Planning Strategies Under Recent Tax Law Changes

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**Publisher Citation**

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Plan for tax planning opportunities can be missed when changes to the law go under the radar.

In the days when it was more common to see major stand-alone tax reform legislation, practitioners would devote large amounts of time to understanding tax law changes and formulating how these changes affected tax planning strategies. Now that we often see tax law changes peppered piecemeal into larger pieces of legislation, they often go under the radar. This means that tax planning opportunities may be missed.

Tax law changes that have appeared in just the past year provide numerous instances of tax planning strategies that warrant attention.

**Required minimum distribution laws**

For many Americans, IRAs and qualified retirement plans — pension and profit-sharing plans, including 401(k) plans — are among the top tax planning tools available. These tax-deferred, or in some cases tax-exempt, entities are among the few tax freebies that middle-class and upper middle-class taxpayers can take advantage of.

Often the goal is to keep money in these accounts as long as possible. Once money is distributed, it's taxable. For accounts other than Roth-type accounts, the entire distribution is taxable, and with all such accounts, future earnings are fully taxable on a current basis. So the law provides for required minimum distributions ("RMDs") so that the tax benefit doesn't go on forever.

In just a few short years there have been multiple changes to the RMD rules, mostly encapsulated in two laws. As part of much larger appropriations legislation, these laws are referred to by the name of the division in which they appear. That is, they are referred to as the SECURE ("Setting Every Community Up for Retirement Enhancement") Act of 2019,¹ and the SECURE 2.0 Act of 2022.²

The original SECURE Act increased the age that triggered the start of RMDs from 70.5 to age 72 in Internal Revenue Code Section 401(a)(9)(C)(i)(I). As before, the first year's RMD could be delayed until April 1 of the following year.

Section 107 of the SECURE 2.0 Act of 2022 amends that provision by replacing "age 72" with "the applicable age," and then goes on to define that term as follows:

1. In the case of an individual who attains age 72 after December 31, 2022, and age 73 before January 1, 2033, the applicable age is 73.
2. In the case of an individual who attains age 74 after December 31, 2032, the applicable age is 75.

Note that anyone who turned 72 before 2023 will be subject to the rules in effect prior to the passage of the SECURE 2.0 Act of 2022. In all of these cases there remains the option of making the first payment by April 1 of the following year.

To illustrate: If someone turns 72 in 2023, then his or her 73rd birthday in 2024 triggers the RMD start. If this person decides to delay the first payment to the following year, 2025, then two payments need to be made that year—the 2024 payment due by April 1, and the 2025 payment due by December 31.

The lengthening of the time period is an unqualified tax benefit to anyone who wants to maintain tax deferral as long as possible. As it was passed at the end of the year, it’s entirely possible that someone might make a distribution before needed, based on prior law. For this reason, everyone turning 72 after 2022 needs to know about the extended RMD date.

The first upward adjustment, taking place this year, is clear and unambiguous. The second adjustment, moving the age to 75 in ten years, has been the subject of discussion as there is some ambiguity in the language of the law. For instance, someone born in 1959 would attain age 73 in 2032 and age 74 in 2033, so it’s not clear which category such a person would be in. Fortunately, there is time for Congress to clarify and correct this well before anyone is actually affected by it, but it’s something for practitioners to monitor for clients in that transitional period.

There had been a quirk in the RMD rules that thankfully was cleaned up in the SECURE 2.0 Act. Prior law mandated RMDs for Roth accounts in 401(k) and 403(b) plans even though they were not required for Roth IRAs. The SECURE 2.0 Act eliminates the RMD requirement for Roth 401(k) and 403(b) accounts to eradicate this disparity, although that change doesn’t go into effect until 2024. This exemption of Roth accounts from RMD rules will, as before, apply only during the participant’s lifetime, as RMD rules will apply to Roth accounts after a participant’s death.

It is important to note that these RMD rules don’t apply to employer-sponsored pension and profit-sharing plans, including 401(k) and 403(b) plans, if the participant has not yet retired. An RMD is not required from such an employer-sponsored plan while the participant is still working if the participant does not own more than five percent of the employer, directly or constructively. Someone covered by both an employer plan and an IRA will still need to make RMD payments from the IRA, even though RMD payments from the employer plan may be delayed until retirement.

One final point on this is that prior to enactment of the SECURE 2.0 Act, the penalty for failing to make an RMD was punishing. The SECURE 2.0 Act reduces the penalty from 50 percent of the shortfall in what should have been distributed. The penalty is now 25 percent, but can be as low as 10 percent if the required distribution is made before the IRS imposes a penalty and before the end of the year following when the RMD should have been made.

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It may seem that the reduction in penalty should have no effect on tax planning. That is, a taxpayer should make the RMD irrespective of the amount of the penalty. While this is true, it is also true that there may be taxpayers who inadvertently neglect to make the required distribution and do not realize this until after the end of the applicable year. As before, a taxpayer has the option to make the late distribution and request that the IRS waive the penalty because of a reasonable excuse for the delay. With a lower penalty, some taxpayers may choose to play the "tax lottery" on this. It has yet to be seen how liberally the IRS will waive the smaller penalty, and this may end up being a factor in a taxpayer’s decision to make a late distribution and request a waiver of the penalty. A gift to the neglectful in the new law is that the statute of limitations now starts to run with the filing of the Form 1040, and not, as before, with the filing of the request for a waiver of the penalty.

The SECURE 2.0 Act was the most recent law with major tax-law changes. A few months earlier, there was another such law. The Inflation...
tion Reduction Act of 2022 (the "Act") signed by President Biden on August 16, 2022, contained an array of targeted tax provisions — a collection of tax incentives that taxpayers and their advisers should consider in doing tax planning.

"Clean vehicle" tax credit
Under prior law, there was a tax credit of up to $7,500 for the purchase of an electric vehicle (EV) placed in service until December 31, 2022. The Inflation Reduction Act extends the credit 10 years, up to December 31, 2032.

Under Section 30D, the original "electric vehicle" tax credit is replaced by a "clean vehicle" credit in order to include a wider range of vehicles. The Inflation Reduction Act broadens the vehicles for which the credit is eligible. Under Section 30D, the original "electric vehicle" tax credit is replaced by a "clean vehicle" credit in order to include a wider range of vehicles. This would now include hydrogen fuel cell cars, for instance. Eligibility for the credit is limited to cars with an MSRP of up to $55k, or vans, SUVs, and pickup trucks with an MSRP of up to $80k. Also, it is unavailable if the taxpayer's modified adjusted gross income for the current or prior year is greater than $300k for joint filers or surviving spouses, $225k for heads of households, or $150k for single filers and married couples filing separately. Additionally, it is only available for vehicles that do not cost more than $25k. In all cases, the credits are only available if the final assembly of the vehicle occurs within North America.

Affordable Care Act's premium tax credit
The Affordable Care Act, also known as the ACA or Obamacare, offers various health insurance plan options, including state healthcare exchanges and a federal healthcare marketplace. In addition, there was a refundable tax credit for premiums paid into such a plan. Prior to the Act, the credit was in place only through 2022. The Act increases the credit and extends it through 2025. More significantly, the Act removes income caps on eligibility for the credit, which makes it available to a wider range of taxpayers.

While this subsidy for participation in a healthcare marketplace plan is important, by far the Act's emphasis is on energy-efficient construction and improvements. This is done with significant expansion and extension of existing deductions and credits.

Expansion of the Section 179D Energy Efficient Commercial Buildings Deduction
Internal Revenue Code Section 179D was first introduced as part of the Energy Policy Act of 2005 as a temporary provision, to be extended periodically. It was made permanent in the Consolidated Appropriations Act of 2021. In its then form, Section 179D authorized a deduction of up to $1.80 per square foot, indexed for inflation, for "energy efficient commercial building property," as defined in Section 179D(c)(1). That definition includes property installed as part of: 1. the interior lighting systems; 2. the heating, cooling, ventilation, and hot water systems; or 3. the building envelope.

In order to be eligible for this deduction, the property is certified as "...being installed as part of a plan designed to reduce the total annual energy and power costs with respect to the interior lighting systems, heating, cooling, ventilation, and hot water systems of the building by 25 percent..."
Increases in the amount and availability of the deduction

Under the Inflation Reduction Act of 2022, the amount of the deduction is increased from the then-current $1.88 per square foot to $5.00 per square foot. In addition, the deduction can be taken every three years for additional improvements to a particular building, a significant change from prior law which permitted the deduction only once per building.

There’s also a more generous rule for retrofits, that is, modifications to a building which reduce the building’s energy use intensity. Under prior law, retrofits would only be eligible for the Section 179D deduction if the reduction was at least 50 percent. The Inflation Reduction Act reduces that standard, so that retrofits are eligible for the Section 179D deduction if they are expected to reduce the building’s energy use intensity by 25 percent or more.

Expanded eligibility

Prior to the Inflation Reduction Act, the Section 179D deduction was only available if the construction was by for-profit entities, or for projects owned by federal, state, and local governments. In cases where the projects were owned by governments or their agencies not subject to taxes, the benefit of the deduction could be allocated to the architects, engineers, or other designers responsible for the building’s design.

After the Act, the deduction is now available for buildings constructed for other tax-exempt entities, as well as for native tribal governments and Alaska native corporations. This expands the range of eligible construction to include previously ineligible projects such as construction for churches and other religious organizations, private schools and universities, political organizations, and other tax-exempt organizations under subchapter F of the Internal Revenue Code, Sections 501–530.

As with the prior rule regarding governmental entities, these tax-exempt entities will generally have no income taxes to pay and thus no benefit from the deduction. However, Section 179D(d)(3) provides for regulations “... to allow the allocation of the deduction to the person primarily responsible for designing the property in lieu of the owner of such property. Such person shall be treated as the taxpayer for purposes of this section.” Thus, the economic benefit of the deduction and the incentive toward energy efficiency is preserved.

While this provision is no doubt pro-taxpayer, it does add an element of planning required. There may be a factual issue as to who is the person primarily responsible for designing the property. Where there is a potential for this issue to arise, there should be a clear paper trail establishing who that person is. The tax-exempt entity relinquishing this tax benefit may receive compensation from the recipient for doing so, thereby indirectly getting the benefit of the tax incentive.

New energy efficient home credit

The new energy efficient home credit is a tax credit authorized by Section 45L. It can be taken by a contractor who has constructed a “qualified new energy efficient home,” that is, a newly constructed or substantially reconstructed single family or multifamily home that meets certain qualifying standards of energy efficiency. If such a home is manufactured, then the credit may be taken by the producer of the home.17

The Act extends this credit, which otherwise would have expired at the end of 2022, so that it is now available through 2032. Additionally, starting in 2023, it redefines external criteria used to determine eligibility for and the amount of the credit.

The first criterion is “Energy Star” certification. Energy Star is a program run jointly by the Environmental Protection Agency and the Department of Energy, and certification indicates meeting certain environmental standards. Homes eligible for Energy Star certification are eligible for a $2,500 tax credit.

The second criterion is certification under the U.S. Department of Energy’s Zero Energy Ready Home (ZERH) Program.
A DOE Zero Energy Ready Home is a high-performance home that is so energy efficient that a renewable energy system could offset most or all the home’s annual energy use. Each DOE Zero Energy Ready Home meets rigorous efficiency and performance criteria found in the DOE Zero Energy Ready Home national program requirements. Most types of new homes in the U.S. are eligible to participate in the DOE Zero Energy Ready Home program, and the homes are verified by a qualified third-party as part of the certification process.18

Under a provision of Section 45L added by the Inflation Reduction Act, certification under the ZERH program entitles the contractor to a credit of $5k for single-family homes, or $1k to $5k for units in multifamily homes.

In order to maximize the credit under Section 45L, laborers and mechanics employed in the construction of the residence need to be paid the prevailing wage for the locality where the residence is located, as determined by the Secretary of Labor.19

The Act contains a bonus for investments in qualified affordable housing. Ordinarily a taxpayer cannot increase the basis of property for expenditures to the extent of any credits under Section 45L. However, this disallowance of basis increase now won’t apply for purposes of calculating the low-income housing credit, effectively giving the taxpayer a double tax benefit for qualified affordable housing.20

Residential energy tax credits

Two upgraded credits are now available for homeowners, the Energy Efficient Home Improvement Credit in Section 25C (formerly called the Nonbusiness Energy Property Credit) and the Residential Clean Energy Credit in Section 25D (formerly called the Residential Energy Efficient Property Credit)

Energy efficient home improvement credit

This tax credit, authorized by Section 25C, applies to home improvements that reduce energy consumption, and was set to expire at the end of 2021. However, the Inflation Reduction Act extended the credit to apply through 2022 and cre-
ated an extended and expanded credit for expenditures that are put in service between calendar years 2023 through 2032. The amount of the credit jumps from 10 percent in 2022 to 30 percent in 2023 and later years.

The credit applies to expenditures in three categories:
1. Expenditures for energy-efficient components in the building envelope, such as windows, doors, skylights, and insulation, which meet stated standards.
2. Other expenditures that increase energy efficiency, such as an electric or natural gas heat pump water heater; an electric or natural gas heat pump; a central air conditioner; a natural gas, propane, or oil water heater; or a natural gas, propane, or oil furnace or hot water boiler.
3. Expenditures for a home energy audit.

The Inflation Reduction Act did some tweaking in the definition of qualifying expenditures. As noted by the Congressional Research Service: "Investments in roofs will no longer qualify, but certain investments in biomass stoves and air-sealing material placed in service in 2023 or later will. Improvements to, or replacement of, panelboards, sub-panelboards, branch circuits, or feeders also qualify beginning in 2023."

In addition to the expansion of expenditures that qualify, limits on the amount of the credit have been expanded beyond what might have previously been considered nominal amounts. Instead of a lifetime limit of $500 there is now a $1,200 annual limit, with no lifetime limit for the savvy taxpayer staging projects over time.

Under prior law this credit was only available for improvements to the taxpayer’s primary residence. The Inflation Reduction Act extends the availability of the credit to any residence of the taxpayer. Additionally, the Inflation Reduction Act increases the maximum annual amount of the credit allowable and eliminates a lifetime maximum under prior law.

Residential clean energy credit
This credit creates a tax incentive for taxpayers who invest in renewable energy production at their residences. As defined in the Code section, the credit is for residential expenditures for:
1. qualified solar electric property expenditures;
2. qualified solar water heating property expenditures;
3. qualified fuel cell property expenditures;
4. qualified small wind energy property expenditures;
5. qualified geothermal heat pump property expenditures; and
6. qualified battery storage technology expenditures.

Under prior law, there was a credit equal to 30 percent of qualifying expenditures in 2019. The credit reduced to 26 percent in the years 2020-2022 and 22 percent in 2023. The credit was scheduled to expire after 2023.

The Inflation Reduction Act extends the credit through the end of the calendar year 2034, and increases the applicable percentage for the credit. Under the Inflation Reduction Act the credit for calendar years 2022 through 2032 is 30 percent, not reducing to 26 percent until 2033 and 22 percent in 2034.

Remember earlier in this article when we discussed the credit available for installing a home electric vehicle charging station? Under the residential clean energy credit, it’s possible to get a double benefit. For instance, if a taxpayer has solar panels that are used to provide power to the EV charging station both credits would apply.

Conclusion
Whether or not these tax incentives are utilized by a particular taxpayer, it is important that a practitioner be aware of these changes so they are communicated to taxpayer clients in order for the client to make their own planning decisions.

The new laws have precise effective dates regarding the availability and amount of tax incentives, offering long-term planning opportunities for informed practitioners to advise their clients.

One final point to consider is that, given the extent of changes in these areas over the past few years, it’s foreseeable that there will be further changes. Accordingly, a practitioner advising clients in any of these areas must stay current with future developments which may appear in legislation specifically identified as tax legislation or may be a part of broader legislation that does not specifically focus on changes in the tax law.