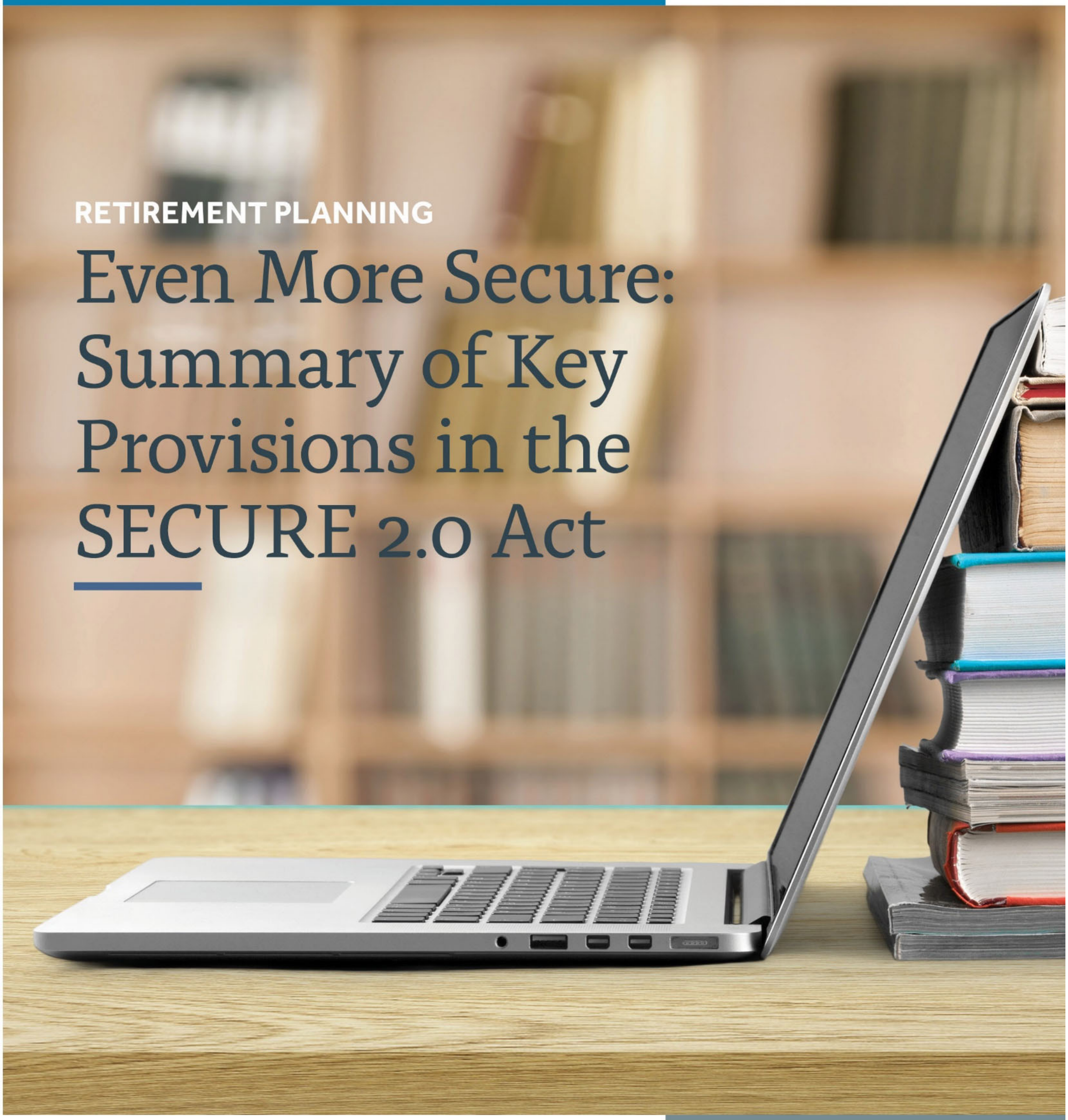
Navigating
Income Tax



RETIREMENT PLANNING

Even More Secure: Summary of Key Provisions in the SECURE 2.0 Act

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Many people struggle to save for retirement and feel they are not on track with their savings. According to a survey by the Federal Reserve, one quarter of the non-retired individuals surveyed had no retirement savings or pension. Of those aged 60 and older, 13% had no retirement savings or pension. Given these sobering statistics, help may be on the way to increase people's readiness for retirement with the passage of the Setting Every Community Up for Retirement Enhancement (SECURE) Act 2.0, commonly called SECURE 2.0, on December 29, 2022. From increasing the time horizon – and thus the opportunity for tax deferral – for required minimum distributions (RMDs) to helping people purchase long-term care contracts using retirement plan distributions, SECURE 2.0 appears to offer something for everyone.

Unlike most legislation emanating out of Washington, both the initial SECURE Act and SECURE 2.0 represent something that both parties can agree on: the need (and importance) for financial security in retirement. This legislation will provide millions of workers the opportunity to build retirement savings through employer-provided retirement plans. The hope is that these new rules will encourage people to save more for retirement.

Automatic enrollment is a proven method for increasing worker participation. Thus, a key feature of SECURE 2.0 is an automatic enrollment provision for new retirement plans that would require employers with 401(k) and 403(b) plans to automatically enroll eligible employees into a company's retirement plans at a savings rate beginning at 3% but not more than 10%, and each year thereafter that amount would be increased by 1% until it reaches at least 10% (but not more than 15%).

All current 401(k) and 403(b) plans are grandfathered. However, employees may opt out at any time or opt to save less or more up to the IRS annual contribution limits. Businesses with fewer than 10 employees, businesses opened less than three years ago, and retirement plans for employees of churches and government agencies are exempt from this legislation.

In addition to the automatic enrollment provisions above, the legislation also makes changes to employer-sponsored retirement plans by expanding coverage and increasing retirement savings, as well as simplifying and clarifying plan rules. Below is a summary of some of the more significant provisions of SECURE 2.0 that became law with the signing of the legislation (provisions with a delayed future effective date are specifically noted).

Increase in Age for Required Minimum Distributions - Section 107

The original SECURE Act raised the age when individuals had to start taking RMDs from traditional retirement plans such as 401(k)s and IRAs from age 70½ to 72. Under this provision, the age for beginning mandatory minimum distributions increases to 73 starting on January 1, 2023, with a further increase to age 75 starting on January 1, 2033. The increase in ages would provide an individual the opportunity to accumulate several more years of tax deferral on their retirement savings.

Inflation Indexing for IRA Catch-Up Contributions and Higher Catch-Up Limits for Individuals Aged 60-63 - Sections 108 and 109

Currently in 2023, workers aged 50 and older may make additional contributions of $7,500 to their 401(k)s (after hitting the $22,500 limit in 2023) and an additional contribution of $1,000 to their IRAs (after hitting the $6,500 limit in 2023). For SIMPLE IRAs, workers can add $3,500 above the current limit of $15,500 (in 2023). With the passage of SECURE 2.0, all of the provisions above regarding catch-up contributions are now indexed for inflation (except the $1,000 catch-up contributions for IRAs which will begin indexing in 2024).

Section 109 provides workers aged 60-63 a special savings incentive that allows them the opportunity to make additional catch-up contributions equal to the greater of: $10,000 ($5,000 for SIMPLE plans) or 150% of the regular catch-up limit applicable in 2025, which is the effective date of this provision. These increased amounts also will be indexed for inflation for taxable years beginning after 2025.

Special Rules Governing Distributions from Long-Term Qualified Tuition Programs to Roth IRAs - Section 126

This provision which amends the Internal Revenue Code would allow beneficiaries of 529 college savings accounts to rollover tax and penalty free up to $35,000 over the course of their lifetime to their Roth IRA. However, these rollovers are subject to the Roth IRA annual contribution limits and the 529 account must have been open for more than 15 years. (§126 will be effective with respect to distributions made after December 31, 2023.)

Removes RMD Barriers for Life Annuities - Section 201

This provision removes the actuarial test under the RMD regulations that served as a barrier to the availability of life annuities in qualified retirement plans and IRAs that limited tax deferral opportunities by precluding commercial annuities from providing payments that started out small but increased over time, such as guaranteed annual increases and the return of premium death benefits.

Qualifying Longevity Annuity Contracts (QLACs) - Section 202

A QLAC is a type of deferred annuity that is designed to start paying benefits toward the end of a beneficiary's life expectancy thus providing them longevity protection. An individual purchasing a QLAC must specify when they want the income to start, which cannot be past age 85.

Before enactment of §202, retirement plan participants could only purchase QLACs in an amount equal to the lesser of 25% of their retirement plan funds or $145,000. However, Section 202 repealed the 25% limit and allows up to $200,000 (indexed for inflation) to be used from a retirement account to purchase a QLAC. It also facilitates the sale of QLACs with spousal survival rights and permits a free-look period up to 90 days regarding contracts purchased or received in exchange on or after July 2, 2014. Moreover, the Treasury Secretary is required to update the relevant regulations within 18 months from the date of enactment of this provision.

Insurance-Dedicated Exchange Traded Funds (ETFs) - Section 203

This provision eliminates the conflict between the ETF rules and the insurance industry segregated account rules by letting all variable annuity holders buy insurance-dedicated funds that track the performance of publicly traded ETFs as well as the performance of mutual funds. Effective for segregated account investments made on or after seven years from the date of enactment.

Reduction of Excise Taxes on Excess Accumulations in Qualified Retirement Plans - Section 302

After enactment of this provision, the failure to withdraw the full amount of a RMD results in a 25% excise tax (down from 50%) on the difference between the amount of the RMD and the actual amount withdrawn. For example, if an individual's RMD was $10,000 but the individual did not withdraw anything for that tax year, the excise tax owed would be $2,500 (($10,000 -$0) x 25%). However, if the mistake is corrected in a timely manner, defined under SECURE 2.0 as the end of the second tax year following the year in which the distribution should have been made, the penalty would be reduced further to 10%.

One-Time Election for Qualified Charitable Distribution (QCD) to Split Interest Entity and Increase in the QCD Limitation - Section 307

Currently, individuals aged 70½ or older can transfer up to $100,000 tax-free each year from their traditional IRAs directly to a charity. In addition to the QCDs being excluded from tax, they also can count for all or a portion of an individual's annual RMD.

With the enactment of this provision, the annual QCD limit of $100,000 is now indexed for inflation and expanded to permit a one-time election to treat $50,000 of the contribution to fund a split-interest entity such as a charitable gift annuity, charitable remainder unitrust (CRUT), or charitable remainder annuity trust (CRAT) as if it were a qualified charitable distribution made directly to a charitable entity.

Contributions to a split-interest entity benefit not only the charity but also the individual IRA owner by generating an income stream to that individual for a selected term of years (not to exceed 20 years) or for their lifetime. This allows donors to be philanthropic while at the same time receiving an income stream during their retirement years.

Elimination of Roth 401(k) RMDs - Section 325

This provision eliminates the pre-death distribution requirement for Roth accounts in employer plans, effective for taxable years beginning after December 31, 2023. Consequently, Roth 401ks will no longer have RMDs starting next year.

Long Term Care Premium Exception to 10% Early Withdrawal Penalty - Section 334

This provision permits retirement plans to distribute up to $2,500 per year for the payment of premiums for certain long-term care insurance contracts or for life insurance policies or annuity contracts that provide long-term care benefits. Distributions from retirement plans to pay for such premiums are exempt from the additional 10% tax on early distributions. It is important to note that only a policy that provides for high quality coverage is eligible for early distribution and the waiver of the early distribution penalty. However, what is considered "high quality coverage" has yet to be explicitly defined under the regulations. This provision becomes effective three years after the date of the enactment of SECURE 2.0.

Special Needs Trust Can Have Charity as Remainder Beneficiary - Section 337

Special rules apply to certain beneficiaries such as those with a disability. This provision clarifies that for a special needs trust established for a beneficiary with a disability, the trust may now designate a charitable organization as a remainder beneficiary.

SIMPLE and SEP IRAs Permitted to Accept Roth Contributions - Section 601

Generally, most qualified retirement plans that allow pre-tax employee contributions are permitted to accept Roth contributions, with the only exceptions SIMPLE IRAs and most simplified employee pension plans (SEPs). This provision remedies that situation by now allowing employees the ability to make Roth contributions to their SIMPLE and SEP IRAs.

Roth Treatment Mandatory for Catch-Up Contributions of High Earners - Section 603

No longer will catch-up contributions of high earners (defined as individuals earning $145,000 or more, indexed for inflation) be allowed to be tax deferred. This provision provides that all catch-up contributions to qualified retirement plans from high earners must be on a Roth basis, effective for all taxable years beginning after December 31, 2023.

Optional Treatment of Employer Matching Contributions as Roth Contributions - Section 604

Currently, employer matching contributions must be on a pre-tax basis. Under this provision, qualified retirement plans such as 401(k), 403(b), and 457(b) plans may now allow a participant to designate some or all of their matching contributions and nonelective contributions as designated Roth contributions. However, these matching Roth contributions would be taxable to the employee and the employee would immediately be vested in such contributions.