Advanced Planning Insights

CLARIFYING THE COMPLEX

The SECURE 2.0 Act: Changes to retirement plan withdrawals and contributions

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DID YOU KNOW? The SECURE 2.0 Act of 2022 was signed into law as part of an omnibus appropriations bill on December 29, 2022, and several provisions will impact many—if not all—American retirees and pre-retirees.

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Like many sequels, SECURE 2.0 has generated headlines but contains arguably less substance than its predecessor. Most of its provisions are not paradigm-shifting but may be impactful for your clients—and your business. This article is a summary of some of the most impactful retirement-planning provisions within SECURE 2.0. This summary is not exhaustive. As always, you should consult competent legal and tax professionals when developing financial and legacy plans or modifying plans to comport with SECURE 2.0's many rule changes.

SECURE 2.0 withdrawal rule changes

SECURE 2.0 has many provisions that modify the rules for required distributions from retirement accounts as well as new exceptions to the 10% early withdrawal penalty. Many of these provisions are finely targeted at specific groups (e.g., the public safety officer exception to the 10% withdrawal penalty is extended to correction officers). As you'll see below, some are more broadly applicable.

Increased required minimum distribution (RMD) age. SECURE 1.0 increased the RMD age from 70½ to 72 for account owners who turned 70½ or older in 2020 or later. SECURE 2.0 again increased the RMD age. The new RMD age is 73 for account owners who turn 72 after December 31, 2022, and age 73 before January 1, 2033. The act further increases the RMD age to 75 for individuals turning 75 in 2033 or later.

Reduced penalty for missed RMDs. SECURE 2.0 also reduced the penalty for missed RMDs from 50% to 25%. The penalty is further reduced to 10% if the missed RMD is corrected within the "correction window," as noted in the act. That is the period beginning, generally, January 1 of the year following the year of the missed RMD and ending on the earliest of these dates: when notice of the missed RMD is mailed to the account owner, when the penalty is assessed, or the last day of the second tax year after the penalty is imposed.

The content in this article is our summarization of the SECURE 2.0 Act of 2022 unless otherwise footnoted.

Revised rules for qualified longevity annuity contracts (QLACs). Regulations enacted in 2014 allowed individuals to reposition a portion (limited by the regulations) of their qualified retirement assets into a QLAC. The regulations noted that the maximum amount that could be allocated to a QLAC was the lesser of $125,000 (indexed up to $145,000 in 2022) or 25% of the retirement plan. The regulations also limited QLACs to note that they must begin paying out when the owner reaches age 85 or earlier, must provide a fixed payout (that they cannot be variable or indexed), and cannot have a cash surrender value once purchased.[1]

The perceived advantage of a QLAC is that monies allocated to the QLAC are not included in the fair market value (FMV) of the account for the purposes of calculating RMDs. For example, if John Doe has an IRA worth $150,000, he could position up to $37,500 into a QLAC, which would be removed from the RMD calculation and RMDs would be calculated on the remaining $112,500.

SECURE 2.0 changed the maximum QLAC contribution amount by removing the 25% limit on retirement assets that could be used to fund the QLAC and increased the dollar amount cap to $200,000. The act also amended the QLAC rules to allow for spousal survival rights and allows for a 90-day free-look period.

PLANNING NOTE: While the QLAC increased contribution amounts may be helpful for some clients who don't want or need RMDs, the restrictions on QLAC growth may not make them attractive to such clients. The returns offered by a QLAC—as they must be fixed—coupled with the requirement that they must begin paying out by age 85 or earlier, may not be enough to overcome the key benefit that the monies placed in the QLAC are removed from RMD calculations. Instead, some clients may find more value in products with a guaranteed[*] add-on living benefit, coupled with a return of premium death benefit—both available for an extra charge—to preserve qualified assets for legacy planning. For more information on these product types, contact your Jackson® representative.

Qualified charitable distributions. Qualified charitable distributions (QCDs) allow IRA owners over age 70½ to send their RMDs to a qualified public charity.[†] This allows account owners to satisfy their RMD without realizing a taxable event for the distribution. The maximum amount that can be sent as a QCD annually was set at $100,000 more than 15 years ago and remains at $100,000. However, SECURE 2.0 provides that—beginning in 2024—the maximum QCD amount will be linked to inflation.[2] This may provide a greater opportunity for clients with larger qualified accounts to satisfy their RMDs without a corresponding tax liability.

SECURE 2.0 also provides an interesting opportunity to use QCDs as a split-interest charitable gift. It allows a one-time transfer of up to $50,000 (indexed for inflation) to a charitable remainder unitrust, charitable remainder annuity trust, or charitable gift annuity.

PLANNING NOTE: While the new allowance of QCD transfers to a split-interest charitable entity may sound appealing, in practice—due to the regulatory restriction on the amount of the transfer—it is not likely to be an option pursued by many, if any, accountholders.

A transfer of $50,000 (or $100,000 for married couples) may not be large enough to justify the drafting and ongoing administrative expenses of a charitable remainder trust. Additionally, this technique is only available if the charitable remainder trust is funded solely by the QCD, meaning that the transfer cannot be made to an existing charitable remainder trust.

Perhaps the greatest opportunity offered by this provision is the funding of a charitable gift annuity (CGA). A detailed explanation of the function and rules surrounding a CGA is beyond the scope of this article, but they generally don't have the drafting and ongoing administration costs of a charitable remainder trust, so they may be the most attractive option for one-time QCD transfers.

[*] Guarantees are backed by the claims-paying ability of Jackson National Life Insurance Company or Jackson National Life Insurance Company of New York and do not apply to the investment performance of the separate account or its underlying investments.

[†] QCDs are reported as distributions. Your clients should consult a tax advisor regarding how to deduct QCDs from their AGI when preparing their tax filing.

[1] Michael Kitces, Kitces, "Why the New Qualified Longevity Annuity Contract (QLAC) Regulations Don't Mean Much for Retirement Income…Yet?" July 9, 2014.

[2] Jeffrey Levine, Kitces, "SECURE Act 2.0: Later RMDs, 529-to-Roth Rollovers, and Other Tax Planning Opportunities," December 28, 2022.

New exceptions to the 10% early withdrawal penalty. SECURE 2.0 contains several exceptions to the penalty for pre-59½ withdrawals from qualified retirement accounts. These exceptions include:

- Emergency expenses up to $1,000 per year, which can be repaid within three years (effective January 1, 2024)
- Terminal illness
- Domestic abuse (effective on distributions made after December 31, 2023)
  - Participants can self-certify and withdraw the lesser of $10,000 (indexed for inflation) or 50% of their retirement account.
  - These withdrawals can be repaid to the account and income taxes refunded on monies repaid.
- Federally declared disasters
  - Up to $22,000 can be withdrawn penalty-free (this amount is includible in gross income over three years and can be repaid).
- Distributions to pay for long-term care insurance
  - Beginning in 2026, SECURE 2.0 enables retirement-plan participants to take penalty free withdrawals of up to the lesser of 10% of their vested balance or $2,500 (adjusted for inflation) each year to pay for long-term care insurance.

Annuitization and RMDs. SECURE 2.0 attempts to limit an imputed "penalty" on annuitizing a portion of retirement accounts. Prior to SECURE 2.0, if an individual annuitized a portion of their retirement account, that annuitized portion could be removed from the calculation for future RMDs.[‡] This was as a double-edged sword. It lessened the total account balance for RMD calculations but also meant that income from the annuitized payments couldn't count toward RMDs due from the account. In some circumstances, this led to greater total withdrawals from the account than if the account had not been annuitized. Now, annuitized payments may count toward an account owner's total RMD from the account.

Inherited IRAs. From a planning perspective, perhaps the most impactful change under SECURE 1.0 was the elimination of stretch, in favor of an out in ten, for many IRA beneficiaries. SECURE 2.0 contains a sole provision relating to inherited IRAs, but this time, one that may benefit spousal IRA beneficiaries.

Beginning in 2024, when a surviving spouse inherits an IRA from their spouse, in addition to their previous options, they have the option to be treated as the deceased spouse for RMD purposes. This means that the surviving spouse can delay RMDs until the deceased spouse would have reached their RMD age and calculate RMDs using the life expectancy table for owners (IRS Publication 590-B, Table III) as opposed to the life expectancy table for beneficiaries (IRS Publication 590-B, Table I). This option may lead to smaller RMDs for surviving spouses who are older than their deceased spouse. If the surviving spouse elects to be treated as the deceased spouse and passes away before beginning RMDs, their beneficiaries would have the option to stretch the inherited IRA—if they are eligible designated beneficiaries.

Surviving spouses still retain the option to treat the inherited IRA as their own at any time, which presents them with planning opportunities to delay RMDs and/or combine inherited spousal IRAs with their own IRA and calculate RMDs based on their own life expectancy.

[‡] Whether the annuitized payment counted towards RMDs previously depended on how the annuity carrier reported the annuitization.

SECURE 2.0 Act contribution rule changes

SECURE 2.0 also contains provisions relating to changes in contribution amounts for retirement accounts and the nature of those contributions. The section below covers changes to Roth contribution rules and catch-up contributions.

Changes to Roth accounts. SECURE 2.0 contains multiple provisions relating to Roth accounts. Some provisions represent tax/income savings for accountholders, while others may represent additional initial tax burdens for high-income earners.

Advantageous Roth provisions

SECURE 2.0 provides the following potentially advantageous provisions for Roth accounts:

- Beginning in 2024, RMDs will no longer be required from Roth accounts in employer plans, bringing them in line with the RMD rules for Roth IRAs.
- Employers are now permitted to offer Roth accounts for simplified employee pension plans (SEPs) and SIMPLE IRAs.
- Employers can now make matching or nonelective contributions into employees' designated Roth accounts, like Roth 401(k)s. These contributions are taxable to employees and cannot be subject to a vesting schedule. They are now able to grow tax-free[§] like other Roth accounts.
- Excess 529 Plan funds can be rolled to the plan beneficiary's Roth IRA, effective for distributions after December 31, 2023.

PLANNING NOTE: SECURE 2.0 creates an escape route for funds trapped inside 529 accounts that were designated for beneficiaries who didn't access them for education. Provided that the 529 account has been open for at least 15 years, beneficiaries may rollover up to $35,000 of these funds, tax- and penalty-free, into a Roth account in their name. However, the timing of the rollover (or rollovers) is somewhat thorny for two reasons. First, any contributions made in the last five years cannot be rolled over. Second, any amount rolled over cannot exceed the lesser of the beneficiary's earned income or the IRA contribution limit for a given year. This new provision provides an opportunity to liberate funds that were once subject to penalties and redeploy them for retirement.

Less advantageous Roth provisions

Starting in 2024, high earners who are making catch-up contributions to employer sponsored plans—specifically 401(k), 403(b), and governmental 457(b) accounts—must make them on a Roth basis. This means that these catch-up contributions will be taxable. SECURE 2.0 defines a high earner as one with wages greater than $145,000 (adjusted for inflation) in the previous calendar year.

This presents potential opportunities and complications.

First, the act notes that the wage test applies to wages paid in the preceding year from the employer sponsoring the plan. Two questions come to mind. Can a high earner who changes jobs and has no previous year income from their current employer make pre-tax catch-up contributions? Can a self-employed individual with self-employment income (beyond wages) over the limit continue to make pre-tax catch-up contributions?

Second, what would be the result if a high-earner's employer plan did not contain a Roth component? The language of the act appears to indicate that if the plan does not contain a Roth component, then catch-up contributions may not be available for any plan participants.

IRA catch-up contributions. The $1,000 catch-up limit has been in place, and stuck at the same amount, since 2006.[3] Beginning in 2024, the IRA catch-up contribution limit will once more be indexed for inflation.

Retirement plan catch-up contributions. Beginning in 2025, some retirement plan participants will find an increase in their catch-up contribution cap. Participants aged 60 to 63 will have their catch-up limit increased to the greater of $10,000 or 150% of the regular catch-up contribution amount for those plans in 2024. In 2025, participants in SIMPLE plans aged 60 to 63 will have their catch-up contribution limit raised to the greater of $5,000 or 150% of the SIMPLE catch-up contribution amount for 2025.

There's a little math to be done with these scenarios, but rest assured that Jackson will publish follow-up notices on these amounts as they come. Navigating the complex rules of retirement accounts is difficult. Jackson's knowledgeable team can help you identify planning obstacles and chart a clear path for your clients' financial futures.

[§] Tax deferral offers no additional value if an annuity is used to fund a qualified plan, such as a 401(k) or IRA. It also may not be available if the annuity is owned by a legal entity such as a corporation or certain types of trusts.

[3] IRS, Publication 590-A, "Contributions to Individual Retirement Arrangement (IRAs)," February 18, 2022.

To learn more about SECURE 2.0 Act may impact you and your clients, please call:

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