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Tax Newsletter

New Final Regs Expand on RMD Rules
IRS addresses inherited accounts

The IRS has issued comprehensive final regulations on rules pertaining to required minimum distributions (RMDs) from qualified retirement plans and traditional IRAs in the wake of recent legislation. The final regs take effect on September 17, 2024.

Background: Generally, participants in qualified retirement plans, like 401(k) plans, and traditional IRAs must begin taking RMDs once they reach a specified age and in each succeeding year. Under SECURE 2.0, a follow-up to the initial SECURE Act, the age threshold has been raised from 72 to age 73 (scheduled to increase to 75 in 2033). Similar rules apply to individuals who inherit qualified plan and IRA accounts.

In contrast, participants in Roth IRAs do not have to take lifetime distributions. However, participants in Roth 401(k) accounts, a Roth IRA-like version of a regular 401(k), were previously required to take lifetime RMDs, as were beneficiaries. Beginning in 2024, Roth 401(k) account owners no longer have to take RMDs.

RMDs are taxed at ordinary income tax rates currently topping out at 37%. The amount of each RMD is based on IRS-prescribed life expectancy tables and the value of the account on the last day of the prior year.

Previously, the penalty for failing to take timely RMDs was equal to 50% of the shortfall. Beginning in 2023, SECURE 2.0 reduces the penalty to 25% (10% if corrected promptly). Due to the COVID-19 pandemic, the IRS waived the penalty for failing to take RMDs for tax years spanning 2021 through 2024. It also extended the exemption for lifetime RMDs to participants in Roth 401(k) accounts (but not their beneficiaries).

Notably, the SECURE Act requires qualified plan and IRA beneficiaries to empty out an inherited account over a ten-year period, beginning in 2020. In the past, beneficiaries could take RMDs over their own life expectancies, creating so-called "stretch IRAs" that could defer tax for generations, but that has effectively been eliminated. However, the law creates exceptions for "eligible designated beneficiaries" (EDBs), including:

- A surviving spouse;
- A minor child (until they reach age 21);
- A disabled or chronically ill individual; and
- Any other individual who is not more than ten years younger than the IRA participant.

These beneficiaries have more favorable RMD options at their disposal. For instance, a surviving spouse can effectively treat an inherited account as their own.

Nevertheless, the law was not clear whether beneficiaries had to take RMDs over the course of ten years or if they could wait until the last year to take a lump-sum payout. Proposed regulations issued in 2022 provided that beneficiaries must take RMDs in years one through nine if the decedent had died after the initial owner had started RMDs. Reacting to negative public comments, the IRS then postponed the requirement to 2025.

New rules: Under the final regulations, IRA beneficiaries still must follow the ten-year rule as stated in the proposed regs. However, beneficiaries are allowed to skip annual RMDs that were required for accounts of owners who died in 2020 through 2023. For example, if you inherited an IRA in 2021, you must take RMDs only from 2025 through 2031.

The final regs also complicate matters by imposing special rules for beneficiaries who inherit a Roth 401(k) that constitutes the decedent's "entire plan balance." As a result, the account might have to be emptied out within ten years. On the plus side, the regulations provide more flexibility in allocating RMDs among multiple beneficiaries of a single account.

Wrap-up: The IRS is expected to issue additional guidance for participants and beneficiaries of qualified plans and IRAs. In the meantime, consult with your professional tax advisors concerning your situation.

Keys to Mortgage Interest Deductions

Coping with the latest tax rules

Mortgage interest rates have been dropping through the summer. As of August 5, 2024, the average rate on a 30-year fixed rate mortgage was 6.95%, the lowest it has been in a year. Accordingly, this may be a good time to purchase the dream home you always wanted or downsize to a smaller place. But what about taxes?

Fortunately, many homeowners can write off all their mortgage interest expenses if they itemize deductions on their personal tax returns. Despite recent legislation, the tax law boundaries remain relatively generous.

Main tax rules: Prior to the Tax Cuts and Jobs Act (TCJA), you could deduct mortgage interest paid on your principal residence and one other home (e.g., a vacation home) as either acquisition debt or home equity debt, or both, within certain limits.

1. Acquisition debt: This constitutes debt where the mortgage proceeds are used to buy, build or substantially improve a qualified residence. Usually, acquisition debt represents the main part of a mortgage interest deduction. The interest was deductible on loans up to $1 million.

2. Home equity debt: When permitted by state law, you could deduct the interest on home equity loans secured by a qualified residence, regardless of how the proceeds were used. Home equity debt deductions were limited to interest paid on the first $100,000 of debt. Plus, the loan amount could not exceed your equity in the home.

In addition, mortgage interest deductions were subject to the "Pease Rule," along with certain other itemized deductions. This rule reduced deductions for certain high-income taxpayers.

However, beginning in 2018, the TCJA imposed these other restrictions.

- The threshold for deducting interest paid on acquisition debt was lowered from $1 million to $750,000 for loans originating after December 15, 2017 (or April 1, 2018, if there was a binding contract in place before December 16, 2017). Thus, existing homeowners were "grandfathered in" under the prior rules for acquisition debt. Alternatively, you can still benefit under the $750,000 threshold.

- The deduction for interest paid on home equity debt was suspended from 2018 through 2025. It does not matter when you acquired the residence. Currently, the deduction is scheduled to return in 2026.

- In conjunction with other TCJA changes for itemized deductions, the Pease rule was suspended for 2018 through 2025. It is also set to return in 2026, absent any further legislation.

Typically, these revised rules still give most homeowners plenty of leeway. Plus, you can take advantage of a special tax break: If you take out a new home equity loan or line of credit and use the proceeds for significant home improvements, the debt may be treated as an acquisition debt instead of a home equity debt. Reason: The debt is being incurred to "substantially improve" a qualified residence. Therefore, itemizers can add this mortgage interest to their deductible total.

What if you refinance an existing acquisition debt in 2024? The interest on the new loan remains deductible subject to the TCJA rules, but refinancings of pre-2018 loans are generally grandfathered under prior law.

Final words: Maximize mortgage interest deductions available under the current tax rules. When warranted, contact your professional tax advisor for guidance.

Run for the Tax Gold

The U.S. took home 126 medals from the Paris Olympics. Do the athletes owe any tax on this hardware?

Under a 2016 federal law, athletes are generally exempt from paying tax on the value of their medals or other prize money received from the U.S. Olympic Committee. But other income received by athletes, like wages, remains taxable.

Note: For the first time, track and field gold medalists in Paris were awarded $50,000 for their efforts (split evenly among relay team members), The tax exemption applies to these winnings.

Facts and Figures
Timely points of particular interest

Early IRA Withdrawals—The IRS has issued new guidance on exceptions to the early withdrawal penalty for IRA owners. Normally, you would owe a 10% tax penalty, on top of regular income tax, for traditional IRA withdrawals before age 59½. But the SECURE 2.0 law carved out new exceptions for emergency personal expenses and for victims of domestic abuse. These changes take effect in 2024.