SECURE 2.0 Aims to Brighten the Future for Retirement Savers

westwoodgroup.com/weeklyfp/secure-2-0-aims-to-brighten-the-future-for-retirement-savers/

The $1.7 trillion appropriations bill passed by Congress at the end of last year included some notable provisions affecting workplace retirement plans and IRAs. Dubbed the SECURE 2.0 Act of 2022, the new legislation builds on the sweeping Setting Every Community Up for Retirement Enhancement Act that was passed in 2019.

Here's an overview of the Act's changes to the complicated rules that govern tax-advantaged retirement accounts.

The following provisions, though far from a complete list, are intended to help workers save more money for retirement and let retirees leave their savings untouched and untaxed for longer.

Looser RMD rules

The 2019 SECURE Act raised the age at which retirement savers must begin taking taxable distributions from their traditional IRAs and most work-based retirement accounts to 72. SECURE 2.0 raises that age again to 73 beginning in 2023 (for those who reach age 72 after December 31, 2022) and to 75 in 2033.

Current law requires those who fail to take their full RMD by the deadline to pay a tax of 50% of the amount not taken. The new law reduces that tax amount to 25% in 2023; the tax is further reduced to 10% if account holders take the full required amount and report the tax by the end of the second year after it was due and before the IRS demands payment.

Bringing Roth 401(k)s and similar employer plans in line with Roth IRAs, the legislation eliminates the requirement for savers to take minimum distributions from their workplace Roth accounts (starting in 2024).

Expanded QCDs

The amount eligible for a qualified charitable distribution from an IRA ($100,000) will be indexed for inflation starting in 2024. In addition, beginning in 2023, investors will be able to make a one-time charitable distribution of up to $50,000 from an IRA to a charitable remainder annuity trust, charitable remainder unitrust or charitable gift annuity.

Not all charitable organizations are able to use all possible gifts, so it is prudent to check first. The type of organization selected can also affect the tax benefits the donor receives.

Rising catch-up contributions

Individuals who are age 50 and over can make an additional catch-up contribution of $1,000 to their IRA. Starting in 2024, this amount will be indexed annually for inflation, similar to employer plan catch-up contributions (limited to $7,500 in 2023). Also, starting in 2025, the catch-up contribution for people aged 60 to 63 will increase to a minimum of $10,000 for 401(k)s and similar workplace plans ($5,000 for SIMPLE plans). However, beginning in 2024, all catch-up contributions for workers with incomes above $145,000 will be after-tax (Roth) contributions.

New penalty exceptions

Distributions from retirement savings accounts are generally subject to ordinary income tax. In addition, distributions prior to age 59½ also may be subject to an early-withdrawal penalty of 10%, unless an exception (such as death or disability) applies. SECURE 2.0 ushers in several new exceptions to the early-withdrawal penalty, including an emergency personal expense, terminal illness, domestic abuse, to pay long-term care insurance premiums, and to recover from a federally declared disaster. Amounts, rules and effective dates differ for each circumstance, with some exceptions effective immediately.

Changes to employer plans

Beginning in 2025, the Act requires most new employer-sponsored plans to automatically enroll employees with contribution levels between 3% and 10% of income, and automatically increase their savings rates by 1% each year until they reach at least 10% (but not more than 15%) of income. Workers will be able to opt out of the programs.

The new law permits employer matches to be made to Roth accounts. Currently, employer matches must go into an employee's pre-tax (traditional) account. This provision takes effect immediately; however, it may take time for employers to amend their plans to include this feature.

Beginning in 2024, the legislation permits employers to automatically enroll non-highly compensated employees into emergency savings accounts where they can set aside up to $2,500 (or a lower amount that an employer stipulates) in a Roth-type account. Savings above this limit can go into a Roth retirement account, if the employee has one, or would not be accepted. Employers may also help workers who are making qualified student loan repayments to simultaneously save for retirement by investing matching contributions in a retirement account in their name.

Rolling 529 plans to Roth IRAs

When parents or grandparents contribute to a 529 college savings plan for a student, the investment earnings accumulate on a tax-deferred basis, and withdrawals are tax-free as long as they are used for qualified education expenses. But for withdrawals not used for qualified education expenses, earnings may be subject to taxation as ordinary income and possibly a 10% tax penalty. Thus, when there is money left over in a 529 account that won't be used for a family member's college expenses, the owner may dread the tax bill that would come from cashing out and repurposing the money.

Fortunately, starting in 2024, account beneficiaries will be able to directly roll over up to $35,000 from 529 plan accounts to Roth IRAs, provided the 529 accounts were open for at least 15 years. The rollover amounts would be subject to Roth IRA annual contribution limits ($6,500 in 2023 and indexed for inflation thereafter). Distributions from the Roth IRA will be tax-free and penalty-free as long as the five-year holding requirement has been met and after age 59½ (or an exception applies).

As with other investments, there are generally fees and expenses associated with participation in a 529 savings plan. There is also the risk that the investments may lose money or not perform well enough to cover college costs as anticipated. The tax implications of a 529 savings plan should be discussed with your legal and/or tax professionals because they can vary significantly from state to state. Also be aware that most states offer their own 529 plans, which may provide advantages and benefits exclusively for their residents and taxpayers. These other state benefits may include financial aid, scholarship funds and protection from creditors.

Before investing in a 529 savings plan, please consider the investment objectives, risks, charges and expenses carefully. The official disclosure statements and applicable prospectuses — which contain this and other information about the investment options, underlying investments and investment company — can be obtained by contacting your financial professional. You should read these materials carefully before investing.

IMPORTANT DISCLOSURES

Broadridge Investor Communication Solutions, Inc. and Westwood Holdings Group, Inc. do not provide investment, tax, legal, or retirement advice or recommendations. The information presented here is not specific to any individual's personal circumstances.

To the extent that this material concerns tax matters, it is not intended or written to be used, and cannot be used, by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Each taxpayer should seek independent advice from a tax professional based on his or her individual circumstances.

These materials are provided for general information and educational purposes based upon publicly available information from sources believed to be reliable — we cannot assure the accuracy or completeness of these materials. The information in these materials may change at any time and without notice.