SECURE ACT 2.0

As 2022 came to a close, Congress approved and President Biden signed into law the Setting Every Community Up for Retirement Enhancement Act 2.0. This law was a follow-on to the original SECURE Act 1.0, which was passed at the end of 2019.

SECURE 1.0 had 29 provisions, which included the loss of the stretch inherited IRA for 'non-eligible beneficiaries' (replaced with the 10-year rule) and an increase in the starting age for required minimum IRA distributions from 70 ½ to 72. SECURE 2.0 is significantly more complex with 92 provisions, which will go into effect over the next several years. We've tried to keep it simple by highlighting what are likely to be the most impactful provisions below.

Required Minimum Distribution Ages Extended Again

For IRA owners who were born in 1950 or earlier, there will be no change to the age at which required minimum distributions start (age 72). For IRA owners born in 1951-1959, that age has been pushed back from 72 to 73. For IRA owners born in 1960 or later, distributions do not need to start until the year that the owner turns 75. This provides greater flexibility with respect to income planning for clients who may be retired and are not yet required to take taxable distributions from their IRAs. Specifically, it may make sense for younger retirees to convert pre-tax IRA dollars into a tax-free Roth IRA at relatively low tax rates prior to their required minimum distribution age.

529-to-Roth IRA Conversions Allowed

Starting in 2024, 529 educational account balances can be moved into a Roth IRA for the 529 beneficiary both penalty and tax-free. The 529 will need to have been open for at least 15 years. Contributions over the previous 5 years and growth on those contributions will be ineligible. Any transfer into the Roth will count toward the beneficiary's annual Roth contribution and the beneficiary must have qualifying earned income, just like a Roth contribution. Unlike Roth IRA contributions, eligibility is not phased-out based upon income levels. Also, there will be a maximum lifetime transfer of $35,000 per beneficiary. Lots of rules!

Older Surviving Spouses Given More Flexibility

Historically, surviving spouses have tended to follow one of two routes when inheriting a deceased spouse's retirement account. First, they could roll the balance into their own IRA and take distributions according to their own life expectancy, as if the account were theirs all along. Second, they could roll the balance into a separate inherited IRA and take distributions on an annual basis, starting in the year following the original owner's death. This second option has given flexibility to survivors who are under 59 ½ and are needing to access funds penalty-free right away. SECURE 2.0 will now give older surviving spouses the ability to roll the balance into an inherited IRA and not require distributions until the original owner would have attained RMD age. As an extreme example, if an 80-year-old inherits an IRA from a spouse who passed away at 50, the survivor could keep that IRA separate from their own and not have to distribute anything until the deceased spouse would have turned 75! Extreme examples may be rare, but the provision is worth noting.

Establishing a Solo 401(k) Gets Easier

We work with many small business owners who open and fund solo 401(k) plans. This is a very simple, clean retirement plan structure that is only available to businesses with 2 or fewer full-time employees consisting of the owner and their spouse. Historically, these plans had to be established and salary deferrals funded before the end of the calendar year. Going forward, those who wish to set up and fund a plan will have until April 15th of the following year to establish the plan and make the first year's salary deferrals.

401(k)/403(b)/457(b) Plans Get More Complex

Here is where there is going to be a fair amount of change, some of which may prove to be unnecessarily complex. Starting in 2023, employer matching contributions for 401(k)/403(b)/457(b) plans are now eligible to go into the Roth 'bucket' for plan participants. It should be noted that any contribution that goes into Roth is included in the employee's taxable income for that year. Further, starting in 2024, catch-up contributions that go into a 401(k)/403(b)/457(b) for a 'high earner' who is over age 50 must go into a Roth option. A high earner is an employee who had $145,000 or more of wages from that same employer during the preceding tax year. This is bound to get complicated, as someone who switches jobs will technically be excluded as a high-earner based upon their prior year's wages. Further, if a plan fails to make catch-up contributions for high earners into the Roth option, then no participants are allowed to make catch-up contributions. Seeing as some plans don't even have a Roth option built-in at present, many plan sponsors are going to be scrambling to adjust to these new rules.

Also, whereas 401(k), 403(b), 457(b) and SIMPLE IRA plans have always allowed for catch-up contributions for those who are over 50, SECURE 2.0 gives an additional tier of larger catch-up contribution limits for those who are turning 60, 61, 62 or 63 in a given year. Those limits then revert to the normal catch-up limits for age 64 and beyond. This one is a head scratcher.

IRA Catch-Up Contributions Indexed

Finally, one provision that is long overdue is an indexing of the $1,000 IRA catch-up contribution with inflation. For 2023 the IRA contribution limit is $6,500 with an extra $1,000 allowed for those who are over 50. Starting in 2024 the extra amount that someone who is over 50 can contribute to an IRA will inflate from $1,000 to the nearest increment of $100 on an annual basis.

While this is not an all-inclusive list of SECURE Act 2.0 provisions, we've tried to highlight those that will affect the greatest number of clients. Please reach out to our advisors directly todiscuss how your plan may be affected by SECURE Act 2.0.

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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives