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Highlights of the SECURE Act 2.0

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The 2023 Omnibus Appropriations Act, signed by President Biden on December 29, 2022, included the SECURE Act 2.0, a follow-up to the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act), Pub.L. 116–94, signed by President Trump. A wide range of changes will be phased in over the coming years. Herewith, a brief summary of:

- New RMD starting ages
- Reduced penalty for missing an RMD n Improved QCDs
- Roth-related changes
- More penalty-free withdrawals
- Choices for surviving spouses n Larger catch-up contributions
- New savings incentives
- Changes for the disabled

The extensive changes of SECURE Act 2.0 generally are pro-taxpayer and have been welcomed by professionals in the retirement plan community. Although there has been press coverage of many of the features of the new law, the phasing in of the changes is rather extensive. Table Two summarizes the years in which key SECURE Act 2.0 changes will be implemented.

New RMD Starting Ages

The original SECURE Act bumped up the beginning date for Required Minimum Distributions (RMDs) from qualified plans and IRAs from age 70½ to age 72, dropping the half-year convention that only caused taxpayer confusion. The new law raises the age to 73, as of this year, and promises an additional boost to age 75 in ten years. Table One summarizes the new rule. Table Two on page 3 summarizes the years in which key SECURE Act 2.0 changes will be implemented.

TABLE ONE

Birth Year	Age for RDMs to begin
1950 and earlier	72
1951-1959	73
1960 and later	75

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Because of this change, no one will have to begin RMDs in 2023. Those who turned 72 in 2022 were required to have an RMD for that tax year, which they must have received no later than April 1, 2023. Those who turn 72 in 2023 won't have an RMD until 2024, which they will have to receive no later than April 1, 2025.

Note that this change has no effect on the eligibility for Qualified Charitable Distributions (QCDs). Taxpayers who are 70½ or older may arrange for a direct transfer to charity of up to $100,000, and the amount will not be included in taxable income. Such transfers will count as RMDs for those who are 73 and older.

Planning points. Many taxpayers do not have to worry about RMDs, as they will have consumed their IRAs before reaching the magic age. For the more affluent, the later age may mean another year of tax-deferred growth in the retirement accounts. Keep in mind that the denominators in the distribution table keep growing, however, so when the RMDs do begin, they may push the taxpayer into a higher tax bracket.

One way to avoid RMDs is to convert an IRA to a Roth IRA and pay income taxes on the conversion. An RMD is not eligible to be rolled into the Roth IRA. Once the RMDs begin, stacking a Roth conversion on top of the RMD may lead to an unacceptably high tax bill. The increase in the age for RMDs gives taxpayers an extra year to implement the conversion strategy, while they are in a lower tax bracket.

Reduced Penalty for Missing an RMD

The prior law rule was that failure to take an RMD resulted in a penalty tax of 50% of the amount that should have been distributed. Effective this year, the penalty tax is reduced to 25%, and if the taxpayer corrects the error by taking the RMD the following year, the penalty is further reduced to 10%.

Planning point. With the lower penalties, the IRS may prove to be less generous in granting waivers for failing to take an RMD for a reasonable cause.

Improved QCDs

The Qualified Charitable Distributions noted above have two important improvements. First, the $100,000 limit, which has never been increased, will be indexed for inflation beginning in 2024.

Second, up to $50,000 may be transferred as a QCD to a charitable remainder unitrust, a charitable remainder annuity trust, or a charitable gift annuity. This is a once-in-lifetime opportunity, and the trust may only be funded with the QCD. The income beneficiaries are limited to the owner and spouse, but they will receive a small lifetime income from the split-interest trust. All trust distributions will be taxed as ordinary income.

Planning point. QCDs are still not allowed for donor-advised funds, which have boomed in recent years.

Roth-Related Changes

Roth IRAs are funded with after-tax dollars and offer the possibility of tax-free distributions during retirement. Roth IRAs are not subject to the RMD rules.

Some 401(k) plans offer the option of Roth treatment for employee deferrals. Employer matching deferrals have been required to be placed in a traditional, pre-tax account. Starting immediately, employees may request that the employer contribution also receive Roth treatment (which means that the employer contribution will have to be included in the employee's income). Roth SIMPLE plans and Roth SEP plans are also now allowed.

Beginning in 2024, the RMD rules will no longer apply to designated Roth accounts in employer plans—they will have the same treatment as Roth IRAs. In the past, a taxpayer with a designated Roth account could roll the money into a Roth IRA to avoid the RMDs. That will no longer be necessary, if the taxpayer prefers to have the money remain in the employer plan.

Planning points. In contrast to the Roth IRA, there are no income limits on who may contribute to a designated Roth account in a 401(k) or other employer plan.

If a plan does not offer Roth accounts and has an age-eligible high-wage participant, no participants will be able to make catch-up contributions.

529 to Roth IRA Transfer

As of June 2022, there were 15.9 million 529 accounts holding some $412.5 billion toward future education expenses [https://www.bestcolleges.com/research/529-college-savings-plan-statistics/]. If the beneficiary does not go to college, or does not exhaust the account, amounts withdrawn are subject to ordinary income tax plus a 10% tax penalty. It is not well documented how much 529 money is not used for education, but the uncertainty may discourage some taxpayers from using this approach to building a financial foundation for higher education.

Beginning in 2024, there will be an additional choice. Unused 529 plan money will be rollable into a Roth IRA for the plan beneficiary. However, several restrictions apply:

- the account must have existed for at least 15 years;
- contributions made in the previous five years are not eligible for rollover;
- the contribution limit for IRAs will apply and must be coordinated with any other IRA contributions by the beneficiary; and
- the maximum lifetime transfer is $35,000.

Planning point. The income limits for Roth IRA contributions do not apply to transfers to a Roth IRA from a 529 account.

TABLE TWO, Phased-in SECURE Act 2.0 Changes, partial list

2024	2025	2026	2027
Treatment of student loan repayments as elective deferrals for employer matching contributions	Higher catch-up limits for those at age 60, 61, 62, and 63	Increase in age limit for onset of disability from 25 to 45 for ABLE accounts	Saver’s match program, replacing the saver’s cash credit with a federal matching contribution to the taxpayer’s IRA or retirement plan
Indexing IRA and 401(k) catch-up contribution limits	Creation of searchable database of lost retirement accounts		
Certain emergency withdrawals permitted without penalty	Shorter service requirement for part-time worker participation in 401(k) plan		
Additional nonelective contributions allowed for SIMPLE plans	Expanded automatic enrollment in 401(k) and 403(b) plans		
Rollover of unused 529 plan money to Roth IRA	Penalty-free withdrawals for long-term care insurance		
Catch-up contributions to qualified retirement plans must be to Roth accounts for employees with compensation of $145,000 or more			
Hardship withdrawals for 403(b) plans conformed to the 401(k) rules			

More Penalty-Free Withdrawal Options

Withdrawals from qualified retirement plans and IRAs before age 59½ are subject to ordinary income tax plus a 10% tax penalty. SECURE Act 2.0 has created some limited access to the funds penalty free, but the regular income tax must still be paid.

Personal or family emergency. Up to $1,000 may be withdrawn per year. The participant has the option of restoring the money to the account within three years.

Terminal illness. Individuals who have a terminal illness are fully exempted from the 10% penalty tax.

Domestic abuse. A victim of domestic violence may withdraw the lesser of $10,000 or 50% of the vested account balance without penalty. The amounts withdrawn may be repaid for three years, and if they are repaid, the income taxes on the withdrawals will be refunded.

Federal disaster areas. Up to $22,000 may be withdrawn by persons who live in a federally declared disaster area who have suffered an economic loss. The money may be repaid for three years, with a refund of taxes paid. This provision is effective for any disasters declared after January 26, 2021.

Long-term care premiums. Beginning in 2025, up to $2,500 may be withdrawn penalty-free to pay for qualified long-term-care insurance policies. However, this provision may not have much impact, as many purchasers of such policies do so from age 55 to 60. From age 59½ on, all withdrawals are penalty-free, so this change will affect only a few tax years.

QLACs

Qualified Longevity Annuity Contracts (QLACs) offer a mechanism for turning a portion of an IRA or 401(k) balance into something resembling a pension benefit, while also reducing the size of RMDs. The QLAC may be for the account owner's life, or the joint lives of the owner and a designated beneficiary. The QLAC starting date for payouts must be no later than the first day of the month following the account owner's 85th birthday. The RMD rules will not apply to the QLAC, but will continue to apply to any balance remaining in the IRA or 401(k).

Effective this year, the amount that may be moved from an IRA or 401(k) to a QLAC is increased from $145,000 to $200,000. Also, the cap of 25% of the account balance for a QLAC investment has been dropped.

A variety of additional restrictions apply to QLACs, including that the annuity contract is not variable or indexed, but a cost-of-living adjustment is allowed. A QLAC may also provide for a return of premium feature. One expects that the total payouts from the QLAC will be larger than the premium paid for it. In the event of an early death, to the extent that the total annuity payments are less than the premium paid, the difference may be paid to the estate or a beneficiary.

Choices for Surviving Spouses

One of the most important changes of the first SECURE Act was the elimination of the "stretch IRA" for most beneficiaries who inherited retirement plan assets. In most cases, the inheritance must be distributed over the ten years following the owner's death. One exception concerns a surviving spouse, who may elect to treat an inherited IRA as his or her own IRA, which may postpone the date for RMDs to begin. On the other hand, if the surviving spouse is not yet 59½ and would like to take penalty-free distributions before reaching that age, he or she might opt for the ten-year rule, under which the 10% penalty tax for premature distributions does not apply.

Effective next year, a surviving spouse will have an election to be treated as the decedent for purposes of the RMD, which may be advantageous in some circumstances. More significantly, according to estate planner Ed Morrow, one effect of the change will be to make conduit trusts more advantageous for IRAs for surviving spouses ["Secure 2.0 Offers Longer Stretch for Conduit Trusts, but Contains Traps for Surviving Spouses," LISI Estate Planning Newsletter #3010 (January 24, 2023)]. Under current law, when a conduit trust is used to manage an IRA for a surviving spouse, the RMDs are determined using the single life annuity table. With a proper election, under the new law the Uniform Life table will be used instead, which leads to lower RMDs and a longer stretch of the IRA for the surviving spouse. However, this may add complexity to the estate plan, Morrow suggests. "Not only does the trustee have to be on the ball in making sure the election is made, but if the trustee is different from the surviving spouse (which is often the case for blended family situations in which the settlor wants to protect some of the funds), the trustee must work with the surviving spouse, who is the party under the statute who must make the election. What if the surviving spouse (or their guardian) is not cooperative?"

Larger Catch-Up Contributions

The only retirement account without inflation indexing for catch-up contributions for those 50 and older is the IRA. The catch-up has been stuck at $1,000 since 2006. Beginning next year, this limit will be inflation-increased in increments of $100. Unless inflation this year comes in at more than 10%, the first actual adjustment to the catch-up limit won't happen until 2025.

A more substantial change to catch-up contributions is in store for 401(k) and similar plans. This year, the catch-up limit is $7,500 for those plans. Beginning in 2025, there will be a bonus catch-up limit for those aged 60, 61, 62, or 63. For these folks, the catch-up limit will be the greater of $10,000 or 150% of the regular catch-up.

However, there is a catch. Those who earn more than $145,000 will have to put their catch-up contributions in a designated Roth account. Using a Roth account will be optional for lower-paid employees.

Planning points. If a plan does not offer Roth accounts and has an age-eligible high-wage participant, no participants will be able to make catch-up contributions.

New Savings Incentives

Beginning in 2025, there will be new requirements for employers adopting new 401(k) or 403(b) plans. Such plans will need to automatically enroll new employees, at a contribution rate of between 3% and 10% of compensation. The contribution rate will have to ratchet up by 1% every year automatically, to a maximum of at least 10% but not more than 15%. However, employees will be allowed to opt out if they don't want to participate, in contrast to the current system where they have to opt in.

Currently, part-time employees must be allowed to participate in an employer retirement plan when they have worked for 500 hours annually for three years, or over 1,000 hours in one year. Starting in 2025, the eligibility level drops to 500 hours a year for two years.

Student Loan Matches

Beginning next year, an employer matching contribution to an employee's retirement account may be made based upon the employee's repayment of a student loan. The vesting and matching schedules must be the same as if the student loan payments were employee deferrals.

Emergency Savings Accounts

One barrier to young workers setting aside money for retirement is the permanence of the decision. Parting with funds for 30 years or more might seem somewhat reckless when one doesn't know what financial emergencies might pop up in the meantime. Although it is possible to access one's 401(k) money, either through loans or hardship distributions, that process is not automatic.

The solution offered by SECURE 2.0 is a new "Emergency Savings Account," available beginning next year. The account must be attached to an employer plan. Highly compensated employees will not be eligible for this perk. Contributions will be after tax (like a Roth account), and the contribution limit will be $2,500. Employees may be auto-enrolled in the program at up to 3% of compensation. Investments are limited to cash or similar liquid assets. Participants must have a minimum of monthly access to the funds. The first four withdrawals from the account each year will be free of taxes (because the contributions were after tax) and penalties. Given the investment limitations, there likely won't be much income generated by these accounts.

Matching contributions from the employer will be allowed, but the match will go into the participant's retirement account.

Government Matches

In 2027, the current Saver's Credit for contributing to a qualified retirement plan will be converted to a Saver's Match. The idea is that, just as an employer will match the employee's deferral, so will the federal government. Up to 50% of the first $2,000 in contributions to an IRA or other retirement plan will be matched, so the maximum match is $1,000. Rather than receive a credit against income taxes, the match amount will be deposited directly into the taxpayer's retirement account. However, this novel tax benefit phases out at relatively low income levels. For singles, the match disappears from $20,500 to $35,500; for marrieds filing jointly, the range is $41,000 to $71,000.

The new government match will not be available to anyone under age 18, anyone who may be claimed as a dependent on another taxpayer's return, or to full-time students.

Changes for the Disabled

Established in 2014, the Achieving a Better Life Experience Account, or ABLE Account, offers an affordable and approved method of providing financial support to a disabled individual, support that will not jeopardize government benefits that are means-tested. Maximum contributions to such accounts are tied to the federal gift tax annual exclusion ($17,000 this year). Funds from the ABLE account may be used for a wide variety of supportive expenses for the beneficiary.

Such accounts have been limited to individuals who become disabled before reaching age 26. SECURE 2.0 boosts the age limit to 46, but not until 2026. Once the change kicks in, someone whose disability developed from, for example, an auto accident when they were in their 30s will be an eligible beneficiary. It's been projected that the change could allow up to 8 million more people to qualify for ABLE accounts, including an estimated 1 million veterans.

The more complicated approach to financial support for the disabled is the Special Needs Trust. It gets really complicated when retirement plan benefits are involved.

The Special Needs Trust cannot be a conduit trust, because the conduit trust must distribute RMDs to the beneficiary as it receives them. To avoid affecting qualification for government benefits, the trust must be a discretionary trust. Under the original SECURE Act, a Special Needs Trust may accumulate distributions and pay out RMDs over the

life of the beneficiary, rather than the ten years that applies to most inherited retirement assets. However, providing a remainder interest for a charity would spoil the plan, because all beneficiaries of such a trust must have a life expectancy, which the charity lacks. SECURE 2.0 addresses this problem, allowing distributions to public charities, but not to private foundations or donor-advised funds. Drafting ideas for dealing with this part of the law are offered by Ed Morrow and Nancy Welber in "Secure 2.0 Act Enhances Special Needs—See Through Trust Planning," LISI Estate Planning Newsletter #3027 (March 30, 2023).

Reception

SECURE 2.0 is a lot to digest, especially coming so soon after the original SECURE Act. Retirement industry sources generally have welcomed the changes of SECURE 2.0 as steps in the right direction. Whether they achieve the hoped-for dramatic increase in retirement savings remains to be seen.

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