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SECURE 2.0 Act Brings Additional Estate Planning Opportunities

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Last month, President Biden signed the SECURE 2.0 Act of 2022 (SECURE 2.0) into law. Building upon the original SECURE Act passed in December 2019, SECURE 2.0 significantly changes laws governing retirement savings. The primary focus of both pieces of legislation is to help Americans better save for retirement. While a comprehensive summary of SECURE 2.0 is beyond the scope of this article, the provisions most pertinent to estate, tax and retirement planning are discussed in detail below.

Increase in Required Minimum Distribution (RMD) Age

Because of the tax-deferred nature of various retirement accounts, tax law requires that individuals of a certain age begin withdrawing money from their employer-sponsored retirement plans, traditional IRAs and other similar retirement accounts. These mandatory distributions are referred to as “Required Minimum Distributions” (RMDs) and are included in the participant’s income in the year of withdrawal.

In 2019, the SECURE Act increased the age at which RMDs were required to begin from 70.5 to 72. SECURE 2.0 further increases the RMD age to 73. In addition, SECURE 2.0 provides that in 2033, the RMD age will increase to 75. As a result of these changes, individuals can delay the time at which funds must be withdrawn from tax-deferred accounts, which allows for continued appreciation of their retirement savings. However, because RMDs are based on life expectancy, a delayed starting age will result in a larger RMD.

Reduction of Penalty for Failure to Take RMD

Under SECURE 2.0, the penalty for failing to take RMDs is reduced from 50percent to a 25percent penalty on the amount not withdrawn. The penalty can be further reduced to 10percent if corrected in a timely manner. Given the significant and complex changes to the laws relating to retirement savings over the last few years, this decreased penalty will provide welcome relief to taxpayers as they navigate the new rules.

Catch-Up Contributions Limits Increased and Indexed for

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Inflation

Because of the tax-deferred nature of some retirement plans, Congress limits the amount that individuals can contribute to these funds each year. “Catch-up” contributions permit individuals age 50 or older to save additional funds above the standard limit as they near retirement. SECURE 2.0 increases the maximum catch-up contribution for most workplace plans to $7,500 (up from $6,500). The annual catch-up contribution limit for IRAs is $1,000 and SECURE 2.0 indexes that amount for inflation.

Beginning in 2025, SECURE 2.0 permits most individuals ages 60 through 63 to contribute an additional $10,000 to their workplace plans and an additional $5,000 to their SIMPLE plans each year above the standard catch-up contribution limit. These dollar amounts will also be indexed for inflation. Beginning in 2024, SECURE 2.0 will require individuals who earn over $145,000 annually to direct all catch-up contributions to Roth (after-tax) accounts.

Automatic Enrollment in Retirement Plans

To promote retirement savings, SECURE 2.0 requires new 401(k) and 403(b) plans to automatically enroll participants in those plans once eligible as of 2025. The initial enrollment amount is at least 3percent but not more than 10percent of the participant’s earnings. The amount is then increased each year by 1percent, with a maximum of 15percent. Employees may opt out of the automatic enrollment.

Note that existing plans are grandfathered and are not required to change, as are SIMPLE plans and certain government and religious plans. Employers with fewer than 11 employees are also exempt.

Charitable Remainder Trust Rollovers

Under current law, individuals age 70.5 or older may distribute up to $100,000 each year from their IRAs to certain charitable organizations as qualified charitable distributions (QCDs). SECURE 2.0 indexes the $100,000 QCD limit for inflation. In addition, individuals may make a one-time rollover of up to $50,000 (also indexed for inflation) to certain charitable remainder trusts or charitable gift annuities as part of their annual QCDs. This additional rollover can be an efficient way to fund a charitable remainder trust. Careful consideration should be taken as this planning opportunity is a one-time event.

Student Loan Payments and Employer Matching Contributions

To assist individuals straddled with student loans to save for retirement, SECURE 2.0 permits employers to make matching contributions to an employee's retirement plan based on that employee's student loan payments. Whether the employer will match and to what extent is at the employer's discretion. Matching may begin in 2024.

Section 529 Plan Rollovers to Roth IRAs

Currently, surplus balances in 529 education savings plans, such as Edvest accounts, may be distributed for non-educational expenses, but the portion of the distribution resulting from earnings is subject to income tax and a 10percent penalty. SECURE 2.0 permits a 529 plan beneficiary with a surplus balance to distribute (or "rollover") up to $35,000 into a Roth IRA for the individual's benefit (subject to annual contribution limits). These rollovers may begin in 2024.

To qualify, the 529 account must have existed for at least 15 years and the distribution must be made directly into the Roth IRA. Contributions and earnings on the contributions made within five years of the distribution are not available for disbursement. These rules provide a long overdue path to using funds in an overfunded 529 account without subjecting the funds to a 10percent penalty.

SECURE 2.0 brings yet another round of foundational changes to the rules relating to retirement savings. These changes not only impact retirement savers nearing retirement, but also those just starting out in the workforce. With some of the changes effective today, next year or over the next decade, now is a great time to connect with a member of Reinhart's Trusts and Estates Practice or your Reinhart attorney to discuss specific opportunities or updates to meet your estate planning objectives.