Federal Income Tax Changes – 2023

Contents

Introduction to the Course

Each year, various limits affecting income tax preparation and planning change. Some changes commonly occur each year as a result of inflation indexing, while others occur because of new legislation or the sunsetting of existing law. This course will examine the tax changes affecting 2023 as a result of passage of the Inflation Reduction Act and the inflation-changed limits effective for 2023 that are more significant from the perspective of an income tax preparer. Some context will be supplied, as appropriate, to assist readers in understanding the changes.

Learning Objectives

Upon completion of this course, you should be able to:

- List the 2023 changes in various amounts including the –
  - Standard mileage rates,
  - Standard deduction,
  - AMT exemption amount,
  - Limits related to income from U.S. Savings Bonds for taxpayers paying higher education expenses, and
  - Deductions for qualified long-term care insurance premiums;
- Identify the 2023 tax credit changes affecting the –
  - Saver's credit,
  - Additional Child Tax Credit,
  - Earned income credit, and
  - Adoption credit;
- Recognize the 2023 changes affecting –
  - Health Savings Account (HSA) and Archer Medical Savings Accounts (MSA) requirements and contribution limits,
  - Roth IRA eligibility, and
  - Traditional IRA contribution deductibility for active participants in employer-sponsored qualified plans;
- List the changes effective for 2023 with respect to the –
  - Small employer premium tax credit, and
  - Applicable large employer mandate; and
- Describe the principal Inflation Reduction Act (IRA) provisions affecting taxpayers in 2023.

Chapter 1 – Changes in Various Limits

Introduction

Federal tax law requires that various limits be adhered to in the preparation of tax returns, and such limits may change from year to year based on an inflation adjustment or on other factors. Included in those changes for 2023 are individual tax rates, standard mileage rates, standard deductions and various other limits.

This chapter will examine these changes for 2023 and will offer some context within which they apply.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to:

- Identify the individual income tax rate changes affecting taxpayers;
- Calculate the standard mileage deductions for –
  - Use of a personal vehicle for business purposes,
  - Use of a personal vehicle to obtain medical care, and
  - Charitable use of a personal vehicle;
- Identify the 2023 standard deduction amounts available to taxpayers;
- Recognize the changes made to the alternative minimum tax exemption amount for 2023;
- Apply the tax-free United States savings bond income limits for taxpayers who paid qualified higher education expenses in 2023; and
- Calculate the tax-deductible premiums for and tax-free benefits received under qualified long-term care insurance contracts;
- Determine the amount of assets that may be passed tax-free at death; and
- Identify the qualified business income (QBI) threshold amount.

Individual Tax Rates

The individual tax brackets for 2023 are as follows:

2023	Bracket for Income in Excess of…				
Tax Bracket	**MFJ**	**HOH**	**Unmarried**	**MFS**	**Estates & Trusts**
10%	$0	$0	$0	$0	
12%	$22,000	$15,700	$11,000	$11,000	
22%	$89,450	$59,850	$44,725	$44,725	
24%	$190,750	$95,350	$95,375	$95,375	$2,900
32%	$364,200	$182,100	$182,100	$182,100	
35%	$462,500	$231,250	$231,250	$231,250	$10,550
37%	$693,750	$578,100	$578,125	$346,875	$14,450

Standard Mileage Rates

The standard mileage rates enable a taxpayer using a vehicle for specified purposes to deduct vehicle expenses on a per-mile basis rather than deducting actual car expenses that are incurred during the year. The rates vary, depending on the purpose of the transportation.

Accordingly, the standard mileage rates differ from one another depending on whether the vehicle is used for:

- Business purposes;
- Charitable purposes; or
- Obtaining medical care or moving.

Rather than using the optional standard mileage rates, however, a taxpayer may choose to take a deduction based on the actual costs of using the vehicle.

Business Use of a Taxpayer's Personal Vehicle

As a result of the passage of the TCJA, taxpayers may no longer deduct unreimbursed employee expenses—including unreimbursed expenses related to business use of a personal vehicle—as "miscellaneous itemized deductions" to the extent the total of such expenses exceeds 2% of his or her AGI. However, the 2023 alternative standard mileage rate applicable to ***eligible*** business use of a vehicle is 65.5¢ per mile, up from 62.5¢ in the last half of 2022. In order for such expenses to be deductible, they must have been:

- Paid or incurred during the tax year;
- For the purpose of carrying on the taxpayer's trade or business; and
- Ordinary and necessary.

Provided the vehicle expenses meeting these three criteria are not reimbursed, the deductible personal vehicle expenses include those incurred while traveling:

- Between workplaces;
- To meet with a business customer;
- To attend a business meeting located away from the taxpayer's regular workplace; or
- From the taxpayer's home to a *temporary* place of work.

In addition to using the standard mileage rate, a taxpayer may also deduct any business-related parking fees and tolls paid while engaging in deductible business travel. However, parking fees paid by a taxpayer to park his or her vehicle at the usual place of business are considered commuting expenses and are not deductible.

Personal Vehicle Use for Charitable Purposes

A taxpayer may deduct as a charitable contribution any unreimbursed out-of-pocket expenses, such as the cost of gas and oil, directly related to the use of a personal vehicle in providing services to a charitable organization. Alternatively, a taxpayer may use the standard mileage rate applicable to the use of a personal vehicle for charitable purposes. The standard mileage rate applicable to a taxpayer's use of a personal vehicle for charitable purposes is based on statute and remains unchanged at 14¢ per mile. The taxpayer may also deduct parking fees and tolls regardless of whether the actual expenses or standard mileage rate is used.

Use of a Taxpayer's Personal Vehicle to Obtain Medical Care

A taxpayer who uses a personal vehicle for medical reasons is permitted to include the out-of-pocket vehicle expenses incurred—the expenses for gas and oil, for example—or deduct medical travel expenses at the standard medical mileage rate. For 2023, the standard medical mileage rate is 22¢ per mile, the same as in the last half of 2022. The taxpayer may also deduct any parking fees or tolls, regardless of whether the actual expense or the standard mileage rate is used.

Moving Expenses in Military Relocations

Although the Tax Cuts and Jobs Act (TCJA) suspended the moving expense deduction and made any moving expense reimbursement taxable income for non-military relocations, the inclusion of reimbursed moving expenses in the recipient's gross income does not apply to military relocations meeting certain criteria. In the case of a military relocation, the taxpayer's move must be pursuant to a military order and involve a permanent change of station. If those criteria are met, no paid or incurred moving and storage expenses:

- Furnished in kind, or
- For which reimbursement or allowance is provided to the service member, spouse or dependents

…are includible in gross income or reported.

In addition, if the moving expenses paid or incurred in connection with a military relocation are furnished or reimbursed (or an allowance is provided) to the service member's spouse and dependents to move:

- To a location other than the one to which the service member moves, or
- From a location other than the one from which the service member moves

…such expenses are likewise neither includible in gross income nor reported.

Standard Mileage Rates

Activity	**2022 Mileage Rate**	**2023 Mileage Rate**
Eligible business use	58.5¢ - 1st half year 62.5¢ - 2nd half year	65.5¢
Medical or moving purposes	18¢ - 1st half year 22¢ - 2nd half year	22¢
Charitable purposes*	14¢	14¢

*Set by statute; not subject to inflation adjustment

Standard Deduction Increased

The standard deduction has increased for 2023. The standard deductions for 2023 are:

- $27,700 for married couples whose filing status is "married filing jointly" and qualifying widow(er);
- $13,850 for singles and married couples whose filing status is "married filing separately"; and
- $20,800 for taxpayers whose filing status is "head of household."

A taxpayer who can be claimed as a dependent is generally limited to a smaller standard deduction, regardless of whether the individual is actually claimed as a dependent. For 2023 returns, the standard deduction for a dependent is the greater of:

- $1,250; or
- The dependent's earned income from work for the year plus $400 (but not more than the standard deduction amount, generally $13,850).

Standard Deduction for Blind and Senior Taxpayers

Elderly and/or blind taxpayers receive an additional standard deduction amount added to the basic standard deduction. The additional standard deduction for a blind taxpayer—a taxpayer whose vision is less than 20/200—and for a taxpayer who is age 65 or older at the end of the year is:

- $1,500 for married individuals; and
- $1,850 for singles and heads of household.

The additional standard deduction for taxpayers who are both age 65 or older at year-end and blind is double the additional amount for a taxpayer who is blind (but not age 65 or older) or age 65 (but not blind). For example, a 65 year-old single blind taxpayer would add $3,700 to his or her usual standard deduction: $1,850 for being age 65 plus $1,850 for being blind. ($1,850 x 2 = $3,700). Thus, his or her standard deduction would normally be $17,550. ($13,850 + $3,700 = $17,550)

Standard Deduction Eligibility

The general rule with respect to deductions is that a taxpayer may choose to take a standard deduction or itemize his or her deductions. Although that general rule applies in the case of most taxpayers, certain taxpayers are ineligible to take the standard deduction and must itemize.

Taxpayers who are ineligible to take the standard deduction are the following:

- Taxpayers whose filing status is "married filing separately" and whose spouse itemizes deductions;
- Taxpayers who are filing a tax return for a short tax year due to a change in their annual accounting period; and

- Taxpayers who were nonresident aliens or dual-status aliens during the year.

Standard Deductions

	2022		2023	
Filing Status	**Standard**	**Blind/Age 65+**	**Standard**	**Blind/Age 65+**
Married filing jointly & qualifying widow(er)s	$25,900	$1,400	$27,700	$1,500
Unmarried (other than qualifying widow(er)s or head of household)	$13,850	$1,750	$13,850	$1,850
Married filing separately	$12,950	$1,400	$13,850	$1,500
Head of household	$19,400	$1,750	$20,800	$1,850
Dependent	$1,150 or earned income + $400		$1,250 or earned income + $400	

Alternative Minimum Tax Exemption Amount Increased

The tax code provides for an AMTI exemption for purposes of determining the alternative minimum tax amount. The amount of the AMTI exemption varies according to the taxpayer's filing status and the tax year. The applicable AMTI exemption amounts are as follows:

AMTI Exemption Amounts

	2022		2023	
Filing Status	**Exemption Phaseout Begins**	**AMTI Exemption**	**Exemption Phaseout Begins**	**AMTI Exemption**
Married filing jointly & qualifying widow(er)s	$1,079,800	$118,100	$1,156,300	$126,500
Unmarried (other than qualifying widow(er)s)	$539,900	$75,900	$578,150	$81,300
Married filing separately	$539,900	$59,050	$578,150	$63,250
Estates and trusts	$88,300	$26,500	$94,600	$28,400

The AMTI exemption amounts are indexed for inflation.

The AMTI exemption amount is reduced (but not below zero) by 25 percent of the amount by which the taxpayer’s alternative minimum taxable income exceeds:

- $1,156,300 for taxpayers whose filing status is “married filing jointly” or “qualifying widow(er)”;
- $578,150 for taxpayers whose filing status is “single,” “head of household,” and “married filing separately”; and
- $94,600 for trusts and estates.

Education Savings Bond Program

A taxpayer may exclude some or all interest income received on qualified U.S. savings bonds if the taxpayer:

- Paid qualified education expenses for the taxpayer, a spouse or a dependent claimed as an exemption;
- Has a modified adjusted gross income (MAGI) not exceeding specified maximum amounts that are adjusted for inflation each year; and
- Has a federal income tax filing status other than married filing separately.

Qualified Education Expenses

Education expenses considered qualified education expenses under the education savings bond program are education expenses incurred at an eligible educational institution by the taxpayer for the taxpayer, the taxpayer's spouse or a dependent claimed by the taxpayer. Such expenses include:

- Tuition and fees;
- Contributions to a qualified tuition program; and
- Contributions to a Coverdell education savings account (ESA)

Room and board expenses **are not** qualified education expenses for purposes of the education savings bond program.

Eligible Educational Institutions

An eligible educational institution for purposes of the education savings bond program is broadly defined as one eligible to participate in a student aid program administered by the U.S. Department of Education and includes:

- College;
- University;
- Vocational school; and
- Other post-secondary educational institution.

Thus, the definition of an eligible educational institution includes virtually all accredited U.S. public, nonprofit, and proprietary post-secondary institutions.

Qualified Education Expenses Reduced by Certain Tax-free Benefits Received

To determine the amount of tax-free interest, the qualified education expenses incurred must be reduced, for purposes of the education savings bond program, by certain tax-free education benefits received. The resulting education expenses, reduced as required, are referred to as "adjusted qualified education expenses."

Thus, *adjusted* qualified education expenses are equal to the qualified education expenses reduced by all of the following tax-free benefits:

- The tax-free part of scholarships and fellowships;
- Expenses used to figure the tax-free portion of Coverdell ESA distributions;
- Expenses used to figure the tax-free portion of qualified tuition program distributions;
- Any tax-free payments received as education assistance, including –
    - Veterans' educational assistance benefits,
    - Qualified tuition reductions, and
    - Employer-provided educational assistance; and
- Any expenses used in figuring the American opportunity and lifetime learning credits.

Neither gifts nor inheritances received, however, reduce qualified education expenses for purposes of the education savings bond program.

Figuring the Tax-Free Amount

If the total amount received by the taxpayer when eligible bonds are cashed in, including both the bond investment and accrued interest, does not exceed the adjusted qualified education expenses, all interest received may be tax free. (Note, the taxpayer must still be eligible based on income.) If the total amount received on liquidation of the bonds is greater than the adjusted qualified education expenses, only a portion of the interest may be tax free.

Determining the tax-free amount of the interest distributed when the bonds are cashed in **and the adjusted qualified education expenses are less than the distribution** requires that the interest received be multiplied by a fraction. The numerator of the fraction is the adjusted qualified education expenses, and the denominator of the fraction is the total proceeds received on liquidation of the bonds during the year the bonds were cashed in.

Education Savings Bond Program Eligibility Subject to Income Limits/Filing Status

The exclusion of interest under the education savings bond program reduces as the taxpayer's income increases and is eliminated at higher income levels. Under the bond program rules, the amount of a taxpayer's interest exclusion is gradually reduced if the taxpayer's modified adjusted gross income (MAGI) exceeds the applicable dollar amount for the taxpayer's filing status. (See **Determining Taxpayer's Modified Adjusted Gross Income** below.)

When the part of the bond interest that normally would be tax free under the education savings bond program is determined, the taxpayer's MAGI is compared to the applicable dollar amount for the tax year to calculate the amount of the potentially tax-free interest that is excludible by the taxpayer. If a taxpayer whose filing status is married filing jointly has a MAGI that exceeds the applicable dollar amount by $30,000 or more, no interest may be excluded under the program. Similarly, if a taxpayer whose filing status is single, qualifying widow(er) or head of household has a MAGI that exceeds the applicable dollar amount by $15,000 or more, no interest is excludible under the program.

The applicable dollar amounts with which taxpayers' MAGI are compared are as follows:

Taxpayer's Filing Status	2023 Applicable Dollar Amount	Phase-Out Income Range	Completely Phased-Out
Single, qualifying widow(er) or Head of Household (HH)	$91,850	$91,850 - $106,850	$106,850
Married filing jointly	$137,800	$137,800 - $167,800	$167,800

The amount of excludible savings bond interest to which a taxpayer whose MAGI is in the phase-out income range is entitled, if any, can be determined using the following equation that calculates the part of the interest that is includible:

$$\frac{\text{(MAGI – Applicable dollar amount)}}{\text{\$30,000 (\$15,000 single or HH)}} \quad \text{X} \quad \text{Maximum tax-free interest} \quad = \quad \text{Includible interest}$$

The amount determined under the equation is then subtracted from the maximum tax-free interest amount to figure the amount of excludible savings bond interest.

When figuring the excludible interest amount, use IRS Form 8815, a replicated sample of which is shown in Appendix A. The excludible interest amount should be shown on Form 1040.

Qualified Long-Term Care Insurance Premiums and Benefits

In 1996, Congress passed the Health Insurance Portability and Accountability Act (HIPAA). The law clarified the tax treatment of long-term care insurance policies by defining "qualified long-term care insurance." In addition, it provided for the tax-deductibility of qualified long-term care insurance premiums and the tax-exemption of long-term care insurance benefits within certain limits for individuals deemed to be chronically-ill.

Those limits generally change yearly.

Favorable Benefits Tax Treatment Reserved for Chronically-Ill

In order for long term care benefits to receive favorable tax treatment, the individual on whose behalf they are paid must meet the "chronically-ill" definition included in HIPAA. A *chronically-ill individual* is defined as an insured individual who has been certified by a licensed health care practitioner within the previous 12 months as an individual who:

- Is unable, for at least 90 days, to perform at least two activities of daily living (ADLs) without substantial assistance from another individual, due to loss of functional capacity; or
- Requires substantial supervision to be protected from threats to health and safety due to severe cognitive impairment.

Tax-Qualified Long Term Care Premiums Deductible within Limits

Premiums paid for tax-qualified long term care insurance may be deductible. Tax-qualified long term care insurance policy premiums are included in the definition of "medical care" and are, therefore, eligible for income tax deduction within certain limits.

The amount of any long term care insurance premium that may be included in medical care expenses is limited by certain dollar maximums that are indexed for inflation and which change as the insured's attained age changes. The dollar limitations applicable to tax-qualified long term care premiums in 2022 and 2023 are as follows:

Attained Age Before Close of Tax Year	2022 Limitation on Premium*	2023Limitation on Premium*
40 or younger	$450	$480
41 to 50	$850	$890
51 to 60	$1,690	$1,790
61 to 70	$4,510	$4,770
Older than 70	$5,640	$5,960
** Indexed for inflation*		

Tax-Qualified Long Term Care Insurance Benefits Tax-Free within Limits

Benefits received under tax-qualified long term care insurance policies that may be excluded from income are those benefits not exceeding the greater of:

- The applicable *per diem* limitation for the year; or
- The costs incurred for qualified long term care services provided for the insured.

The applicable *per diem* limitation for 2023is $420. The *per diem* limitation amount is adjusted each year, as needed, to reflect inflation. (Note: Periodic payments under a life insurance contract received on behalf of a chronically-ill insured are likewise tax-exempt, subject to the limits applicable to qualified long-term care insurance benefits.)

Social Security Taxable Earnings Limit

Social Security taxes are comprised of two components: OASDI (old age, survivors and disability income) and HI (health insurance) taxes. OASDI is a tax imposed on a worker's wages up to the applicable Social Security taxable earnings limit. That limit is $160,200 in 2023 and generally increases annually. The employee tax rate for the OASDI part of Social Security is 6.2%.

HI, the second component of Social Security taxes, is a tax of 1.45% imposed on all taxpayer wages—no earnings limit applies, in other words—to fund Medicare Part A.

Maximum Capital Gain/Dividend Tax Rate Increased for High-Income Taxpayers

- High-income taxpayers are subject to higher capital gain and qualified dividend tax rates. For tax years beginning in 2023, the long-term capital gain and qualified dividend tax rate is as follows:
- The 0% rate applies to –
  - Single filers and married filers filing separately with income up to $44,625,
  - Head of household filers with income up to $59,750,
  - Joint filers with income up to $89,250,

    - Trusts and estates with income up to $3,000;
- The 15% rate applies to –
    - Single filers with income between $44,625 and $492,300,
    - Married filers filing separately with income between $44,625 and $276,900,
    - Head of household filers with income between $59,750 and $523,050,
    - Joint filers with income between $89,250 and $553,850,
    - Trusts and estates with income between $3,000 and $14,650; and
- The 20% rate applies to –
    - Single filers with income exceeding $492,300,
    - Married filers filing separately with income exceeding $276,900,
    - Head of household filers with income exceeding $523,050,
    - Joint filers with income exceeding $553,850,
    - Trusts and estates with income exceeding $14,650.

Estate and Gift Tax Exemption

Every taxpayer is entitled to gift or bequeath assets during lifetime or at death tax free insofar as such assets do not exceed a basic exclusion amount. The gift and estate tax exemption is increased to $12.92 million in 2023. The resulting unified credit for decedents dying in 2023 is $5,113,800.

Section 199A Threshold Amount

The TCJA impacts many taxpayers; among those for whom it has a more significant effect, however, are owners of businesses organized as pass-through entities, i.e. as sole proprietorships, partnerships (including certain LLCs) and S corporations. Such entities may qualify for a special tax deduction, generally referred to as the Section 199A pass-through deduction, which enables eligible taxpayers to deduct up to 20% of their qualified business income (QBI).

In general, the pass-through deduction under section 199A is available as follows:

- All pass-through business owners whose personal taxable income does not exceed a threshold amount are eligible for the deduction;
- Pass-through business owners of certain types of business known as "specified service trades or businesses (SSTBs)" whose personal taxable income is greater than the threshold amount but less than the sum of the threshold amount and $50,000 or $100,000, based on their filing status, are eligible for a reduced deduction; and
- Pass-through business owners of non-SSTBs, irrespective of their personal taxable income, are eligible for the deduction.

The applicable threshold amounts are adjusted annually for inflation and, for 2023, are as shown in the chart below:

Taxpayer's Filing Status	**2023 Threshold Amount**	**Phase-In Range**
Married filing jointly	$364,200	$100,000
Married filing separately	$182,100	$50,000
Single & head of household filers	$182,100	$50,000

Thumbnail Summary of 2023 Changes

Subject	**2023 Change**
Standard mileage rates	Charity - 14¢ Medical & moving – 22¢

	Business – 65.5¢
Standard deduction	Married filing jointly & qualifying widow(er)s - $27,700 Married filing separately & single - $13,850 Head of household - $20,800 Additional standard deduction for blind or elderly: Married - $1,500 Head of household and single - $1,850
Alternative minimum tax	Single and head of household - $81,300 exemption; 25% phaseout beginning at $578,150 taxable income Married filing jointly and qualifying widow(er) - $126,500 exemption; 25% phaseout beginning at $1,156,300 taxable income Married filing separately - $63,250 exemption; 25% phaseout beginning at $578,150 taxable income Estates and trusts - $28,400 exemption; 25% phaseout beginning at $94,600 taxable income
Education savings bond interest exclusion	Single, head of household and qualifying widow(er) – MAGI of $91,850, phased-out to $106,850 Married filing jointly - $137,800, phased-out to $167,800
Qualified LTCi premiums & benefits Limit on premium deduction	Age of taxpayer: 40 or younger - $480 41 to 50 - $890 51 to 60 - $1,790 61 to 70 - $4,770 71 or older - $5,960
Per diem limit on benefit exclusion	$420
Social Security taxable earnings limit	$160,200
Estate and gift tax exclusion	Increased to $12.92 million
Taxable income threshold amount applicable to section 199A pass-through deduction	Increased to: • $364,200 for taxpayers with MFJ filing status • $182,100 for taxpayers with MFS filing status • $182,100 for taxpayers with all other filing statuses

Chapter Review

1. Philip uses his personal vehicle for charitable purposes. If he drove 1,400 miles, spent $50 on gas and oil, $40 on parking fees, $60 on tolls and elected to use the standard mileage deduction, how much of the expenses would be tax-deductible?

   A. $0

   B. $196

   C. $296

   D. $346

2. Karl received qualified long term care insurance benefits in 2023 of $440 per day. How much of such daily benefits must he include in income, if any, assuming his actual long term care costs were $350 per day and the applicable per diem limitation is $420?

   A. $0

   B. $20

   C. $70

   D. $90

3. A taxpayer's 16 year-old dependent son earned $7,000 in 2023. What is the standard deduction for him?

   A. $7,400

   B. $13,850

   C. $1,250

   D. $0

Chapter 2 – Tax Credit Changes

Introduction

Although the U.S. Tax Code serves as the legal authority facilitating the nation's funding, it is also an instrument through which the government attempts to bring about social change by encouraging certain types of behavior and discouraging other types. Many of the behaviors the federal government wishes to promote are encouraged through the use of tax credits. Principal among the tax credits providing such encouragement are the retirement savings contribution credit—often referred to as the "saver's credit"—and the child adoption credit. Other tax credits—the earned income credit, for example—are designed to provide additional funds to working taxpayers whose income is below certain levels. The limits affecting these and other credits may change from one year to the next.

This chapter will briefly discuss the principal tax credit changes for 2023.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to:

- Calculate the retirement savings contribution credit available to eligible taxpayers;
- Recognize the rules and income limits applicable to eligibility for the earned income credit; and
- Apply the adoption credit rules.

Retirement Savings Contribution Credit

The retirement savings contribution tax credit is a *nonrefundable* credit that is limited to the applicable percentage of the taxpayer's eligible retirement savings contributions; the credit cannot exceed $1,000 per taxpayer. A nonrefundable tax credit is a tax credit that is limited by the individual's tax liability and acts to reduce the amount of federal income tax payable. If a taxpayer has no income tax liability or has an income tax liability that is less than the tax credit, a nonrefundable tax credit will not result in a payment of any amount in excess of the taxpayer's tax liability from the federal government.

The retirement savings contribution tax credit, if any, for which a taxpayer is eligible does not affect the tax treatment to which the contribution would normally be subject.

Saver's Credit Applicable to Range of Retirement Contributions

The retirement savings contribution credit is available to taxpayers who make a wide range of retirement plan contributions. The retirement plan contributions eligible for the credit are contributions to traditional and Roth individual retirement arrangements (IRAs) and elective deferrals to:

- 401(k) plans;
- 403(b) tax sheltered annuity plans;
- Section 457 governmental plans;
- SIMPLE IRAs; and
- Salary reduction SEPs (SARSEPs).

In addition, the SECURE Act amends the term "compensation," for purposes of the retirement savings tax deduction to include any amount included in the taxpayer's gross income and paid to the taxpayer in the pursuit of graduate or postdoctoral studies. The SECURE Act addition is effective for years after December 31, 2019. Thus, a contribution to an IRA based on that compensation could enable the recipient, if otherwise eligible, to qualify for a saver's credit. Despite the number of plans to which the taxpayer makes contributions and the amount of those contributions, the total saver's credit will not exceed $1,000 per taxpayer for the year.

Saver's Credit Eligibility Based on Income and Filing Status

The percentage of the retirement savings contribution (not exceeding $2,000) available to the taxpayer as a tax credit, up to the $1,000 maximum tax credit, depends upon the individual's adjusted gross income and income tax filing status. The applicable percentages for 2023 retirement contributions are as shown below:

Saver's Credit Adjusted Gross Income Limits (2023)[1]						
Joint Return		**Head of Household Return**		**All Other Statuses**		**Applicable Credit**
Over	Not over	Over	Not over	Over	Not over	Percentage
$0	$43,500	$0	$32,625	$0	$21,750	50%
$43,500	$47,500	$32,625	$35,625	$21,750	$23,750	20%
$47,500	$73,000	$35,625	$54,750	$23,750	$36,500	10%
$73,000		$54,750		$36,500		0%

Since the maximum tax credit percentage is 50% and the maximum contribution eligible for the tax credit is $2,000, the maximum retirement savings contribution tax credit that may be taken for 2023is $1,000 per taxpayer. For example, suppose Bill and Trudy Smith file a joint federal income tax return and have an adjusted gross income of $43,500. If Bill and Trudy each make a $2,000 eligible retirement savings contribution—to an IRA, a 401(k), 403(b), or other eligible plan—they would receive a total tax credit of $2,000, i.e. $1,000 for each of them. ($4,000 x 50% = $2,000) If their adjusted gross income was $43,501, however, their total tax credit would be reduced to $800 because the applicable percentage falls to 20%. ($4,000 x 20% = $800)

When taking the credit, a taxpayer must subtract the amount of any distributions received from his or her retirement plans from the contributions made. The distributions that must be subtracted for purposes of determining the saver's credit are those received:

- During the two years before the year the credit is claimed;
- In the year the credit is claimed; and
- The period after the end of the credit year but before the due date (including any extensions) for filing the return for the credit year.

The saver's credit is not available to a taxpayer who a) is single, married filing separately or a qualifying widow(er) with a 2023 income of more than $36,500, b) is a head of household with a 2023 income of more than $54,750, or c) files a return as married filing jointly with a 2023 income of more than $73,000.

Additional Child Tax Credit Increased

The Internal Revenue Code provides a Child Tax Credit for each of a taxpayer's qualifying child. A qualifying child, for purposes of the Child Tax Credit, is a child who:

- Is the taxpayer's son, daughter, stepchild, foster child, brother, sister, stepbrother, stepsister, or a descendent of any of them;
- Is under age 17 at the end of the tax year;
- Does not provide more than one half of his or her own support during the year;
- Lives with the taxpayer for more than half of the year;
- Is claimed as a dependent on the taxpayer's return;
- Does not file a joint return for the year, or files it only as a claim for refund; and
- Is a U.S. citizen, a U.S. national, or a resident of the United States.

[1] Note that the adjusted gross income limits may change from year to year.

The Child Tax Credit is reduced by $50 for each $1,000 (or fraction) by which the taxpayer's MAGI exceeds the threshold amount. The threshold amount is:

- $400,000 for taxpayers filing as married filing jointly; and
- $200,000 for taxpayers filing as other than married filing jointly.

If a child tax credit is reduced because of the taxpayer's high MAGI or because the taxpayer's tax liability is lower than the credit to which the taxpayer would otherwise be eligible, the ***additional*** child tax credit may be payable. The additional child tax credit is a credit for certain individuals who get less than the full amount of the child tax credit. Unlike the child tax credit, the additional child tax credit is a refundable tax credit and, for 2023, is $1,600.

Earned Income Credit

The earned income credit (EIC) is a tax credit for certain low-income working taxpayers who meet income, filing status and other requirements. Eligibility to claim the credit requires, among other things, that the taxpayer have an earned income; the taxpayer must also have an adjusted gross income (AGI) below a specific level. The applicable AGI level generally changes annually. Unlike the saver's credit, EIC is a *refundable* credit and, accordingly, it is available to eligible individuals regardless of whether or not they have a federal income tax liability.

In order to receive EIC, the taxpayer must meet certain rules. The EIC rules fall into three categories:

- Rules that apply to everyone;
- Rules that apply if the taxpayer has a qualifying child; and
- Rules that apply if the taxpayer does not have a qualifying child.

EIC Rules Applicable to Everyone

Determining whether a taxpayer qualifies for EIC begins with the seven rules that apply to everyone. If the taxpayer meets all of the seven rules that apply to everyone, the taxpayer must then meet the additional rules that apply a) if the taxpayer has a qualifying child, or b) if the taxpayer does not have a qualifying child.

The rules for everyone relate to:

- Adjusted gross income (AGI) limits;
- Social Security number;
- Tax filing status;
- Citizenship or residency;
- Foreign earned income;
- Investment income; and
- Earned income.

If the taxpayer does not meet all seven of the rules applicable to everyone, the taxpayer cannot receive the earned income credit, regardless of whether or not the taxpayer has a qualifying child.

Adjusted Gross Income Limits

To meet the rule concerning adjusted gross income limits, a taxpayer must have an AGI that is less than the maximum amount for his or her filing status and number of qualifying children. The applicable AGI limits generally change each year and, for 2023, are as shown in the following chart:

2023 EIC ADJUSTED GROSS INCOME LIMITS		
Children	**Married Filing Jointly**	**Other Than Married Filing Jointly***
3 or more qualifying children	$63,398	$56,838
2 qualifying children	$59,478	$52,918
1 qualifying child	$53,120	$46,560
No qualifying children	$24,210	$17,640

*Taxpayer's filing status cannot be married filing separate.

Valid Social Security Number Required

In order to claim the EIC, the taxpayer—and spouse, if filing a joint return—must have a valid social security number issued by the Social Security Administration. In addition, if a qualifying child is listed on Schedule EIC the child must also have a valid social security number. A social security card stating "Not valid for employment" is not sufficient for purposes of the EIC.

Tax Filing Status

A married taxpayer cannot qualify for the EIC if he or she has a "married filing separate" filing status. If the taxpayer is married, he or she must normally file a joint return to claim the EIC. (An exception may apply if the taxpayer's spouse did not live with the taxpayer during the last 6 months of the year. In such a case, the taxpayer may be able to file as head of household and claim the EIC.)

Citizenship or Residency

If the taxpayer (or spouse, if married) was a nonresident alien for any part of the tax year, the taxpayer cannot claim the EIC unless the taxpayer's filing status is married filing jointly. (Such filing status is available only if one spouse is a U.S. citizen or resident alien and chooses to treat the nonresident spouse as a U.S. resident.) If the taxpayer or spouse was a nonresident alien for any part of the year and the taxpayer's filing status is other than married filing jointly, the EIC is not available.

Note: Making the election to treat the nonresident spouse as a U.S. resident will cause the worldwide income of both spouses to be subject to U.S. taxation.

Foreign Earned Income

A taxpayer is ineligible for the EIC if he or she files Form 2555, Foreign Earned Income, or Form 2555-EZ, Foreign Earned Income Exclusion. These forms are used to exclude income earned in foreign countries from the taxpayer's gross income or to exclude a foreign housing amount.

Investment Income

The 2023 investment income of a taxpayer eligible for EIC cannot be greater than $11,000. If the taxpayer's investment income is greater than $11,000, the taxpayer is ineligible for the EIC.

Earned Income

A taxpayer eligible for the EIC must work and have earned income. The requirements of the earned income rule are met if the taxpayer is married, files a joint return and at least one spouse works and has earned income.

Although earned income generally excludes non-taxable pay, a taxpayer can elect to include non-taxable combat pay in earned income for purposes of the EIC.

EIC Rules That Apply if Taxpayer Has a Qualifying Child

In addition to meeting the EIC rules that apply to everyone, a taxpayer who has a qualifying child must meet certain other rules in order to qualify for the EIC. The rules applicable to a taxpayer with a qualifying child are:

- The relationship, age, residence and joint return tests;
- The qualifying child of more than one person rule; and
- The qualifying child of another taxpayer rule.

Relationship, Age, Residence and Joint Return Tests

A taxpayer's child is a qualifying child for purposes of the EIC if the child meets four tests:

- The relationship test;
- The age test;
- The residency test; and
- The joint return test.

All four tests must be met.

Qualifying Child of More than One Person Rule

In some cases, a child may meet the tests to be a qualifying child of more than one person. However, even if a child meets the tests to be a qualifying child of more than one person, only one person is permitted to treat the child as a qualifying child. Only that person is permitted to use the child as a qualifying child to take all the following tax benefits, assuming the taxpayer is eligible for each benefit:

- The child tax credit;
- Head of household filing status;
- The credit for child and dependent care expenses;
- The exclusion for dependent care benefits; and
- The EIC.

The other person cannot take any of these benefits based on the same qualifying child. Accordingly, the taxpayer and the other person cannot divide these tax benefits between themselves based on the same child. In the event the taxpayer and another person meet the qualifying child tests, the tiebreaker rules are used to determine which person can treat the child as a qualifying child.

However, the IRS has changed its position so that even if a taxpayer is not permitted to claim an individual as a qualifying child after application of the tiebreaker rules, the taxpayer may still be able to claim the EITC without a qualifying child ***for all open tax years*** if all other requirements are met. In such a case, the taxpayer not claiming the EITC with the qualifying child may become an eligible individual for claiming the EITC without a qualifying child if the taxpayer otherwise qualifies and meets ***all*** the following rules:

- A resident of the United States for more than half of the year,
- Cannot be claimed as a dependent or qualifying child on anyone else's return, and
- Be at least 25 but under 65 years old at the end of the tax year.

Taxpayer as the Qualifying Child of Another Taxpayer Rule

A taxpayer cannot claim the EIC if he or she is a qualifying child of another taxpayer. A taxpayer is considered a qualifying child of another person only if *all* of the following are true:

- The taxpayer is the other taxpayer's son, daughter, stepchild, grandchild, or foster child;
- The taxpayer is the brother, sister, half-brother, half-sister, stepbrother, or stepsister (or a child or grandchild of the brother, sister, half-brother, etc.) of the other taxpayer;
- The taxpayer was –
  - Under age 19 at the end of the tax year and younger than the other taxpayer (or spouse, if the other taxpayer files jointly),
  - Under age 24 at the end of the tax year, a student, and younger than the other taxpayer (or spouse, if the other taxpayer files jointly), or
  - Permanently and totally disabled, regardless of age;
- The taxpayer lived with the other taxpayer in the United States for more than half of the year; and
- The taxpayer is not filing a joint return for the year (or is filing a joint return only as a claim for an income tax refund).

EIC Rules That Apply if Taxpayer Does Not Have a Qualifying Child

A taxpayer may claim the EIC without a qualifying child, provided the taxpayer meets all the rules that apply to everyone and all the following rules that apply to taxpayers without qualifying children. The EIC rules applicable to a taxpayer with no qualifying children are:

- The age rule;
- The dependent of another person rule;
- The qualifying child of another taxpayer rule; and
- The main home rule.

The Age Rule

A taxpayer claiming the EIC must be at least age 25 but less than age 65 at the end of the tax year. If the taxpayer is married filing a joint return, either the taxpayer or spouse must be at least age 25 but under age 65 at the end of the year.

The Dependent of Another Person Rule

A taxpayer claiming the EIC cannot be the dependent of another person, regardless of whether or not the other person actually claimed the taxpayer as a dependent. Thus, if someone else can claim the taxpayer (or the taxpayer's spouse, if filing a joint return) as a dependent, the taxpayer cannot claim the EIC.

The Qualifying Child of Another Taxpayer Rule

A taxpayer claiming the EIC cannot be a qualifying child of another taxpayer. As noted earlier, a taxpayer is a qualifying child of another person if all of the following are true:

- The taxpayer is the other person's son, daughter, stepchild, grandchild, or foster child;
- The taxpayer is the brother, sister, half-brother, half-sister, stepbrother, or stepsister (or a child or grandchild of the brother, sister, half-brother, etc.) of the other person;
- The taxpayer was –
    - Under age 19 at the end of the tax year and younger than the other person (or spouse, if the other person files jointly),
    - Under age 24 at the end of the tax year, a student, and younger than the other person (or spouse, if the other person files jointly), or
    - Permanently and totally disabled, regardless of age;
- The taxpayer lived with the other person in the United States for more than half of the year; and
- The taxpayer is not filing a joint return for the year (or is filing a joint return only as a claim for an income tax refund).

The Main Home Rule

Under the main home rule, a taxpayer claiming the EIC must have lived in the United States more than half the year. A taxpayer will meet this rule if he or she lived in the 50 states or the District of Columbia for more than half the year. It does not include Puerto Rico or U.S. possessions. The rule does not require that a taxpayer reside in a traditional home; instead, a taxpayer who lived in one or more homeless shelters in the United States for more than half the year will meet the rule.

U.S. military personnel stationed outside the United States on extended active duty are considered to live in the United States during that duty period for purposes of the EIC.

Figuring the Amount of the Earned Income Credit

If the taxpayer meets all of the rules applicable to his or her claiming EIC, the next step is figuring the amount of EIC. Determining the earned income credit is done on either EIC Worksheet A or EIC Worksheet B, found in the instructions for IRS Form 1040, as discussed below:

- **EIC Worksheet A** is used if the taxpayer was not self-employed at any time during the tax year and was not a member of the clergy, a church employee who files Schedule SE, or a statutory employee filing schedule C or C-EZ.
- **EIC Worksheet B** is used if the taxpayer was self-employed at any time during the year or was a member of the clergy, a church employee who files schedule SE or a statutory employee filing schedule C or C–EZ.

Adoption Credit/Exclusion

The adoption credit is a nonrefundable tax credit designed to offset qualified adoption expenses for eligible taxpayers adopting an eligible child or children. The adoption assistance program enables a taxpayer to exclude from income amounts a) paid by the taxpayer to adopt an eligible child or b) paid for the taxpayer by an employer to offset qualified adoption expenses under a qualified adoption assistance program.

Eligible Child

An eligible adopted child, for whose adoption expenses an adoption credit or exclusion could apply, may be a) a U.S. citizen or resident, or b) a foreign child. However, the rules concerning the benefit vary somewhat depending upon the citizenship status of the adopted child and whether the child has special needs.

A child whose qualified adoption expenses may give rise to the adoption credit or exclusion is a child who is:

- Under age 18 (if the child turned age 18 during the year, the child is an eligible child for the part of the year he or she was under age 18); or
- A disabled individual physically or mentally unable to care for himself or herself, regardless of age; such a child is generally referred to in connection with the adoption credit and exclusion as a "special needs" child.

Qualified Adoption Expenses

Qualified adoption expenses are those expenses that are reasonable and necessary and which are related to, and for the principal purpose of, a legal adoption of an eligible child. Such expenses include:

- Adoption fees;
- Attorney fees;
- Court costs;
- Travel expenses, including meals and lodging, while away from home; and
- Re-adoption expenses relating to the adoption of a foreign child.

Expenses that are not considered qualified adoption expenses for purposes of the adoption credit or exclusion include expenses:

- For which the taxpayer received funds under a state, local, or federal program;
- That violate state or federal law;
- For carrying out a surrogate parenting arrangement;
- Paid or reimbursed by the taxpayer's employer or any other person or organization; or
- Allowed as a credit or deduction under any other provision of federal income tax law.

The Benefit

A taxpayer may be able to take the adoption credit or exclusion if the following criteria are met:

1. The taxpayer's filing status is single, head of household, qualifying widow(er), or married filing jointly. In most cases, a married taxpayer must file a joint return in order to take the credit or exclusion;
2. The taxpayer's modified adjusted gross income (MAGI) is less than the applicable limit for the year; and
3. The taxpayer reports the required information concerning the eligible child in part I of IRS Form 8839.

Timing of the Credit/Exclusion

The year in which the taxpayer can take the adoption credit or exclusion depends upon whether the eligible child is a citizen or resident of the United States at the time the adoption effort began. If the eligible child is a U.S. citizen or resident—an adoption referred to as a "domestic adoption"—the taxpayer can take the adoption credit or exclusion even if the adoption never became final.

The year in which a taxpayer may take the credit or exclusion in connection with a domestic adoption is as shown in the following table:

Domestic Adoptions

Qualifying Expenses Paid by Taxpayer in…	**Credit Taken in…**
Any year before the year the adoption becomes final	The year after the year of the payment
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment
Qualifying expenses paid by an employer under an adoption assistance program in…	**Exclusion Taken in…**
Any year	The year of the payment

A taxpayer who adopts a U.S. child with special needs may be able to exclude up to the maximum amount **and** take a credit for additional expenses up to the maximum amount. The exclusion may be available even if neither the taxpayer nor the taxpayer's employer paid any qualified adoption expenses.

The year in which a taxpayer may take the credit or exclusion in connection with a foreign adoption is similarly shown in the chart below (foreign adoption rules that vary from domestic adoption rules are highlighted):

Foreign Adoptions

Qualifying Expenses Paid by Taxpayer in...	**Credit Taken in...**
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment
Qualifying expenses paid by an employer under an adoption assistance program in...	**Exclusion Taken in...**
Any year before the year the adoption becomes final	The year the adoption becomes final
The year the adoption becomes final	The year the adoption becomes final
Any year after the year the adoption becomes final	The year of the payment

Unlike the rules applicable to domestic adoptions that permit a taxpayer to take the adoption credit or exclusion even if the adoption never became final, an adoption credit or exclusion for a foreign adoption is available to a taxpayer only if the adoption becomes final.

Benefit Phased-Out at Higher Taxpayer MAGI

In 2023, the maximum adoption credit is $15,950 per child. Similarly, the maximum amount of employer-provided adoption assistance that a taxpayer may exclude from gross income in 2023 is $15,950 per child. The amount of the adoption credit or excludable assistance, however, is phased out for taxpayers whose 2023 modified adjusted gross income (MAGI) exceeds $239,230 (the "applicable amount") and is eliminated for taxpayers whose MAGI is $279,230 or more.

The reduction in the maximum adoption credit or exclusion for taxpayers whose MAGI exceeds the applicable amount may be determined by using the following equation:

$$\text{Maximum adoption credit/excludable amount} \times \frac{\text{MAGI} - \text{Applicable amount}}{\$40{,}000} = \text{Reduction in maximum adoption credit/excludable amount}$$

Thumbnail Summary of 2023Changes

Subject	**2023 Change**
Saver's credit	Available at AGI up to: Married filing jointly - $73,000 Head of household - $54,750 All other statuses - $36,500
Earned income credit AGI limits	Married filing jointly: 3 or more children - $63,398 2 children - $59,478 1 child - $53,120 No children - $24,210 Other qualifying statuses: 3 or more children - $56,838 2 children - $52,918

	1 child - $46,560 No children - $17,640
Adoption credit/excluded assistance Maximum amount Phase-out MAGI range	 $15,950/child $239,230 to $279,230

Chapter Review

1. Hank is single and has a $30,000 adjusted gross income in 2023. What would his saver's credit be if he deferred $1,000 in his employer's 401(k) plan and received a $500 employer match?

   A. $100

   B. $150

   C. $200

   D. $500

2. Sally made a $4,000 traditional IRA contribution in 2023 and received a $1,000 saver's credit. If she would be eligible to deduct the contribution in the absence of a saver's credit, how much of her contribution may she deduct?

   A. $0

   B. $2,000

   C. $3,000

   D. $4,000

Chapter 3 – PPACA-Related Tax Changes

Introduction

In addition to its various healthcare-related provisions, the PPACA also brought about several changes that affect the tax liability of many taxpayers. They include changes in allowable health flexible spending arrangement contributions, unreimbursed medical expense deductions and Social Security tax rates for higher-income taxpayers. In 2023 additional changes may affect taxpayers, including a) an increase in the limit for employee contributions to an employer-sponsored health care flexible spending arrangement, b) an increase in the level of a small employer's average annual wages at which the health care premium credit is phased out, and c) changes in the employer mandate under which large employers employing 50 or more full-time employees are required to offer affordable health insurance coverage and make contributions toward premiums or potentially pay a penalty.

In this chapter we will briefly summarize the principal tax changes that became effective as a result of passage of the healthcare law and will then discuss the changes effective in 2023.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to identify the changes effective in 2023 related to the –

- Health flexible spending arrangement contribution limits;
- Small business health care tax credit; and
- Large employer shared responsibility provision.

Health Flexible Spending Arrangement Contributions

Health FSAs enable workers to contribute before-tax amounts to an account that may then be accessed tax-free to pay various out-of-pocket health-related expenses. Although annual caps on the amount that can be contributed to a health FSA are generally imposed by employers—usually as a way to limit their risk of pre-funding—no limit was previously imposed by the federal government. That changed for years 2013 and later.

For years 2013 and 2014 a $2,500 per year limit was imposed on the amount that may be contributed to a flexible spending arrangement for medical expenses. That limit may be increased annually by a cost of living adjustment and, for 2023, is $3,050.

Refundable Premium Tax Credit to Assist in Purchase of Qualified Health Plan

Although the tax penalty for a taxpayer's failure to maintain health coverage has been reduced to zero, individuals who meet specified income, coverage and other criteria are eligible to receive a refundable tax credit to enable them to purchase a qualified health plan. Since the tax credit is a *refundable* tax credit, the taxpayer may receive the credit even though he or she has no income tax liability.

Eligibility for Credit

Individuals are eligible to receive a refundable tax credit for purchase of one or more qualified health plans provided they meet all of the following criteria:

- The covered individuals are enrolled in a qualified health plan through an Affordable Insurance Exchange;
- The taxpayer's expected contribution toward health insurance under the second-lowest cost Silver plan in 2023 would exceed 8.5% of household income;
- Covered individuals are legally present in the United States and not incarcerated;
- Covered individuals are not eligible for other qualifying coverage, such as Medicare, Medicaid, or affordable employer-sponsored coverage; and

- The individual cannot be claimed as a dependent by another person.

In order to be eligible for a premium tax credit, a taxpayer who is married at the close of the taxable year must file a joint income tax return, unless he or she meets the criteria that allow victims of domestic abuse to claim the premium tax credit for the year while using the Married Filing Separately filing status.

Federal Poverty Level

The federal government's poverty level is based on the amount of income received in a year relative to annually-published poverty guidelines. The incomes in the guidelines, which are published by the federal government in January each year, generally increase annually to account for the higher prices for goods and services that result from inflation.

The federal poverty guidelines are as shown in the chart below:

HHS Poverty Guidelines			
Persons in family/household	**48 Contiguous States and D.C.**	**Alaska**	**Hawaii**
1	$13,590	$16,990	$15,630
2	$18,310	$22,890	$21,060
3	$23,030	$28,790	$26,490
4	$27,750	$34,690	$31,920
5	$32,470	$40,590	$37,350
6	$37,190	$46,490	$42,780
7	$41,910	$52,390	$48,210
8	$46,630	$58,290	$53,640
For each additional person add	$4,720	$5,900	$5,430

Amount of the Credit

The amount of the tax credit for an eligible taxpayer is generally equal to the difference between the premium for the benchmark plan and the taxpayer's expected contribution, a contribution that increases as the taxpayer's income increases. The amount of the credit is capped at the premium for the plan chosen. Thus, the tax credit will never be larger than the premium for the plan.

Tax Credit = Benchmark Plan Premium - Taxpayer's Expected Contribution

Benchmark Plan

The "benchmark plan," as the term is used in connection with the insurance premium tax credit, is the second-lowest-cost plan that would cover the family at the silver level of coverage. The PPACA defines[2] such a silver level plan as one "designed to provide benefits that are actuarially equivalent to 70 percent of the full actuarial value of the benefits provided under the plan." In other words, the plan pays at least 70 percent of covered charges.

Taxpayer's Expected Contribution

The taxpayer's expected contribution, as the term is used with respect to the premium tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income applicable in 2023 increases—from 2.0% of income for families at less than 150% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level—as the taxpayer's income increases. The amount a family actually pays for coverage will be less than the expected contribution if the family chooses a plan that is less expensive than the benchmark plan.

The income percentages, based on the taxpayer's household income as a percentage of the federal poverty line, are as shown in the table below:

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[2] Affordable Care Act §1302(d)(1)(B).

Household Income Percentage of Federal Poverty Line – 2023	Initial Percentage	Final Percentage
Less than 150%	0.0%	0.0%
At least 150% but less than 200%	0.0%	2.0%
At least 200% but less than 250%	2.0%	4.0%
At least 250% but less than 300%	4.0%	6.0%
At least 300% but less than 400%	6.0%	8.5%
At 400% or more	8.5%	8.5%

Calculating the Credit

The tax credit available for premium assistance for a coverage month is equal to the lesser of:

1. The premiums for the month for one or more qualified health plans in which a taxpayer or member of the taxpayer's family enrolls; or
2. The excess of the adjusted monthly premium for the benchmark plan over 1/12th of the product of a taxpayer's household income and the applicable percentage for the taxable year. (see **Adjusted Monthly Premium** below.)

Although the language of the regulations makes the calculation of the second part of the tax credit appear complicated, the calculation is fairly simple and is more readily understood by considering an equation. Thus, in the form of an equation, the calculation of the second component of the tax credit is as follows:

$$\text{Adjusted monthly premium for the benchmark plan} - \frac{\text{Taxpayer's household income x applicable \%age}}{12} = \text{Tax credit (component 2)}$$

We can illustrate how component 2 is determined by looking at an example. For purposes of the example, assume the following:

Adjusted monthly premium: $2,000
Taxpayer's household income: $63,332
Members of taxpayer's family: 3
Applicable poverty level guideline: $23,030

The only value that we need to calculate before substituting them into the equation is the applicable percentage that is multiplied by the taxpayer's household income.

The following steps will produce the correct applicable percentage for the equation:

1. Divide the taxpayer's household income ($63,332) by the applicable poverty level guideline for a three-person household ($23,030); by doing so, we can see that the taxpayer's household income is 275% of the poverty level. ($63,332 ÷ $23,030 = 2.75 = 275%)
2. Consult the household income percentage chart (above) to determine the initial and final percentages for the taxpayer's household income; by doing so, we see that the initial percentage for a taxpayer whose household income is between 250% and 300% of the federal poverty level is 4.0%; the final percentage is 6.0%.
3. Determine the excess of the taxpayer's federal poverty line percentage over the initial household income percentage in the taxpayer's range; that amount is 25. (275% - 250% = 25)
4. Determine the difference between the initial household income percentage and the final household income percentage in the taxpayer's range, which is 50. (300% - 250% = 50)
5. Divide the result in step 3 by the result in step 4; the answer is .50. (25 ÷ 50 = .50)
6. Subtract the initial percentage (4.0%) from the final percentage (6.0%) in the taxpayer's range; the amount is 2.0. (6.0 – 4.0 = 2.0)
7. Multiply the result obtained in step 6 by the result obtained in step 5; that calculation yields 1.0. (2.0 x .50 = 1.0)
8. Add the result obtained in step 7 (1.0) to the initial premium percentage in the taxpayer's range to calculate the applicable percentage; the result is 5.0%. (4.0% + 1.0% = 5.0%)

Now that we have the applicable percentage value, we can substitute the amounts into the equation to determine component 2 of the tax credit calculation as follows:

$$\$2{,}000 \quad - \quad \frac{\$63{,}332 \times .05}{12} \quad = \quad \$1{,}736.11$$

By solving the equation, we see that component 2 of the tax credit calculation for any month is $1,736.11. Since $1,736.11 is less than the $2,000 monthly premium (component 1), it is the tax credit available as a premium assistance amount. The balance of the monthly premium—$263.89 in this case—is the taxpayer's contribution. The tax credit for the entire year would be $20,833.32. ($1,736.11 x 12 = $20,833.32)

Adjusted Monthly Premium

The term used for the monthly premium in the final regulations implementing the PPACA when calculating the tax credit is *adjusted monthly premium* rather than simply *monthly premium*. The "adjusted monthly premium" used in the calculation of the credit is the premium an issuer would charge for the applicable benchmark plan to cover all members of the taxpayer's coverage family, *adjusted only for the age of each member*.

Special Rules Applicable to the Tax Credit

Although tax credits are normally applied at the conclusion of the year, the premium tax credit may be advanced if desired by the taxpayer. Such advance payments are made directly to the insurer on the taxpayer's behalf. When the taxpayer's federal income tax return is filed, the advance payments are reconciled with the amount of the taxpayer's actual premium tax credit. Although a repayment of the advance payment may be due, any repayment due from the taxpayer may be subject to a cap. (See **Reconciling Advance Premium Tax Credits** below.)

Tax credits are also available to qualified individuals who are offered, but not enrolled in, employer-sponsored insurance. Such tax credits are available only if:

- The self-only premium payable by the taxpayer under the employer-sponsored insurance would exceed 9.5% of household income (9.61% in 2022 and 9.12% in 2023); or
- The employer-sponsored insurance does not provide a minimum value, i.e. it covers less than 60% of total covered costs.

Note that the 8.5% of income applicable to the premium tax credit **does not** apply to taxpayers covered by employer-sponsored insurance that provides at least minimum value. For such employees to be eligible for premium tax credits, the employer-sponsored coverage providing at least minimum value must cost more than 9.12% of the individual's household income.

Reconciling Advance Premium Tax Credits

If advance premium tax credits are provided for a taxpayer, the individual must file a federal income tax return for that year. Such advance credits must be reconciled at the time of filing the individual's federal income tax return for the year in which advance credits were received.

In general, if the reconciliation of the premium tax credit with advance tax credit payments made on behalf of the taxpayer shows an excess payment, that excess is owed by the taxpayer as an additional income tax liability. In certain cases, however, the amount of any additional income tax liability resulting from such excess payment may be limited.

The additional tax imposed on a taxpayer because of excess advance credit payments is limited to the dollar amounts in the additional tax limitation table if the taxpayer's household income is less than 400% of the federal poverty line. The dollar limit on the additional tax depends upon the taxpayer's filing status and his or her household income as a percentage of the federal poverty line.

The limits for 2023 are as shown in the additional tax limitation table below:

2023 - Additional Tax Limitation Table*

	Limitation Amount for Unmarried Individuals (other than	Limitation Amount for All

Household Income Percentage of Federal Poverty Line	qualifying widow(er)s or heads of households)	Other Taxpayers
Less than 200%	$350	$700
At least 200% but less than 300%	900	1,800
At least 300% but less than 400%	1,500	3,000

*Subject to inflation adjustment.

Small Business Premium Tax Credit

Small employers may be eligible to receive a nonrefundable tax credit for premiums paid for employee health insurance coverage. The credit may be carried back one year and forward 20 years.

The credit is available to eligible employers for two consecutive taxable years and is subject to limitations based on:

- The number of employees; and
- The average annual wages paid to employees.

The maximum small employer health insurance premium credit available to eligible small employers is 50% of workers' healthcare premiums paid by small employers and 35% of such premiums paid by small tax-exempt employers, such as charities. If an employer receives a tax credit for premiums paid, its tax deduction for the cost of providing health insurance coverage is reduced by the amount of the credit.

Eligibility Requirements

Not all small employers are likely to be eligible to receive the small employer health insurance premium credit. The credit is available only if the employer meets the following three requirements:

1. The employer paid premiums for employee health insurance coverage under a qualifying arrangement—one under which the employer is required to pay at least 50% of the premium for the employee—obtained through a Small Business Health Options Program (SHOP);
2. The employer had fewer than 25 full-time equivalent employees, not counting employees with ownership interest, for the tax year; and
3. The employer paid average annual wages for the tax year of less than $50,000 (indexed for inflation) per full-time equivalent employee.

Small employer health insurance premium tax credits are available for no more than two consecutive years.

Limitations Affect Health Insurance Premium Credit

Various limitations may apply that have the effect of reducing any health insurance premium credit to which a small employer is entitled. Those limitations are the:

- Full-time equivalent employee (FTE) limitation;
- Average annual wage limitation;
- State average premium limitation; and
- State premium subsidy and tax credit limitation.

Full-Time Equivalent Employee (FTE) Limitation

A small employer's health insurance premium credit will be reduced if the employer had more than 10 FTEs for the tax year. If the employer had 25 or more FTEs for the tax year, the credit is reduced to zero. A small employer has 1 FTE for each 2,080 hours worked by an individual considered an employee.

Average Annual Wage Limitation

A small employer's health insurance premium credit is also reduced if the employer paid average annual wages of more than $25,000 (inflation-adjusted to $30,700 in 2023) for the tax year and is eliminated if the employer paid average annual wages of $50,000 or more for the tax year ($61,400 in 2023).

Average Premium Limitation

A small employer's credit is reduced if the employer premiums paid are more than the employer premiums that would have been paid if individuals who are considered employees enrolled in a plan with a premium equal to the average premium for the small group market in the rating area in which the employee enrolls for coverage.

The average premium for the small group market in the rating area in which the employee enrolls is determined by referring to the current table of average premiums for small group markets which is contained in the IRS Form 8941 instructions for the applicable tax year.

State Premium Subsidy and Tax Credit Limitation

A small employer's premium tax credit may be reduced if the employer is entitled to a state tax credit or a state premium subsidy for the cost of health insurance coverage it provides under a qualifying arrangement to individuals considered employees. Even though a state tax credit or premium subsidy does not reduce the amount of the employer premiums paid, the amount of an employer's credit cannot be greater than its net premium payments.

(Net premium payments are employer premiums paid less the amount of any state tax credits the employee or employer received or will receive and any state premium subsidies paid.)

Calculating the Credit

IRS Form 8941, **Credit for Small Employer Health Insurance Premiums**, is used to calculate the credit and is attached to the small employer's tax return. Several worksheets are used to assist preparers in figuring the amounts to report on various lines of the form, and those worksheets are contained in the instructions for Form 8941.

Large Employer Shared Responsibility: The Employer Mandate

The Affordable Care Act requires that large employers offer their full-time employees and dependents health plan coverage at least equal to minimum essential coverage or face a possible tax penalty. The possible penalties imposed on a large employer for failing to comply with the employer mandate vary, depending upon the nature of its noncompliance. Thus, liability for a penalty may arise as a result of:

- The employer's failure to offer coverage; or
- An employer's offering coverage whose employee received a premium tax credit.

Employers Not Offering Coverage

A large employer that does not offer full-time employees and their dependents the opportunity to enroll in minimum essential coverage under an employer-sponsored plan may be liable for a penalty[3] if one or more of its full-time employees enrolls in health insurance coverage through an exchange and receives a premium tax credit or cost-sharing reduction.

The penalty for each month in such a case is an amount equal to the number of the employer's full-time employees in excess of 30 multiplied by 1/12th of $2,000 adjusted for years after 2014. That penalty applies regardless of the number of employees who are enrolled in health insurance coverage obtained through a state exchange and who receive a tax credit or cost-sharing reduction. For calendar year 2023, the $2,000 penalty is adjusted to $2,880.

Since the liability imposed on a large employer for a failure to offer health insurance coverage to its full-time employees is triggered by an employee's obtaining health insurance coverage through a state exchange and receiving a tax credit or subsidy to assist in its purchase, an employer failing to offer such coverage may, nonetheless, avoid a penalty. Specifically, an employer who has no full-time employee whose income would qualify him or her for a subsidy when purchasing health insurance coverage through an exchange will not be liable for the penalty ***even though it offers no health insurance coverage to its full-time employees***.

[3] IRC §4980H(a).

Employers Offering Coverage

It is not only large employers who fail to offer coverage that may be liable for a penalty. In some cases, employers who offer health insurance coverage to their full-time employees may, nonetheless, be subject to a penalty. If a large employer offers coverage to its full-time employees but at least one full-time employee receives a premium tax credit or cost-sharing reduction, the employer is subject to a penalty. Thus, even if an applicable large employer offers coverage to at least 95% of its full-time employees and their dependents, it may be subject to a penalty if one or more of the full-time employees obtains a premium tax credit because the coverage fails to provide minimum value or its premium exceeds 9.12% (2023) of the individual's income[4] or the employee obtaining the premium tax credit is not one of the 95% of employees offered coverage.

Unlike the penalty to which an employer who fails to offer health insurance coverage to its full-time employees may be subject—whose penalty is based on the total number of full-time employees in excess of 30—the penalty applicable to an employer who offers coverage but whose employee purchases coverage through an exchange and receives a premium tax credit or subsidy is based solely on the number of full-time employees who actually purchase health insurance through a state exchange and receive a premium tax credit or cost-sharing reduction. For each full-time employee receiving a credit or subsidy through a state exchange, the penalty for any month is equal to 1/12th of $3,000, i.e. $250. ($3,000 ÷ 12 = $250) For calendar year 2023, the penalty amount is adjusted to $4,320 ($360 per month). Thus, if 25 employees of such large employer receive a credit or subsidy in 2023, the applicable employer penalty for that month would be $9,000. ($360 x 25 = $9,000)

The penalty for the month to which a large employer offering unaffordable coverage (or coverage failing to provide minimum value) to its full-time employees in 2023 would be subject is limited to no more than the penalty for which it would have been liable if it didn't offer coverage at all, i.e. an amount equal to the number of full-time employees in excess of 30 during the month multiplied by 1/12th of $2,880. Accordingly, if the large employer employed 50 full-time employees in 2023, and 25 of those employees received a credit or subsidy, the applicable penalty limit would be the lesser of:

a) 25 x $360 (25 x $360 = $9,000), or
b) (50 – 30) x $240 (20 x $240 = $4,800)

Clearly, in such a case, the applicable monthly penalty for the employer who offered coverage in which 25 employees declined to participate and purchased coverage through an exchange and received a credit or subsidy would be the smaller of the two possible penalties, i.e. $4,800. ((50 – 30) x $240 = $4,800)

Thumbnail Summary of 2023 Changes

Subject	**2023 Change**
Small business premium credit	Average annual wage at which small business premium credit begins to be reduced is increased to $30,700 in 2023.
Large employer mandate	Employers with 50 or more full-time employees must offer health coverage at least equal to minimum essential coverage to full-time employees and dependents or be subject to a possible tax penalty.

Chapter Review

1. If a taxpayer's household income of $30,000 places the taxpayer at 110% of the federal poverty level, what is the taxpayer's expected contribution when calculating the refundable tax credit for which the taxpayer may be eligible under the PPACA to purchase a qualified health plan in 2023?

   A. $0

   B. $300

[4] IRC §4980H(b).

C. $621

D. $1,200

2. Burger Barn is eligible for a small employer health insurance premium credit. If the company employs 10 full-time employees, all of whom have family coverage, and its monthly group insurance premium rates are $500 for employee-only coverage and $1,200 for family coverage, what is the minimum monthly premium contribution Burger Barn must make in order to qualify for the credit?

   A. $2,500

   B. $5,000

   C. $6,000

   D. $12,000

Chapter 4 – Changes in Archer MSAs, HSAs & IRAs

Introduction

Archer medical savings accounts and health savings accounts permit taxpayers to make deductible contributions annually to a trust from which they can take tax-free withdrawals, as needed, to pay qualified medical expenses. Individual retirement arrangements enable taxpayers to make annual contributions to a personal retirement plan that offers tax-deferred growth and either tax-deductible contributions or tax-free qualified distributions. The limits applicable to these tax-favored plans change from year to year.

This chapter will briefly discuss each of plans and the 2023 changes that affect them.

Chapter Learning Objectives

Upon completion of this chapter, you should be able to:

- Recognize the eligibility rules applicable to Archer MSAs and HSAs;
- Calculate the maximum contributions that may be made to an Archer MSA;
- Apply the tax treatment rules to contributions to and distributions from Archer MSAs and HSAs;
- Calculate the traditional IRA tax deduction available to a taxpayer who is an active participant in an employer-sponsored retirement plan; and
- Recognize the MAGI limits that apply to a taxpayer's eligibility to make a Roth IRA contribution.

Medical Savings Accounts

Archer MSAs are trusts created solely to pay the qualified medical expenses of the individuals for whom established. Archer MSAs call for an individual to:

- Buy a high-deductible health insurance policy (HDHP), and
- Make tax-deductible contributions to the trust.

Trust earnings are tax-deferred and may be withdrawn tax-free to pay qualified healthcare expenses.

High Deductible Health Plan Requirement

To be eligible for an Archer MSA, an otherwise eligible individual must be covered under a high-deductible health plan. A "high-deductible health plan" is defined differently for individuals and families, and the deductible under the definition of such a plan tends to increase annually. For a policy that covers only the individual, a high deductible health plan in 2023 is one whose annual deductible is at least $2,650 but not more than $3,950. It must also provide that annual out-of-pocket expenses other than for premiums do not exceed $5,300.

A high-deductible health plan providing family coverage in 2023 must have an annual deductible of at least $5,300 but not more than $7,900 and must require annual out-of-pocket expenses other than for premiums of not more than $9,650. (These limits tend to be adjusted upward each year.) Since the term "family coverage" applies to any health plan coverage except self-only coverage, the term would apply to a health insurance plan covering only a husband and wife as well as one covering a husband, wife and multiple children.

High Deductible Health Plan (MSA) – 2023

Deductible and out-of-pocket limits in an Archer MSA high deductible health plan for a specific year depend on whether the plan provides self-only coverage or family coverage. The limits applicable to an Archer MSA in 2023 are the following:

	Minimum HDHP Deductible	***Maximum HDHP Deductible***	***Maximum Annual Out-of-Pocket***
Self-only coverage	$2,650	$3,950	$5,300
Family coverage	$5,300	$7,900	$9,650

Archer MSA Contributions

The maximum deductible contribution that may be made to an Archer MSA depends on whether the high deductible health plan provides self-only coverage or family coverage and the amount of the applicable deductible. An eligible individual may deduct the contributions he or she makes to an Archer MSA during the taxable year in an amount not to exceed:

- 65% of the annual deductible for individuals with self-only coverage; or
- 75% of the annual deductible for individuals with family coverage.

The time of the year the qualifying high deductible coverage began is important since the maximum amount that may be contributed to the trust for any year is based on a full calendar year; thus, if the MSA high-deductible health plan coverage began later than January 1st, the maximum trust contribution permitted for that calendar year would be reduced. (Note that this is different for health savings accounts, discussed next.)

Penalty for Excess Contributions

A taxpayer's contributions to an Archer MSA in excess of the limits are subject to a 6% excise tax penalty, not to exceed 6% of the value of the Archer MSA at the close of the tax year. If a taxpayer makes an excess contribution to his or her Archer MSA, it may be withdrawn, along with any net income attributable to it, on or before the last day for filing the individual's income tax return (including extensions) for the year.

Special Rules for Employer-Installed MSAs

Archer MSAs may be sponsored by small employers and self-employed individuals. Contributions made by an employer to employees' Archer MSAs are deductible by the employer on the "Employee benefit programs" line of the business income tax return for the year in which the employer made the contributions.

If an Archer MSA is installed by an employer, some additional rules come into play. The additional rules applicable to employer-installed MSAs that affect contributions to it include the following:

- In any year in which an employer makes a contribution to an Archer MSA, no contributions to the Archer MSA may be made by the individual account holder;
- The deduction for contributions made to an Archer MSA in any year cannot exceed the employee's compensation attributable to the employer maintaining the MSA. Likewise, a self-employed individual's Archer MSA contribution cannot exceed the individual's earned income from the self-employment with respect to which the plan is established; and
- Contributions for all employees of the employer must be comparable, but they are not required to be identical.

Archer MSA Distributions

Although distributions taken from Archer MSAs are designed principally to pay qualified medical expenses, they may be taken by the individual to meet any kind of need. The tax treatment of the distribution, however, is different—and less favorable—when distributions are taken to meet other than qualified medical expenses.

For Archer MSA purposes, ***qualified medical expenses*** are those expenses that would generally qualify for the medical and dental expenses deduction and include amounts paid by the individual for unreimbursed medical care for the taxpayer, a spouse and dependents.

Archer MSA Rollovers

Not unlike other qualified funds, the funds in an Archer MSA can be rolled over to a different MSA or to an HSA. (See **Health Savings Accounts** below.) The applicable rollover rules are much like those that apply to IRA rollovers and rollovers from qualified plans insofar as they require the rollover to be completed within 60 days of a distribution and limited to once every 12 months.

Account Transfer Incident to Divorce

The account holder's divorce or death may cause the Archer MSA account to be transferred. If the account holder divorces, the Archer MSA interest may be transferred from one spouse (or former spouse) to another ***without income taxation***. To avoid taxation on the transfer it must be made under a divorce or separation agreement. (See IRC §71(b)(2)(A).) Upon such a transfer, the Archer MSA is treated as the MSA of the spouse (or former spouse) to whom it was transferred.

Account Transfer at Death

The disposition of an Archer MSA upon the death of the account holder depends on who the beneficiary is. The Archer MSA designated beneficiary may be:

- A spouse;
- A designated beneficiary other than a spouse; or
- The individual account holder's estate.

If the designated beneficiary of the Archer MSA is the account holder's surviving spouse, he or she becomes the new account holder. In such a case, no income needs to be recognized as a result of the original account holder's death. Alternatively, an Archer MSA designated beneficiary may be someone other than a spouse—a friend or the individual's estate, for example. In such a case, the account stops being an Archer MSA when the account holder dies, and the value of the Archer MSA must be recognized by the beneficiary to the extent its value exceeds the amount of the decedent's qualified medical expenses paid by the beneficiary within one year following the account holder's death.

Archer MSA Taxation

A taxpayer who is an MSA account holder must file Form 8853, Archer MSAs and Long-Term Care Insurance Contracts, and attach it to Form 1040 or Form 1040NR if:

- The taxpayer or employer made contributions to the taxpayer's Archer MSA during the year;
- The taxpayer files a joint return and his or her spouse or spouse's employer made contributions to the spouse's Archer MSA during the year; or
- The taxpayer (or spouse, if filing jointly) acquired an interest in an Archer MSA because of the death of the account holder.

In addition, the taxpayer must report any contributions and/or taxable MSA distributions on Form 1040 or 1040NR, as appropriate.

Contribution Tax Treatment

When Archer MSA contributions are made by an individual account holder they are deductible above the line. When an individual's employer makes Archer MSA contributions to an account for the individual, the contributions are considered employer-provided coverage for medical expenses up to the allowable amount of Archer MSA contributions. They are generally deductible to the employer as a business expense but are not included in the employee's gross income for tax purposes.

Contributions made to an Archer MSA earn tax-deferred interest, and tax-deferral continues as long as the funds remain in the MSA. However, tax-deferral may be lost if the account holder pledges the Archer MSA as security for a loan.

Deductible contributions may be made through the due-date of the federal income tax return (without extensions). Such contributions should be reported on Form 1040 or Form 1040NR, as appropriate.

Distribution Tax Treatment

Distributions from an Archer MSA may be tax-free or taxable as ordinary income. The difference between the tax treatments lies in the use to which the distribution is put.

Archer MSA distributions are fully tax-free when the funds distributed are used to pay qualified medical expenses. For MSA purposes, ***qualified medical expenses*** are those expenses that would generally qualify for the medical and dental expense deduction and include amounts paid by the individual for unreimbursed medical care for the taxpayer, spouse and dependents.

Archer MSA distributions are taxable and must be included in the account holder's gross income for tax purposes to the extent used for any purpose other than the payment of qualified medical expenses.

Archer MSA Distribution Tax Penalty

A taxable Archer MSA distribution may also subject the account holder to a substantial tax penalty. Archer MSA distributions are includible in income ***and subject to income tax penalties*** when they are used for other than qualified medical expenses and fail to meet specific exceptions.

An Archer MSA distribution includible in an account holder's income is subject to a 20% penalty tax levied on the amount of the distribution includible in income, unless one of the following exceptions applies:

- The distribution is received while the account holder is disabled;
- The distribution is received following the account holder's death; or
- The distribution is received by the account holder after reaching the eligibility age for Medicare, i.e. age 65.

Even if one of these exceptions to the tax *penalty* applies, however, a distribution *not used to pay qualified medical expenses* is still includible in the distributee's income for tax purposes.

Health Savings Accounts

Based, in part, on the experience of the Archer MSA pilot program, legislation was signed into law establishing health savings accounts (HSAs). HSAs are similar to Archer MSAs in many areas. Like MSAs, HSAs are trusts created solely to pay the qualified medical expenses of an account beneficiary and call for an individual to:

- Buy a high-deductible health insurance policy, and
- Make tax-deductible contributions to the trust.

Contributions made to the trust and any earnings are tax-deferred for as long as they remain in the trust. HSA account holders may withdraw funds from the trust to pay any qualified healthcare expenses. When the account holder's expenses for healthcare exceed the policy's deductible, those expenses are covered, in whole or in part, by the health insurance.

Although HSAs and their accompanying high-deductible health plans (HDHPs) are intended to provide insurance coverage for covered costs only to the extent they exceed the HDHP deductible, the CARES Act has modified this requirement, effective on and after January 1, 2020, by:

- Allowing HDHP participants with HSAs to obtain telemedicine[5] and other remote care services free of any cost sharing without jeopardizing the HSA;
- Eliminating the ACA ban on the pre-tax reimbursement of over-the-counter drugs not prescribed by a physician; and
- Treating expenses incurred for menstrual care products as qualified medical expenses.

Additionally, the Families First Coronavirus Response Act (FFCRA) requires all group health plans and health insurers to cover coronavirus tests and related services without any type of cost sharing. Thus, no deductible or coinsurance charges apply to testing for the coronavirus, and receiving such first-dollar benefits will not adversely affect the HSA or the individual's eligibility.

Distributions from an HSA may be taken by an account holder at any time. If taken to pay or be reimbursed for qualified healthcare expenses, such distributions are tax free provided they are not compensated by insurance or otherwise. If taken for any purpose other than to pay qualified

[5] "Telemedicine" refers to the use of technology to provide remote medical services to individuals over a smart phone or computer.

healthcare expenses, the distribution is taxable as ordinary income and may be subject to a tax penalty.

HSA Eligibility

An individual eligible to establish an HSA is one who meets all the following requirements. The individual:

- Is covered under a high deductible health plan (HDHP) on the first day of the month;
- Has no other health coverage except for certain specified coverages;
- Is not enrolled in Medicare; and
- Cannot be claimed as a dependent on another person's tax return for the year.

HSA High Deductible Health Plan Requirement

To be eligible for an HSA, an otherwise eligible individual must be covered under a high-deductible health plan. For a policy that covers only the *individual*, a high deductible health plan in 2023is one whose annual deductible is at least $1,500 and which also provides that annual out-of-pocket expenses do not exceed $7,500. A high-deductible health plan providing *family* coverage in 2023 must have an annual deductible of at least $3,000 and must require annual out-of-pocket expenses of not more than $15,000. (These limits tend to be adjusted upward each year.)

High Deductible Health Plan (HSA) – 2023				
Contribution, deductible and out-of-pocket limits in an HSA high deductible health plan for a specific year depend on whether the plan provides self-only coverage or family coverage. The limits applicable to an HSA in 2023 are the following:				
Coverage Type	Minimum Deductible	Maximum Annual Out-of-Pocket*	Maximum Individual Annual Contribution	Individual Annual Catch-up Contribution
Self-only coverage	$1,500	$7,500	$3,850	$1,000
Family coverage	$3,000	$15,000	$7,750	$1,000
*The maximum out-of-pocket limit does not apply to deductibles and expenses for out-of-network services if the plan uses a network of providers. Instead, only deductibles and out-of-pocket expenses for services within the network should be used to figure whether the limit applies.				

HSA Contributions

Contributions to an HSA may be made up until April 15th of the year following the year for which contributions are made. Similar to Archer MSA contribution limits, the maximum deductible contribution that may be made to an HSA depends on whether the high deductible health plan provides self-only coverage or family coverage. However, the *amount* of the applicable deductible—a factor in determining the maximum MSA contribution—does not affect the maximum HSA contribution. The test to determine whether self-only or family coverage limits apply occurs on the first day of the month.

An eligible individual who has not attained age 55 by the end of the taxable year may deduct the contributions he or she makes to an HSA during 2023 in an amount not to exceed:

- $3,850 for account holders with self-only coverage; or
- $7,750 for account holders with family coverage.

HSA Contributions from Multiple Sources

Contributions made to an account holder's HSA may come from multiple sources. If the account holder has an HSA under an employer's plan, contributions may be made by the employer, the employee or both for the same year. In addition, family members or any other person may also contribute to an HSA on behalf of an eligible individual.

Additional Contributions for Age 55 and Older Account Holders

HSA account holders who attain age 55 before the close of a taxable year are eligible to make an additional contribution. The maximum additional contribution amount is $1,000. Thus, an HSA account holder who is age 55 or older and has self-only coverage may make a maximum contribution in 2023 of $4,850; such an individual with family coverage may make a maximum contribution of $8,750. (If both spouses are age 55 or older, each may make a catch-up contribution of up to $1,000.)

First-Year Contributions for New Account Holders

An individual who becomes an eligible individual (for HSA purposes) after the beginning of a taxable year and who is an eligible individual for the last month of the taxable year is treated, for purposes of maximum contributions, as being an eligible individual for the entire year. Thus, an individual who becomes eligible for an HSA in December 2023 and establishes the HSA may make a contribution not exceeding the applicable maximum for the entire year. (Note the difference from an Archer MSA.)

However, if such an individual fails, at any time during the following taxable year (the same "plan" year, in other words), to be an eligible individual (for HSA purposes), the taxpayer must include in his or her gross income the aggregate amount of all HSA contributions made by the taxpayer that could not have been made under the general rule. The amount includible in the former account holder's gross income is also subject to a 10% penalty tax for failure to maintain HDHP coverage. An exception exists if the failure to remain HSA eligible is the result of death or disability.

Maximum HSA Contributions may be Reduced

An HSA account holder must reduce the amount that can be contributed to the HSA, but not below zero, by any amounts contributed:

- To an Archer MSA, including employer contributions, for the year;
- To the HSA by any other person, including the HSA account holder's employer, that are excludible from the account holder's income; and
- Under a qualified HSA funding distribution, i.e. a distribution from the account holder's IRA to the HSA.

Penalty for Excess Contributions

If a taxpayer makes an excess contribution for the year the account holder must withdraw it or be subject to a 6% excise tax penalty, not to exceed 6% of the value of the HSA at the close of the tax year. An excess contribution to an HSA may be withdrawn, along with any net income attributable to it, on or before the last day for filing the individual's income tax return (including extensions) for the year. The excess contribution withdrawn before the tax-filing date is not includible in the distributee's income, nor is the contribution deductible. Any income that is attributable to the excess contribution being withdrawn must be included in gross income in the year in which received.

Employer HSA Participation

Contributions made by an employer to employees' HSAs are deductible by the employer on the "Employee benefit programs" line of the business income tax return for the year in which the employer made the contributions. If an employer makes contributions to employees' HSAs, the employer is required to make comparable contributions to all comparable participating employees' HSAs.

HSA Distributions

Although distributions taken from HSAs are designed to pay qualified medical expenses, they may be taken by the individual to meet any kind of need. The tax treatment of the distribution, however, is different—and less favorable—when distributions are taken to meet other than qualified medical expenses.

Qualified medical expenses are those expenses that would generally qualify for the medical and dental expenses deduction and include amounts paid by the individual for unreimbursed medical care for the taxpayer, spouse and dependents.

As noted earlier, the Cares Act also adds telehealth and other remote care services to the list of coverages that can be provided on a first-dollar basis, i.e. with no deductible, without adversely affecting the taxpayer's eligibility to establish and maintain an HSA. Without this provision, a taxpayer receiving first-dollar coverage for such services would be disqualified from establish an HSA or making tax-favored HSA contributions.

Health insurance premiums are not normally considered a qualified medical expense for HSA purposes; however, exceptions apply. The following health insurance premiums ***are*** deemed HSA-qualified medical expenses:

- Premiums for healthcare continuation coverage (such as coverage under COBRA);
- Premiums for long term care insurance; and
- Health plan premiums paid while the account holder is receiving unemployment compensation

HSA Rollovers

Funds in an HSA or Archer MSA can be rolled over to an HSA. The applicable rollover rules are much like those that apply to IRA rollovers and rollovers from qualified plans and require the rollover to be completed within 60 days of a distribution. Rollovers are limited to no more than one every 12 months.

Account Transfer Incident to Divorce

The account holder's divorce or death may cause the HSA account to be transferred. If the account holder divorces, the HSA interest may be transferred from one spouse (or former spouse) to another ***without income taxation***. To avoid taxation on the transfer it must be made under a divorce or separation agreement. (See IRC §71(b)(2)(A).) Upon such a transfer, the HSA is treated as the HSA of the spouse to whom it was transferred.

Account Transfer at Death

The disposition of an HSA upon the death of the account holder depends on who the beneficiary is. If the designated beneficiary of the HSA is the account holder's surviving spouse, he or she becomes the new account holder and no income needs to be recognized. If the beneficiary is other than a spouse, the account stops being an HSA when the account holder dies and the value of the HSA must be recognized by the beneficiary to the extent its value exceeds the amount of the decedent's qualified medical expenses paid by the beneficiary within one year following the account holder's death.

When the HSA account holder's estate is designated as the beneficiary, the account's fair market value is taxable in the account holder's final taxable year and included in the final income tax form prepared by the executor or administrator. In such a case, the assets in the HSA are distributed income tax-free according to the terms of the account holder's will or the intestacy laws if the account holder dies without a will.

HSA Taxation

The tax treatment of HSA contributions varies, depending on the source of the contributions. A taxpayer who is an HSA account holder must file Form 8889, Health Savings Accounts (HSAs), and attach it to Form 1040 or Form 1040NR if:

- The taxpayer or employer made contributions to the taxpayer's HSA during the year;
- The taxpayer files a joint return and his or her spouse or spouse's employer made contributions to the spouse's HSA during the year; or
- The taxpayer (or spouse, if filing jointly) acquired an interest in an HSA because of the death of the account holder.

In addition, the taxpayer must report any contributions and/or taxable distributions on Form 1040 or 1040NR, as appropriate.

Contribution Tax Treatment

When HSA contributions are made by an individual account holder they are deducted by the individual from his or her income for purposes of determining the account holder's adjusted gross income.

When an individual's employer makes HSA contributions to an account for the individual, the contributions are considered employer-provided coverage for medical expenses up to the allowable amount of HSA contributions. Accordingly, employer-provided HSA contributions are generally deductible to the employer as a business expense but are not included in the employee's gross income for income tax purposes. Contributions made to an HSA earn tax-deferred interest, and tax-deferral continues as long as the funds remain in the account.

Deductible contributions may be made through the due-date of the federal income tax return (without extensions). Such contributions should be reported on Form 8889, Health Savings Accounts (HSAs) and on Form 1040 or Form 1040NR.

Distribution Tax Treatment

Distributions from an HSA may be tax-free or taxable as ordinary income. The difference between the tax treatments lies in the use to which the distribution is put.

A distribution, including a rollover distribution, from an HSA must be reported on Form 8889, Health Savings Accounts (HSAs). The amount by which a distribution (other than a distribution that is rolled over) exceeds the account holder's unreimbursed qualified medical expenses must be reported as "Other income" on Form 1040 or Form 1040NR. On the adjacent dotted line, enter "HSA" and the amount. In addition, 20% of the taxable HSA distribution during the year that does not meet any of the exceptions to the tax penalty must be reported as "Other taxes" on Form 1040 or Form 1040NR. The amount of the additional tax and "HSA" should be entered on the adjacent dotted line.

Tax-Free HSA Distributions

HSA distributions are fully tax-free when the funds distributed are used to pay qualified medical expenses, including non-prescription over-the-counter medical products.

Taxable HSA Distributions

HSA distributions are taxable and must be included in the account holder's gross income for tax purposes to the extent used for any purpose other than the payment of qualified medical expenses.

An HSA owner who is at the age at which he or she is eligible for Medicare may withdraw funds from the account for other than to pay qualified medical expenses without incurring a tax penalty. Although the funds thus withdrawn are subject to income taxation as ordinary income—just as a distribution from a traditional IRA would be—no tax penalty applies.

HSA Distribution Tax Penalty

A taxable HSA distribution may also subject the account holder to a substantial tax penalty. HSA distributions are includible in income and subject to income tax penalties when they are used for other than qualified medical expenses and fail to meet specific exceptions. An HSA distribution includible in an account holder's income is subject to a 20% penalty tax levied on the amount of the distribution includible in income, unless one of the following exceptions applies:

- The distribution is received while the account holder is disabled;
- The distribution is received following the account holder's death; or
- The distribution is received by the account holder after reaching the eligibility age for Medicare.

Even if these exceptions apply, however, a distribution *not used to pay qualified medical expenses* is includible in the distributee's income for tax purposes.

Early Distributions

Contributions to IRAs are afforded special tax benefits under the Internal Revenue Code—benefits including possible deductibility of contributions, tax-deferred accumulations, possible tax-free distributions—principally to encourage individuals to participate in such plans that will provide them with retirement income. In an attempt to limit the use of such funds to producing retirement income, early distributions—taxable distributions from an IRA before the account holder becomes age 59 ½—are generally subject to a 10% penalty tax.

This penalty is usually waived only in the following circumstances:

- The taxpayer plans to use the funds to purchase a first home;
- The taxpayer becomes disabled before the distribution occurs;
- A beneficiary receives assets after the account owner's death;
- The taxpayer uses the funds for unreimbursed medical expenses, health insurance costs incurred after job loss;
- The taxpayer uses the funds for adoption or higher education expenses;
- The distribution results from an IRS levy;

- The distribution is from returns on non-deductible contributions;
- The taxpayer is in the military and is called to active duty for more than 179 days; or
- The distribution is part of a SEPP (substantially-equal periodic payments) program.

In addition to these specified exceptions to imposition of the penalty that traditionally apply, the CARES Act added coronavirus-related distributions. As a result of the CARES Act, the 10% tax penalty was waived for any coronavirus-related early distributions up to $100,000 from an individual's IRA made in 2020. This $100,000 limit applies to the aggregate of distributions to a single person – not per account. A retirement plan administrator may rely on an employee's certification that the early distribution is related to the coronavirus. Although a coronavirus-related distribution is one occurring in 2020, its possible effects on taxation and tax preparation extend beyond the date of distribution, as discussed below.

Taxation of IRA Withdrawals Over Three-Year Period

Not only is the tax penalty waived in the case of any coronavirus-related distribution, such a distribution is afforded additional special tax treatment. Under the CARES Act, unless the taxpayer elected to have the entire amount included in income in the year of withdrawal, any withdrawal amount required to be included in gross income for the taxable year—in most cases, the entire amount withdrawn is includible in gross income—is included ratably over the three-taxable-year period beginning with the taxable year in which the withdrawal was made.

Rollover of IRA Withdrawals Within Three Years of Distribution

Most retirement plan distributions may be rolled over and, thereby, avoid current taxation. Coronavirus-related plan distributions enjoy a similar benefit in that they do not have to be included in income to the extent the taxpayer subsequently redeposits the distribution. In such a case, the redepositing will be treated, for tax purposes, as though the taxpayer had made a direct transfer of the redeposited funds from trustee to trustee.

Any IRA account holder who receives such a distribution is permitted to redeposit the distribution. Under the CARES Act, the recipient of a coronavirus-related distribution may make a single repayment contribution or multiple contributions in an aggregate amount not to exceed the amount of the coronavirus-related distribution to an eligible retirement plan.

The repayment must occur during the three-year period beginning on the day after the date on which it was received. The redeposited withdrawals, for tax purposes, will be treated as if the redeposited distribution had been transferred to an eligible retirement plan in a direct trustee to trustee transfer within 60 days of the distribution; in short, it will avoid taxation.

Roth IRA Eligibility

A Roth IRA is a personal retirement savings plan, funded by an annuity or trust/custodial account, which provides income tax deferral and may provide tax-free distribution of earnings through qualified distributions. It does not provide for contribution deductibility. Eligibility for a Roth IRA is limited to individuals, regardless of age or qualified plan participation, whose income does not exceed certain modified adjusted gross income limits.

Limits on Contributions

The maximum amount an individual can contribute to a Roth IRA is $6,500 (in 2023) or, if he or she is age 50 or older, $7,500, less any amount contributed to a traditional IRA for the same year. The maximum contribution that may be made to a Roth IRA is reduced, based on the individual's modified adjusted gross income, according to the following formula:

$$\text{Contribution reduction} = \frac{\text{MAGI – applicable dollar amount}}{\text{\$15,000 (\$10,000 if married filing a separate return or jointly)}} \times \text{Maximum contribution}$$

The “applicable dollar amount” in the Roth IRA formula is based on the individual’s filing status, as shown in the following chart:

Federal Income Tax Filing Status	Applicable Dollar Amount (2022)	Applicable Dollar Amount (2023)
Individual	$129,000	$138,000
Married, filing a joint return	$204,000	$218,000
Married, filing separately	$0	$0

Traditional IRA Contributions by Active Participants

Every taxpayer who has earned income may make a traditional IRA contribution. In most cases, traditional IRA contributions are deductible by the taxpayer. However, when the taxpayer is an active participant in an employer-sponsored retirement plan, the usual deductibility of traditional IRA contributions may be changed, depending on the participant’s MAGI and filing status.

Tax Treatment of Contributions by Active Participants

There are three possibilities with respect to the tax deductibility of a traditional IRA contribution made by an active participant in an employer-sponsored retirement plan. The traditional IRA contribution may be:

- Fully deductible, or
- Partially deductible, or
- Not deductible

The tax status of the traditional IRA contribution for an active participant depends entirely on his or her modified adjusted gross income and filing status. Traditional IRA contributions made by active participants whose MAGI does not exceed the applicable dollar amount for his or her filing status are fully deductible.

The applicable dollar amounts for tax year 2023 are as shown in the chart below:

Active Participants – Applicable Dollar Amounts		
Taxable Year	**Married Filing Jointly Return**	**Single or Head of Household Return**
2018	$101,000	$63,000
2019	$103,000	$64,000
2020	$104,000	$65,000
2021	$105,000	$66,000
2022	$109,000	$68,000
2023	$116,000	$73,000

Reduced Deductibility of Traditional IRA Contributions for Active Participants

The reduction of the deductible amount of a traditional IRA contribution for an active participant filing a *single or head-of-household* federal tax return is determined by using the following formula:

$$\text{Reduction of Deduction (Single or HOH)} = \text{Maximum contribution} \times \frac{\text{MAGI – applicable dollar amount}}{\$10{,}000}$$

The reduction of the deductible amount of a traditional IRA contribution for an active participant filing a *joint* federal tax return is determined by using the following formula:

$$\text{Reduction of Deduction (Married filing jointly)} = \text{Maximum contribution} \times \frac{\text{MAGI – applicable dollar amount}}{\$20{,}000}$$

(Note: The difference between the two formulas shown above is in the denominator of the fraction. For active participants filing single or head-of-household federal tax returns, the denominator is $10,000; for active participants filing a joint federal tax return, it is $20,000.)

Notice that the formula is NOT a formula for determining the extent of the tax-deductibility of a traditional IRA contribution. It is the formula for determining an active participant's (or spouse's) REDUCTION in his or her traditional IRA deductibility.

Thumbnail Summary of 2023 Changes

Subject	**2023 Change**
MSA limits	Individual: Deductible - $2,650 to $3,950 Out-of-pocket maximum - $5,300 Maximum contribution – 65% of deductible Family: Deductible - $5,300 to $7,900 Out-of-pocket maximum - $9,650 Maximum contribution – 75% of deductible
HSA limits	Individual: Minimum deductible - $1,500 Out-of-pocket maximum - $7,500 Maximum contribution* - $3,850 Family: Minimum deductible - $3,000 Out-of-pocket maximum - $15,000 Maximum contribution* - $7,750 * HSA account holders aged 55 or older may contribute up to an additional $1,000 annually
IRA contribution maximum	Regular - $6,500 Catch-up - $1,000
Roth IRA contribution income limits	Single & head of household: Maximum MAGI for full contribution - $138,000 Contribution eliminated at MAGI of - $153,000 Married Filing Jointly: Maximum MAGI for full contribution - $218,000 Contribution eliminated at MAGI of - $228,000
Traditional IRA deductibility for active participants in employer-sponsored qualified retirement plan	Single & head of household: Maximum MAGI for full deductibility - $73,000 All deductibility eliminated at MAGI of - $83,000 Married Filing Jointly: Maximum MAGI for full deductibility - $116,000 All deductibility eliminated at MAGI of - $136,000
CARES Act-related IRA changes	Coronavirus-related distributions receive favorable tax treatment: • No early withdrawal penalty for distributions up to $100,000 • Taxpayer may choose ratable 3-year income recognition • Distribution may be repaid within 3 years of distribution, resulting in no income recognition

Chapter Review

1. Ellen has maintained self-only health insurance coverage with a $2,700 deductible under her Archer MSA throughout 2023. What is the maximum tax-deductible contribution she can make to the MSA in 2023?

    A. $1,875

    B. $1,755

    C. $4,750

    D. $3,650

2. Peter, age 45, had $5,000 in qualified medical expenses in 2023 and took an $8,000 Archer MSA distribution during the year. If the excess distribution fails to meet a specific exception applicable to the tax penalty, for what tax penalty will he be liable?

    A. $1,000

    B. $1,600

    C. $600

    D. $0

Chapter 5 – Inflation Reduction Act

Introduction

The Inflation Reduction Act, legislation designed in large part to lower consumer energy costs and provide economic incentives to reduce the human impact on climate change, became law in 2022. Among other provisions, the new law provides multiple tax incentives for taxpayers to:

- Make energy efficient home improvements;
- Purchase electric vehicles; and
- Afford health insurance coverage.

This chapter provides a brief discussion of the provisions of the Inflation Reduction Act most likely to have an effect on tax preparers in 2023.

Chapter Learning Objectives

After completing this course, students should be able to:

- Recognize the rule change affecting deductibility of business meals in 2023;
- Describe the energy-efficient home improvement provisions of the Inflation Reduction Act;
- Recognize the tax credits available for a new or previously-owned clean vehicle; and
- Describe the qualified refueling property credit.

Inflation Reduction Act

The principal legislation passed into law and likely to affect individual tax preparation in 2023 is the Inflation Reduction Act (IRA). IRA's provisions affecting tax preparers include the:

- Energy-efficient home improvement credit;
- Qualified energy property credit;
- New clean vehicle credit;
- Previously-owned clean vehicle credit;
- Qualified refueling property credit;
- Premium tax credit expansion; and
- Extension of the limitation on excess business losses of noncorporate taxpayers.

Energy-Efficient Home Improvement Credit

The IRA provision authorizing the energy-efficient home improvement credit provides a nonrefundable tax credit equal to 30% of the cost, not exceeding $1,200 in total, for new windows, skylights, exterior doors meeting specified energy requirements, and energy audits. Effective for property placed in service after December 31, 2021, the credit is further limited to no more than:

- $600 in the aggregate for windows and skylights;
- $250 for exterior doors ($500 in the aggregate); and
- $150 for home energy audits.

Qualified Energy Property Credit

The IRA provision authorizing the qualified energy property credit provides a maximum aggregate credit equal to the lesser of 30% of cost or $2,000 for heat pumps, heat pump water heaters and biomass stoves and boilers. Additionally, it provides for a maximum credit of $600 to cover expenditures for labor costs allocable to the preparation, assembly or original installation of qualified energy property. It is effective for property placed in service after December 31, 2021.

New Clean Vehicle Credit

The provision of the IRA authorizing the nonrefundable tax credit for the purchase or lease of a new electric vehicle—a provision generally effective for vehicles placed in service after December 31, 2022 and not later than December 31, 2032—provides for a maximum tax credit of $7,500.

Eligibility for the tax credit is contingent on meeting various requirements including:

- Battery component and critical materials requirements;
- Battery capacity and recharging specifications;
- Maximum purchaser income requirements;
- Manufacturer's suggested retail price (MSRP) maximums; and
- Vehicle compliance with applicable safety and air quality requirements.

New Clean Vehicle Tax Credit Requirements

The amount of the tax credit for purchase of a new clean vehicle is equal to the total amount determined based on two factors:

1. The critical minerals used in the battery from which the EV draws electricity, a factor that may account for a maximum credit of $3,750; and
2. The battery components, a manufacture/assembly factor that may account for a maximum credit of $3,750.

Manufacturer's Suggested Retail Price Affects Tax Credit Eligibility

The new EV tax credit is not available for a vehicle with a manufacturer's suggested retail price (MSRP) in excess of the following:

Class of Vehicle	Manufacturer's Suggested Retail Price
Vans	$80,000
Sport utility vehicles	$80,000
Pickup trucks	$80,000
Other vehicles	$55,000

Income-Based EV Tax Credit Limitations

The tax credit available with respect to an EV meeting the definition of a new clean vehicle may be limited based on the taxpayer's modified adjusted gross income (MAGI). Pursuant to the income limitation, no previously-owned vehicle tax credit is available if the taxpayer's MAGI for the current or prior taxable year exceeds the threshold amount which is:

- $300,000 in the case of a joint return or a surviving spouse;
- $225,000 in the case of a head of household; and
- $150,000 in the case of any other taxpayer.

Transfer of Credit

Tax credits, with certain exceptions, are generally taken at the time a taxpayer's return is filed, and a taxpayer eligible for the clean vehicle tax credit may choose to take the credit at that time. However, a taxpayer may elect to transfer the clean vehicle tax credit to an eligible entity, i.e., the dealer who sold the vehicle to the taxpayer, and receive the credit at the time of purchase of the vehicle in cash or in the form of a partial payment or down payment. A transferred credit does not result in includible income to the purchaser and is not deductible by the dealer.

Special Rules Applicable to New Clean Vehicle Credit

Various requirements apply to a new clean vehicle tax credit, including the following:

- Basis is reduced by the tax credit allowable;
- No double credit is permitted. Thus, the amount of any deduction or other credit allowable under this chapter is reduced by the amount of clean vehicle credit allowed;
- No clean vehicle credit is allowable for vehicles used outside the U.S.;
- Clean vehicle tax credits may be recaptured if the vehicle ceases to be eligible for the credit;

- No clean vehicle tax credit is allowed if the taxpayer elects not to have the credit apply to the vehicle;
- A vehicle is ineligible for a clean vehicle credit unless it complies with –
    - the applicable provisions of –
        - the Clean Air Act for the make and model year of the vehicle, or
        - the air quality provisions of State law if adopted under a Clean Air Act waiver, and
    - the motor vehicle safety provisions of sections 30101 through 30169 of title 49, United States Code;
- Only one clean vehicle credit is permitted per vehicle, based on its VIN, including any vehicle for which the taxpayer elected to transfer the credit. Accordingly, if the credit has been transferred, it may not also be taken by the taxpayer; and
- No clean vehicle tax credit is allowed unless the taxpayer includes the vehicle identification number (VIN) of the vehicle on the tax return for the taxable year.

Previously-Owned Clean Vehicle Credit

The provision of the IRA authorizing the nonrefundable tax credit for the purchase of a previously-owned electric vehicle applies to the purchase of a used electric vehicle whose model year is 2 or more years earlier than the calendar year in which the taxpayer acquires it and provides for a nonrefundable tax credit not exceeding the lesser of 30% of the sale price or $4,000. The maximum price of a previously-owned clean vehicle on which the credit is authorized is $25,000.

Income-Based EV Tax Credit Limitations

The tax credit available with respect to an EV meeting the definition of a previously-owned clean vehicle may be limited based on the taxpayer’s modified adjusted gross income (MAGI). Pursuant to the income limitation, no previously-owned vehicle tax credit is available if the taxpayer’s MAGI for the current or prior taxable year exceeds the threshold amount which is:

- $150,000 in the case of a joint return or a surviving spouse;
- $112,500 in the case of a head of household; and
- $75,000 in the case of any other taxpayer.

Transfer of Credit

Similar to a clean new vehicle credit transfer, a taxpayer may elect to transfer the previously-owned vehicle tax credit to an eligible entity, i.e., the dealer who sold the vehicle to the taxpayer, and receive the credit at the time of purchase of the vehicle in cash or in the form of a partial payment or down payment. A transferred credit does not result in includible income to the purchaser and is not deductible by the dealer. The transfer of credit provision applies only to previously-owned vehicles acquired after December 31, 2023.

Special Rules Applicable to a Previously-Owned Clean Vehicle

As in the case of new clean vehicles, various requirements apply to a previously-owned clean vehicle tax credit, including the following:

- Basis is reduced by the tax credit allowable;
- No double credit permitted. Thus, amount of any deduction or other credit allowable under this chapter is reduced by the amount of previously-owned vehicle credit allowed;
- No previously-owned vehicle credit is allowable for vehicles used outside the U.S.;
- Previously-owned vehicle tax credits may be recaptured if the vehicle ceases to be eligible for the credit;
- No previously-owned vehicle tax credit is allowed if the taxpayer elects not to have the credit apply to the vehicle;
- A vehicle is ineligible for a previously-owned vehicle credit unless it complies with –
    - the applicable provisions of –
        - the Clean Air Act for the make and model year of the vehicle, or
        - the air quality provisions of State law if adopted under a Clean Air Act waiver, and

    - the motor vehicle safety provisions of sections 30101 through 30169 of title 49, United States Code;
- Only one clean vehicle credit is permitted per vehicle, based on its VIN, including any vehicle for which the taxpayer elected to transfer the credit. Accordingly, if the credit has been transferred, it may not also be taken by the taxpayer;
- No clean vehicle tax credit is allowed unless the taxpayer includes the vehicle identification number (VIN) of the vehicle on the tax return for the taxable year.

Qualified Refueling Property Credit

The IRA authorizes a tax credit for property placed in service and used to refuel alternative fuel vehicles. The property must be:

- For the storage or dispensing of a clean-burning fuel into the fuel tank of a motor vehicle propelled by such fuel, but only if the storage or dispensing of the fuel is at the point where such fuel is delivered into the fuel tank of the motor vehicle, or
- For the recharging of motor vehicles propelled by electricity, but only if the property is located at the point where the motor vehicles are recharged.

The credit, effective for property placed in service after December 31, 2022 and before January 1, 2033, with respect to any single item of qualified alternative fuel vehicle refueling property placed in service by the taxpayer during the taxable year is equal to thirty percent of the cost limited to no more than:

- $100,000 to property subject to depreciation[6]; or
- $1,000 to property not subject to depreciation.

A tax credit equal to 6% of total taxable year costs related to qualified alternative fuel vehicle property is available for property placed in service after December 31, 2021 and before December 31, 2022.

Extension of ARPA-Expanded Premium Tax Credit

The Inflation Reduction Act extended the modifications made by the American Rescue Plan Act (ARPA) to the premium tax credit for 2021 and 2022 through December 31, 2025. Pursuant to the extension, taxpayers are eligible to receive refundable tax credits for purchase of one or more qualified health plans provided they meet all of the following criteria:

- The taxpayer's expected contribution toward health insurance under the second-lowest cost Silver plan would exceed 8.5% of household income;
- The covered individuals are enrolled in a qualified health plan through an Affordable Insurance Exchange;
- Covered individuals are legally present in the United States and not incarcerated; and
- Covered individuals are not eligible for other qualifying coverage, such as Medicare, Medicaid, or affordable employer-sponsored coverage.

In order to be eligible for a premium tax credit, a taxpayer who is married at the close of the taxable year must file a joint income tax return.

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[6] Depreciable property is property that meets all the following requirements:

1. It is used in a business or income-producing activity.
2. It has a determinable useful life.
3. It is expected to last more than one year.
4. It must not be excepted property.

Determination of Premium Tax Credit

The amount of the tax credit for an eligible taxpayer is generally equal to the difference between the premium for the benchmark plan and the taxpayer's expected contribution. The "benchmark plan" is the second-lowest-cost plan that would cover the family at the silver level of coverage. The Marketplaces are able to provide information concerning benchmark plan premiums.

The taxpayer's expected contribution is a specified percentage of the taxpayer's household income. The percentage of the taxpayer's household income increases—from 2.0% of income for families at less than 200% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level—as the taxpayer's income increases and are as shown in the table below:

Household Income Percentage of Federal Poverty Line – 2022	Initial Percentage	Final Percentage
Up to 150%	0.0%	0.0%
At least 150% but less than 200%	0.0%	2.0%
At least 200% but less than 250%	2.0%	4.0%
At least 250% but less than 300%	4.0%	6.0%
At least 300% but less than 400%	6.0%	8.5%
400% and over	8.5%	8.5%

Limitation on Losses for Non-Corporate Taxpayers

The Tax Cuts & Jobs Act (TCJA) disallowed the deduction of "excess business losses" for tax years beginning after December 31, 2017 and ending before January 1, 2026 by non-corporate taxpayers. Accordingly, non-corporate taxpayers were generally required to carry forward losses in excess of $250,000 ($500,000 for joint filers), indexed, as NOLs. Such carryovers were limited to 80% of net income for tax years beginning after December 31, 2017.

The CARES Act retroactively deferred the effective date of this rule to tax years beginning after December 31, 2020. Because of that deferral, a non-corporate taxpayer could recognize those losses for the 2018, 2019, and 2020 tax years. CARES Act Section 2303 removes the 80% limitation for tax years beginning before January 1, 2021. The 80% limitation returns for tax years beginning January 1, 2021 and later.

The excess business loss rules, scheduled to expire at the end of 2025, were extended by the American Rescue Plan Act and were then scheduled to expire for years after December 31, 2026. The Inflation Reduction Act further extends the limitation on excess business losses of noncorporate taxpayers for two additional years. Accordingly, the excess business loss rules are now scheduled to expire for years after December 31, 2028.

Increase in Business Meal Deductibility Ends After 2022

The Consolidated Appropriations Act (CAA) provided for temporarily increased deductions for business meals. Businesses were permitted a 100% tax deduction for business meals—up from 50%—if the food or beverages were provided by a restaurant. The increased business meal deduction was available for 2021 and 2022, and the deduction returns to 50% for 2023.

Summary

The material covered in Chapter 5 is summarized as follows:

- The Energy Efficient Home Improvement Credit is a nonrefundable tax credit limited to 30 percent, not exceeding $1,200 in any year, of the sum of costs for qualified energy efficiency improvements (energy efficient windows, skylights, exterior doors, and energy audits). Limitations apply to exterior windows and skylights ($600), exterior door ($250, individually & $500 in the aggregate) and home energy audits ($150).

- A nonrefundable tax credit of 30 percent of expenditures, limited to no more than $2,000, is allowed for heat pump and heat pump water heaters, biomass stoves and boilers meeting specified requirements purchased and installed between January 1, 2023 and December 31, 2032.
- A nonrefundable tax credit of up to $7,500 for purchase of a new clean vehicle (depending on the critical minerals used in the battery from which the EV draws electricity and the battery components) and subject to eligibility based on the vehicle's MSRP and taxpayer's MAGI is provided.
- A nonrefundable tax credit for purchase of a previously-owned clean vehicle is available in an amount equal to the lesser of $4,000, or 30 percent of the vehicle's sale price not exceeding $25,000, subject to eligibility based on the taxpayer's MAGI.
- A nonrefundable tax credit is available for qualified alternative fuel vehicle refueling property placed in service by the taxpayer during the taxable year equal to thirty percent of the cost limited to no more than:
  - $100,000 to property subject to depreciation; or
  - $1,000 to property not subject to depreciation.
- The Inflation Reduction Act extended the modifications made by the American Rescue Plan Act (ARPA) to the premium tax credit through December 31, 2025.
- The limitation on losses for noncorporate taxpayers, scheduled to expire at the end of 2026, was extended by the Inflation Reduction Act for two additional years and is now scheduled to expire on December 31, 2028.
- The 100% tax deduction for business meals in a restaurant temporarily authorized under the Consolidated Appropriations Act expired at the end of 2022 and is replaced by a 50% tax deduction for years 2023 and later.

Chapter Review

1. John spent $700 in total for qualified energy improvements during the taxable year. If his total tax liability is $500, for what tax credit is he eligible?

   A. $150

   B. $210

   C. $500

   D. $700

2. Edward, an unmarried taxpayer, is interested in purchasing a new clean vehicle and receiving the tax credit. Assuming he meets all other criteria for credit eligibility, what is the maximum modified adjusted gross income he may have and still be eligible for the credit?

   A. $75,000

   B. $150,000

   C. $225,000

   D. $300,000

3. Sheila, a business executive, paid $150.00 for a business meal with her company's biggest client at a local restaurant in 2023. What amount may the business deduct?

   A. $0

   B. $75

   C. $100

   D. $150

Chapter 6 – SECURE Act 2.0

Introduction

The SECURE Act 2.0 became law as part of the Consolidated Appropriations Act, 2023 enacted on December 29, 2022. It contains a wide range of provisions designed to encourage retirement savings as well as changes affecting required minimum distributions, Roth IRAs and designated Roth accounts. Although the Act's provisions become effective on various dates, the examination of the Act's provisions will be restricted to those deemed more likely to impact tax preparers and advisers in 2023.

Chapter Learning Objectives

After completing this course, students should be able to describe the SECURE Act 2.0's provisions effective for 2023, including:

- Identifying the provisions designed to expand retirement plan coverage and increase retirement savings;
- Describe the provisions designed to enable plan participants to preserve their retirement income;
- List the provisions that simplify retirement plan rules; and
- Identify those provisions designed to enhance federal revenue.

2023 SECURE Act 2.0 Changes

The principal changes to tax law effective in 2023 resulting from the Act's passage include changes with respect to:

- Expanding retirement plan coverage and increasing retirement savings;
- Preserving participant income;
- Simplifying retirement plan rules; and
- Federal revenue enhancement.

Let's consider each of these changes.

Expanding Retirement Plan Coverage and Increasing Retirement Savings

Provisions of the Act effective in 2023 designed to expand coverage and increase retirement savings address the following:

- Tax credits for small employers;
- Authorization of multiple employer plans for tax sheltered annuity 403(b) plans;
- Age at which required minimum distribution (RMDs) must begin;
- Small financial incentives to encourage plan participation;
- SEPs for domestic employees;
- Elimination of defined benefit limit for certain rural electric cooperative employees; and
- Availability of broader investment choices for tax sheltered annuity plans.

Tax Credits for Small Employer Plan Startup Costs

The current law provides for a three-year small business tax credit for pension plan startup costs equal to 50% of administrative costs not exceeding $5,000 annually. The Act, for employers with 50 or fewer employees:

- Increases the percentage of administrative costs to 100%; and
- Provides an additional credit not exceeding $1,000 per employee of a percentage of employer contributions made to certain employees' defined contribution plan accounts equaling –
    - 100% of contributions in years 1 and 2,
    - 75% of contributions in year 3,
    - 50% of contributions in year 4, and

- 25% of contributions in year 5.

Note: No employer contributions made for employees whose wages from the employer exceed $100,000 (indexed after 2023) are taken into account. Additional credits are phased out at the rate of 2% per employee for employers employing 51 to 100 employees.

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 Credits for Small Employers – Military Spouses

The Act provides an additional credit for small employers hiring military spouses who meet the following criteria:

- The spouse is made immediately eligible for plan participation within two months of hire;
- The spouse is eligible upon plan eligibility for any matching or nonelective contribution for which he or she would normally have been eligible at two years of service, and
- The spouse is 100% immediately vested in all employer contributions.

The tax credit for which a small employer meeting the criteria is eligible is equal to the sum of (1) $200 per military spouse and (2) 100% of all employer contributions (up to $300) made on behalf of each military spouse. The credit applies for three years with respect to each military spouse and does not apply to highly compensated employees[7].

Multiple Employer Plans for Tax Sheltered Annuity 403(B) Plans

Multiple employer plans offer smaller employers the opportunity to come together to obtain access to improved investment options and enjoy somewhat lower administrative costs for their retirement plans. The Act extends this opportunity to tax sheltered annuity (TSA) plans.

Age at Which Required Minimum Distribution (RMDs) Must Begin

Required minimum distributions—often just referred to as RMDs—represent the federal government's opportunity to impose income taxes on traditional IRA and qualified plan funds. Traditional IRAs and qualified plans enjoy the unquestionable benefits of before-tax investing and tax-deferral of gain until distributed. For many years traditional IRA holders and defined contribution plan participants were required to begin taking distributions from those accounts upon reaching age 70½. Plan participants (but not IRA holders) who continued to be employed by the employer were permitted to defer minimum distributions until the later of age 70½ or the year of retirement. Actual receipt could be delayed until April 1st of the year following the age at which RMDs were required, a date referred to as the required beginning date (RBD).

As life expectancy generally increased—and the need to provide income for a longer retirement period increased along with it—it was important to allow taxpayers an opportunity to give their funds some additional time to grow in a non-taxable environment. Accordingly, the SECURE Act, in 2019, increased the age at which RMDs were required to 72. The SECURE Act 2.0 has increased the age at which RMDs must begin for individuals who attain age 72 after 2022 to age 73. Accordingly, traditional IRA holders may defer receipt of their first RMD until April 1st of the year following their 73rd birthday. Plan participants continuing to be employed by the employer sponsoring the plan in which they participate may delay their RMDs until the later of age 73 or retirement. They, too, may defer receipt of the payment until April 1st of the year following age 73 or retirement.

RMDs are further delayed to age 75 for an individual who becomes age 74 after December 31, 2032.

Small Financial Incentives to Encourage Plan Participation

Under current law, immediate financial incentives—gift cards in small amounts and the like—are prohibited even though employees may be especially motivated by them to join their employers' retirement plans. The Act changes that prohibition and allows 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.

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[7] A highly compensated employee is one who receives compensation of $150,000 or more (2023).

SEPs for domestic employees

The Act permits employers of domestic employees—nannies and housekeepers, for example—to provide retirement benefits for such employees under a Simplified Employee Pension (SEP).

Elimination of Defined Benefit Limit for Rural Electric Cooperative Employees

Rural electric cooperatives are nonprofit electric utilities that are owned by member-owners, the customers for which they provide electricity. Under current law, plans are limited with respect to the amount that may be paid by a pension plan in annual benefits to a participant to the lesser of $265,000 (2023) or 100% of the participant's average compensation. The Act eliminates the compensation-based limit for participants who are non-highly compensated employees, i.e. have wages less than $150,000 (2023) and participate in a rural electric cooperative retirement plan.

Increased Investment Choices for Tax Sheltered Annuity Plans

Under current law, 403(b) plan investments are generally limited to annuity contracts and publicly traded mutual funds. This limitation cuts off 403(b) plan participants—generally, employees of charities and public schools, colleges, and universities—from access to collective investment trusts, which are often used by pension and profit sharing plans to expand investment options for plan participants at a lower overall cost. The Act removes that prohibition and permits 403(b) custodial accounts to participate in group trusts with other tax-preferred savings plans and IRAs.

Preserving Participant Income

The Act's provisions designed to help preserve plan participant income effective in 2023 address the following areas:

- RMD restrictions on life annuities;
- Qualifying longevity annuity contracts (QLACs); and
- Penalty on partial annuitization.

RMD Restrictions on Life Annuities

Required minimum distributions (RMDs)—the mandated recognition of previously-untaxed retirement assets—have a single purpose: to enable the federal government to impose an income tax on a specified portion of the funds that had hitherto avoided taxation. To help ensure that taxpayers recognize an appropriate amount of income, actuarial tests or adjustments designed to limit tax deferral are sometimes required. Current law requires such an actuarial test in the case of commercial annuities, and that test results in annuities' inability to provide certain guarantees seen as important by IRA owners and plan participants.

Since life annuitization is the only method that guarantees an income that can't be outlived, the Act carves out an exception that enables insurers to offer specified annuity guarantees expected to encourage more retirees to use life annuities. Under the Act, an eligible retirement plan other than a defined benefit plan may provide one or more of the following types of payments on or after the annuity starting date:

- Annuity payments that increase by a constant percentage less than 5 percent per year,
- A lump sum payment that—
    - results in a shortening of the payment period with respect to an annuity or a full or partial commutation of the future annuity payments, or
    - accelerates the receipt of annuity payments scheduled to be received within the ensuing 12 months, regardless of whether such acceleration –
        - shortens the payment period with respect to the annuity,
        - reduces the dollar amount of benefits to be paid under the contract, or
        - results in a suspension of annuity payments during the period being accelerated,
- An amount similar to a dividend, or
- A final payment at death not exceeding the amount by which the consideration exceeds total annuity distributions.

Qualifying Longevity Annuity Contracts

Qualifying longevity annuity contracts—often referred to simply as "QLACs"—are deferred annuities purchased in an individual retirement account or a participant's individual account in a defined contribution retirement plan. A QLAC starts making periodic payments at some age not later than age 85 and continues to make periodic payments until the annuitant dies. QLACs may provide lifetime periodic payments to a single annuitant or to joint annuitants.

Because periodic payments start so late, they are an inexpensive way for retirees to hedge the risk of outliving their retirement plan savings. The final regulations, published in 2014, generally exempted QLACs from the minimum distribution rules until payments commence and limited allocation of retirement funds to the lesser of 25% of vested plan assets or a specific inflation-adjusted dollar amount. However, due to a lack of statutory authority to provide a full exemption, the regulations imposed certain limits on the exemption that have prevented QLACs from achieving their intended purpose in providing longevity protection.

The Act addresses these limitations by:

- Repealing the 25% limit allocation to QLACs;
- Allowing up to $200,000 (indexed) to be used from an account balance to purchase a QLAC;
- Facilitating the sales of QLACs with spousal survival rights; and
- Clarifying that 90-day free-look periods are permitted.

Penalty on Partial Annuitization

Under current law, a tax-preferred retirement account that holds an annuity must be split (conceptually) between the portion of the account holding the annuity and the rest of the account for purposes of applying the required minimum distribution rules. This treatment may result in higher minimum distributions than would have been required if the account did not hold an annuity. The Act permits the account owner to elect to aggregate distributions from both portions of the account for purposes of determining minimum distributions, thereby removing the possibly higher RMD from an account containing an annuity contract.

Simplifying Retirement Plan Rules

Retirement plan rules are typically opaque in part because they are often required to apply to multiple types of retirement plans and a wide variety of circumstances. The Act makes numerous changes to the rules designed to simplify and clarify them. Those changes address:

- **Recovering retirement plan overpayments** – The Act permits plan fiduciaries to choose not to recoup overpayments and imposes limitations as well as retiree protections for plan fiduciaries electing to recoup overpayments.

- **Reducing tax penalties for RMD insufficiencies** – The tax penalty for a failure to take an RMD is reduced from 50% of the insufficiency to 25% of the insufficiency. Additionally, if an RMD insufficiency is timely corrected, the tax penalty is reduced to 10% of the insufficiency.

- **Expanding the Employee Plans Compliance Resolution System** – The Act expands the Employee Plans Compliance Resolution System (EPCRS) to –
  - allow more types of errors, such as plan loan errors, to be corrected internally through self-correction,
  - apply to inadvertent IRA errors, and
  - exempt certain failures to make RMDs from the otherwise applicable penalty tax.

- **Eliminating the "first day of the month" 457(b) plan requirement** – The law allows elections to be made by a 457(b) plan participant at any time prior to the date that the compensation being deferred is available.

- **Electing split-interest entities for qualified charitable distributions** - The law expands the IRA charitable distribution provision to allow for a one-time, $50,000 distribution to charities through charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts It also indexes for inflation the annual IRA charitable distribution limit of $100,000 for distributions made in 2023 and later.

- **Eliminating premature distribution tax penalty at age 50 for private sector firefighters** - Qualified public safety employees in governmental plans, age 50 or older are exempt from the 10% premature distribution penalty tax. The Act extends the age 50 rule also to private sector firefighters.

- **Repaying qualified birth or adoption distributions** - The Act amends the QBAD provision of the SECURE Act to restrict the qualified birth or adoption recontribution period to 3 years from the day following receipt of the distribution.
- **Simplifying hardship distributions** - The Act provides that, 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.
- **Clarifying IRA tax penalty statute of limitations** - The Act provides that a 3 year period of limitations begins when the taxpayer files a Form 5329 (Additional Taxes on Qualified Plans (Including IRAs) and Other Tax-Favored Accounts) <u>or</u> an individual tax return for the year of the violation, except in the case of excess contributions or a bargain sale to the IRA, in which case the period of limitations runs 6 years from the date Form 1040 is filed.
- **Authorizing retroactive elective deferrals for sole proprietors** - The Act allows an individual who owns the entire interest in an unincorporated trade or business, is its only employee, and who has established a new 401(k) plans after the end of the taxable year but before the employer's tax filing date, to receive employee contributions up to the date of the employee's tax return filing date for the initial year.
- **Limiting penalties for IRA prohibited transactions** - The Act clarifies that if an individual engaged in a prohibited transaction involving an IRA and has more than one IRA, only the IRA with respect to which the prohibited transaction occurred will be disqualified.
- **Clarifying the substantially equal periodic payments rule** - The Act provides that the exception to the 10% premature distribution penalty tax applicable to substantially equal periodic payments made over the account owner's life expectancy continues to apply in the case of a rollover of the account, an exchange of an annuity providing the payments, or an annuity that satisfies the required minimum distribution rules.
- **Exempting tax penalties for premature distribution by terminally ill** - The Act provides an exception to the 10% premature distribution penalty tax in the case of a retirement plan distribution to a terminally ill individual.
- **Repealing the direct payment requirement for health and long term care insurance premiums** - The Act provides that the requirement that a governmental retirement plan pay health and long term care insurance premiums directly for them to be excluded from a public safety officer's gross income is repealed.
- **Modifying the premature distribution tax penalty for public safety officers** - The Act provides that the 10% tax penalty on premature distributions from tax preferred retirement savings plans does not apply to a distribution from a governmental plan to a public safety officer who is at least age 50 or who has at least 25 years of service with the employer sponsoring the plan.
- **Extending the exemption from the premature distribution tax penalty to corrections employees** - The Act extends the public safety officer exception to the 10% premature distribution penalty tax to corrections officers aged 50 or older who are employees of state and local governments.
- **Providing permanent rules for qualified federally-declared disasters** - The Act provides a permanent provision authorizing a distribution of up to $22,000 in the case of a qualified disaster. An individual eligible for such a distribution:
    - has his or her home (called "principal place of abode" in the Act) in the federally-declared disaster area at the time of the disaster, and
    - has sustained an economic loss due to the disaster.

  The withdrawn amount:
    - is not subject to the premature distribution penalty tax,
    - is recognized evenly over three years unless recognition in the year of withdrawal is elected, and

- may be repaid at any time up to three years following the date of distribution and be considered a trustee-to-trustee rollover, i.e. tax-free.

- **Eliminating additional tax penalties on IRA excess contribution corrective distributions** - The Act exempts an IRA distribution of an excess contribution and earnings allocable to it from the 10% penalty tax on premature distributions.
- **Modifying RMD rules applicable to special needs trusts** – The Act clarifies that, in the case of a special needs trust established for a beneficiary with a disability, the trust may provide for a charitable organization as the remainder beneficiary.
- **Recognizing tribal government domestic relations orders** - The Act adds Tribal courts to the list of courts authorized under federal law to issue qualified domestic relations orders.

Enhancing Federal Revenue

Provisions of the Act effective in 2023 designed to enhance federal revenue address the following topics:

- **Roth contributions to SIMPLE and SEPs** - The Act authorizes SIMPLE IRAs to accept Roth contributions and employers to offer employees the ability to treat employer and employee SEP contributions as Roth contributions.
- **Employer matching or nonelective contributions as Roth contributions -** The Act authorizes defined contribution plans to provide participants and employees making qualified student loan payments with the option of receiving matching and nonelective contributions on a Roth basis.
- **Charitable conservation easements** - The Act disallows a charitable deduction for a qualified conservation contribution if the deduction claimed exceeds two and one half times the sum of each partner's relevant basis in the contributing partnership, unless –
    - the contribution meets a 3 year holding period test,
    - substantially all of the contributing partnership is owned by members of a family, or
    - the contribution relates to the preservation of a certified historic structure.

  The Act also provides taxpayers the opportunity to correct certain defects in an easement deed (excluding easements involved in abusive transactions) and makes certain changes to statute of limitations and penalty provisions.
- **Retiree health benefits in pension plans** - Current rules permitting an employer to use assets from an overfunded pension plan to pay retiree health and life insurance benefits sunset at the end of 2025. The Act extends the sunset date to the end of 2032 and permits transfers of pension plan assets to pay retiree health and life insurance benefits provided the transfer is no more than 1.75 percent of plan assets and the plan is at least 110 percent funded.

Summary

As discussed in Chapter 6, the SECURE Act 2.0's provisions effective for 2023 are designed to:

- Expand retirement plan coverage and increase retirement savings by –
    - offering increased tax credits for small employer plan startup costs and improved participant treatment of military spouses,
    - authorizing use of multiple employer plans for tax sheltered annuity 403(b) plans,
    - increasing the age at which required minimum distribution (RMDs) must begin to 73,
    - authorizing the use of small financial incentives to encourage plan participation,
    - expanding the use of SEPs for domestic employees,
    - eliminating the defined benefit limit for certain rural electric cooperative employees, and
    - making broader investment choices available in tax sheltered annuity plans;
- Preserving participant income by –
    - removing RMD restrictions on life annuities in qualified plans,
    - easing qualifying longevity annuity contracts (QLACs) rules, and
    - eliminating the penalty on partial annuitization;
- Simplifying retirement plan rules by –

- broadening choices available to fiduciaries recovering of retirement plan overpayments,
- reducing tax penalties for RMD insufficiencies,
- expanding the employee plans compliance resolution system to allow more plan errors to be self–corrected,
- eliminating the "first day of the month" 457(b) plan requirement for participant elections,
- allowing participants to elect split-interest entities for qualified charitable distributions and inflation-indexing the annual IRA charitable distribution limit of $100,000,
- eliminating premature distribution tax penalty at age 50 for private sector firefighters,
- clarifying that repayment of qualified birth or adoption distributions is limited to three years from the date of distribution,
- simplifying hardship distributions to permit participant self-certification,
- clarifying IRA tax penalty statute of limitations,
- authorizing retroactive elective deferrals for sole proprietors,
- limiting penalties for IRA prohibited transactions,
- clarifying the substantially equal periodic payments rule,
- exempting tax penalties for premature distribution by terminally-ill participants,
- repealing the direct payment requirement for public safety officer participant health and long term care insurance premium payment,
- modifying the premature distribution tax penalty for public safety officers,
- extending the exemption from the premature distribution tax penalty to corrections employees,
- providing permanent rules for qualified federally-declared disasters,
- eliminating additional tax penalties on IRA excess contribution corrective distributions,
- modifying RMD rules applicable to special needs trusts, and
- recognizing tribal government domestic relations orders; and

- Federal revenue enhancement by –
  - authorizing Roth contributions to SIMPLE and SEPs
  - authorizing Employer matching or nonelective contributions as Roth contributions
  - disallowing certain Charitable conservation easements
  - extending payment of retiree health benefits from pension plans

Chapter Review

1. Harry became age 72 in 2022. Which of the following choices is correct concerning his need to take required minimum distributions from his traditional individual retirement account?

   A. No RMD is required

   B. RMDs must begin by April 1, 2022

   C. RMDs must begin by April 1, 2023

   D. RMDs are delayed for Harry until December 31, 2023

2. Pete's Doggie House, a hot dog vendor with 10 employees, hired Shirley in 2023 as its general manager and made her immediately eligible to participate in the employer's 401(k) plan. If Shirley is the only company military spouse and the plan made a $1,000 contribution on her behalf, for what tax credit would the employer be eligible for 2023?

   A. $200

   B. $500

   C. $1,000

   D. $1,200

3. Susan is required to take a $30,000 minimum distribution from her traditional IRA but decided only to take a distribution of $20,000. For what penalty tax, if any, is she liable?

   A. No tax penalty is imposed

   B. $1,000

C. $2,500

D. $5,000

Glossary

Active participant	An active participant for traditional IRA purposes is an individual that participates in his or her employer's retirement plan. An employer-sponsored retirement plan includes a pension plan, profit sharing plan, 401(k) plan, 403(b) tax sheltered annuity plan, SEP or SIMPLE.
Alternative minimum tax	A special tax applicable to taxpayers who benefit from the tax law by being afforded special treatment or special deductions and credits. The alternative minimum tax is designed to ensure such taxpayers are required to pay at least a minimum amount of federal tax.
Benchmark plan	A benchmark plan is the second-lowest-cost health insurance plan that would cover a family at the silver level of coverage.
Catch-up IRA contributions	Additional contributions for individuals who have attained age 50 before the close of the taxable year for which the IRA contribution is made.
Citizen or resident test	Although an exception applies in the case of adopted children who meet certain conditions, a taxpayer cannot claim a person as a dependent unless that person is a U.S. citizen, U.S. resident alien, or U.S. national or a resident of Canada or Mexico.
Deductible moving expenses	Suspended under the Tax Cuts and Jobs Act of 2017 except for certain military moves.
Deductible unreimbursed employee expenses	Suspended under the Tax Cuts and Jobs Act of 2017. These formerly deductible unreimbursed employee expenses include the employee's car expenses incurred in traveling: • From one workplace to another; • In order to meet with customers; • To attend business meetings at a location away from the taxpayer's regular workplace; and • From the taxpayer's home to a temporary place of work.
Dependent	A person who meets either the qualifying child test or the qualifying relative test.
Dependent exemption	Exemptions are suspended under the Tax Cuts and Jobs Act of 2017.
Dependent taxpayer test	If a taxpayer can be claimed as a dependent by another taxpayer, he or she is not permitted to claim another person as a dependent.
Exemption	Exemptions are suspended under the Tax Cuts and Jobs Act of 2017.
Individual mandate	The individual shared responsibility provision of the PPACA—sometimes referred to as the "individual mandate"—imposed a tax penalty for a non-exempt individual's failure to maintain minimum essential coverage. The tax penalty is reduced to zero for years after 2018.

Joint return test	Although certain exceptions apply, the joint return test generally prohibits a taxpayer from claiming as a dependent any married person if the married person's filing status is "married filing jointly."
Main home (first-time homebuyer's credit)	A home in which the taxpayer lives most of the time. It can be a house, houseboat, mobile home, cooperative apartment or condominium.
Minimum essential coverage	Minimum essential coverage refers to basic health insurance coverage that may be provided as a) employer-sponsored coverage, b) individual health insurance coverage, or c) coverage provided under government-sponsored programs.
Personal exemption	Exemptions are suspended under the Tax Cuts and Jobs Act of 2017.
Premature IRA distribution tax penalty	In order to ensure that traditional IRAs are used for the purpose they were designed—specifically to accumulate retirement savings—Congress imposed a limitation on their liquidity by specifying a penalty for premature distributions. Usually, in order to avoid a premature withdrawal penalty, the individual must be at least age 59 1/2 before receiving a distribution from a traditional IRA.
Premium tax credit	A tax credit provided for purchase of a qualified health plan available to individuals who cannot be claimed as a dependent by another person and whose household income is between 100% and 400% of the federal poverty level.
Qualified distribution from Roth IRA	A qualified distribution from a Roth IRA is one that is made no earlier than five years after the year for which the owner made his or her first Roth IRA contribution and: • The individual is age 59 1/2 or older; • The distribution is a qualified first-time homebuyer distribution; • The individual is disabled; or • The distribution is made to a beneficiary on or after the individual's death.
Roth conversion	A qualified rollover contribution from a traditional IRA or any eligible retirement plan to a Roth IRA or rollover from a 401(k) or 403(b) plan to a designated Roth account.
Roth IRA	A Roth IRA is a personal retirement savings plan, funded by an annuity or trust/custodial account, which provides income tax deferral and may provide tax-free distribution of earnings. Eligibility for a Roth IRA is limited to individuals, regardless of age or qualified plan participation, provided their AGI doesn't exceed certain limits.
Saver's credit	The saver's tax credit is a nonrefundable credit that is designed to encourage certain lower-income individuals to contribute to a retirement savings plan and is limited to the applicable percentage of such contributions but not more than $1,000 per taxpayer.
Short-term coverage gap	A gap in healthcare coverage for less than three consecutive months.
Silver level plan	A silver level plan as one designed to provide benefits that are actuarially equivalent to 70 percent of the full actuarial value of the benefits provided under the plan.

Small business tax credit	A nonrefundable tax credit available to an employer equal to a percentage of premiums paid for employee health insurance coverage provided the employer a) paid average annual wages for the tax year of less than $50,000 per full-time equivalent employee (inflation adjusted), b) employed fewer than 25 full-time equivalent employees for the tax year, and c) paid premiums for employee health insurance coverage under a qualifying arrangement, i.e. one in which the employer pays at least 50% of the premium for employee-only coverage.
Standard deduction eligibility	With certain exceptions, any taxpayer generally may elect to take a standard deduction rather than itemize deductions.
Standard mileage rates	Per-mile amounts that a taxpayer may use to deduct car expenses in lieu of deducting the actual expenses incurred by the taxpayer.
Tax deferral	Tax deferral is a favorable tax treatment under which an account's earnings are not subject to income taxation until distributed.
Traditional IRA	A traditional IRA is a personal retirement savings plan, funded by an annuity or a trust that meets certain requirements and may permit tax-deductible contributions and tax-deferral of earnings.
U.S. national	An individual who is not a U.S. citizen but who owes allegiance to the United States, such as an American Samoan or Northern Mariana Islander who chooses to be a U.S. national rather than a U.S. citizen.

Answers to Review Questions

Chapter 1

Question 1 Feedback

A. Your answer is incorrect. Although not all charitable expenses may be deductible, such expenses are normally deductible. Please try again.

B. Your answer is incorrect. Your answer identifies only the mileage as being deductible when using a personal vehicle for charitable purposes. However, more than just the mileage deduction is available. Please try again.

C. Your answer is correct. Philip's unreimbursed charitable expense deduction is limited to $296. Taxpayers are permitted to deduct personal vehicle expenses when used for charitable purposes. Since Philip traveled 1,400 miles, paid $40 for parking and $60 for tolls and chooses to use the standard mileage deduction, he may deduct $296. The money spent on gas and oil is not deductible, however, since the standard mileage deduction was elected.

D. Your answer is incorrect. Not all charitable expenses associated with a taxpayer's use of his personal vehicle are deductible. In this case, Philip elected to use the standard mileage deduction rather than actual costs. Since he did not choose to deduct actual costs, his expenses for gas and oil are not deductible. Please try again.

Question 2 Feedback

A. Your answer is incorrect. Qualified long term care insurance benefits are includible in the recipient's income to the extent such benefits exceed the greater of a per diem amount which is $420/day in 2023 or the actual costs for the care. Since the amount of benefits received exceeds those limits, some benefits must be included. Please try again.

B. Your answer is correct. Karl need include only $20 per day in his income. Benefits received under qualified long term care insurance policies that may be excluded from income are those benefits not exceeding the greater of:

- The applicable *per diem* limitation for the year; or
- The costs incurred for qualified long term care services provided for the insured.

The applicable *per diem* limitation for 2023 is $420.

C. Your answer is incorrect. It erroneously suggests that the difference between the per diem limitation and the actual expenses, if less, would be includible in income. In contrast, the amount includible is the amount of the benefit that exceeds the greater of the actual costs or the per diem amount. Please try again.

D. Your answer is incorrect. The amount of the difference between the long term care insurance benefits received and the actual expenses incurred for the care is not necessarily includible in income. Only the amount by which such insurance benefits exceed the *greater* of the expenses or the applicable per diem amount needs to be recognized as income. Please try again.

Question 3 Feedback

A. Your answer is correct. The taxpayer's standard deduction for the dependent son is $7,400. For 2023 returns, the standard deduction for dependents is the greater of a) $1,250, or b) the dependent's earned income from work for the year plus $400 (but not more than the standard deduction amount, generally $13,850).

B. Your answer is incorrect. The $13,850 standard deduction, when applied to a dependent, acts as a cap on the deduction. However, the standard deduction for dependents is the greater of a) $1,250, or b) the dependent's earned income from work for the year plus $400. Please try again.

C. Your answer is incorrect. That is the *minimum* standard deduction for a dependent. Since the dependent had an income, the minimum standard deduction amount does not apply in this case. Please try again.

D. Your answer is incorrect. Despite the dependent's earnings, the taxpayer is still entitled to take a standard deduction for the dependent. Please try again.

Chapter 2

Question 1 Feedback

A. Your answer is correct. Hank qualifies for a 10% retirement savings contribution tax credit. Since the credit is based on his retirement savings contribution during the year, his saver's credit is $100. ($1,000 x 10% = $100)

B. Your answer is incorrect. The saver's credit for which Hank qualifies is based on his contribution to the 401(k) plan multiplied by the percentage credit to which he is entitled. However, the employer match is not considered in determining the credit. Please try again.

C. Your answer is incorrect. Your answer indicates that Hank's saver's credit would be based on a 20% rate. Although he would qualify for a 20% saver's credit if he filed as head of household, the saver's credit rate for a single taxpayer is not 20%. Please try again.

D. Your answer is incorrect. Although Hank would be eligible for a saver's credit equal to 50% of his $1,000 401(k) deferral if he were married and filed a joint tax return, the saver's credit to which he is entitled as a single taxpayer is less. Please try again.

Question 2 Feedback

A. Your answer is incorrect. Sally's receipt of a saver's credit does not eliminate her deduction of a traditional IRA contribution. Please try again.

B. Your answer is incorrect. The saver's tax credit for which Sally is eligible does not reduce the deductible portion of her traditional IRA contribution. Please try again.

C. Your answer is incorrect. Sally's traditional IRA deduction is not netted by the saver's credit she receives. Please try again.

D. Your answer is correct. Sally may deduct the entire traditional IRA contribution, provided she is otherwise eligible to take the deduction. The retirement savings contribution tax credit, if any, for which a taxpayer is eligible does not affect the tax treatment to which the contribution would normally be subject.

Chapter 3

Question 1 Feedback

A. Your answer is correct. The passage of the American Rescue Plan Act (ARPA) on March 11, 2021 significantly expanded the reach of the health insurance premium tax credit for 2021 and 2022, and this expansion was extended by the Inflation Reduction Act to December 31, 2025. Under prior law, the taxpayer's expected contribution, as the term is used with respect to the tax credit, would have increased—from 1.92% of income for families at less than 133% of the federal poverty level to 9.12% of income for families at 400% of the federal poverty level—as the taxpayer's income increases. ARPA, however, reduced taxpayers' expected contribution to 0% for taxpayers with household incomes of less than 200%, and that level of taxpayer contribution continues through December 31, 2025.

B. Your answer is incorrect. The taxpayer's expected contribution, as the term is used with respect to the tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income increases under the American Rescue Plan Act (extended under the Inflation Reduction Act)—from 2.0% of income for families at 200% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level. Please try again.

C. Your answer is incorrect. Although the taxpayer's expected contribution if he or she has a household income equal to 133% of the federal poverty level in 2023 would have been 1.92%

of such income, that was changed by the American Rescue Plan Act for 2021 and 2022and then extended by the Inflation Reduction Act through 2025. Please try again.

D. Your answer is incorrect. The taxpayer's expected contribution, as the term is used with respect to the tax credit, is a specified percentage of the taxpayer's household income. The applicable percentage of the taxpayer's household income increases under the American Rescue Plan Act (extended under the Inflation Reduction Act)—from 2.0% of income for families at less than 200% of the federal poverty level to 8.5% of income for families at 400% or more of the federal poverty level. Please try again.

Question 2 Feedback

A. Your answer is correct. Burger Barn must pay at least $2,500. In order for an employer to be eligible to receive the small employer health insurance premium credit, the employer must pay employee health insurance premiums *under a qualifying arrangement*. Although certain variations may be qualifying arrangements under the PPACA, a "qualifying arrangement" is generally one under which the employer is required to pay a uniform percentage—at least 50%—of the premium for the employee enrolled in health insurance coverage.

B. Your answer is incorrect. Although Burger Barn may elect to pay the entire employee monthly premium for health insurance coverage, it is not required to do so in order to qualify for the health insurance premium credit. Please try again.

C. Your answer is incorrect. Burger Barn is not required to pay any part of the premium for dependent coverage to qualify for the credit. Please try again.

D. Your answer is incorrect. A small employer need not pay any part of the premium for dependent coverage to qualify for the credit. Please try again.

Chapter 4

Question 1 Feedback

A. Your answer is incorrect. Ellen has self-only coverage under her MSA; accordingly, she is limited to a tax-deductible MSA contribution of no more than a specified percentage of her deductible. However, the answer chosen is based on an incorrect percentage. Please try again.

B. Your answer is correct. Ellen can contribute up to $1,755 to her MSA in 2023. An eligible taxpayer with self-only coverage may deduct the contributions he or she makes to an Archer MSA during the taxable year in an amount not to exceed 65% of the annual HDHP deductible.

C. Your answer is incorrect. That is the maximum out-of-pocket permitted under Ellen's high deductible health plan in 2023; however, it is not her maximum contribution. Please try again.

D. Your answer is incorrect. That is the maximum deductible Ellen could have under her Archer MSA in 2023; it is not the maximum contribution permitted her this year. Please try again.

Question 2 Feedback

A. Your answer is incorrect. The tax penalty is not applied to the portion of the distribution that is NOT in excess of the account holder's qualified medical expenses. Only the part of the distribution in excess of those expenses may be subject to it. Please try again.

B. Your answer is incorrect. Your selected answer would apply the tax penalty to the entire distribution. However, Peter's liability is assessed only against the amount of MSA distribution in excess of his qualified medical expenses. Please try again.

C. Your answer is correct. The tax penalty is $600. Only the $3,000 excess distribution is subject to the applicable tax penalty. Archer MSA distributions are includible in income and subject to a 20% income tax penalty when they are used for other than qualified medical expenses and fail to meet specific exceptions.

D. Your answer is incorrect. Although Archer MSA distributions are tax-free when used to pay qualified medical expenses, they are subject to a tax penalty when taken in excess of such expenses unless a specific exception applies. Please try again.

Chapter 5

Question 1 Feedback

A. Your answer is incorrect. The applicable tax credit is equal to 30 percent of the aggregate expenditures for qualified energy improvements, not 30 percent of the taxpayer's tax liability.

B. Your answer is correct. A non-refundable tax credit is available in an amount equal to 30 percent of the sum of the amounts paid or incurred during the taxable year, subject to an aggregate annual limitation of $1,200, by the taxpayer for qualified energy efficiency improvements including energy efficient windows and skylights, exterior doors, and energy audits. Since John's aggregate expenditures for qualified energy improvements amounted to $700, his tax credit is $210 ($700 x 30% = $210).

C. Your answer is incorrect. You have identified John's tax liability which, although it could be a limiting factor with respect to a non-refundable tax credit, is not a limit in this case.

D. Your answer is incorrect. You have identified John's aggregate expenditures for qualified energy improvements. The tax credit, however, is limited both as to the percentage of qualified expenditures and limits applicable to the type of property purchased and installed.

Question 2 Feedback

A. Your answer is incorrect. Your answer would have been correct if Edward had been interested in purchasing a previously-owned clean vehicle. However, he is interested in purchasing a new clean vehicle.

B. Your answer is correct. No new clean vehicle tax credit is available if the taxpayer's MAGI for the current or prior taxable year exceeds the threshold amount which is $150,000 in the case of any taxpayer not filing a married filing jointly or head of household return.

C. Your answer is incorrect. Edward would have been eligible for a tax credit for purchasing a new clean vehicle with a MAGI of $225,000 if he filed his tax return as head of household. However, he filed as unmarried.

D. Your answer is incorrect. Edward would have needed to file his tax return as married filing jointly to be eligible for a tax credit for purchasing a new clean vehicle if he had a MAGI of $300,000. Instead, he filed as unmarried.

Question 3 Feedback

A. Your answer is incorrect. The Internal Revenue Code permits a business to deduct some of the expenses incurred for a business meal in 2023.

B. Your answer is correct. CAA provides for an increased deduction of 100% for business meals in a restaurant only for 2021 and 2022. For 2023, the business meal deduction returned to 50%, whether or not the food or beverages are provided by a restaurant.

C. Your answer is incorrect. Although CAA provides for temporarily increased deductions for business meals in 2021 and 2022, the applicable percentage of the cost in 2023 is not 75%.

D. Your answer is incorrect. CAA provides for temporarily increased deductions for business meals. Businesses were permitted a 100% tax deduction for business meals—only for 2021 and 2022—if the food or beverages were provided by a restaurant for 2023.

Chapter 6

Question 1 Feedback

A. Your answer is incorrect. Although the SECURE Act 2.0 modified the age at which RMDs must begin, it did not eliminate them.

B. Your answer is incorrect. If Harry had become age 72 in 2021, his RMD would have been required by April 1, 2022. However, Harry became age 72 in 2022.

C. Your answer is correct. The SECURE Act 2.0 increased the age at which RMDs must begin for individuals who attain age 72 after 2022 to age 73. However, Harry became age 72 in 2022 and is required to take an RMD at age 72 that he may defer until April 1, 2023.

D. Your answer is incorrect. The SECURE Act 2.0 moved the commencement of RMDs to age 73 only for individuals who become age 72 after 2022. Harry became age 72 in 2022.

Question 2 Feedback

A. Your answer is incorrect. Although Pete's Doggie House would be eligible for a tax credit of $200 for hiring Shirley, a military spouse, and meeting other criteria, that is not the total credit.

B. Your answer is correct. Pete's Doggie House would be eligible for a tax credit of $500. The tax credit for which a small employer meeting the criteria is eligible is equal to the sum of (1) $200 per military spouse and (2) 100% of all employer contributions (up to $300) made on behalf of each military spouse. The credit applies for three years with respect to each military spouse and does not apply to highly compensated employees.

C. Your answer is incorrect. While the plan contribution made on behalf of a military spouse would figure into the tax credit for which an employer meeting specific plan criteria would be eligible, not all of the contribution is returned as a tax credit.

D. Your answer is incorrect. Although the employer meeting specified retirement plan criteria is eligible for a tax credit of $200 per military spouse, the entire contribution made by the employer is not considered for credit purposes.

Question 3 Feedback

A. Your answer is incorrect. Although the SECURE Act 2.0 modified the tax penalty imposed for an RMD insufficiency, it did not eliminate the penalty.

B. Your answer is incorrect. A 10% tax penalty for an insufficiency is imposed in the case of an IRA insufficiency that was timely corrected; however, no timely correction is noted.

C. Your answer is correct. The SECURE Act 2.0 reduced the applicable tax penalty for a failure to take an RMD from 50% of the insufficiency to 25% of the insufficiency. Accordingly, Susan will be liable for a $2,500 tax penalty unless her insufficient distribution is timely corrected.

D. Your answer is incorrect. While the former tax law imposed a draconian 50% tax penalty on any RMD insufficiency, it was modified by the SECURE Act 2.0.

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Appendix A

Form 8815 Department of the Treasury Internal Revenue Service (99)	**Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989** (For Filers With Qualified Higher Education Expenses) ➢ Attach to Form 1040	OMB. No. 1545-0074 20XX Attachment Sequence No. 167

Name(s) shown on return	Your social security number

1 **(a)** Name of person (you, your spouse, or your dependent) who was enrolled at or attended an eligible education institution	**(b)** Name and address of eligible educational institution

If you need more space, attach a statement.

2	Enter the total qualified higher education expenses you paid in 20XX for the person(s) listed in column (a) of line 1. See the instructions to find out which expenses qualify.		2	
3	Enter the total of any nontaxable educational benefits (such as nontaxable scholarship or fellowship grants) received for 201X for the person(s) listed in column (a) of line 1 (see instructions)		3	
4	Subtract line 3 from line 2. If zero or less, **stop**. You **cannot** take the exclusion.		4	
5	Enter the total proceeds (principal and interest) from all series EE and I U.S. savings bonds **issued after 1989** that you **cashed during 20XX**		5	
6	Enter the interest included on line 5 (see instructions).		6	
7	If line 4 is equal to or more than line 5, enter "1.000." If line 4 is less than line 5, divide line 4 by line 5. Enter the result as a decimal (rounded to at least three places).		7	
8	Multiply line 6 by line 7		8	
9	Enter your modified adjusted gross income (see instructions). . . **Note:** *If line 9 is $XXX,XXX or more if single or head of household, or $XXX,XXX or more if married filing jointly or qualifying widow(er) with dependent child,* ***stop.*** *You* ***cannot*** *take the exclusion.*	9		
10	Enter: $XX,XXX if single or head of household; $XXX,XXX if married filing jointly	10		
11	Subtract line 10 from line 9. If zero or less, skip line 12, enter -0- on line 13, and go to line 14	11		
12	Divide line 11 by: $15,000 if single or head of household; $30,000 if married filing jointly or qualifying widow(er) with dependent child. Enter the result as a decimal (rounded to at least three places)		12	
13	Multiply line 8 by line 12		13	
14	**Excludable savings bond interest.** Subtract line 13 from line 8. Enter the result here and on Form 1040 . . . .>		14	

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FINAL EXAM

Federal Income Tax Changes - 2023

The following exam is attached only for your convenience. To access the official exam for this self-study course, please log into your account online and take the Final Exam from the course details page. A passing score of 70 percent or better will receive course credit and a Certificate of Completion.

1. What is the 2023 standard deduction for a 50 year-old married couple filing jointly, neither of whom is blind?
   A. $8,100
   B. $13,850
   C. $27,700
   D. $20,800
2. Lloyd is chronically-ill and received tax-qualified long-term care insurance benefits in 2023 amounting to $9,100 to cover a 30-day nursing home stay. What amount, if any, must he include in income if actual nursing home costs for the 30 days amounted to $8,561 and the applicable *per diem* limitation was $420?
   A. $0
   B. $500
   C. $8,561
   D. $9,100
3. What is the standard deduction in 2023 for a single taxpayer under age 65 who is not blind?
   A. $6,700
   B. $13,850
   C. $27,000
   D. The standard deduction is eliminated for 2023
4. What is the unified estate tax credit applicable to a taxable estate of $12,920,000 of a decedent dying in 2023?
   A. $1,000,000
   B. $5,113,800
   C. $6,625,800
   D. $12,920,000
5. Barbara is a single taxpayer who had a 2023 adjusted gross income of $25,000 and who contributed $4,000 to her traditional IRA. Assuming she has a $2,000 income tax liability for the year, what is her maximum retirement contribution savings credit?
   A. $200
   B. $800
   C. $1,000
   D. $2,000

6. Gail and Bob are married and file a joint tax return in 2023. They had a $34,000 adjusted gross income and each deferred $2,000 into their employer's 401(k) plan. If they have a $500 income tax liability, what is the amount of their retirement contribution savings credit?

   A. $0

   B. $500

   C. $1,000

   D. $2,000

7. Lois, a single taxpayer, contributed $1,200 to her traditional IRA in 2023. If she received a $240 saver's credit and was not an active participant in an employer-sponsored retirement plan, how much of the contribution can she deduct?

   A. $0

   B. $240

   C. $960

   D. $1,200

8. A qualifying child in 2023, for purposes of the child tax credit, is one who, in addition to meeting other existing requirements, is under the age ___ by the end of the year.

   A. 6

   B. 17

   C. 18

   D. 21

9. Joyce and Bob, a married couple filing jointly, received an advance insurance premium tax credit in 2023. When reconciling the tax credit it was determined they received an excess credit of $3,500. If their household income is 300% of the federal poverty line, what is the total amount of credit that must be repaid as additional tax?

   A. $0

   B. $1,000

   C. $3,000

   D. $3,500

10. How frequently may an Archer MSA be rolled over?

    A. Every 6 months

    B. Every 12 months

    C. Every 24 months

    D. An Archer MSA cannot be rolled over

11. Jack is age 45 and owns a self-only high deductible health policy with a $5,000 deductible under his HSA. What is his maximum permitted HSA contribution in 2023?

    A. $3,250

    B. $3,850

    C. $4,650

    D. $7,750

12. Cheryl took early retirement at age 55 in 2023 and received a $10,000 taxable distribution from her Archer MSA during the year. What, if any, tax penalty will be imposed on her MSA distribution if no exception to the penalty applies?

A. $500

B. $1,000

C. $2,000

D. $5,000

13. Linda, age 58, contributed $3,000 to her traditional IRA in 2023. If her permitted Roth IRA contribution is not reduced because of her income, what is the maximum amount she can contribute to it in 2023?

    A. $7,500

    B. $6,500

    C. $4,500

    D. $2,500

14. Gary is age 55 and married. He files a joint tax return and is an active participant in his employer's 401(k) plan. What is the maximum tax-deductible IRA contribution he can make in 2023 if his AGI is $138,000?

    A. $7,000

    B. $0

    C. $6,000

    D. $1,000

15. What is the maximum amount of the tax credit for purchase of a $25,000 previously-owned clean vehicle, assuming the transaction otherwise qualifies for the tax credit?

    A. $3,750

    B. $4,000

    C. $7,500

    D. $7,750