Davis Polk

SECURE 2.0 Act of 2022 enacts new retirement savings provisions

February 3, 2023 | Client Update | 11-minute read

This client update highlights select changes enacted under the SECURE 2.0 Act that may be of interest to estate planning clients.

The SECURE 2.0 Act of 2022 was signed into law at the end of December as part of the $1.7 trillion omnibus federal spending package. The SECURE 2.0 Act contains a wide range of new or modified provisions which aim to improve participation in individual retirement accounts and employer-sponsored plans. In many respects, the SECURE 2.0 Act builds on changes made in the SECURE (Setting Every Community Up for Retirement Enhancement) Act of 2019.

In addition, further below is a summary of federal transfer tax inflation adjustments for 2023 and certain state transfer tax considerations. Our October 31, 2022 estate planning update describing these adjustments in more detail is also available here.

Changes to required minimum distribution rules

Increase in age for required beginning date for required minimum distributions (RMDs)

Under the SECURE 2.0 Act, the owner of a tax-deferred IRA, 401(k) or other employer-sponsored retirement plan must begin taking distributions, known as required minimum distributions (RMDs), no later than April 1 of the year after the account owner reaches age 73 if the owner was born in 1951 or later, or age 75 if the owner was born in 1960 or later.[1] Under prior law, the relevant age was 72, which is still the required beginning date age for individuals born in 1950 or earlier.

No required minimum distributions for employer-sponsored Roth accounts

Under prior law, designated Roth accounts under employer-sponsored plans (Roth 401(k), Roth 403(b) and Roth governmental 457(b) accounts) were subject to RMD requirements during the account owner's lifetime, even though Roth IRAs are not. Under the SECURE 2.0 Act, for tax years beginning after December 31, 2023, owners of employer-sponsored Roth accounts will no longer be required to take RMDs during their lifetimes.[2]

For clients considering converting a traditional employer retirement plan into a Roth plan, it is generally best practice to do so in a year in which portfolio performance is down and/or there are losses in the IRA that could offset taxable income generated by a Roth conversion. Such planning should be made only upon advice of an accountant or financial advisor.

New election available to surviving spouse

Where an account owner dies prior to beginning to receive RMDs and the designated beneficiary is the account owner's surviving spouse, the surviving spouse enjoys the ability to "stretch" account distributions over his or her life expectancy, a longer period of time than would typically apply to non-spouse beneficiaries. Under the SECURE 2.0 Act, beginning in 2024, this treatment continues with certain modifications: such surviving spouse may elect to delay receiving RMDs until the date on which the account owner would have been required to begin receiving them (a benefit that was automatically available under prior law) and be treated as if such surviving spouse were the account owner for purposes of the required minimum distribution rules. This affirmative election would allow the surviving spouse's RMDs to be calculated based on a more favorable life expectancy table which would lengthen the ability to "stretch" account distributions and allow the retirement account assets to continue to grow on a tax-deferred basis over a longer period.

Reduction of penalties for failure to take RMDs

The SECURE 2.0 Act reduces the excise tax imposed for failure to take RMDs by the annual deadline to 25% of the amount by which the RMD exceeds the actual amount distributed during the calendar year (under prior law, this tax was 50%). The tax is further reduced to 10% if the account owner takes the RMDs and makes a certain tax filing within a statutory "correction window."

Changes to employer-sponsored retirement plans

Higher "catch-up" contribution limit at ages 60-63; Roth requirement for all "catch-up" contributions

Many employer-sponsored retirement plans allow employees who have reached age 50 and above to make annual "catch-up" contributions to their retirement plans. For example, for 401(k) plans, the standard contribution limit for all employees in 2023 is $22,500 (as adjusted for inflation). Employees who are age 50 and above may make an additional "catch-up" contribution in an amount up to $7,500 (as adjusted for inflation).

Under the SECURE 2.0 Act, for employees who are age 60, 61, 62, or 63, this "catch-up" contribution limit is increased to $10,000, with inflation adjustments, for tax years beginning after December 31, 2024. In addition, for tax years beginning after December 31, 2023, all "catch-up" contributions at age 50 and above must be designated Roth contributions (*i.e.*, made with after-tax dollars), unless the employee's wages in the prior year did not exceed $145,000.

Expanding automatic enrollment in employer-sponsored retirement plans

For plan years beginning after December 31, 2024, eligible newly-established 401(k) and 403(b) plans must automatically enroll all employees into the plan and increase their percentage contribution levels on an annual basis. The percentage of compensation contributed during the first year of an employee's participation in such a plan must be between 3% and 10% of compensation. In each subsequent year, the contribution percentage must increase by 1%, up to a maximum of at least 10% but no more than 15% of compensation. Employees may opt out of automatic enrollment and/or elect to contribute at a different percentage. New and small businesses are exempt from these rules. Plans in existence prior to December 29, 2022 are also not subject to the automatic enrollment rules.

Changes to IRAs and other provisions

IRA "catch-up" contributions indexed for inflation

An individual who has reached age 50 may make a $1,000 “catch-up” contribution to an IRA each year (in addition to any other amounts contributed to an IRA up to the standard contribution limit, which is $6,500 in 2023). Under the SECURE 2.0 Act, for tax years beginning after December 31, 2023, this IRA “catch-up” amount will be indexed for inflation.

One-time charitable distribution to split-interest entity

IRA account owners who have reached age 70.5 may distribute up to $100,000 per year from their IRAs to qualified charities. Under the SECURE 2.0 Act, for tax years beginning after December 29, 2022, this annual allowance is indexed for inflation.

In addition, under the SECURE 2.0 Act, an IRA account owner may now make a one-time distribution of up to $50,000, with inflation adjustments, from his or her IRA to a charitable remainder trust or charitable gift annuity. A charitable remainder trust (CRT) is a tax-advantaged trust which provides for payments to one or more non-charitable beneficiaries (*i.e.* the IRA account owner and/or his or her spouse) for a specified period of time, after which the remaining trust property is distributed to one or more charitable organizations. We described CRTs and their advantages in our October 31, 2022 estate planning update, available here.

Special rollovers to Roth IRAs from 529 plans

Generally, 529 plans allow tax-free, penalty-free distributions only for qualified educational expenses (*e.g.*, tuition for elementary, secondary and post-secondary educational institutions). In addition, if a 529 plan contains funds in excess of amounts necessary for the designated beneficiary’s educational expenses, such excess funds may be rolled over to a 529 plan for certain family members without tax or penalty, or the designated beneficiary on the plan may be changed to certain family members.

Under the SECURE 2.0 Act, beginning in 2024, a 529 plan beneficiary may roll funds from the 529 plan to a Roth IRA, up to the annual Roth IRA contribution limit. The maximum aggregate rollover amount is $35,000 per beneficiary. This rollover option is only available to 529 plan accounts that have been in place for 15 years or more, and the rollover cannot be made from funds contributed to the 529 plan within the 5-year period prior to the rollover.

Other provisions in SECURE 2.0

As noted above, the SECURE 2.0 Act contains a wide range of other provisions, including the following:

- Employer-sponsored retirement plans may allow penalty-free distributions up to $2,500 per year, with inflation adjustments, to pay premiums on certain long-term care insurance contracts covering the employee or the employee’s spouse. This change is effective after December 29, 2025.
- If an IRA account owner or beneficiary engages in a prohibited transaction or investment, the IRA is disqualified and treated as fully distributed. The SECURE 2.0 Act clarifies that only the IRA in which the prohibited transaction occurred is disqualified (not any other IRAs owned by the same individual).
- For tax years beginning after December 29, 2022, employers of domestic employees may create a SEP (simplified employee pension) retirement plan for such employees without incurring penalties, even though the employer is not operating a business. SIMPLE retirement accounts (408(p)) and SIMPLE plans (401(k)(11)) also continue to be eligible for this treatment.
- Effective after December 31, 2023, certain employers may make contributions to 401(k), 403(b), 457(b) and SIMPLE retirement accounts on behalf of an employee as a match for student loan payments made by such employee, up to the maximum contribution such employee could have made towards the employer’s retirement plan. This benefit is

available to both part-time and full-time employees.

- The dollar limitation of premiums on qualifying longevity annuity contracts (which are, generally, annuities that pay out at the end of an individual's life expectancy) issued in connection with an eligible retirement plan is increased to $200,000, with inflation adjustments (up from $125,000). The regulations effectuating this change must be adopted no later than June 29, 2024.
- A national online searchable database will be established, to be known as the "Retirement Savings Lost and Found," in order to enable participants and beneficiaries to locate the retirement plan administrator and obtain relevant contact information, in order to make claims for benefits owed to such individuals.

2023 federal transfer tax inflation adjustments – a reminder

Exemption amounts and rates

The inflation-adjusted federal estate, gift and generation-skipping transfer (GST) tax exemption amounts are now $12.92 million for an individual (up from $12.06 million in 2022) or a combined $25.84 million for a married couple. For taxable estates and transfers in excess of the exemption amounts, the federal estate, gift and GST tax rate is 40%. Absent legislative action, these increased exemption amounts are scheduled to expire on December 31, 2025, after which they will revert to $5 million, plus the relevant inflation adjustments. When consistent with other family goals and financial considerations, it is advisable to make lifetime gifts to take advantage of the increased federal exemption amount. Before making significant lifetime gifts, donors should weigh the loss of the income tax basis step-up at death with the transfer tax savings achieved by the gifts.

Annual exclusion gifts

The federal gift tax annual exclusion amount is $17,000 (up from $16,000 in 2022), which allows donors to exclude from taxable gifts the first $17,000 of qualifying gifts to or in respect of a particular donee.[3]

For gifts by a U.S. citizen or domiciliary to his or her non-U.S. citizen spouse, the available annual exclusion amount is $175,000.[4]

It is often a best practice to make use of the federal gift tax annual exclusion amount each year by making a "present interest" gift to or in respect of a particular donee.[5]

State transfer tax considerations

New York

The New York estate tax exemption equivalent is now $6.58 million. This exemption equivalent continues to be phased out for New York taxable estates valued between 100% and 105% of the exemption amount, with no exemption being available for taxable estates in excess of 105% of the exemption amount. The top New York estate tax rate is 16%.

Estate taxes paid to New York may be deducted for federal estate tax purposes, to the extent a federal estate tax would otherwise be payable (resulting in a lower effective rate).

There is currently no New York gift or GST tax.

Connecticut

The Connecticut estate and gift tax exemption amounts now match the federal estate and gift tax exemption amounts of $12.92 million per individual. Likewise, the Connecticut gift tax annual exclusion amount is $17,000.

A flat tax rate of 12% applies to the value of Connecticut taxable estates and gifts that exceed the federal exemption amount. The maximum amount of Connecticut gift and estate taxes that may be imposed is capped at $15 million.

Estate taxes paid to Connecticut may be deducted for federal estate tax purposes, to the extent a federal estate tax would otherwise be payable (resulting in a lower effective rate), but there is no corresponding federal gift tax deduction.

Connecticut does not impose a GST tax.

New Jersey

Although New Jersey no longer has an estate tax, it has retained its separate inheritance tax. The inheritance tax does not generally apply to transfers to a spouse, civil union or domestic partner, child or grandchild and certain other close family members. The New Jersey inheritance tax rates depend on the amount received and the relationship between the decedent and the beneficiary receiving assets from the decedent. Under the inheritance tax, transfers to siblings are generally taxed at a rate beginning at 11% (top rate is 16%) and transfers to others are taxed at a rate of 15% or 16%.

New Jersey inheritance tax is also deductible for federal estate tax purposes. There is currently no New Jersey gift or GST tax.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

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[1] With respect to employer-sponsored qualified plans where the account owner is not a 5% owner of the company, the account owner may defer RMDs past the "required beginning date" age until retirement if permitted under the plan. Note that there is a drafting error in the legislation that makes it unclear which required beginning date age applies to individuals born in 1959; this is expected to be resolved well before such individuals reach the required beginning date age.

[2] This change does not apply to RMDs with respect to years beginning before January 1, 2024 which are permitted to be paid on or after such date.

[3] Spouses who elect to split certain gifts can claim a combined exclusion of $34,000 with respect to a particular donee, even if one spouse funds more than half (or the whole) of that combined exclusion in respect of the same donee.

[4] There is a larger annual exclusion for such gifts because, unlike gifts to a U.S. citizen spouse, gifts to a non-U.S. citizen spouse that exceed the annual exclusion cannot qualify for the unlimited gift tax marital deduction.

[5] The types of gifts that qualify for treatment as gifts of present interests include outright gifts of cash or marketable securities to, and similar contributions to a 529 account, custodial account or minority trust for the benefit of, a particular individual donee or gifts to a "Crummey" trust which provides the particular donee with a power to withdraw property that lapses over time.