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Retirement Planning

What You Need to Know About the SECURE Act 2.0

The new law boosts retirement savings opportunities and modernizes many rules.

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SECURE ACT 2.0 QUICK HIGHLIGHTS

- The age to start taking RMDs increases to 73 in 2023 and to 75 in 2033.
- Catch-up contributions will increase in 2025 for 401(k), 403(b), governmental plans, and IRAs account holders.
- The legislation requires businesses adopting new 401(k) and 403(b) plans to automatically enroll eligible employees, starting at a contribution rate of at least 3%, beginning in 2025.
- Other changes help people continue to save for retirement while paying off student debt, make it easier to move accounts from employer to employer, and help people save for emergencies within retirement accounts.

Almost three years to the day after Congress passed the original SECURE Act, the SECURE Act 2.0, signed into law on December 29, 2022, follows its predecessor with a sweeping package of roughly 100 provisions intended to increase retirement savings in workplace retirement plans and IRAs, reduce costs for establishing a new workplace retirement plan, and renew a focus on Roth accounts.

The new law recognizes that the workforce has evolved and gives employers the flexibility to offer benefits tailored to employees' needs. As Brian Graff, CEO of the American Retirement Association, puts it: "This important legislation will enhance the retirement security of tens of millions of American workers, and for many of them, give them the opportunity for the first time to begin saving."

What to focus on in SECURE Act 2.0

The list of changes is long, but here is a summary of the most prominent examples. (We'll be covering this in more detail later; stay tuned to this column.) Interestingly, there is no single change on the order of magnitude of the "Stretch" IRA elimination found in the original SECURE Act, but the volume of updates is impressive.

REQUIRED MINIMUM DISTRIBUTIONS

1. **Increased age for Required Minimum Distributions (RMDs)** – The SECURE Act of 2019 changed the RMD age to 72 (from 70 ½). SECURE 2.0 increases the RMD age to 73 for an individual that turns age 72 after December 31, 2022. Age 73 will continue to be the age that RMDs must begin through 2032, then increases to age 75 in 2033.

2. **Reduction in 50% excise tax for missing an RMD (or taking too little)** – In general, a 50% penalty tax is imposed on an individual if the amount distributed is less than the RMD under that retirement plan or account for that year. SECURE 2.0 reduces the tax to 25%. Furthermore, if the RMD shortfall is corrected in the "Correction Window," the penalty is reduced to 10%. This change is effective in 2023.

3. **Elimination of RMDs for Workplace Plan Roth Accounts** – Currently, Roth IRAs, not Roth Plan accounts, (i.e., 401(k)) are exempt from lifetime RMDs. SECURE 2.0 eliminates RMDs from Roth plan accounts (401(k), 403(b), 457(b), etc.) effective in 2024.

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ROTH CHANGES

1. **SIMPLE and SEP IRA Roth IRAs** – Currently, all SIMPLE and SEP-IRA contributions are required to be made on a pre-tax basis. SECURE 2.0 allows for the creation of a SIMPLE and SEP Roth IRA in 2023. Roth contributions will be included in the employee's income for the year of the contribution.

   (Technically, employees can create and contribute to a Roth SEP or SIMPLE today. However, it will take time for IRA custodians and employers to update their educational programs, paperwork, processes, and systems to allow for such contributions.)

2. **Employer contributions eligible to be treated as Roth contributions** – SECURE 2.0 authorizes a qualified plan, 401(k), 403(b), or governmental 457(b) plan to treat an employer contribution (match or non-elective, not Profit Sharing) as a Roth contribution, effective after enactment. Notably, amounts must be fully 100% vested and would be included in employee's income in the year of contribution.

3. **High wage earners required to make Roth catch-up contributions** – Currently, age 50 catch-up contributions (401(k), 403(b), governmental 457(b), but not SIMPLE IRAs) can be made on either a pre-tax or Roth basis. In 2024, SECURE 2.0 will **mandate** plan participants that have wages more than $145,000 in the prior year (subject to inflation) make a catch-up contribution to a Roth plan account (assuming the plan has a Roth option).

   NOTE: A catch-up contribution is **not** permitted for any employee (regardless of whether their wages are more or less than $145,000) if a high wage earner (greater than $145,000 in wages) cannot make a catch-up contribution because the plan does not offer a Roth option.

4. **529 plan to Roth IRA rollover** – Effective in 2024, SECURE 2.0 authorizes 529 plan funds to be directly transferred to a Roth IRA tax and penalty free. Importantly, several conditions must be satisfied to be eligible: The Roth IRA receiving the funds needs to be in the name of the 529 plan beneficiary, the 529 plan must have been maintained for a minimum of 15 years, any contributions (plus earnings) to a 529 plan in the last five years are ineligible to be transferred, the annual transfer limit is the Roth IRA contribution for that year (i.e. $6,500 in 2023), and the lifetime rollover is limited to $35,000.

5. **Traditional/Roth IRA catch-up contribution limit** – Currently IRA age 50 catch-up contributions are not indexed for inflation and remain flat at $1000, where the limit has stood for 15 years. In 2024, 2.0 authorizes the IRS catch-up limit to automatically adjust for inflation in increments of $100.

6. **Higher catch-up contribution limits (age 60–63)** – 2.0 increases the catch-up limit for those individuals age 60, 61, 62, or 63 only to the greater of: $10,000 or 150% of regular catch-up contribution amount for 2024, indexed for inflation. Effective in 2025, SIMPLE IRA participants age 60, 61, 62, or 63 will also see their catch-up contribution amount increased to the greater of $5,000 or 150% of the SIMPLE IRA catch-up contribution amount for 2025, indexed for inflation.

Note: 2.0 requires certain high wage earners (discussed earlier) to make catch-up contributions to Roth accounts only. Therefore, some employees aged 60–63 who are eligible to make larger catch-up contributions will have to make contributions to a Roth account.

QUALIFIED CHARITABLE DISTRIBUTIONS

1. **QCD limit indexed for inflation** – When the QCD was first introduced in 2006 as part of the Pension Protection Act, the limit was set at $100,000 annually. The annual limit has remained flat since its introduction. The QCD limit of $100,000 will be indexed for inflation beginning in 2024.

2. **Option to use QCD to fund a split-interest entity** – A one-time $50,000 QCD to a charitable gift annuity, charitable remainder unit trust, or charitable remainder annuity trust is permitted effective in 2023.

EXPANDED RETIREMENT ACCOUNT DISTRIBUTION OPTIONS

Taking a distribution from a retirement account before age 59 ½ generally subjects an individual to a 10% early distribution penalty, although exceptions apply (i.e., death, disability, higher education, etc.). SECURE 2.0 creates several new exceptions (to the early distribution penalty), while authorizing additional ways for investors to access their account before retirement.

1. **Distribution for individuals with a terminal illness** – 2.0 creates an exception to the 10% early withdrawal penalty for distributions to individuals whose physician certifies that they have a terminal illness or condition that is reasonably expected to result in death in 84 months (7 years), effective upon enactment. The distribution may be repaid in three years.

2. **Distribution for victims of domestic abuse** – Effective in 2024, a victim of domestic abuse can withdraw up to the lesser of: $10,000 (indexed for inflation) or 50% of their vested account balance without being assessed the 10% early withdrawal penalty. The distribution generally must be made from a 401(k), 403(b), governmental 457(b) plan, or IRA and must be made within a one-year period after an individual has become a victim of abuse. The distribution may be repaid within three years.

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3. **Emergency withdrawal exception** – 2.0 creates "Emergency Withdrawals" for a retirement investor who experiences "unforeseeable or immediate financial needs relating to necessary personal or family emergency expenses" and are exempt from the 10% early distribution penalty. Distributions cannot exceed $1,000 and are limited to no more than one per calendar year.

4. **Qualified long-term care distributions** – Penalty-free distribution for "Qualified LTC Distributions" can be taken, and the amount permitted to be distributed is the lowest of: amount paid by the employee during the year for long-term care insurance or 10% of the employee's vested account or $2,500 (indexed for inflation) annually to pay for Long-Term-Care insurance. This is effective for distributions occurring three years after the date of enactment.

5. **Emergency Savings Accounts** – 2.0 creates a new type of account – Emergency Savings Account (ESA) in which distributions are not subject the 10% early distribution penalty. Notably, an ESA must be "linked" to a 401(k) or like plan. An ESA would be funded with Roth contributions; plan participants may be auto enrolled up to 3% of their compensation with contributions capped at $2,500 (indexed for inflation). Participants must be allowed to take at least one withdrawal per month, and the first four withdrawals per year cannot be subject to fees. ESA investments are limited to cash, interest-bearing deposit accounts, and principal preservation accounts.

6. **Qualified distributions and increased loan amounts due to federally declared disasters** – Congress historically has authorized tax-advantaged distributions from retirement accounts after certain federally declared disasters. 2.0 eliminates the need for Congress to reauthorize distributions for each disaster by permanently authorizing "Qualified Disaster Recovery Distributions." The distribution is capped at $22,000, and income resulting from the distribution can be spread evenly over a three-year period, or an individual can elect to include all income (in the year of distribution), and distribution may be repaid within three years of the time the distribution is received. This is effective retroactively to disasters occurring on or after January 26, 2021.

   2.0 also enables eligible individuals in federal declared disaster areas to take larger loans from their qualified retirement plan. A plan participant make take a loan up to 100% of their vested balance up to a maximum of $100,000.

7. **Age 50 exception expanded to private sector firefighters** – Extends the age 50 early withdrawal exception (to the 10% penalty) for qualified public safety employees to also apply to **private sector** firefighters receiving distributions from a qualified retirement or 403(b) plan. Effective date of enactment.

8. **Exemption from early withdrawal penalty for certain state and local government employees** – 2.0 expands the Age 50 Qualified Public Safety Employee exception to the 10% early distribution penalty to include additional employee types. The exception now includes State and Local Correction Officers and forensic security employees, thus making them eligible for the age 50 exception to the 10% early withdrawal penalty. Effective date of enactment.

9. **State and local corrections officers and qualifying workers with 25 or more years of service as of the date of enactment** – Extends the age 50 exception to the 10% early withdrawal penalty to those qualified public safety employees who have separated from service and have attained age 50 or 25 years of service, whichever comes first. Effective date of enactment.

Some other notable provisions

- **Student loan payments as elective deferrals** – SECURE 2.0 authorizes employers to make matching contributions by reason of an employee repaying their student loans under a 401(k), 403(b), or governmental 457(b). This is effective for contributions made for plan years beginning after Dec. 31, 2023.

- **Qualified Longevity Annuity Contracts (QLAC)** – SECURE 2.0 immediately repeals the 25% account-balance limitation and increases the maximum QLAC purchase to $200,000.

- **Hardship distributions** – SECURE 2.0 allows a plan administrator to rely on an employee's self- certification that they have an event that constitutes a hardship for purposes of taking a hardship withdrawal from a 401(k) or a 403(b) plan.

- **Governmental 457(b) employee deferral timing** – Currently a participant in a governmental 457(b) must request a change in their salary deferral rate prior to the beginning of the month in which deferral will be made. 2.0 allows elections to be made at any time prior to the date compensation being deferred is available, thus conforming with the rule that applies to a 401(k) plan.

- **Repayment of qualified birth or adoption distributions** – The original SECURE Act allowed retirement plan participants or IRA owners penalty-free distributions in the case of a qualified birth or adoption and to repay the funds at a later date. There will now be a three-year time frame to repay such funds.

- **Retroactive first-year elective deferral Solo 401(k)** – Currently, a self-employed individual who wants to open a new Solo 401(k) must establish the plan by December 31 of the plan's first year. SECURE 2.0 gives sole proprietors until tax filing (not including extensions) of the individual's tax return to open a new plan for the prior year. Applies to plans that start in 2023 or later.

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- **Starter 401(k)** – SECURE 2.0 created a new type of employer-sponsored retirement plan for those businesses that do not currently offer a retirement plan. A "Starter 401(k)" plan requires the following: Participants are auto enrolled, deferrals only (no employer contributions), and employee salary deferrals are limited to the IRA contribution limit for the year. Effective for plan years beginning after 2023.

We'll have a lot more to say about the SECURE Act 2.0 in coming weeks, including a detailed explanation of its key provisions.

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A **401(k) plan** is a qualified plan that includes a feature allowing an employee to elect to have the employer contribute a portion of the employee's wages to an individual account under the plan. The underlying plan can be a profit-sharing, stock bonus, pre-ERISA money purchase pension, or a rural cooperative plan. Generally, deferred wages (elective deferrals) are not subject to federal income tax withholding at the time of deferral, and they are not reported as taxable income on the employee's individual income tax return.

A **403(b) plan**, also known as a tax-sheltered annuity plan, is a retirement plan for certain employees of public schools, employees of certain Code Section 501(c)(3) tax-exempt organizations and certain ministers. A 403(b) plan allows employees to contribute some of their salary to the plan. The employer may also contribute to the plan for employees.

Plans of deferred compensation described in IRC section 457 are available for certain state and local governments and non-governmental entities tax exempt under IRC Section 501. They can be either eligible plans under IRC 457(b) or ineligible plans under IRC 457(f). Plans eligible under 457(b) allow employees of sponsoring organizations to defer income taxation on retirement savings into future years.

A **Traditional IRA** is an individual retirement account (IRA) that allows individuals to direct income, up to specific annual limits, toward investments that accumulate tax-deferred. Contributions to the traditional IRA may be tax-deductible depending on the taxpayer's income, tax-filing status, and other factors.

A **SIMPLE IRA** is a retirement plan that may be established by employers, including self-employed individuals. The employer is allowed a tax deduction for contributions made to the SIMPLE. The employer makes either matching or nonelective contributions to each eligible employee's SIMPLE IRA, and employees may make salary deferral contributions.

A **Roth IRA** is a tax-deferred and potentially tax-free savings plan available to all working individuals and their spouses who meet the IRS income requirements. Distributions, including accumulated earnings, may be made tax-free if the account has been held at least five years, and the individual is at least 59½, or if any of the IRS exceptions apply. Contributions to a Roth IRA are not tax-deductible, but withdrawals during retirement are generally tax-free.

A **Roth 401(k)** is an employer-sponsored savings plan that gives employees the option of investing after-tax dollars for retirement. Although you pay taxes on your contributions, withdrawals that you take after age 59½ will be tax-free if the account has been funded for at least five years.

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