Planning Strategies

Congress Passed New Retirement Account Reforms: Here's What You Should Know

In December 2022, Congress passed the "SECURE 2.0 Act" as part of the 2023 $1.7 trillion omnibus spending bill, and President Biden signed it into law on December 29, 2022. Hundreds of pages in the bill pertain to retirement account reforms, so we thought it would be helpful to highlight a few key items in this article. As always, your 1919 team is available to help answer any questions or provide more specific guidance.

Why did Congress pass these additional reforms?

"Secure 2.0" follows the first SECURE Act, a sweeping retirement package that took effect in 2020. The first SECURE Act revamped the rules for inherited IRAs and changed the age at which one must take Required Minimum Distributions (RMDs) from 70½ to 72, among other things.[1] Secure 2.0 builds on a legislative trend to make retirement savings easier and more accessible for savers, as well as to put the burden of securing a financial future on the individual rather than an employer or the government. The law also strives to ease the administrative burdens on small businesses and empower them to offer retirement savings options to all employees, including part-time workers. The new Act also eases stiff penalties in a few instances so people can use their retirement savings for special situations and in cases where someone may have committed a small error, such as failing to take an RMD. Secure 2.0 also takes steps to improve Americans' short-term financial security and long-term care savings.

What aspects of Secure 2.0 will impact the most Americans?

Note the effective dates of the various provisions. Some are effective immediately, others in 2023, and some in 2024 and beyond.

Increases the age for RMDs

- Effective January 1, 2023, the age at which RMDs are required increases to 73 for anyone who had not turned 72 prior to that date. The applicable age increases to 75 on January 1, 2033.
  - If you turn 72 in 2023, you are not required to take an RMD for 2023.

Allows Larger Catch-up Contributions to IRAs and 401(k)s[2]

- Persons age 50 and older are allowed to contribute an additional $6,500 to their 401(k) plan above usual contribution limits in 2022. For 2023, that figure increases to $7,500 due to an inflation adjustment.
- Effective in 2024, all 401(k) catch-up contributions for employees having wage income over $145,000 in the previous year must be made on an after-tax basis and deposited in a Roth 401(k) account. The wage threshold will be adjusted annually for inflation.[3]
- Starting in 2025, for employees aged 60 to 63, Secure 2.0 increases the catch-up limit for 401(k)s to $10,000 or 1.5 times the limit then in effect, whichever is greater.

[1] See 2020 Tax Update--SECURE Act Passed: New Rules for IRAs and Beyond (Jan. 2020). https://1919ic.com/library/2020-tax-update/
[2] Generally, the rules that are applicable to 401(k) plans also apply to 403(b) and 457 retirement savings plans, which are each considered to be "defined contribution plans;" but that's not true in all cases.
[3] After enactment, a technical flaw was found in the legislative language regarding catch-up contributions but it should be corrected this year.

- The catch-up limit for IRA contributions is $1,000. Starting in 2024, that figure will be indexed for inflation.

Allows Expanded Types of 401(k) Matching Contributions

- Effective immediately, Secure 2.0 allows employees to elect to have matching contributions go into a Roth 401(k) instead of a traditional pre-tax plan.
    - Withdrawals from a Roth 401(k) are tax-free and there are no RMDs for the owner.
- Starting in 2024, Secure 2.0 allows employers to make matching contributions for student loan payments instead of only retirement plan contributions.

Requires Automatic Enrollment for New Retirement Plans

- Starting in 2025, employers must provide automatic enrollment in the employer's 401(k) or 403(b) plan at the minimum rate of 3% per year. This savings rate increases by one percentage point per year up to a cap of 10% unless the employee opts out.
    - Note that Secure 2.0 grandfathers 401(k) and 403(b) plans already in existence before the date of enactment.

Establishes New Rules to Meet Emergency Expenses

- Starting in 2024, employees may take a penalty-free withdrawal of up to $1,000 per year from a retirement account to meet the expenses of an unforeseen personal or family emergency.
    - Employees would self-certify that the withdrawal is for an emergency.
- The Act establishes new Emergency Savings Accounts. Starting in 2024, employees can be enrolled in a program to set aside up to $2,500 of after-tax earnings in a designated Roth IRA which runs alongside their other retirement accounts and may be tapped for emergency purposes. This program is not available to "highly compensated" employees.

Expands Rules for Qualified Charitable Distributions (QCDs)

- Under current rules, individuals who are age 70½ or older may make a Qualified Charitable Distribution directly from their IRA to charitable organizations of up to $100,000 per year. These distributions are tax-free and qualify as part of the owner's RMD for that year. Starting in 2023, the QCD dollar limit will be indexed for inflation.
    - Note that distributions to a Donor-Advised Fund do not qualify as QCDs.
- Effective in 2023, retirement account owners will be allowed a one-time tax-free distribution of up to $50,000 from a retirement account to a charitable remainder trust (CRUTs and CRATs) or a charitable gift annuity that benefits the grantor or their spouse. Funds may not be added to an existing charitable remainder trust, however.

    As to CRTs, this new rule seems to be of little benefit given the complexity and cost associated with setting up and maintaining a CRT. However, setting up a charitable gift annuity directly with a charitable organization may be more appealing. These are essentially contractual arrangements: The charity is obligated to pay an annuity to the donor for his or her lifetime. As a result, it could work quite well for someone with a long lifespan.

Allows Certain Charities to be Remainder Beneficiaries of Special Needs Trusts

- The first SECURE Act revamped the way inherited IRAs are treated. The Act imposed a new 10-year rule on most beneficiaries of inherited IRAs, but carved out some exceptions. One exception is that an IRA inherited by a disabled and chronically ill individual (or a trust for their benefit) may remain in place for the beneficiary's lifetime (instead of only 10 years). A technical flaw in that rule was that a charity could not be named as the remainder beneficiary of the trust without the trust losing the benefit of that lifetime payout exception. Secure 2.0 corrects that by allowing a charity to be the reminder beneficiary of the trust after the disabled or chronically ill person dies.

Allows Unused Funds in 529 Plans to be Rolled Over to a Roth IRA

- Starting in 2024, persons with unused funds leftover in a 529 college savings account can roll over the funds to a Roth IRA. The tax-free transfer is subject to a lifetime limit of $35,000 and the 529 account must have been open for at least 15 years.

New Categories of Penalty-free Withdrawals

- Secure 2.0 introduces new categories of taxpayers eligible to take withdrawals from retirement accounts without incurring a 10% early withdrawal penalty:
    - Individuals with a terminal illness (effective date of enactment)
    - Domestic abuse victims (subject to a $10,000 cap) (effective 2024)
    - Individuals affected by a declared disaster (up to $22,000) (effective date of enactment with a look-back provision for qualified disasters)
    - The foregoing distributions may be repaid within 3 years; if so, they will be treated like a rollover.
- In addition, penalty-free distributions to pay long-term care insurance premiums up to $2,500 per year are allowed effective immediately. The amount will be adjusted for inflation.

Reduces Penalty for Failing to Take an RMD

- Secure 2.0 reduces the penalty for failing to take an RMD to 25% from 50% of the undistributed amount. And if the RMD is corrected within a specified period of time, the penalty is reduced to 10%.
    - A reasonable cause exception also may apply in these situations and should be explored if an RMD was missed.
    - Note: Due to confusion about application of the 10-year rule after passage of the first SECURE Act, the IRS has waived the 50% penalty for missing an RMD in 2021 and 2022 for all IRAs inherited from persons who died in 2020 or 2021.[4]

Creates a "Retirement Savings Lost and Found"

Another new development is the establishment of the "Retirement Savings Lost and Found." The program would allow former employees to track down their forgotten or wayward retirement accounts using a searchable online database.

What's next on the horizon?

"Secure 2.0" is truly a bi-partisan piece of legislation. Components of the bill were assembled by members of Congress from very different points along the political spectrum. In March 2022, a version of the bill passed the House of Representatives by a vote of 414-5. There is still a desire among some in Congress to enact more reforms in other areas, such as paying for and controlling the cost of healthcare, as well as the need to address some perceived abuses and tax loopholes. But given what promises to be a contentious next two years in Washington, it's anyone's guess what will happen. Barring something that compels bi-partisan action (as we saw in 2020), we do not expect major legislative action before the 2024 election.

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[4] IRS Notice 2022-53. The first SECURE Act was effective January 1, 2020, and requires that inherited IRAs be fully drawn down by the end of the 10th year following the owner's death. However, soon after its enactment, there was a widely-held (but erroneous) view that no RMDs were required during this 10-year period. The IRS issued regulations in February 2022 that RMDs are required if the decedent died after his or her Required Beginning Date. Because of the confusion associated with this rule, the IRS announced that, for affected IRAs only, the 50% penalty for not taking an RMD on time would be waived for 2021 and 2022. The waiver does not apply if the decedent died before January 1, 2020. No RMDs were required in 2020 per the CARES Act.

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