | Elective deferrals generally limited to regular contribution limit | All catch-up contributions to qualified retirement plans are subject to Roth tax treatment.<br>An exception is provided for employees with compensation of $145,000 or less (indexed). | Tax years beginning after December 31, 2023 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS – 12/31/23

P. 190

| | | | |
|---|---|---|---|
| 110 | Treatment of student loan payments as elective deferrals for purposes of matching contributions | Permits an employer to make matching contributions under a 401(k) plan, 403(b) plan, or SIMPLE IRA with respect to qualified student loan payments. | Contributions made for plan years beginning after December 31, 2023 |
| 121 | Starter 401(k) plans for employers with no retirement plan | An employer that does not sponsor a retirement plan can offer a starter 401(k) plan [or safe harbor 403(b) plan].<br>The plan would generally require that all employees be default enrolled in the plan at a 3% to 15% of the compensation deferral rate.<br>The limit on annual deferrals would be the same as the IRA contribution limit. | Plan years beginning after December 31, 2023 |
| 127 | Emergency savings accounts linked to individual account plans | Provides employers the option to offer their non-highly compensated employees a pension-linked emergency savings account. | Plan years starting after December 31, 2023 |
| 332 | Employers allowed to replace SIMPLE retirement accounts with safe harbor 401(k) plans during a year | Allows an employer to replace a SIMPLE IRA plan with a SIMPLE 401(k) plan or other 401(k) plan that requires mandatory employer contributions during a plan year. | Plan years beginning after December 31, 2023 |
| 602 | Hardship withdrawal rules for 403(b) plans | Conforms the 403(b) hardship rules to the 401(k) hardship rules. | Plan years beginning after December 31, 2023 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS – 12/31/23 - 24 P. 190

| | | | |
|---|---|---|---|
| 115 | Withdrawals for certain emergency expenses | Provides an exception for certain distributions used for emergency expenses that are unforeseeable or immediate financial needs relating to personal or family emergency expenses.<br>Only one distribution is permissible per year of up to $1,000, and a taxpayer has the option to repay the distribution within 3 years. | Distributions made after December 31, 2023 |
| | | | |
| 126 | Special rules for certain distributions from long-term qualified tuition programs to Roth IRAs | Allow for tax- and penalty-free rollovers from 529 accounts to Roth IRAs, under certain conditions.<br>Beneficiaries of 529 college savings accounts would be permitted to roll over up to $35,000 over their lifetime from any 529 account in their name to their Roth IRA. | Distributions after December 31, 2023 |
| 314 | Additional tax-free withdrawal from retirement plans for individual cases of domestic abuse | Allows retirement plans to permit participants that self-certify that they experienced domestic abuse to withdraw money (the lesser of $10,000, indexed for inflation, or 50% of the participant's account) without the 10% additional tax on early distributions. | Distributions after December 31, 2023 |
| 109 | Higher catch-up limit to apply at age 60, 61, 62, and 63 | Increases the catch-up limits to the greater of $10,000 or 50% more than the regular catch-up amount in 2025 for individuals who have attained ages 60, 61, 62 and 63.<br>The increased amounts are indexed for inflation after 2025. | Tax years beginning after December 31, 2024 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS – 12/31/24

P. 191

| | | | |
|---|---|---|---|
| 125 | Improved coverage for part-time workers | Employers maintaining a 401(k) plan must have a dual eligibility requirement under which an employee must complete either 1 year of service (with the 1,000-hour rule) or 2 consecutive years (reduced from 3 years) of service (where the employee completes at least 500 hours of service). | Plan years beginning after December 31, 2024 |
| 101 | Expansion of automatic enrollment in retirement plans | 401(k) and 403(b) plans automatically enroll participants in the respective plans upon becoming eligible (and the employees may opt out of coverage).<br>The initial automatic enrollment amount is at least 3% but not more than 10%.<br>Each year thereafter, that amount is increased by 1% until it reaches at least 10%, but not more than 15%.<br>All current 401(k) and 403(b) plans are grandfathered.<br>There is an exception for small businesses with 10 or fewer employees, new businesses (i.e., those that have been in business for less than 3 years), church plans, and governmental plans. | Plan years beginning after December 31, 2024 |

# ISSUE 5: SECURE 2.0 SUMMARY YEARS – 12/31/25-6

P. 191

| | | | |
|---|---|---|---|
| 334 | Long-term care contracts purchased with retirement plan distributions | Permits retirement plans to distribute up to $2,500 per year for the payment of premiums for certain specified long-term care insurance contracts.<br>Distributions from plans to pay such premiums are exempt from the additional 10% tax on early distributions. | December 29, 2025 |
| 103 | Saver's match change | 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 into a federal matching contribution that must be deposited into a taxpayer's IRA or retirement plan.<br>The match is 50% of IRA or retirement plan contributions up to $2,000 per individual. The match phases out based on AGI. | Tax years beginning after December 31, 2026 |

# Questions?