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MBL Legislative Alert 23-1: The Consolidated Appropriations Act of 2023 (aka Secure Act 2.0)

In the waning hours of 2022, Congress passed what the talking heads referred to as an omnibus spending bill with a budget over $1.7 Trillion (yes, with a T). The official name of the bill is The Consolidated Appropriations Act of 2023, but everyone is really just calling a large part of it "Secure Act 2.0," since it builds on changes made to the retirement system by the Secure Act[1] passed in 2019.

The bill itself was 5,593 pages and is the longest bill ever passed in Congress (according to the Senate Historical Office, and who on earth else would have taken the trouble to count). So it would be difficult to do more than try to hit the highlights here. For your reference, what follows is a summary of what we believe are the most impactful provisions relevant of Secure 2.0 to our private wealth management clients, about half of which provisions have to do with retirement planning.

Provisions Pertaining to Retirement

RMD Age Increase (Sec 107). The SECURE Act raised the age for Required Minimum Distributions from 70½ to 72. Secure 2.0 moves the RMD age up again. In this first summary point, you might begin to understand why the bill was over 5,500 pages. The new RMD age is 73 for taxpayers turning 73 beginning Jan 1, 2023 and then again to age 75 beginning Jan 1, 2033. We'll wait while you go get another cup of coffee. The short version is the new RMD age is 73, and it will rise again in a decade to 75.

Higher Catch-Up Contribution Thresholds for Ages 60-63 (Sec 109). Defined contribution retirement plans (i.e., 401k, 403b, 457b plans) allow participants age 50 and older to make additional pre-tax elective deferrals, referred to as "catch-up contributions." In 2023, the current contribution limit for all employees is $22,500 (up from $20,500 in 2022). Currently, catch-up contributions for plan participants ages 50 and older is $7,500 per year. Beginning in 2025, the catch-up contribution amount is increased to the greater or $10,000 or 50% of the 2024 amount. These figures will be indexed for inflation starting in 2026.

[1] We've written on the "OG" Secure Act recently here.

One limitation here is that participants over 50 who also earn more than $145k/year must make the contributions into a Roth, beginning in 2024.

LTC Contracts Purchased with Retirement Plan Distributions (Sec 334). Retirement plan owners are required to take RMDs as described elsewhere in this bulletin. They may also begin to take distributions from a pre-tax IRA without any penalties upon reaching the age of 59 ½. Typically, early withdrawals (withdrawals prior to age 59 ½) are subject to a 10% penalty, though there are several noted exceptions to the premature penalty tax.[2] Secure 2.0 creates another new exception to fund Long-Term Care (LTC) insurance premiums, which is most likely to be of interest to early retirees who need income to pay for LTC premiums. The penalty-free early withdrawal must be limited to the lesser of $2,500 or 10% of the vested balance of the IRA annually. The income tax associated with the withdrawal is still due; only the 10% penalty is avoided.

Surviving Spouse Election to be Treated as an Employee (Sec 327). This provision is likely only to benefit a unique and limited set of individuals, namely a surviving spouse who inherits an IRA from a *younger* predeceasing spouse. The benefit is created by being able to delay RMDs longer and for RMDs to be smaller once they begin than if the surviving spouse had elected for a spousal rollover. The rule allows a surviving spouse who is designated as a sole beneficiary of an employer-provided plan to step into the shoes of the deceased employee spouse who dies prior to RMD age. In such a case, RMDs are delayed until the date that the younger deceased spouse would have reached RMD age instead of beginning at the earlier date when the older surviving spouse reaches RMD age.

Smorgasbord of Other Provisions

Qualified Charitable Distributions (Sec 307). Two separate changes to QCD rules are contained in this provision. First, the $100,000 annual QCD limitation in existence in 2006 has finally been given an inflation adjustment rider, which will become effective in 2024. Second, there is now a one-time opportunity to use up to $50,000 to fund a split-interest charitable entity like a Charitable Remainder Trust or a Charitable Gift Annuity. While a nice addition to QCD rules, the benefits are fairly limited given some restrictions like that the CRT cannot receive any other funding.

Tax Deferral for S-Corp Sponsored ESOPs (Sec 114). The ability for the owner of a closely held business to sell their shares to an ESOP (Employee Stock Ownership Program) has been in existence for many years now. And those owners whose companies are C corporations have also been able to defer gains associated with the sale if they use the proceeds of the sale to purchase QRP (Qualified Replacement Property like the stock of many domestic public companies. This provision expands benefits to owners of S Corporations as well with two notable limitations: the allowance does not begin until 2028, and at least as drafted the deferral has a 10% limit.

[2] The list of other exceptions to the 10% early withdrawal penalty are here.

Tax-free Rollovers from 529 Accounts to Roth IRAs (Sec 126). The ability to use 529 plan assets has gotten another limited expansion. Now a beneficiary of a 529 plan can make a "trustee-to-trustee" transfer from the 529 plan to a Roth IRA. Limited is the key word, because there are several restrictions. The 529 plan must have been open for at least 15 years; the annual limit on the rollover is the same amount as the Roth annual contribution limit (currently $6,500 under 50 years old and $7,500 if 50 or older); and the lifetime limit is $35,000. The use here is for individuals whose 529 plans were "overfunded" relative to their educational needs.

Conclusion

Not since David Foster Wallace wrote Infinite Jest have so many words been used to say so little. Secure 2.0 has numerous provisions that create very limited expansions of benefits for taxpayers, but those benefits are so limited as to make it nearly moot.
