Hutchinson
CAPITAL MANAGEMENT

January 2023

INVESTMENT PERSPECTIVES

The SECURE Act 2.0: What You Need to Know

The SECURE Act 2.0 was recently passed into law, and it is an update to the Setting Every Community Up for Retirement Enhancement (SECURE) Act, which was originally signed into law in 2019. Both iterations of the SECURE Act are designed to help or provide incentives for people to save for retirement. This is in no way meant to be a comprehensive review of the new provisions (92 in total!) but rather, a curated collection of the provisions that are most likely to impact you, either immediately or in the future.

Required Minimum Distribution (RMD) Ages Pushed Back… Again.

For those individuals who haven't already begun taking their RMD, one of the most important changes included in the act is the increase of the RMD age from 72 to 73 in 2023. Eventually, this will increase to 75 in 2033 for individuals born in 1960 or later. This change will allow individuals to keep money in their tax-advantaged retirement plans for a longer period. As more people choose to work longer, it will also allow them the opportunity to save and invest more, increasing their chances of accumulating enough assets to fund their retirement.

Turning 72 in 2023? Under the old rules, you would have begun taking your RMD in 2023 but under the new provision you won't be required to take your RMD until 2024.

In addition, the new rules addressed the penalties for failing to take or not taking enough of your RMD. Previously, the penalty was 50% of the required amount that wasn't taken. This has been lowered to a 25% penalty, and if the mistake is corrected in a "timely manner" the excise tax could potentially be lowered to 10%.

401(k) Roth (after-tax) Accounts

Note: *There are several provisions that include changes to Roth retirement accounts. As a basic primer, Roth accounts feature after-tax contributions and tax-free distributions. This is juxtaposed against Traditional retirement accounts that feature pre-tax contributions and taxable distributions. The similarity is both IRA types offer tax-deferred growth of assets.*

The creation of the Roth 401(k) and Roth options in other defined contribution plans was a huge change to the retirement planning landscape when it was first introduced. Whereas a Roth IRA has income limitations on contributions, the Roth 401(k) was not limited by income, giving higher income taxpayers the ability to significantly increase their participation in Roth accounts. The one major detractor was that if you held balances in a Roth 401(k) into your RMD years, you were required to take an RMD from that pool of assets. This same dynamic did not exist with a regular Roth IRA, where balances are not subject to an RMD, unless the Roth IRA was inherited. This change levels the playing field for Roth accounts.

Increased Catch-Up Contributions

The Secure Act 2.0 has increased catch-up contributions in employer retirement plans for individuals over the age of 50. This change allows those individuals to make catch-up contributions to their 401(k), 403(b) or 457(b) plans, up to a maximum of $7,500, starting in 2023. As a reminder, this amount is in addition to the salary deferral limit of $22,500 that is in place for 2023. Furthermore, individuals aged 60-63 have the option of contributing an additional 50% more than the regular catch-up limit starting in 2025. This will allow individuals to fund their retirement accounts more aggressively as they near retirement age.

Interestingly, catch-up contributions for higher income earners will experience a significant change in 2024. Individuals with income over $145,000, will be required to fund their catch-up with Roth (after-tax) contributions. While you will lose the pre-tax income reduction, the funds will grow tax-deferred and can be withdrawn tax-free in retirement.

Qualified Charitable Dstribution (QCD) Changes

A QCD allows individuals who are 70 ½ (this age has not increased as RMD ages have increased) to donate up to a maximum of $100,000 directly to one or more charities from a pre-tax IRA, rather than taking the RMD. While you don't receive a charitable tax deduction, you do avoid income taxation on the amounts given directly to charities. Again, this is limited to the RMD amount.

Since the QCD provision was enacted over 10 years ago, the $100,000 limit has not budged. Beginning in 2024, this annual limit will be indexed for inflation, allowing it to gradually rise over time.

529 to Roth

The SECURE Act 2.0 has introduced a new planning opportunity for parents in the realm of college sa. 529 education savings accounts can now be rolled over to a Roth IRA for the beneficiaries of 529 plans. While this is a big change, it comes with many stipulations. The annual rollover amount is limited to the annual Roth contribution amount ($6,500 in 2023) and the rollover must come from earned income, meaning the beneficiaries need to be employed at the time of the rollover. Also, the maximum amount that can be rolled over in the beneficiaries lifetime is $35,000. Here are the additional stipulations that need to be met before this strategy becomes actionable:

- Account must be opened for 15 years or longer (if the beneficiary is changed, it triggers a new 15-year seasoning rule for the new beneficiary).
- The Roth IRA receiving the funds must be in the name of the beneficiary.
- Any contributions to the 529 plan within the last 5-years (and earnings on those contributions) are ineligible to be moved to a Roth IRA.

The planning opportunities for this provision are limited. It provides an additional option for parents that may have overfunded a 529, where a portion of the funds go unspent. If executed strategically, it could allow account owners to seed early retirement savings for children or grandchildren.

What's Not in the Bill?

This is an important note as many observers were looking to see if the legislation altered rules that would impact existing strategies. Here is what we found notable:

- No limit placed on the use of Back-Door Roth IRAs.
- Placed no new limits on Roth conversions.
- No change the age at which QCDs can be made (as it continues to be age 70 ½).
- Also, it didn't correct or clarify the manner in which the 10-year Rule created by the original SECURE Act should be implemented for Non-Spouse Beneficiaries

Source: kitces.com

In Conclusion

These new rules will continue to shape retirement savings and retirement plan distribution strategies over the next several years. At HCM, we will remain attentive to how these changes may impact you and your family's financial situation. These provisions are complex, and everyone's situation is unique, so please reach out to your portfolio manager if you have questions about how they may impact you.

Please see a timeline for when individual SECURE Act 2.0 provisions take effect below: