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Private Wealth Management

# Highlights of Secure 2.0 Act

## Follow-up to 2019 bill provides flexibility around retirement savings and withdrawals

Delayed RMDs, increased contribution limits, new savings options and more highlight the latest efforts to enhance retirement savings. Meanwhile, many other anticipated changes were left out.

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December 2022

In their last major act before the holiday recess, Congress passed an omnibus spending bill that provides funding for various departments throughout the government. Included in that bill was a section titled "Secure 2.0 Act of 2022", which is a follow-up to the first Secure Act passed in late 2019. This bill addresses a variety of retirement planning topics that will affect how individuals save to, or withdraw from, different retirement savings accounts. Versions of this bill had been in both houses of Congress during 2022, and the final version includes provisions from both bills.

The bill is more about quantity over quality, as it includes a long list of new provisions, but few that would be considered meaningful to most individuals. The aspect with the broadest impact is likely the phased-in increase in the age when Required Minimum Distributions must begin, along with increases to several types of plan contribution limits. There are also new types of savings accounts, including Roth versions of SEP and Simple IRAs, and a variety of new exceptions to the 10% penalty for early withdrawals from retirement accounts.

What is not included in the bill is any new clarity around the 10-year rule for beneficiaries of inherited IRAs, something that was a significant part of the original Secure Act. As a result, those beneficiaries will head into 2023 still unsure how much, if any, of the account must be withdrawn that year. The bill also did not include any of the retirement, tax or estate provisions that were discussed in late 2021 through earlier this year, such as limitations on backdoor Roth contributions or Roth conversions, forced distributions from larger retirement accounts, changes to the basis adjustment at death rules or any other estate-related items, or an increase in the $10,000 cap for deducting state and local taxes. With the control of Congress being split between Democrats and Republicans in 2023, it seems unlikely any of these more hotly-debated issues will be addressed in the foreseeable future.

Below are highlights of many of the provisions included in Secure Act 2.0 that will affect individual taxpayers. The bill includes numerous changes to the administration of retirement plans by employers – such as employee enrollment and eligibility – which are outside the scope of this summary.

### INCREASE IN THE BEGINNING AGE FOR REQUIRED MINIMUM DISTRIBUTIONS

The original Secure Act changed the starting age for required minimum distributions (RMDs) from 70½ to 72, and this bill pushes it out even further. RMDs will be required at age 73 beginning in 2023, meaning those turning 72 that year will receive a one-year delay before having to take withdrawals. Beginning in 2033, that age increases again to 75. *(Please note: the bill as currently written has created two different rules for those born in 1959, a technical error that will need to be addressed by Congress.)*

Retirement account owners will still be allowed to delay their first RMD until April 1 of the year after reaching the applicable age, but would have to take a second withdrawal before the end of that year. None of these changes will impact those who are already subject to RMDs in 2022. It also won't impact the ability to make Qualified Charitable Distributions from an IRA, as those can still be made once the IRA owner reaches age 70½.

### ENHANCEMENTS TO QUALIFIED CHARITABLE DISTRIBUTION RULES

Direct gifts to charity from an IRA, known as Qualified Charitable Distributions (QCDs), were first introduced in 2006, and the rules regarding these gifts have been largely unchanged since. However, this bill provides two important enhancements to this popular charitable giving technique. First, the $100,000 annual limit on gifts per donor will be adjusted for inflation beginning in 2024.

Secondly, donors are now able to make a gift from an IRA to a "split interest" entity, which includes vehicles such as charitable remainder trusts (CRTs) or charitable gift annuities. However, there are several limitations on these gifts:

- Each donor can make just one QCD of this nature during their lifetime, with a maximum transfer of $50,000 (adjusted annually for inflation).
- The trust or annuity must be solely funded from the QCD. No other contributions may be made to the vehicle.
- For annuities, fixed payments of at least 5% of the value must begin within 1 year of the gift. For both annuities and trusts, the donor and/or their spouse must be the sole income beneficiary.
- All distributions from the trust or annuity will be treated as taxable, ordinary income to the income beneficiary.

No other changes were made to the QCD rules, including the age 70½ requirement or the inability to use QCDs to fund a donor advised fund. Given the strict limitations on the use of these new gifts, in particular that only QCDs can fund the trust or annuity, it's unlikely these changes have a material impact on charitable giving. However, they could open the door to further relaxing of the rules in the future.

### RETIREMENT PLAN CONTRIBUTION ENHANCEMENTS

The primary focus of the original Secure Act was to expand opportunities for employers and employees to increase savings to retirement accounts. This bill expands on that by implementing the following changes:

- To support workers who are balancing saving for retirement with paying down student loans, employers can treat a qualified student loan payment made by the employee as a plan contribution when determining eligibility for a matching contribution. This provision, beginning in 2024, applies to participants in a 401(k), 403(b), governmental 457 or Simple IRA.
- Beginning in 2027, the tax credit for saving to a retirement plan will be simplified. The credit will be a flat 50% of the taxpayer's contributions to a retirement plan, with a maximum credit of $1,000. The credit will be phased out for married couples filing jointly with income between $41,000 and $71,000 (half those levels for singles), and full-time students or those claimed as a dependent are not eligible. Rather than providing a reduction in a taxpayer's liability on their tax return, the new credit will be directly deposited into the applicable retirement account.
- Beginning in 2024, employers can make a new, non-elective contribution to a Simple plan for qualified employees of up to 10% of their income, with a maximum contribution of $5,000 (adjusted for inflation in 2025).
- Also beginning in 2024, a new form of plan, referred to as a Starter 401(k), can be offered by employers who don't otherwise offer a retirement plan. This new plan would include an automatic deferral feature of 3-15% of earnings (although employees can opt out), with a maximum contribution of $6,000, plus a $1,000 catch-up option for those age 50 or older.

Also in 2024, employers can offer a new Pension-Linked Emergency Savings Account, a short-term savings vehicle for eligible employees ("highly compensated" individuals are excluded from participating). Contributions to this Roth-style account are non-deductible, but earnings would be tax-free upon withdrawal. Employee contributions are allowed up to the point where the account balance reaches the maximum value allowed by the employer (but no more than $2,500) and are to be invested in a way that preserves the principal of the account. Withdrawals from the account can occur at any time the employee requests.

## CHANGES TO PLAN CATCH-UP CONTRIBUTION RULES

In order to encourage more retirement savings, the bill increased what are referred to as the "catch-up" contribution limits for various plans. These are additional contributions that can be made to accounts once the owner reaches specific ages.

- Current rules allow participants in 401(k) and 403(b) plans to contribute an additional $7,500 (for 2023) beginning the year they reach age 50. Beginning in 2025, in the year a participant reaches ages 60 through 63, the catch-up increases to the greater of $10,000 or 150% of the age 50 catch-up amount. In the year the participant reaches 64, this enhanced catch-up goes away, although the base catch-up is still allowed.
    - A similar change was made for Simple IRA participants, with the base $3,500 catch-up amount increasing to $5,000 or 150% of the base amount for participants in that same age range.
    - The $10,000 and $5,000 amounts are both subject to annual inflation adjustments.
- For Traditional and Roth IRAs, the current $1,000 catch up amount that is available when the owner reaches age 50 will be increased for inflation beginning in 2024.

In addition, beginning in 2024, certain catch-up contributions must be treated as Roth contributions, meaning the catch-up contribution will be non-deductible in the year it is made, but the contribution and any earnings will be tax-free when withdrawn from the plan. This rule would only apply in the following situations:

- For participants in 401(k), 403(b) or governmental 457(b) plans only. Participants in SEP or Simple plans would not be subject to this requirement.
- Also, this requirement only applies to plan participants whose wages from that same employer in the prior year were more than $145,000 (adjusted annually for inflation).

## NEW ROTH OPPORTUNITIES FOR EMPLOYER PLANS

In addition to catch-up contributions being treated as Roth contributions for some participants, the bill included several other Roth-related changes to the rules for employer plans:

- Beginning in 2024, RMDs would no longer be required for participants in a Roth 401(k) plan. This will match the existing treatment for Roth IRAs.
- Beginning in 2023, participants in SEP or Simple IRAs can designate their accounts as Roth accounts. Contributions to those accounts would be considered income to the participant, while future withdrawals from the account would be tax-free.
- Beginning immediately, participants in defined contribution plans such as a 401(k) or 403(b) may designate any employer match or other voluntary contribution to be made to a Roth plan. Any such contribution would be considered taxable income to the participant, while future withdrawals from the plan would be tax-free.

## NEW ROLLOVERS FROM 529 PLANS TO ROTH IRAS

Furthering a theme of encouraging the funding of Roth-style accounts, the bill includes the ability to transfer funds from a 529 college savings account to a Roth IRA beginning in 2024. As with other changes, however, there are several restrictions that will limit the effectiveness of this strategy.

- Amounts held in a 529 can only be rolled to a Roth IRA in the name of the same beneficiary as the 529 plan. If an individual is considered the owner of a 529 held for the benefit of a child, the Roth IRA must also be for that child.

- The maximum rollover amount in any year is limited to the IRA contribution limit for that year ($6,500 for 2023) reduced by any actual Traditional or Roth IRA contributions made that year. Also, there is a lifetime maximum rollover of $35,000.
- The 529 plan must have been opened for at least 15 years as of the date of the rollover. Also, the rollover amount is limited to any contributions made to the plan (and attributed earnings) prior to 5 years before the rollover occurs. For example, a rollover done July 1, 2024 must come from a 529 plan opened prior to July 1, 2009 and can only be made from the balance in the account prior to July 1, 2019.

## CHANGES TO PENALTIES APPLICABLE TO RETIREMENT PLANS

Individuals who fail to withdraw their entire Required Minimum Distribution from a plan have been subject to a 50% excise tax on the unwithdrawn amount. That tax is reduced to 25% immediately. In addition, the tax would be further reduced to 10% for those who make a corrective distribution within a specified period of time and who submit a tax return reflecting that 10% tax. The IRS has generally been lenient in waiving this penalty for taxpayers who show the shortfall was due to reasonable error and who are taking steps to remedy it, but perhaps these lower tax amounts will lead to a tightening of their policies toward these errors.

Withdrawals from a retirement plan before age 59½ are generally subject to a 10% early withdrawal penalty, although there are several types of withdrawals that are exempt from that penalty. One such exemption is the "series of substantially equal periodic payments", or SOSEPP, which allows a plan participant to take specific withdrawal amounts for minimum length of time and avoid the penalty. The SOSEPP rules are notoriously rigid, but this bill provides a bit of flexibility. Beginning in 2024, a rollover from a plan which is part of a SOSEPP to a new plan won't constitute a change in the withdrawal as long as the total withdrawal from the old and new plans is the same as what would have been taken from just the old plan.

Pre-age 59½ withdrawals for qualified birth or adoption expenses are considered exempt from the 10% early withdrawal penalty, and those withdrawals can also be returned to the plan. This bill limits the time frame for that repayment to 3 years, beginning on the date of the withdrawal. The bill also created several new exceptions to the 10% penalty for early withdrawals (while still treating the distributions as taxable income, however):

- Beginning in 2024, victims of domestic abuse may withdraw the lesser of 50% of the account value or $10,000 (adjusted for inflation) penalty-free. The withdrawal must occur within one year of the date the individual is a victim of abuse by a spouse or domestic partner. Withdrawn amounts may be repaid to the plan within 3 years.
- Beginning immediately, an individual who is certified by a physician as having a terminal illness expected to result in death in 84 months or less may take a penalty-free early withdrawal from a qualified plan. Documentation must be provided to the plan administrator, there is no limit on the size of the withdrawal, and it can also be repaid within 3 years.
- Congress periodically enacts special rules related to qualified disaster areas, but this bill creates a permanent set of rules for these situations. Beginning immediately, withdrawals of up to $22,000 made within 180 days of a federally declared disaster are exempt from the 10% penalty. The recipient's primary residence must be within the disaster area. The taxable portion of any such distribution will be included in income ratably over 3 years, beginning with the year of the withdrawal, unless the recipient chooses to report the income as fully taxable in the first year. As with the other new penalty exceptions, these withdrawals can be repaid to the account within 3 years.
- Beginning in 2024, plan participants may take an early, penalty-free withdrawal to cover emergency personal expenses for themselves or their family. Withdrawals are limited to the lesser of $1,000 or the plan balance over $1,000. Participants taking such a withdrawal may not do so again for the next 3 calendar years, unless they repay the original withdrawal within 3 years of receipt.
- Effective immediately, withdrawals of earnings attributable to excess contributions to a plan, when withdrawn before age 59½, are exempt from the early withdrawal penalty.

Lastly, the bill expands distribution options for public safety officers. While most employees can access employer plans at age 55 without a penalty, public safety officers have been able to do so at age 50. This is now further expanded by also allowing those withdrawals after 25 years of service under the plan. Eligible employees now include firefighters and corrections officers.

## LIMITATIONS ON CONSERVATION EASEMENTS

Congress is limiting the use of pass-through entities such as partnerships to make gifts of conservation easements. The new rule, which is effective immediately, would prohibit gifts from qualifying as an easement if the gift value exceeds 2.5 times the sum of each partner's total applicable basis in the partnership. This limitation doesn't apply to property that meets a 3-year holding period requirement, to partnerships substantially owned by members of the same family or to gifts meant to preserve certified historical structures.

## OTHER PROVISIONS

The bill also includes the following provisions:

- Participants of 401(k), 403(b) and 457(b) plans can withdraw funds to pay for qualified long-term care insurance premiums. Withdrawals are taxable but are exempt from the 10% early withdrawal penalty for those otherwise subject to the penalty, and are limited to the lesser of the actual premium paid, 10% of the account balance or $2,500. This provision will be effective for withdrawals occurring three years after the bill is enacted (approximately January 2026).
- The eligibility rules for individuals to receive contributions to an ABLE account have been expanded. ABLE accounts benefit those who are blind or disabled by holding funds that do not limit the individual's ability to qualify for programs such as Social Security, Medicaid and others. Beginning in 2026, contributions to an ABLE account can be made for someone whose disability or blindness occurred before age 46, an increase from the current age 26.
- Current law allows employers to automatically distribute a retirement account balance for a former employee if the balance is less than $5,000. This bill increases the threshold to $7,000 beginning in 2024.
- Employee Stock Ownership Plans, or ESOPs, are a popular tool for business owners to transfer ownership of the company to employees while reinvesting the sales proceeds on a tax-deferred basis. This technique is currently only available for owners of C Corporations, but in 2028 it will be expanded to include the sale of shares of an S Corporation. However, unlike with C Corporations, only 10% of the sales proceeds from an S Corporation can be deferred.