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LAGOS
WEALTH ADVISORS
BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

ADVISOR'S BULLETIN

WHAT'S IN THIS MONTH'S NEWSLETTER

What Financial Professionals Need to Know About the Secure Act 2.0

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A MESSAGE FROM MICHAEL W. LAGOS, CFP®

Dear Strategic Advisor:

On December 29, 2022, President Biden signed the 2023 Omnibus Appropriations package. The legislation's main purpose was to continue to provide continuing funding for the federal government to operate.

The SECURE 2.0 Act was included in the package. SECURE 2.0 has many provisions in it that will affect clients, especially related to qualified annuities and retirement accounts. This happened while some of us are still trying to absorb information from the proposed regulations related to the first version of the SECURE Act.

SECURE 2.0 immediately raises the RMD age for owners of qualified accounts. It also has dozens of other provisions that have the potential to affect our clients. In this issue of the *Advisor's Bulletin,* we will give an overview of those features most likely to be relevant to us, the opportunities created and a description of some of the issues that the legislation does not address.

Regards,
Michael W. Lagos, CFP®

The Advisor's Bulletin is provided by Lagos Wealth Advisors and Lagos Financial & Insurance Services, Inc. It is intended to serve as a resource for the advisors which we are associated with. Recent developments in estate, business, and insurance planning are outlined for your reference. Should you wish to receive additional information related to financial planning, estate planning, insurance planning, or investment management, please do

What Financial Professionals Need to Know About the Secure Act 2.0

KEY PROVISIONS OF THE SECURE ACT 2.0

Because the legislation is still fairly new, our analysis may become outdated due to subsequent interpretations—especially IRS published material. Check back for the latest information.

Increases the Age for Required Beginning Date

The SECURE Act of 2019 increased the required minimum distribution age to 72. The SECURE Act 2.0 further increases the required minimum distribution age to 73 starting on January 1, 2023, for those who turned 72 after December 31, 2022.

SECURE 2.0 will increase the RMD age again to 75 starting on January 1, 2033. Although there is some ambiguity in the language of the Act, the age 75 starting date will apparently apply to those born in 1960 or later.

Financial professionals will want to reach out to their clients who are turning 72 this year to let them know the client will not be forced to take distributions from qualified accounts in 2023. SECURE 2.0 did not change the trigger date for qualified charitable distributions from IRAs—QCDs can still be made once a person reaches actual age 70 ½.

The distribution deadline for the first RMD from an IRA for a person turning 73 in 2023 remains April 1, 2024. Likewise, those who work for an employer sponsoring a non-IRA qualified plan may still defer RMDs until the year of retirement—provided that the employee does not have a significant ownership interest in the company.

Under the IRS proposed regulations published in early 2022, the Service clarified that the surviving spouse beneficiary of an inherited qualified account must begin taking RMDs from that account in the year the late spouse would have turned 72. As a result of SECURE 2.0, that age now changes the year in which the deceased spouse would have turned 73. See Section 107(b) of Secure Act 2.0.

Creates New Limited Exceptions to the 10 Percent Additional Tax

The SECURE Act 2.0 creates new exceptions to the extra 10 percent pre-59 ½ tax for certain distributions from qualified accounts.

- **Beginning immediately for those who have been certified by a physician as being terminally ill.** While the Tax Code has long had an exception to the penalty tax for those with disabilities, until now there has been no specific exception for terminally ill individuals. The SECURE Act 2.0 creates a new penalty tax exception and defines the scope of terminal illness to those whom a doctor certifies have a life expectancy of seven years or less. As with emergency expenses, the terminally ill taxpayer has the option to repay a distribution within three years.
- **Beginning in 2024 for emergency expenses, which are unforeseeable or immediate financial needs relating to personal or family emergency expenses.** Only one distribution is permissible per year of up to $1,000, and a taxpayer has the option to repay the distribution within 3 years. No further qualifying distributions are allowed during the 3-year repayment period unless repayment occurs.

- **Beginning in 2024 when a participant self-certifies that they experienced domestic abuse within the past year.** Under those circumstances, the taxpayer may withdraw the lesser of $10,000, indexed for inflation, or 50 percent of the participant's account without the 10 percent tax on early distributions. Additionally, a participant has the opportunity to repay the withdrawn money from the retirement plan over three years.

- **Beginning in 2026, up to $2,500 per year may be used to pay for qualified long-term care coverage.**

- **Beginning immediately for certain age 50 or older government employees.** Prior to the SECURE Act 2.0, certain qualified public safety officers were eligible for an exception to the early distribution penalty if they separated from service from the employer sponsoring the plan in the year they turned 50 or later. Starting now, the SECURE Act 2.0 has expanded the groups entitled to claim the exception to include:

    ◊ Private-sector firefighters,
    ◊ State and local corrections officers and
    ◊ Public safety officers who have not reached age 50 but have had 25 years of service for an employer.

Indexes the $1,000 Age 50 IRA Catch-up Provision for Inflation

For many years, the age 50 catch-up for IRAs has been fixed at $1,000. Beginning in 2024, the catch-up will be indexed for inflation. Any increases will be in $100 increments.

Creates a New Stretch Choice for a Surviving Spouse

The first version of the SECURE Act left stretch options for the surviving spouse beneficiary of a qualified account largely intact. The surviving spouse can:

- Elect to treat an inherited qualified account as her own or

- Leave the account as inherited, in which case minimum distributions must begin no later than the age at which the deceased account owner would have turned 72 (now 73).

If the second option is chosen, the surviving spouse must take minimum distributions every year once RMDs are triggered based on her age using the factors from the Single Life Expectancy table.

Beginning in 2024, a surviving spouse will have the choice to take minimum distributions in the same manner as if the deceased spouse were still alive. If selected that choice would

- Calculate RMDs based on factors using the deceased spouse's projected current age and
- Use the Uniform Lifetime Table's rather than Single Life Expectancy table's factors.

In some cases, the practical effect of making the new choice is that the surviving spouse's RMDs will be lower than they might otherwise be.

Doubles Certain Age-Based Catch-up Limits for Employee Deferrals

Beginning in 2025, those who are specifically ages 60-63 will be able to take advantage of higher age-based deferral limits for SIMPLEs, Section 401K and Section 403(b) plans.

For Section 401K and Section 403(b) plans, the age-based limit will increase from today's $7,500 to $11,250, with any adjustments for inflation between now and then. For SIMPLE plans, the 2023 limit of $3,500 will increase to $5,250, also to be adjusted for inflation.

Allows Extended RMD Credit for an Annuitized Qualified Account

Until now, a portion of a qualified account that has been annuitized for the owner's life expectancy or shorter has been allowed to satisfy the minimum distribution for only the portion that has been annuitized.

> EXAMPLE: Bill is 75 and has two IRAs, one worth $200,000 and the other worth $100,000. Bill decides to annuitize the IRA worth $200,000 for a fixed ten-year period. The immediate annuity distributions satisfy Bill's RMD obligation with regard to the account that has been annuitized, because the annuitization period (ten years) is much shorter than Bill's life expectancy.

Effective immediately, SECURE 2.0's Section 204 explicitly permits excess annuitized distributions to count toward the RMD obligation for the rest of the account.

If an account has been annuitized, how much of a particular distribution will be considered to be excess? We are not sure yet. SECURE 2.0 requires the IRS to update its regulations to reflect the change made by the Act and to provide additional guidance.

Increases the Amounts That Can Be Used to Buy a Qualified Longevity Annuities

In 2014, the IRS finalized its regulations on qualified longevity annuities (QLACs). By repositioning qualified funds into a QLAC, some account owners could defer distributions from that portion until as late as age 85. QLAC deposits were originally limited to 25 percent of a qualified account balance or a maximum of $125,000 indexed for inflation.

Section 202 of SECURE 2.0 repeals account balance limitations for QLACs and immediately increases the maximum amount that can be used to buy QLACs to $200,000.

Liberalizes Some Qualified Charitable Distribution (QCD) Rules

Beginning in 2023, the Act liberalizes some rules with regard to qualified charitable distributions (QCDs). The current QCD program allows a taxpayer older than 70 ½ to direct up to $100,000 of IRA money per year to a qualified charity. The QCD goes toward satisfying the taxpayer's IRA RMD obligation and is not treated as a taxable distribution.

SECURE 2.0 creates a one-time lifetime opportunity to give up to $50,000 to a "split-interest entity" through the QCD technique. Split interest entities include charitable remainder trusts (CRTs) or a charitable gift annuity (CGA).

As a practical matter, this change probably does not really create much of an opportunity. Because of the complexity of setup and administration, creating a CRT isn't for everyone. Furthermore, directing a QCD contribution to an existing CRT is not possible, as Section 307 of SECURE 2.0 requires the QCD deposit be made into a "trust…funded exclusively by qualified charitable distributions…."

The annual $100,000 QCD limit will also be indexed for inflation beginning in 2024.

Liberalizes Certain Section 72(t) Distribution Restrictions

Many taxpayers have used Section 72(t) life expectancy distributions to avoid the early distribution penalty tax. IRS regulations required those taking such distributions to leave the qualified account intact with the current plan custodian.

SECURE 2.0 now makes it possible to do partial or complete rollovers from an account from which Section 72(t) distributions are being taken. Section 323 requires that the new accounts continue to meet the obligations imposed by Section 72(t). That means Section 72(t) distributions must continue unchanged for the longer of five years from the start or until age 59 ½--whichever is longer. However, the taxpayer is allowed to mix and match distributions from the new accounts in whatever proportion so long as the total distributions from both are exactly equal to those required by Section 72(t).

Section 323 of the Act also clarifies the rules around annuitizing a qualified account and Section 72(t). Until recently, many took the position that the three IRS safe harbor methods—set forth originally in Revenue Ruling 2002 and reinforced in the more recent IRS Notice 2022-6—were the only reliable ways to be sure distributions satisfied the requirements of Section 72(t). Annuitization of a qualified account for life wouldn't automatically conform to the safe harbors, and thus couldn't be relied on to avoid the penalty tax.

Now the SECURE Act 2.0 seems to explicitly say that annuitization for life expectancy (or joint life of the owner plus beneficiary) satisfies Section 72(t).

> …(P)eriodic payments shall not fail to be treated as substantially equal merely because they are amounts received as an annuity, and such periodic payments shall be deemed to be substantially equal if they … satisfy the requirements applicable to annuity payments under section 401(a)(9).

Eliminates the Need for Lifetime RMDs From Designated Roth Accounts

While there are no lifetime RMDs required from a regular Roth IRA, minimum distributions have been required from designated Roth accounts created under employer Section 401K plans, Section 403(b) plans or governmental Section 457(b) plans.

That rule will change in 2024 and no further minimum distributions will be required from existing or new designated Roth accounts.

Allows SIMPLE and SEP Plan Deposits To Be Made into Roth IRAs

Unlike 401(k), 403(b), and governmental 457(b) plans, SIMPLEs and SEPs have not been permitted to offer a Roth option; instead, all contributions must be pretax into a participant's SEP or SIMPLE IRA.

Starting in 2023, Section 601 of SECURE 2.0 allows employers to deposit both employer and employee contributions in an employee's Roth IRA if the employee so elects. Of course, unlike SEP or SIMPLE contributions into a traditional IRA, any contributions directed into a SIMPLE or SEP Roth account will be after-tax.

Allows Employer Contributions to Be Deposited into Designated Roth Accounts

In the past, employer contributions on behalf of a participant in a Section 401K, Section 403(b) or governmental Section 457(b) plan had to be made into the pre-tax account rather than an available designated Roth account.

Effective immediately, employers are authorized to make matching or non-elective contributions into a participant's designated Roth account. An employer contribution made under the new program will be immediately income taxable to the participant.

Changes Catch-Up Contribution Rules for Certain High-Income Participants

The SECURE Act 2.0 contains a brand-new idea regarding the age-based catch-up provisions of Section 401K, Section 403(b) and governmental Section 457(b) plans. Those participants who are making more than $145,000—which will be indexed for inflation in the future—will be required to make their catch-up contributions into a designated Roth account. As a result, the contribution will be income taxable.

If the employer plan does not offer a designated Roth option, or if the high-income participant chooses not to make the deposit into the available designated Roth account, the opportunity to make an age-based contribution will be lost.

The new restriction will be effective beginning in 2024.

Allows for Limited Tax-free Rollovers from Section 529 Accounts to Roth IRAs

A 529 plan account beneficiary will be permitted to make a tax-free rollover of leftover 529 account monies to a Roth IRA:

- If the 529 account has been open for 15 years or more and
- Up to the annual Roth IRA contribution limit.

Allows Many Qualified Plan Participants to Self-certify Qualification for a Hardship Distribution

Beginning in 2023, plan administrators may rely on an employee's self-certification that they have had a safe harbor event that qualifies the employee for a hardship distribution.

Under a "safe harbor" in IRS regulations, an employee is automatically considered to have an immediate and heavy financial need if the distribution is for any of these:

- Medical care expenses for the employee, the employee's spouse, dependents or beneficiary.
- Costs directly related to the purchase of an employee's principal residence (excluding mortgage payments).
- Tuition, related educational fees and room and board expenses for the next 12 months of postsecondary education for the employee or the employee's spouse, children, dependents or beneficiary.
- Payments necessary to prevent the eviction of the employee from the employee's principal residence or foreclosure on the mortgage on that residence.
- Funeral expenses for the employee, the employee's spouse, children, dependents, or beneficiary.
- Certain expenses to repair damage to the employee's principal residence.

Plan administrators may also rely on the employee's certification that the distribution is not more than the amount required to satisfy the financial need and that the employee has no other reasonably available resources.

Extends Deadline for Solo 401K First-Year Establishment and Funding

The deadline to establish a solo Section 401K plans for last year was December 31, 2022. The participant was also required to make deferral elections by the same end-of-year date.

Effective for solo Section 401K plans established for 2023 and later, the setup and deferral election deadlines have been moved back to the due date for the year's tax return—NOT including extensions.

Changes Missed RMD Penalty Tax

Those who missed taking required minimum distributions (RMDs) from their own or inherited qualified accounts in the past risked being liable for the 50 percent failure to take RMD penalty tax. However, the taxpayer was able to ask the IRS to forgive the penalty tax by filing tax Form 5329 and submitting a letter of explanation. In our experience, the Service routinely forgave the penalty when the taxpayer followed the Form 5329 procedure.

Section 302 of the SECURE Act 2.0 changes the missed RMD penalty from 50 percent to 25 percent of the amount not taken. Furthermore, the penalty is further reduced from 25 percent to 10 percent if the taxpayer fixes the failure by taking a corrective distribution prior to the earlier of

- When the IRS catches them or
- Before the end of the second calendar year after the missed RMD.

Nothing in SECURE 2.0 says that the Service needs to continue its practice of routinely waiving the missed RMD penalty tax. As a result, we feel it is likely that the new, lower penalty structure will be routinely enforced.

Matches Certain Student Loan Repayments as Qualified Plan Contributions

Effective beginning in 2024, employers will be able to amend their plans to allow the employer to match amounts paid by participants towards their student debt as if those repayments were salary deferral contributions to the plan.

NOT INCLUDED IN THE SECURE ACT 2.0

The federal government had been making noises about shutting the door on the so-called backdoor Roth technique. The strategy involved having a high-income taxpayer make a nondeductible IRA contribution and immediately convert the after-tax traditional IRA to a Roth. When implemented in the right conditions, the process effectively allowed the taxpayer to circumvent the normal Roth IRA AGI-based contribution limits.

There is no provision limiting backdoor Roth in the SECURE Act 2.0.

Similarly, Washington was also thinking about prohibiting the strategy known as the mega-backdoor Roth. We wrote about both the regular backdoor Roth and mega-backdoor Roth techniques in the August 2021 issue of *Think About It*.

There is no provision limiting the mega-backdoor Roth idea in the SECURE Act 2.0.

Finally, we had been surprised by certain IRS proposed regulations related to the original SECURE Act. There was a small hope that Congress might step in to change some of the decisions that the Service had made.

Congress made no changes to the proposed regulations on the 10-year rule for nonspouse inherited qualified accounts.

CONCLUSION

The SECURE Act 2.0 changes much of the landscape surrounding retirement planning. The increase in the RMD age has the potential to affect the greatest number of people. Other provisions, such as the Roth option for SEPs and SIMPLEs, will give financial professionals the opportunity to visit with business owners.

Think of SECURE 2.0 as a gift from the federal government. It is likely that there is some feature in the Act that gives us a reason to visit our clients and prospects.

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IN THIS ISSUE OF ADVISOR'S BULLETIN

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Building Protecting and Perpetuating Family Wealth

LWA strives to develop and maintain sound financial plans designed to achieve our client's wealth accumulation, preservation and transfer objectives, with the goal of preserving their wealth for multiple generations. We provide these services in a confidential and consultative manner, building life-long relationships based upon education, trust, communication and service.

IMPORTANT NOTICE: PLEASE READ