

BULLETIN: JANUARY 12, 2023



LEGISLATIVE UPDATE: CONSOLIDATED APPROPRIATIONS ACT OF 2023 (SECURE ACT 2.0)

The U.S. House of Representatives, on December 23, 2022, passed the Consolidated Appropriations Act of 2023, an omnibus spending bill. On December 29, President Biden signed the \$1.7 trillion budget bill, which includes The SECURE 2.0 Act of 2022 (Secure 2.0, or The Act). Secure 2.0 builds on the changes made to the retirement system by 2019's Setting Every Community Up for Retirement Enhancement (SECURE) Act.

We've compiled a breakdown of SECURE 2.0's most impactful tax provisions to individual taxpayers that will interest Member Firms and their clients.

RETIREMENT-FOCUSED PROVISIONS:

- **Age increases for Required Minimum Distributions (RMDs).** The age at which individuals are required to begin taking mandatory retirement plan withdrawals will be increased from age 72 to:
 - Age 73 for individuals who attain age 72 after December 31, 2022, and age 73 before January 1, 2033
 - Age 75 for individuals who attain age 74 after December 31, 2032
- **Higher Catch-up Limit to Apply at Ages 60–63.** Defined contribution retirement plans under Section 401(k), Section 403(b), or Section 457(b) are permitted, but not required, to allow participants age 50 or older to make additional pre-tax elective deferrals, known as “catch-up” contributions. Starting in 2025, the Act increases the current catch-up limit to the greater of \$10,000 (\$5,000 for SIMPLE plans) or 50% more than the regular catch-up amount in 2024 (2025 for SIMPLE plans) for individuals who attain ages 60–63. The statutory dollar amounts are indexed for inflation commencing in 2026.
- **Restrictions on Catch-up Contributions for High-Earners.** Participants over age 50 who want to make catch-up contributions and earn more than \$145,000 will be required to make Roth contributions. Employees earning less than \$145,000 can choose either a pre-tax or Roth contribution type, as permitted by their plan. The effective date is January 1, 2024.
- **Penalty-Free Withdrawals for Certain Emergency Expenses.** The Act provides an additional exception from the 10% penalty tax on distributions from tax-preferred retirement accounts for certain unforeseeable or immediate personal or family emergency expenses. Only one distribution of up to \$1,000 is allowed per year, and a taxpayer has the option to repay the distribution within three years. No further emergency distributions are permissible during the three-year repayment period unless the earlier distribution has been repaid.
- **Expanding Automatic Enrollment in Retirement Plans.** The Act provides that an arrangement generally will not be treated as a Section 401(k) qualified cash or deferred arrangement or a Section

403(b) annuity contract unless it is an Eligible Automatic Contribution Arrangement under Section 414(w)(3) and satisfies three additional requirements regarding withdrawals, automatic contributions, and investment of automatic contributions.

- **Improving Coverage for Part-Time Workers.** For plan years beginning in 2021, 401(k) plans must generally permit an employee to make elective deferrals if the employee has worked at least 500 hours per year with the employer for at least three consecutive years and has met the minimum age requirement (age 21) by the end of the three-consecutive-year period (a long-term, part-time employee). Thus, a long-term, part-time employee may not be excluded from the plan merely because the employee has not completed a year of service.
- **Surviving Spouse Election to be Treated as an Employee.** A surviving spouse designated as the sole beneficiary of an employer-provided qualified retirement plan account may elect to be treated as the deceased employee spouse for purposes of the RMD rules if the spouse employee dies before their RMDs have begun. RMDs for the surviving spouse are delayed until the deceased spouse would have reached the age at which RMDs begin. *Comment: It appears the primary use will be for surviving spouses who inherit retirement accounts from a younger spouse. By electing to treat themselves as the decedent, they will be able to delay RMDs longer, and once RMDs do start, they will be smaller than if the spouse had made a spousal rollover or remained a beneficiary of the account.*
- **Optional Treatment of Employer Matching or Nonelective Contributions as Roth Contributions.** A 401(a) qualified plan, a 403(b) plan, or a governmental 457(b) plan can permit a participant to designate some or all matching contributions and nonelective contributions to the plan as designated Roth contributions. This provision applies to contributions made after the date of the enactment of the Act.
- **Increased Contribution Limits for Qualified Longevity Annuity Contracts (QLACs).** The Act repealed the 25% of income limitation on QLAC contributions and replaced it with a \$200,000 contribution limit, indexed for inflation.

OTHER ACT PROVISIONS:

- **Tax-free Rollovers from 529 Accounts to Roth IRAs.** Beneficiaries of 529 college savings accounts can make direct trustee-to-trustee rollovers from a 529 account in their name to their Roth IRA without tax or penalty. The 529 account must:
 - Have been open for more than 15 years
 - The rollover can't exceed the aggregate amount contributed to the account (and subsequent earnings) more than five years before the rollover.
 - Aggregate rollovers under the provision can't exceed \$35,000 over the beneficiary's lifetime.

Rollovers are subject to the Roth IRA annual contribution limits, but the limit based on the taxpayer's adjusted gross income is waived. The amendments are effective for distributions after December 31, 2023. *Comment: This provides an option for 529 accounts that have a balance remaining after the beneficiary's education is complete.*

- **Deferral of Tax for Certain Sales of Stock to S-Corporation Sponsored ESOP.** Effective in 2028, certain S-corporation owners who sell their shares to an Employee Stock Ownership Program (ESOP) will be eligible to defer up to 10% of their gain, if reinvested in Qualified Replacement Property in a timely way. Currently, such deferral (of up to 100% of gain) is only available to certain C-corporation owners.
- **New Rules for Qualified Charitable Distributions (QCD).** When the QCD provision was first introduced more than 15 years ago, the maximum annual QCD amount was limited to \$100,000. Since then, the maximum amount has remained the same. Beginning in 2024, however, the QCD limit will change for the first time ever as it will be linked to inflation. *Comment: Since their introduction in 2006 as part of the Pension Protection Act, Qualified Charitable Distributions (QCDs) have become one of the most efficient ways for most individuals 70 ½ or older to satisfy their charitable intentions.*
- Also, there is now a one-time QCD opportunity to use up to \$50,000 to fund a split-interest entity. Beginning in 2023, taxpayers may take advantage of a one-time opportunity to use a QCD to fund a Charitable Remainder UniTrust (CRUT), Charitable Remainder Annuity Trust (CRAT), or Charitable Gift Annuity (CGA). There are many limitations attached

to the provision that will need to be clarified by future guidance. *Comment: Relative to the \$50,000 limit, a CRT's set up and administration costs will likely make this provision more useful with CGAs.*

- **Treatment of Student Loan Payments as Elective Deferrals for Purposes of Matching Contributions.**

An employer can make “qualified student loan payments” matching contributions under a 401(k) plan, 403(b) plan, or SIMPLE IRA. It is intended to assist employees who may not be able to save for retirement because they are overwhelmed with student debt, and are missing out on available matching contributions for retirement plans. Employees can receive those matching contributions by reason of repaying their student loans. Vesting and matching schedules must be the same as if the loan payments had been salary deferrals. *Comment: Expect to see employers adopting this provision into their plan to attract and retain young talent.*

- **Long-term Care (LTC) Contracts Purchased with Retirement Plan Distributions.**

Retirement account owners may take penalty-free, early withdrawal qualified LTC distributions of up to the lesser of 10% of their vested balance, or \$2,500 (adjusted for inflation) annually to pay for LTC premiums. To qualify for the exception, individuals must have either paid, or have been assessed, LTC premiums equal to, or greater than, their distribution in the year the distribution is made. They must also provide their plan with a LTC premium statement containing details, such as:

- The name and Tax ID number of the insurance company
- Identification of the account owner as the owner of the LTC

- A statement that the coverage is certified LTC
- The premiums owed for the calendar year
- The name of the insured individual and their relationship to the retirement account owner

The Act permits qualified LTC distributions for the account owner and, provided a joint return is filed, for the retirement account owner's spouse. (Effective for distributions occurring three years after the date of enactment — 2026 and future years). *Comment: This provision is most useful for early retirees who need income to pay for LTC premiums. Also of note is that distributions from traditional accounts would still be subject to income taxes, only the early withdrawal penalty is avoided.*

SECURE 2.0, LARGELY A GOOD NEWS STORY

Overall, the SECURE Act 2.0 contains a number of positive provisions to encourage taxpayers to save more for retirement. But there is some not-so-good news to consider: The mandatory Roth treatment for qualified plan catch-up contributions for those who earn more than \$145,000 annually could be an unseen tax for high-income earners.

TAX ADVICE MAKES THE DIFFERENCE

Whenever there are significant legislative changes, it's a good idea for taxpayers to consult with a tax professional who can help ensure they are taking advantage of all the opportunities available to enhance their financial plan. M Financial will continue to monitor the Act and other federal tax and legislative developments and provide timely feedback on any changes.

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