The SECURE Act 2.0 and Your Retirement

Sweeping changes impact both those close to and far from their golden years.

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In late 2019 Congress passed the SECURE Act, implementing dozens of changes to retirement accounts that had a far reaching impact on investors and their heirs. Three years later in December 2022, Congress enacted a spending bill known as the Secure Act 2.0.

SECURE 2.0 contains a large number of changes to a wide range of accounts and programs, including changes to the required minimum distribution rules, Roth accounts and contribution limits. Some of the rules are effective immediately, while others take effect over the next few years.

Below we address what the SECURE Act 2.0 entails and who it affects, as well as some planning opportunities that arise from the new regulations.

THE REQUIRED MINIMUM DISTRIBUTIONS BEGINNING AGE IS NOW 73, WILL BE 75

Reflecting the changing nature of retirement and increased life expectancies, the act pushes back the onset of required distributions from retirement accounts from age 72 to age 73, beginning in 2023. In a quirk of timing, this means that no one will be required to start a new required minimum distribution (RMD) in 2023. Those turning 73 in 2023 already started as required under the old rules when they turned 72 last year.

Those born between 1951 and 1959 will be required to start RMDs once they turn 73. Starting in 2030, the starting age will be increased to 75. Thus, anyone born after 1959 will be able to wait until age 75 before they are required to take an RMD.

NEW OPTIONS FOR SPOUSES WHO INHERIT A RETIREMENT ACCOUNT

Previously, spouses who inherited an individual retirement account (IRA) from a deceased spouse typically rolled the account into their own name and calculated future RMDs based on their own age. A new provision allows the surviving spouse to be treated as the deceased spouse and take RMDs using the deceased spouse's age.

Planning opportunity: If the surviving spouse is older than the deceased spouse, and does not need the income, this allows them to take a lower RMD, based on the deceased spouse's age. This would decrease unwanted taxable income (and thus taxes) and increase the amount remaining in the IRA enjoying tax-deferred growth.

PENALTIES REDUCED FOR MISSED RMDs

Speaking of RMDs, the act reduces the penalty for a missed RMD from 50% to 25%. Further, if the missed RMD is corrected in timely fashion, the penalty is reduced further to 10%. Ironically, this could result in increased penalty revenue for the Internal Revenue Service. Under the old 50% penalty it was common to ask for and receive a waiver based on special circumstances. At just 10%, taxpayers may be more likely to pay the penalty than go to the trouble of fighting for an abatement.

RMDS ARE ELIMINATED FOR ROTH 401(K) AND 403(B) ACCOUNTS

One of the primary benefits of a Roth IRA has been that there are no RMDs as long as the account holder is alive. But Roth 401(k) accounts did have to take RMDs once the appropriate age was reached. That split will be mended as RMDs are eliminated for all Roth 401(k) accounts, even for those over age 72 who had already begun taking them, starting in 2024.

ROTH 401(K) MATCHING AND CATCH-UP CONTRIBUTIONS

Two additional changes affect those who use the Roth option in their company retirement plans. First, employers may now make matching contributions to the Roth side of the plan. Previously all employer matching contributions were made to the traditional, tax-deferred side of the plan. The catch here is that matching contributions to the Roth side of the plan are still subject to income tax, like all Roth contributions. Participants will be responsible for paying the tax on those matching contributions. Note that this change is effective immediately for 2023, although it may take a bit for retirement plan systems to implement the change.

In addition, a change is coming for catch-up contributions made by high earners. Remember, catch-up contributions are the extra $7,500 taxpayers over age 50 contribute to a 401(k) plan.

Starting in 2023, taxpayers with wages greater than $145,000 in the previous year will be required to make all catch-up contributions to the Roth side of the plan. This means that any catch-up contributions will be made after-tax.

CATCH-UP CONTRIBUTIONS SET TO INCREASE

Speaking of catch-up contributions, changes are coming to the amount taxpayers over 50 can add to their accounts. Starting in 2024, the IRA catch-up amount (currently $1,500) will be subject to cost-of-living increases.

In addition, the catch-up amount for 401(k) participants will jump further for a select group. Starting in 2025, participants aged 60 to 63 will be able to increase their catch-up contribution amount to $10,000 (or 150% of the regular catch-up amount if it has increased further before then).

ROTH SEP IRA AND SIMPLE IRA ACCOUNTS CREATED

In more Roth news (notice a trend here?), the new act now allows for the creation of Roth SEP IRA and Roth SIMPLE IRA accounts. Previously all SEP IRA and SIMPLE IRA contributions were made pretax. As with the matching contributions above, employer contributions to these plans are taxable.

529 FUNDS CAN NOW BE TRANSFERRED TAX-FREE TO A ROTH IRA

Perhaps the most interesting change in the bill is a new provision that, starting in 2024, allows funds to be converted from a 529 plan to a Roth IRA for the beneficiary, tax-free. Of course, there are a number of limits and conditions that must be met to do this properly.

First, the funds must be rolled to a Roth IRA for the beneficiary of the 529 plan. Second, the 529 plan must be at least 15 years old and you cannot transfer contributions made in the last five years. Third, the transfer is limited to $6,000 per year or less if the beneficiary has already contributed to a Roth IRA on their own.

In addition, there is a lifetime maximum transfer of $35,000. Lastly, these transfers are not subject to any income limits.

This provides an excellent outlet for excess funds that may have built up in a 529 plan, whether due to the child earning a scholarship, attending a more affordable school, failing to finish a degree or simply an account growing faster than expected.

Planning Opportunity: This opens up an interesting opportunity to establish a retirement account early on for those with the ability to make extra contributions. For hypothetical purposes, assume Caroline opens a 529 plan for her newborn daughter, Anne, and that Caroline will earn a 7% rate of return in the 529 plan. If Caroline invests $13,000 into the 529 plan at Anne's birth, the account will grow to $35,867 after 15 years.

With the 529 plan now 15 years old, Caroline could then convert $6,000 per year to a Roth IRA in Anne's name, between ages 16 and 20, and then an additional $5,000 at age 21, to convert the $35,000 maximum.

If Anne were to continue to invest and earn a 7% return, without touching the Roth IRA, it would grow to more than $910,000 by the time she reaches age 65.

Thus, a parent or grandparent could make an extra contribution to a 529 plan and ultimately seed a $1 million retirement plan for the child or grandchild.

If she was able to earn an 8% return in her Roth IRA, the Roth IRA could be worth more than $1.3 million. Thus, a parent or grandparent could make an extra contribution to a 529 plan, on top of the college saving goal, and ultimately seed a $1 million retirement plan for the child or grandchild. All thanks to a $13,000 investment many years ago.

Of note, the language in the bill is unclear on whether the student would need to have income in order for the rollover to be made. We expect clarification from the IRS before 2024

QUALIFIED CHARITABLE DISTRIBUTIONS (QCDS) INCREASE

Charitable contributions made directly from your IRA account, better known as QCDs, are getting a bump as well. As a reminder, when you make a QCD from an IRA, the amount is excluded from your adjusted gross income (AGI) on your tax return, which thus lowers your taxable income and your tax bill. Starting in 2024, the annual limit on QCDs will be subject to cost-of-living increases over and above the current $100,000 limit.

In order to make a QCD, the account owner must be over age 70½. Account owners will need to coordinate with their CPA if they are planning to contribute to their IRA after age 70½, as such contributions may affect the QCD treatment.

Planning Opportunity: The IRS estimates that 90% of taxpayers use the standard deduction. As a result, charitable contributions may not end up providing a tax deduction on most taxpayers' returns. For those subject to RMDs, making charitable contributions via a QCD is the primary way to reduce taxable income and do good at the same time.

NEW RULES FOR RETIREMENT ACCOUNT WITHDRAWALS IN SPECIAL SITUATIONS

Several new exceptions to the 10% early withdrawal penalty were implemented. First, a new "emergency withdrawal exception" may now be taken for "unforeseeable or immediate financial needs relating to personal or family emergency expenses." The withdrawal is limited to $1,000 per year, and a second emergency withdrawal can't be taken until the first is paid back, or three years have elapsed.

The existing "Age 50 exception," was expanded for workers in certain public safety positions. Starting in 2023, private sector firefighters and state and local corrections officers can withdraw from retirement plans penalty-free starting at age 50 if they have separated from their job.

Terminally ill taxpayers may now take penalty-free withdrawals, provided death is expected within seven years. These distributions must be repaid.

Domestic-abuse victims can take the lesser of 50% of the account, or $10,000, penalty-free, starting in 2024.

Farther down the line, starting in 2026, up to $2,500 (or 10% of the account) may be withdrawn penalty-free, in order to pay long-term care insurance premiums.

EMERGENCY SAVINGS ACCOUNTS AND STARTER 401(K) PLANS COMING IN 2024

Two new retirement plans were created by the act, although the limits on each mean they will be of marginal utility to most taxpayers. A new Emergency Savings Account was created, to be offered in tandem with a typical retirement plan. The maximum contribution to the plan is $2,500, and the money must be held in a cash-equivalent investment. Employee contributions must be matched by the employer, with the employer match going to the main retirement plan. Highly compensated employees are ineligible.

Meanwhile, a new Starter 401(k) Plan also goes live in 2024. These plans require auto-enrollment, no employer match and have a maximum contribution equal to current IRA limits.

SMALL TWEAKS TO EXISTING PROGRAMS

Finally, a number of changes were made to expand existing programs and increase limits to keep up with inflation.

The maximum age to establish ABLE accounts for special-needs individuals was increased from 26 to 46.

SIMPLE IRA accounts will allow nonelective contributions of up to 10% of compensation (or $5,000) starting in 2024. In addition, contribution limits on some SIMPLE plans will increase.

Beginning in 2024, employers will be able to make matching contributions into the 401(k) plan of participants who make student loan payments.

Also in 2024, taxpayers can create a SEP IRA plan for a household employee, such as a nanny or caregiver.

CONCLUSION

Even after all that, there are dozens of provisions (92 in all!) that we have not covered here, given their limited impact or technical nature. The most impactful portions of the bill address RMDs, Roth accounts and retirement plan withdrawals. Thus, while no one change will impact everyone, there is something here that touches everyone from students to 401(k) savers in the workforce to retirees. Talk to your financial planner and your accountant as to how the bill may affect your financial picture and tax bill in 2023 and beyond.

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