Recent Updates With the Secure Act (Retirement)

On December 29, 2022, President Biden signed the Secure 2.0 Act into law.[1] It builds on the original Secure Act which former President Trump signed into law on December 20, 2019.[2] These changes will affect the way people plan for retirement and how businesses contribute to their employees' retirement. This is Congress's latest attempt to encourage retirement savings.

Here are some of the key changes included within the Secure 2.0 Act:

Automatic 401(k) enrollment: Effective for plan years beginning on or after January 1, 2025, employers will be required to enroll employees who become eligible and wish to participate into either a new 401(k) or 403(b) retirement plan. The initial participation amount will need to be no less than 3% but cannot be more than 10% of the employee's salary, but over time it will increase every year by 1% up to a minimum of 10% and a maximum of 15%. Employees will not be forced to enroll and may opt out if they so choose. Small businesses with 10 or fewer employees, government plans, church plans and new businesses (in business for less than 3 years) are exempt from auto enrollment.[3]

IRA catch-up contributions for individuals who have reached age 50 will be indexed for inflation. Starting in 2024, the $1,000 catch-up will no longer be a static amount. For example, if applying an annual cost of living adjustment translates to raising the limit to $1,257 from $1,000, the actual catch-up contribution would be set at $1,200. The new guidance requires these adjustments to be rounded down.[4]

In 2025, catch-up contributions for those who are between the ages of 60 and 63 will increase to either 150% of the current contribution limit or $10,000, whichever is higher. Starting in 2024, for those making above $145,000 per year, if they wish to add any catch-up contributions to their 401(k) plan, funds must be deposited in Roth accounts with after-tax dollars. For those making under $145,000 per year, they can still choose whether to contribute to Roth or pre-tax plans.[5]

Improving coverage for part-time workers: The Secure 2.0 Act requires employers to allow long-term, part-time workers to participate in the employers' 401(k) plans, except in the case of collectively bargained plans. Employers maintaining a 401(k) plan must have a dual eligibility requirement under which an employee must complete either one year of service (with the 1,000-hour rule) or three consecutive years of service (where the employee completes at least 500 hours of service). The three-year rule will be reduced to two years, effective for plan years beginning after December 31, 2024. This provision also extends the long-term part-time coverage rules to 403(b) plans that are subject to the Employee Retirement Income Security Act of 1974("ERISA").[6]

Required Minimum Distributions (RMD): One immediate change is that the RMD age has been increased to 73 and will increase again in 2033 to 75. Pushing back the age allows for a longer timeframe for individuals to create a tax plan.[7] It is important to note that the longer a person delays distributions, the larger those amounts will need to be in later years resulting in an increased level of taxable income which could subject them to higher tax rates. The penalty for not withdrawing is being softened. If an individual has not withdrawn their RMD amount for a particular year, the current penalty is 50% of the RMD. The Secure 2.0 Act has reduced that penalty to 25% in 2023. This can be further dropped to 10% if the account holder corrects the missed RMD in a "timely manner" as determined by the Internal Revenue Service (IRS).[8]

There will no longer be mandated RMDs for Roth 401(k)'s prior to the death of the owner starting in 2024.[9]

Use of retirement funds in connection with qualified federally declared disasters: Up to $22,000 can be distributed from employer retirement plans or IRAs for affected individuals in the case of a federally declared disaster. Such distributions are not subject to the 10 percent additional tax and are taken into account as gross income over 3 years. Distributions can be repaid to a tax preferred retirement account. This section (331) would be backdated to disasters occurring on or after January 26, 2021.[10]

Withdrawals for certain emergency expenses: Generally, an additional 10 percent tax applies to early distributions from tax-preferred retirement accounts, such as 401(k) plans and IRAs, unless an exception applies. Beginning in 2024, if a distribution is made due to unforeseeable or immediate financial needs relating to personal or family emergency expenses, the additional 10% tax does not apply. You can withdraw up to $1,000 annually as an emergency distribution and have the option to repay the distribution within 3 years. Until the distribution is repaid, no further emergency distributions are allowed.[11]

Qualified charitable distributions (QCDs): Beginning in 2023, people who are age 70½ and older may elect as part of their QCD limit - a one-time gift up to $50,000, adjusted annually for inflation, to a charitable remainder unitrust, a charitable remainder annuity trust, or a charitable gift annuity. This is an expansion of the type of charity, or charities, that can receive a QCD. This amount counts towards the annual RMD, if applicable. The gift must come directly from the IRA account by the end of the calendar year. QCDs cannot be made to all charities.[12]

529 Plans: After at least 15 years of existence, 529 plan assets (not including contributions made in the prior five years) can be rolled over to a Roth IRA for the beneficiary. The rollover is subjected to the annual Roth contribution limits and an aggregate lifetime limit of $35,000, i.e., it will take over 5 years of converting the existing $6,500 annual contribution limit to convert $35,000. This is a great way for taxpayers to rollover unused funds from 529 plan to a Roth account without incurring the 10% penalty on withdrawal (if funds are not used for education). This change is effective after December 31, 2023.[13]

Overall, the Secure Act 2.0 introduces changes that make saving for retirement more flexible while offering incentives to employers which is beyond the discussion of this alert.

[1] Ted Godbout, "It's Official: SECURE 2.0 Enacted into Law," National Association of Plan Advisors (December 29, 2022) https://www.napa-net.org/news-info/daily-news/it%E2%80%99s-official-secure-20-enacted-law

[2] Ted Godbout, "SECURE Act is Signed into Law," American Society of Pension Professionals & Actuaries (December 20, 2019) https://www.asppa.org/news/browse-topics/secure-act-signed-law

[3] H.R.2954 §101

[4] H.R.2954 §107

[5] H.R.2954 §108

[6] H.R.2954 §116

[7] H.R.2954 §106

[8] H.R.2954 §302

[9] IRS, "Retirement Plan and IRA Required Minimum Distribution FAQs," Internal Revenue Service (March 14, 2023) https://www.irs.gov/retirement-plans/retirement-plan-and-ira-required-minimum-distributions-faqs#:~:text=Roth%20IRAs%20do%20not%20require,required%20from%20designated%20Roth%20accounts

[10] Gregory L. Prescott, DBA, CPA, "Examining the Highlights of the Secure Act 2.0," The CPA Journal (May/June, 2023) https://www.cpajournal.com/2023/08/22/examining-the-highlights-of-the-secure-act-2-0-2/

[11] H.R.2954 §317

[12] H.R.2954 §310

[13] Kelley C. Long, CPA/PFS "Saving for college: The new 529-to-Roth IRA transfer rule," Journal of Accountancy (March 6, 2023) https://www.journalofaccountancy.com/news/2023/mar/saving-college-new-529-to-roth-irs-transfer-rule.html

MICHAEL OSHEROVITZ
Managing Director
+1 646.632.3839
michael.osherovitz@fticonsulting.com

ADA ROBINSON
Senior Director
+1 646.632.3803
ada.robinson@fticonsulting.com

MICHAEL CARBONE
Intern, June – August 2023