Tax Impact

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SECURE 2.0 can help businesses attract and retain workers

The Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 Act has been getting a lot of attention for its many provisions that make it easier for people to save for retirement. Among other things, the law increases catch-up contribution limits, postpones required minimum distributions, enhances matching contributions and expands hardship withdrawals.

SECURE 2.0 can also have an impact on employers. Not only does it expand tax incentives for employers that set up new retirement plans, but it also helps employers boost participation in their plans. Plus, it provides opportunities to adopt plan enhancements that can help attract and retain workers. Here are some highlights.

Expanded credits for small employer plan start-up costs

For purposes of the tax credit for small employers who establish new qualified plans, SECURE 2.0 amends the definition of "small employer" to include employers with up to 50 employees (down from 100). And it allows those employers to claim a credit equal to 100% of their qualified plan start-up costs (up from 50%), up to a $5,000 annual limit.

The law also creates an additional credit of up to $1,000 per employee for contributions to new qualified plans on behalf of employees earning $100,000 or less (adjusted for inflation after 2023). Employers with 50 or fewer employees are entitled to the full $1,000 credit. For larger employers, the credit is reduced by 2% for each employee in excess of 50 and eliminated for employers with more than 100 employees.

Eligible employers are entitled to 100% of the credit in the plan's first two years. Then it's reduced by 25% each year and phased out after year five.

Starter 401(k) plans

To encourage companies without a plan to adopt one, SECURE 2.0 offers the "starter 401(k) plan." This streamlined option promises simpler, less costly administration than a traditional plan. Starting in 2024, these plans will allow employers to maintain 401(k) plans without the need to comply with costly nondiscrimination testing requirements.

Starter 401(k)s are "deferral-only arrangements" — that is, employer contributions are prohibited. Employees are automatically enrolled at a contribution rate of 3% to 15% of compensation (unless they opt out), with contribution limits comparable to those of IRAs.

Incentives for participation in qualified plans

Employers that increase participation in their qualified plans — particularly by non-highly compensated employees — enjoy many advantages. For example, higher participation generates additional tax benefits and cost savings, improves employee satisfaction, and makes it easier to satisfy nondiscrimination requirements. SECURE 2.0 helps boost participation in several ways, including by:

- Requiring most new 401(k) and 403(b) plans (those established after December 29, 2022) to automatically enroll participants, beginning in 2025. Unless a participant opts out, the initial contribution rate must be 3% to 10%, increasing 1% each year until it reaches 10% to 15%.

- Reducing the service requirement for eligible part-time employees from three years to two years of consecutive service if they've worked for their employers at least 500 hours per year.

- Permitting plans to offer "de minimis" financial incentives — for example, low-dollar-value gift cards — to employees who sign up for a qualified plan.

Emergency assistance for employees

Employers may now make their plans more attractive to employees by amending them to permit penalty-free (although taxable) distributions of up to $22,000 to participants who suffer economic losses from a federally declared disaster. Participants can spread the tax over three years or avoid it altogether by repaying the distribution to the plan within three years.

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Employers may also amend their plans to create emergency savings accounts linked to the plans for non-highly compensated employees. Contributions to these accounts (up to 3% of salary) must be made on an after-tax basis, but they're treated as contributions to the plan for matching purposes.

Are you required to amend your plan?

Many changes made by the Setting Every Community Up for Retirement Enhancement (SECURE) 2.0 Act are optional for employers, but some may require a plan amendment. For example, the law increases catch-up contributions to qualified plans for workers nearing retirement. Starting in 2025, employees ages 60 through 63 must be permitted to make catch-up contributions up to the *greater* of $10,000 (adjusted for inflation) or 150% of the regular catch-up amount. (Smaller catch-up contributions are provided for Savings Incentive Match Plans for Employees (SIMPLEs.) Some plans are written in a way that will automatically accommodate this change; others will have to be amended.

SECURE 2.0 also provides that, beginning in 2024, catch-up contributions by employees whose yearly wages exceed $145,000 (adjusted for inflation) must be made on an after-tax basis — in other words, to a Roth account. This provision will generally require a plan amendment.

Emergency accounts must maintain balances of $2,500 or less and permit withdrawals (which are tax- and penalty-free) at least monthly.

Other provisions

Two lesser-known SECURE 2.0 provisions that can help employers make their benefits packages more appealing to employees are:

1. Relief for employees with student loans. Beginning in 2024, employers may amend their plans to treat qualified student loan payments as elective deferrals for matching purposes. That way, employees won't be forced to choose between paying down their student loans and deferring salary to a qualified plan to get matching contributions.

2. Employer Roth contributions. Employers may amend their plans (other than Savings Incentive Match Plan for Employees [SIMPLE] IRA plans) to allow participants to elect to treat fully vested employer contributions (including matching contributions) as after-tax Roth contributions.

A powerful tool

A qualified retirement plan can be an effective recruiting tool for companies struggling to attract and retain employees in today's tight labor market. The improvements made by SECURE 2.0 can help companies set their benefit plans apart from the competition. ■

Complementary documents

An estate plan benefits from a living trust and a pour-over will

A primary reason people want to keep their assets out of probate is because it's a public process. It can also be time consuming and costly.

A living trust is a popular document in a comprehensive estate plan because assets transferred to it don't have to pass through probate. But what about the assets that weren't transferred to a living trust during your life? With a pour-over will, you can spell out how these assets will be transferred at your death.

Benefits of pour-over wills

As the name "pour-over will" implies, any property that isn't specifically mentioned in your regular will is "poured over" into your living trust after your death. Your trustee then distributes the assets to the beneficiaries under the trust's terms. This setup offers the following benefits:

Convenience. It's easier to have one document controlling the assets than it is to "mix and match." With a pour-over will, it's clear that everything goes to the trust, and then it's the trust document that's used to determine who gets what. That, ideally, makes it easier for the executor and trustee charged with wrapping up the estate.

Completeness. Generally, everyone maintains some assets outside of a living trust. A pour-over will addresses any items that have fallen through the cracks or that have been purposely omitted. It closes the door on your estate.

Privacy. In addition to the convenience of avoiding probate for the assets that are titled in the name

of the trust, this setup helps to keep a measure of privacy that isn't available when assets are passed directly through a regular will.

Roles of executors and trustees

Your executor must handle specific bequests included in the will, as well as the assets being transferred to the trust through the pour-over provision before the trustee takes over. (Exceptions may apply in certain states for pour-over wills.) While this may take months to complete, property transferred directly to a living trust can be distributed within weeks of a person's death.

Therefore, this technique doesn't avoid probate completely, but it's generally less costly and time consuming than usual. And, if you're thorough with the transfer of assets made directly to the living trust, the residual should be relatively small, and perhaps there won't be anything at all that will pass via the will.

Note that if you hold back only items of minor value for the pour-over part of the will, your family may benefit from an expedited process. In some states, your estate may qualify for "small estate" probate, often known as "summary probate." These procedures are easier, faster and less expensive than regular probate.

After the executor transfers the assets to the trust, it's up to the trustee to do the heavy lifting. (The executor and trustee may be the same person and, in fact, they often are.) The responsibilities of a trustee are similar to those of an executor with one critical difference: They extend only to the trust assets. The trustee then adheres to the terms of the trust.

Documents working in tandem

A living trust offers many benefits. However, for it to work as intended, assets must be properly transferred to it. As you acquire assets during your life, it's common to overlook retitling them to your living trust. Pairing the trust with a pour-over will may be the answer to wrangling any loose assets into the trust. Contact your estate planning advisor to determine if this strategy is right for you. ■

Should married couples ever file separate tax returns?

Most married couples assume they should file joint income tax returns, and usually, that's the right choice. But under certain circumstances, there may be benefits to filing separate returns.

Bear in mind that the differences between married filing jointly and married filing separately (MFS) can be complicated. Switching from one status to the other may increase some tax breaks while reducing others. So, it's important to analyze the numbers before determining which status is best for you. With that in mind, here are some situations in which it may be advantageous to file separately rather than jointly.

A spouse has unreimbursed medical expenses

Unreimbursed medical expenses are deductible as an itemized deduction to the extent they exceed 7.5% of adjusted gross income (AGI). If one spouse has significant unreimbursed medical expenses and relatively low income, filing separately may result in a substantially larger medical expense deduction.

Note that when filing separately, both spouses must itemize, or both must claim the standard deduction. So, this strategy only works if the spouses' combined deductions are greater than the standard deduction for joint filers.

A spouse has QBI

Eligible business owners are entitled to deduct up to 20% of their qualified business income (QBI) from sole proprietorships or pass-through entities (partnerships, limited liability companies and S corporations). For certain types of businesses (including "specified service businesses"), the QBI deduction is phased out for owners whose taxable income exceeds certain thresholds. For 2023, the deduction is reduced for these businesses once income reaches $182,100 for single and MFS filers or $362,400 for joint filers. It's eliminated once income reaches $232,100 for single and MFS filers or $462,400 for joint filers.

Here's how filing separately can pay off. Let's say Judy and Burt are married and their taxable income on a joint return is $500,000 for 2023. Judy's sole source of income is $150,000 in QBI from a specified service business. If the couple files jointly, the QBI deduction is lost because their income is over the $462,400 threshold. But if they file separately, Judy will be entitled to the full 20% deduction because her income is below the $182,100 threshold for MFS filers.

A spouse has a student loan repayment plan

With income-driven plans, the borrower pays a certain percentage of income for a specified term after which the remaining student loan balance may be forgiven. For married borrowers, some of these plans will base loan payments on the borrower's individual income if the spouses file separate returns.

If one spouse has significant unreimbursed medical expenses and relatively low income, filing separately may result in a substantially larger medical expense deduction.

Do your homework

Under the right circumstances, filing separate returns can generate significant tax savings for married couples. To determine whether this is the right strategy for you, consider the overall impact of MFS status on your combined tax liability.

Filing separately may save taxes in one area, but it may cost you in others. For example, separate filers can't claim certain education credits, child and dependent care credits, or student loan interest deductions. Ask your tax advisor to calculate your tax liability for both joint and separate returns to see which approach produces the best outcome. ■

Avoid capital gains tax with QSBS

Qualified small business stock (QSBS) is an often overlooked, but potentially lucrative, investment. Be aware that it's subject to several strict requirements. But if they're met, you can avoid tax on 100% of your gain when the stock is sold. Among other things, to qualify as QSBS, stock must be issued by a U.S. corporation whose aggregate gross assets don't exceed $50 million before or immediately after the stock is issued. Also, the corporation must use at least 80% of its assets in one or more qualified active businesses. Several types of business are ineligible, including most professional services, banking, insurance, farming, oil and gas, and hospitality.

To enjoy tax-free capital gains, you must acquire the stock as part of an original issuance — or as compensation for services or through gift or inheritance — and hold it for at least five years. C corporations aren't eligible investors. Several other requirements and limitations apply, so don't attempt to make such an investment without professional guidance. ■

Feeling philanthropic? Steer clear of splitting property among charities

Typically, when you make a bequest of property to charity, its value escapes estate tax. But according to the U.S. Tax Court, that may not be the case if you split an asset between two or more charities. In a recent case, a donor left her 100% interest in a limited liability company (LLC) to two charities: 75% to a private foundation and 25% to a church. When she died, the LLC, which owned an interest in a mobile home park, was valued at just over $25 million. On her estate tax return, her estate deducted the LLC's full value as a charitable donation.

The court agreed with the IRS that fractional interest discounts should be applied to each charity's gift, reducing the combined charitable deduction by more than $4 million and triggering nearly $1.7 million in additional estate tax. To avoid this result, donors should consider leaving an asset to a single charity, such as a private foundation, and allow the foundation to determine its ultimate disposition. ■

Watch out for OIC mills

According to the IRS, unscrupulous promoters are claiming taxpayers can settle tax debts for pennies on the dollar using an offer in compromise (OIC). The scammer charges exorbitant fees — even if the taxpayer doesn't qualify for an OIC — for information that taxpayers can easily obtain on their own. If you're seeking to settle a tax debt, use the IRS's Offer in Compromise Pre-Qualifier tool to check your eligibility for free. ■