Four Exciting Aspects of SECURE Act 2.0

SECURE Act 2.0, passed at the end of December, has been described as legislation that is designed to help the hard-working people of America to get their retirement savings back on track. Although it is unclear whether SECURE Act 2.0 will meet such ambitious goals, there are a few provisions that are intriguing and very beneficial.

Before we focus on the four provisions of note, a reminder that the SECURE Act is pushing the RMD to age 73 for this year and age 75 in 2033. Although this change is getting a lot of press, we don't see it as terribly significant except that it does provide extra years for Roth conversions, which is a huge benefit.

And now we review the four more exciting provisions.

1. A way to roll over unused 529 plans to Roth IRAs

Starting in 2024, the legislation allows a tax- and penalty-free rollover from a 529 account to a Roth IRA. More specifically, after 15 years, beneficiaries of 529 college savings accounts are permitted to roll funds over from a 529 account in their name to a Roth IRA account also in their name. These rollovers are subject to a number of limitations, including an aggregate lifetime limit of $35,000.

Rollovers also cannot exceed the aggregate before the 5-year period ending on the date of the distribution. In addition, the rollover is treated as a contribution towards the annual Roth IRA contribution limit, currently $6,500.

Why is this so exciting? The rollover benefit is a boon to parents who socked away dollars in 529 plans but found themselves facing hefty tax bills if they wanted to withdraw the funds when they were no longer needed for higher education costs. Jamie Hopkins, a managing partner of wealth solutions at Carson Group, called the change "one of the most interesting provisions" in SECURE 2.0. He added that the shift will allow parents and grandparents who are funding 529s for their children or grandchildren to shift extra dollars to retirement savings if the beneficiary goes to a less expensive school, receives a scholarship, or forgoes college altogether.

Michael Kitces suggests a more aggressive way to take advantage of this new opportunity: "…at the time a child is born, a meaningful contribution could be made to a 529 plan for their benefit. Later, after the child turns 16 (and the account has been in existence for over 15 years), the account's funds could begin to be moved to a Roth IRA for the child's benefit in the amount of the maximum IRA contribution amount for each year (although notably, the transfer rules require that the child have compensation—such as from a summer or part-time job—in order to make the transfer, such as would be required for them to make a 'regular' Roth IRA contribution). With proper planning and continued annual transfers until the $35,000-lifetime transfer limit is reached, the child's Roth IRA balance at age 65 could easily approach, or even exceed, $1 million."

2. Matching contributions to a Roth account for high earners

Or 'Rothification' of catch-up contributions.

In an apparent attempt to raise tax revenue to offset the costs (i.e., the lost tax revenue) of other provisions, SECURE Act 2.0 provides for certain matching contributions to be made on a Roth (i.e., after-tax) basis. Effective for tax years beginning after 2023, catch-up contributions to 401(k), 403(b), and governmental 457(b) plans by employees whose wages exceed $145,000 (as indexed) must be made on a Roth basis. This Roth treatment of catch-up contributions is mandatory for any plan that makes catch-up contributions available.

Similar to the preceding point, as a revenue-raiser, plans may offer employees the ability to designate as Roth contributions some or all of the matching or non-elective employer contributions made to them under the plan. But this provision only applies if the contributions are fully vested at the time they are made. Although this option is effective for contributions made after the date of enactment of SECURE Act 2.0, it may take time for plan providers to offer it and for payroll systems to be updated.

Why is this so exciting? Previously, matching amounts in employer- sponsored plans were made on a pre-tax basis. Contributions to a Roth retirement plan are made after tax, after which earnings can grow tax-free. This provides a huge opportunity for higher earners to build up their tax-free accounts. Ed Slott, a retirement expert in Rockville Centre, New York, called the catch-up boost "the biggest deal for higher-income people" in the bill. "It's the ability to stuff in more money and catch-up contributions with different growth options."

3. Expansion of QCDs and charitable contributions

At present, QCDs are capped at $100,000 per year, and that amount doesn't go up each year. The SECURE 2.0 Act allows the $100,000 limit to be adjusted annually for inflation (rounded to the nearest $1,000). The adjustments will begin in 2024. Note, for gifts to count, they must come directly from an IRA by the end of the calendar year. QCDs cannot be made to all charities.

In addition, starting in 2023, a one-time QCD of up to $50,000 to charities is allowed through certain charitable remainder annuity trusts (CRATs), charitable remainder unitrusts (CRUTs) or charitable gift annuities (CGAs). The Act expands the ways in which people who are age 70½ and older can use trusts in tandem with charitable giving to potentially lower their federal tax bills. Starting in 2023, such people can make a one-time gift up to $50,000, adjusted annually for inflation, to a CRAT, CRUT or CGA. Essentially, the new rule on so-called qualified charitable distributions expands the types of "charities" that can receive the gift.

The CRUT option mentioned above may be the most intriguing. This type of trust is an estate planning tool that provides income to a named beneficiary during the grantor's life, and then the remainder of the trust is directed to a charitable cause. As Hopkins points out, this type of trust provides variable income to the beneficiary, based on a percentage of the fair market value of the assets in the trust.

CRATs make sense if the values go down, and CRUTs are preferred if the investments within the trust appreciate. However, these trusts are expensive to administer and are not typically put in place for smaller amounts.

Forbes addressed the tax treatments in a recent article, pointing out some of the additional disadvantages of this provision. Normally, payments received from a charitable remainder annuity trust are partly taxable and partly tax-free. If the CRAT had a capital gain from the sale of an appreciated asset then the income comes out as capital gain income. The income comes out "worse first." The income taxation of a CRUT is essentially the same.

Under the new SECURE 2.0 rules, 100% of all payments received by the IRA owner or owner's spouse must be considered ordinary income. For this reason, it is expected that existing charitable remainder trusts will not be used to receive IRA payments, because most existing charitable remainder trusts make payments that do not constitute 100% ordinary income. In addition, SECURE 2.0 requires that CRUTs and CRATs be funded exclusively by qualified charitable distributions.

What could become more exciting is the CGA opportunity, where the institution sets up the CGA and the donation is made directly to the CGA at the institution (such as a university endowment). With the CGA, donors could save some of the administrative costs and tax-filing fees.

Why is this so exciting? By creating this new charitable giving opportunity, the act is expanding the ways in which donors can reduce their tax bill by doing this once-in-a-lifetime gift. And by expanding the definition of a charity to include a charitable trust or CGA, the act creates a way to get income while also making a $50,000 QCD.

4. RMD options for surviving spouses grow

Special rules currently exist for determining when a surviving spouse must start taking RMDs from an inherited retirement account. One of those rules states that, if an account holder dies before RMDs are required and his or her surviving spouse is the beneficiary (and doesn't change that status), RMDs from the inherited account aren't required until the year in which the deceased account holder would have reached age 72.

The SECURE Act 2.0 tweaks this rule by also allowing the surviving spouse to be treated as the deceased account owner for RMD purposes starting in 2024. In some cases, this will allow the surviving spouse to delay taking RMDs from the inherited account—e.g., if the surviving spouse is younger than the deceased spouse.

The surviving spouse will have to elect this treatment according to procedures the IRS will have to establish, and the election will be irrevocable. The surviving spouse will also have to notify the account administrator.

Once RMDs begin (the year the decedent would have reached RMD age, had they lived), the surviving spouse will use the Uniform Lifetime Table that is used by account owners, rather than the Single Lifetime Table that applies to beneficiaries. In addition, if the surviving spouse dies before RMDs begin, the surviving spouse's beneficiaries will be treated as though they were the original beneficiaries of the account. This favorable treatment allows the eligible designated beneficiaries to 'stretch' distributions over their life expectancy instead of being stuck with the 10-year rule that would otherwise apply.

Why is this so exciting? Any time the government allows more flexibility with the starting age for an RMD, we are receptive. That is particularly true in the case where the beneficiary is the surviving spouse, is younger and will likely need the account to grow as much as possible during her life.

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