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SECURE 2.0 – Key Provisions of the Legislation Impacting Retirement Savings

Enacted on December 29, 2022, the *Consolidated Appropriations Act, 2023* included the "Secure 2.0 Act of 2022" (SECURE 2.0) that contains important changes to retirement plan savings. While many provisions impact employer sponsorship of retirement plans and how those plans are administered, the focus of this article is the key provisions that affect individuals with retirement savings accounts.

Required Minimum Distributions

The legislation increases the age at which individuals are required to begin taking required minimum distributions (RMDs) from qualified retirement plans. The applicable age increases from 72 that was in effect for 2022 to 73 in 2023, and increases again from 73 to 75 in 2033.

In addition, SECURE 2.0 reduces the penalties associated with failure to take RMDs, beginning in tax year 2023. The penalty is reduced from the previous level of 50% to 25% and can be reduced to 10% if the failure is corrected during the "correction window." The "correction window" is defined as the earliest of the mailing date of a notice of deficiency with regard to the excise tax, the date on which the excise tax is assessed, or the last day of the second tax year that begins after the end of the tax year in which the excise tax is imposed.

Catch-Up Contribution Limits

Current law allows individuals that are age 50 or older to make additional contributions in excess of annual deferral limitations to defined contribution plans. These are referred to as catch-up contributions. The $1,000 limit for catch-up contributions for individual retirement account (IRA) plan participants will be indexed for inflation beginning in 2024.

Further, effective for tax years beginning in 2025, the catch-up limit for individuals who attain ages 60 to 63 during the tax year will increase to the greater of $10,000 (or $5,000 for SIMPLE plans) or 50% more than the regular catch-up amount in 2024 (or 2025 for SIMPLE plans). These dollar amounts will be indexed for inflation beginning in 2026.

Roth Treatment of Contributions

Catch-up contributions to 401(k), 403(b), or 457(b) plans are subject to mandatory Roth tax treatment (i.e., made on an after-tax basis) unless the participant's wages for the preceding calendar year are $145,000 or less, adjusted for inflation. Accordingly, qualified distributions will generally be excluded from income in the year such distributions occur. This provision is effective beginning in 2024.

Additionally, the legislation allows participants of 401(k), 403(b), and 457(b) plans to designate some or all of an employer's matching contributions and nonelective contributions as designated Roth contributions, but only to the extent that the participant is fully vested in such contributions. This provision is effective beginning in 2023.

Tax-Free Rollovers of Sec. 529 Accounts

The legislation enables beneficiaries of Section 529 college savings accounts to make direct "trustee-to-trustee" rollovers from a Section 529 account to a Roth IRA without incurring taxes or penalties, beginning in 2024. To qualify for this tax-free rollover, the 529 account must have been in existence for more than 15 years at the time the funds are transferred. Rollovers may not exceed $35,000 in aggregate and are subject to annual contribution limits for Roth IRAs.

Penalty-Free Withdrawals

SECURE 2.0 outlines several circumstances for which funds from retirement accounts can be withdrawn without penalty, beginning in 2024. Ordinarily, a 10% tax on early distributions would apply. However, under the new rules a participant will be entitled to take penalty-free early distributions to cover emergency expenses ($1,000 per year, but no more than one distribution within a 3-year period unless the amount has been repaid), if they are a victim of domestic abuse (up to $10,000, adjusted for inflation), or if they are diagnosed with a terminal illness (an illness or condition expected to result in death within 84 months). Note that the amount withdrawn under the applicable provisions would still be included in taxable income, but will not be subject to the 10% excise tax.

Additionally, up to $22,000 may be withdrawn without penalty by participants who have sustained an economic loss as the result of a qualified disaster. To qualify, the individual must have their principal residence within the qualified disaster area. An eligible withdrawal must be made on or after the first date of the "incident period" designated by the Federal Emergency Management Agency (FEMA) and before 180 days after the "applicable date" for the disaster, which is defined as the latest date of the enactment of legislation (December 29, 2022), the first date of the incident period, or the date of the disaster declaration. This provision is effective for distributions made beginning in 2024 in connection with disasters for which the incident period begins on or after January 26, 2021.

Excess Contributions

The legislation allows an exemption from the 10% additional tax if earnings attributable to excess IRA contributions are returned by the due date of the taxpayer's return for the year, including extensions.

Surviving Spouse

In the event an employee who is a participant in an employer-provided qualified retirement plan dies before RMDs have begun and has designated a spouse as the sole beneficiary, the surviving spouse may elect to be treated as if he or she were the employee for purposes of the RMD rules. This provision is effective beginning in 2024.

Please note that in addition to the individual SECURE 2.0 provisions included in this article, there are other provisions in the legislation that may be applicable to your business. JTaylor continues to monitor legislative activity and related guidance. Should you have any questions or need further direction with regard to how these changes might affect you, please contact your JTaylor tax advisor.