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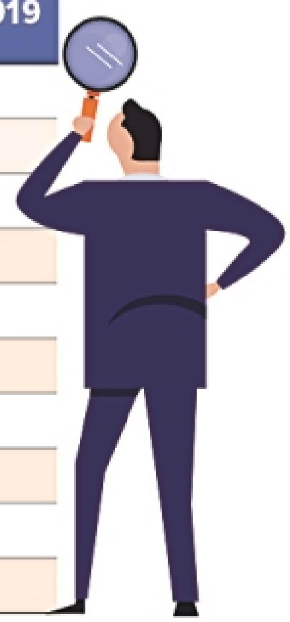
IRS Audit Rates Over Time

IRS audit rates for individual income tax returns have fallen since 2010, but this pattern could reverse as the agency ramps up enforcement. The Inflation Reduction Act of 2022 provided the IRS with an influx of about $80 billion to modernize outdated technology and rebuild a depleted workforce.

Total positive income ranges*	Tax year 2010	Tax year 2019
No total positive income	20.6%	1.1%
$1 – $25,000	1.0%	0.4%
$25,000 – $50,000	0.6%	0.2%
$50,000 – $100,000	0.7%	0.2%
$100,000 – $200,000	0.8%	0.2%
$200,000 – $500,000	2.3%	0.2%
$500,000 – $1 million	3.6%	0.6%
$1 million – $5 million	8.2%	1.3%
$5 million – $10 million	13.5%	2.0%
$10 million or more	21.5%	8.7%

*Total positive income excludes losses



Source: Internal Revenue Service, 2022

SECURE 2.0 Act Expands Early Withdrawal Exceptions

Tax-advantaged retirement accounts such as 401(k) plans and IRAs are intended to promote long-term retirement savings and thus offer preferential tax treatment in return for a commitment to keep savings in the account until at least age 59½. Withdrawals before that age may be subject to a 10% federal income tax penalty on top of ordinary income tax. However, there is a long list of exceptions to this penalty, including several new ones added by the SECURE 2.0 Act of 2022.

Before considering these exceptions, keep in mind that the greatest penalty for early withdrawal from retirement savings could be the loss of future earnings on those savings (see chart). Even so, there are times when tapping retirement savings might be necessary.

Some employer plans allow loans that may be a better solution than an early withdrawal. If a loan or other resources are not available, these exceptions could help. They apply to both employer-sponsored plans and IRAs unless otherwise indicated.

New Exceptions

The SECURE 2.0 Act added the following exceptions to the 10% early withdrawal penalty. Withdrawals covered by these exceptions can be repaid within three years. If the repayment is made after the year of the distribution, an amended return would have to be filed to obtain a refund of any taxes paid.

- **Disaster relief** — up to $22,000 for expenses related to a federally declared disaster; distributions can be included in gross income equally over three years (effective for disasters on or after January 26, 2021)
- **Terminal illness** — defined as a condition that will cause death within seven years as certified by a physician (effective 2023)
- **Emergency expenses** — one distribution of up to $1,000 per calendar year for personal or family emergency expenses; no further emergency distributions allowed during three-year repayment period unless funds are repaid or new contributions are at least equal to the withdrawal (effective 2024)
- **Domestic abuse** — the lesser of $10,000 (indexed for inflation) or 50% of the account value for an account holder who certifies that he or she has been the victim of domestic abuse during the preceding one-year period (effective 2024)

Exceptions Already in Place

These exceptions to the 10% early withdrawal penalty were in effect prior to the SECURE 2.0 Act. They cannot be repaid unless indicated.

- Death or permanent disability of the account owner
- A series of substantially equal periodic payments for the life of the account holder or the joint lives of the account holder and designated beneficiary
- Unreimbursed medical expenses that exceed 7.5% of adjusted gross income
- Up to $5,000 for expenses related to the birth or adoption of a child; can be repaid within three years
- Distributions taken by an account holder on active military reserve duty; can be repaid up to two years after end of active duty
- Distributions due to an IRS levy on the account
- (IRA only) Up to $10,000 lifetime for a first-time homebuyer to buy, build, or improve a home
- (IRA only) Health insurance premiums if unemployed
- (IRA only) Qualified higher education expenses

Lost Opportunity

An early retirement plan withdrawal could end up costing more than you might imagine, even without the 10% penalty. Income taxes will reduce the present value of the withdrawal, and you will lose the potential long-term growth on the amount withdrawn.

This hypothetical example is used for illustrative purposes only and does not represent the performance of any specific investment. Fees and expenses are not considered and would reduce the performance shown if they were included. Rates of return will vary over time, particularly for long-term investments. Actual results will vary.

Special Exceptions for Employer Accounts

The 10% penalty does not apply for distributions from an employer plan to an employee who leaves a job after age 55, or age 50 for qualified public safety employees. SECURE 2.0 extended the exception to public safety officers with at least 25 years of service with the employer sponsoring the plan, regardless of age, as well as to state and local corrections officers and private-sector firefighters.

Retirement account withdrawals can have complex tax consequences. Consult your tax professional before taking specific action.

Are You Eligible for Any of These College-Related Federal Tax Benefits?

College students and parents deserve all the help they can get when paying for college or repaying student loans. If you're in this situation, here are three federal tax benefits that might help put a few more dollars back in your pocket.

American Opportunity Credit

The American Opportunity tax credit is worth up to $2,500 per student per year for qualified tuition and fees (not room and board) for the first four years of college. It is calculated as 100% of the first $2,000 of qualified tuition and fees plus 25% of the next $2,000 of such expenses.

There are two main eligibility restrictions: the student must be enrolled in college at least half-time, and the parents' modified adjusted gross income (MAGI) must be below a certain level. To claim a $2,500 tax credit in 2023, single filers must have a MAGI of $80,000 or less, and joint filers must have a MAGI of $160,000 or less. A partial credit is available for single filers with a MAGI between $80,000 and $90,000, and joint filers with a MAGI between $160,000 and $180,000. The same limits applied in 2022 (and would be used when completing your 2022 federal tax return).

One key advantage of the American Opportunity credit is that it can be claimed for multiple students on a single tax return in the same year, provided each student qualifies independently. For example, if Mom and Dad have twins in college and meet the credit's requirements for each child, they can claim a total credit of $5,000 ($2,500 per child).

Lifetime Learning Credit

The Lifetime Learning credit is worth up to $2,000 for qualified tuition and fees for courses taken throughout one's lifetime to acquire or improve job skills. It's broader than the American Opportunity credit — students enrolled less than half-time as well as graduate students are eligible. The Lifetime Learning credit is calculated as 20% of the first $10,000 of qualified tuition and fees (room and board expenses aren't eligible).

Income eligibility limits for the Lifetime Learning credit are the same as the American Opportunity credit. In 2023, a full $2,000 tax credit is available for single filers with a MAGI of $80,000 or less, and joint filers with a MAGI of $160,000 or less. A partial credit is available for single filers with a MAGI between $80,000 and $90,000, and joint filers with a MAGI between $160,000 and $180,000. The same limits applied in 2022.

One disadvantage of the Lifetime Learning credit is that it is limited to a total of $2,000 per tax return per year, regardless of the number of students in a family who may qualify in a given year. So, in the previous example, Mom and Dad would be able to take a total Lifetime Learning credit of $2,000, not $4,000. Two other points to keep in mind: (1) the American Opportunity credit and the Lifetime Learning credit can't be taken in the same year for the same student; and (2) the expenses used to qualify for either credit can't be the same expenses used to qualify for tax-free distributions from a 529 plan or a Coverdell education savings account.

Student Loan Debt Statistics

Outstanding U.S. student loan debt in 2022:
$1.745 trillion

Loan source breakdown:
92.7% federal
7.3% private

Number of borrowers with federal student loan debt:
42.8 million

Average federal student loan balance:
$37,787

Source: EducationData.org, 2022

Student Loan Interest Deduction

Undergraduate and graduate borrowers can deduct up to $2,500 of interest paid on qualified federal and private student loans during the year if income limits are met. In 2023, a full $2,500 deduction is available for single filers with a MAGI of $75,000 or less, and joint filers with a MAGI of $155,000 or less. A partial deduction is available for single filers with a MAGI between $75,000 and $90,000, and joint filers with a MAGI between $155,000 and $185,000. In 2022, the income limits were slightly lower: a full deduction was available for single filers with a MAGI of $70,000 or less, and joint filers with a MAGI of $140,000 or less; a partial deduction was available for single filers with a MAGI between $70,000 and $85,000, and joint filers with a MAGI between $145,000 and $175,000. The 2022 limits would be used when completing your 2022 federal income tax return.

If you paid at least $600 in student loan interest during the year, your loan servicer should send you a Form 1098-E showing how much you paid. If you don't receive a 1098-E, you can still claim the deduction. You just need to call your loan servicer or log in to your online account to find the amount of interest you paid.

As Your Parents Age, Help Them Protect Their Finances

It's heartbreaking to hear stories of people losing money (even their life savings) as a result of fraud or financial exploitation, especially if they are older and financially vulnerable. In fact, it's quite common. People age 70 and older reported losses of $567 million in 2022.[1] You know your parents could be at risk, and you want to protect them, but how?

One place to start is by looking for warning signs that your parents have been victimized, or are at risk of being influenced, manipulated, or coerced by a stranger or someone they know.

- Unusual bank account activity, including large or unexplained withdrawals, and nonsufficient fund notices
- Missing checks, credit cards, or financial statements
- Unpaid bills
- Lost money or valuables that can't be located after a thorough search
- Relationships with people who seem to have undue influence
- Unexplained changes to legal documents
- Declining memory and decision-making skills

Regularly checking in with your parents may help you spot issues that need to be addressed. If your parents have fallen victim to a financial scam or are being pressured for money from someone they know, they may be embarrassed or reluctant to tell you, even if you ask. Do your best to remain objective and nonjudgmental, and patiently listen to their views while expressing your own concern for their well-being.

Laying some groundwork to help prevent future incidents is also important. For example, talk to your parents about how they might handle common scams. Let them know it's a good idea to get a second opinion from you before acting on any request for information or money, even if it seems to come from their financial institution, a well-known company, law enforcement, a government agency such as the IRS or Social Security Administration, or even a grandchild in trouble.

Encourage them to set up appointments with their elder law attorney or financial professional to talk about concerns and legal and financial safeguards. They might also want to add layers of protection to their financial accounts, such as naming a trusted contact or setting up account alerts.

People are often reluctant to report financial fraud or exploitation, either out of embarrassment or fear of being wrong. But if you suspect your parents have been victimized, you can get help from many sources, including the National Elder Fraud Hotline, sponsored by the U.S. Department of Justice. You can call (833) 372-8311 to be connected with case managers who will assist you and direct you to additional resources.

1) Federal Trade Commission, 2022