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Retirement Legislation in 2022: Action or Act-Shun?

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Pandemic take three—increasing inflation, Supreme Court vacancy, and everything else going on in Washington this year, Congress continues to weigh legislative proposals. Some new laws may be enacted that will include provisions related to retirement accounts.

As of this writing, the leading contenders are SECURE 2.0 and Build Back Better (BBB). Handicappers might favor the former and lay the latter, but the outcome is uncertain. Nevertheless, knowing what's in these bills can help with comprehensive retirement planning in the coming months.

SECURE Part Deux

The Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019, signed into law at the end of that year, is best known for limiting "stretch" Individual Retirement Accounts (IRAs) and other retirement accounts.[1] Now, most non-spouse beneficiaries must deplete their accounts within ten years of inheriting, rather than deferring tax via required minimum distributions (RMDs) over their life expectancies. That said, SECURE had many other significant provisions, such as delaying the start of RMDs until age 72 rather age 70 and a half.

Following up, the proposed Securing a Strong Retirement Act, known as SECURE 2.0, includes many additional provisions that affect retirement accounts.[2] Some highlights:

Delaying RMDs, Again

SECURE 2.0 would raise the required beginning date (RBD) from 72 to 73 from 2022 through 2028. By 2031, the RMDs would move up to 74. Starting in 2032, the RBD would start at 75 (There might be some changes in these dates in the final version).

Easing Excess Accumulation

Any RMD shortfall is subject to a 50% penalty. If Al Brown has a $5,000 RMD this year but takes no IRA distributions by year-end, he will owe a $2,500 penalty in addition to the taxes due. SECURE 2.0 would reduce the excess accumulation penalty from 50% to 25% and, if timely correct, to 10%.

Ratcheting Up Roths

Roth accounts, currently permitted only in 401(k), 403(b) and 457(b) plans as well as in traditional IRAs, would be allowed in SIMPLE IRAs and Simplified Employee Pension (SEP) plans as well. The underlying rules would apply universally. If specific conditions are met, Roth accounts are funded with already-taxed dollars and may generate tax-free distributions.

Cashing In On Catching Up

Many types of retirement accounts allow participants who reach a specified age to increase contributions, effectively "catching up" for past years when they might not have taken full advantage of the tax benefits. In 2022, for example, workers can contribute up to $20,500 to 401(k) plans, but those 50 or older can make a $6,500 catch-up contribution, maxing their 401(k)s at $27,000 this year.[3] SECURE 2.0 would raise the $6,500 catch-up to $10,000, from ages 62 to 64.

In SIMPLE IRAs, the 2022 maximum contribution is $14,000, but people 50 or older can put in up to $3,000 as a catch-up, boosting the total as high

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as $17,000. SECURE 2.0 would raise the $3,000 age-50 catch-up to $5,000.

Some age-50 catch-up contributions, such as those for 401(k) plans, are indexed to inflation. However, the $1,000 catch-up for IRAs has been fixed since 2006, eroding its purchasing power. SECURE 2.0 would index these $1,000 catch-up contributions to keep up with the cost of living going forward.

Reportedly, SECURE 2.0 has wide bipartisan support in Congress, thanks to its continued emphasis on helping Americans save for retirement. Some version of this bill is expected to be enacted during 2022.

Building Blocked?

As its full name suggests, SECURE 2.0 focuses on enhancing Americans' ability to retire comfortably. The Build Back Better (BBB) Act,[4] by contrast, is a wide-ranging proposal covering many areas, from clean energy and climate change to childcare and pre-K education. The retirement-related provisions of BBB include plans to raise revenue by increasing the tax collected from people with high income and substantial assets in retirement accounts. Such provisions include:

Restricting Retirement Account Balances

Single taxpayers whose income exceeds $400,000 ($450,000 for married couples filing jointly and $425,000 for heads of household) and whose aggregate retirement account balances exceed $10 million would face limits on contributions to Roth or traditional IRAs. Although defined contribution plans such as 401(k)s would be counted towards the $10 million threshold, this provision would not prevent affected taxpayers from funding DC plans as well as SEP or SIMPLE IRAs.

Maximizing Minimum Distributions

High-income taxpayers with aggregate retirement plan balances over $10 million would be required to withdraw (and pay tax on) 50% of the excess. For retirement accounts over $20 million, 100% of the excess would be the required distribution, starting with money from Roth accounts. Money withdrawn from Roth accounts to meet this requirement wouldn't be taxed or penalized, but the prospect of future tax-free gains would be reduced.

Requiring Reports of Ample Accounts

Employers would have to report vested account balances over $2.5 million to the IRS.

Slamming the Back Door

High-income taxpayers are not allowed to make Roth IRA contributions. However, there are no income limits on making non-deductible contributions to traditional IRAs and converting those dollars to the Roth side with little to no additional tax if there's negligible or no pre-tax balance in all the IRAs owned. This strategy is known as a backdoor Roth contribution with the goal of generating future tax-free gains. BBB would eliminate the ability to convert after-tax contributions from traditional IRAs or other retirement accounts to Roth accounts.

This provision in BBB also would end so-called "mega backdoor" Roth conversions, available to people who participate in a 401(k) plan that permits after-tax contributions. In 2022, such workers can contribute up to $40,500 in after-tax money ($61,000 annual additions limit less than the pre-tax maximum 401(k) deferral of $20,500). If in-service, non-hardship withdrawals also are permitted, those dollars can be moved to a Roth IRA, regardless of income-based limits on Roth IRA contributions. BBB would stop this tactic.

The provisions described above were in the version of BBB passed by the House of Representatives on November 19, 2021. The Senate Finance Committee released preliminary text reflecting changes to the House version on December 11, 2021.[5] In the House version, these provisions would take effect in 2022, but the

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Senate version would have delayed some of these changes until 2029.

As of this writing, there is considerable doubt that BBB will be passed in its present form, including the changes to retirement accounts mentioned here. However, the proposals show the thinking of some lawmakers, so it's wise to know what might happen if a bill with similar rules eventually passes. This knowledge enables you to develop an action plan for your clients if such provisions go into effect in 2023 or sometime after.

As explained, SECURE 2.0 pushes for more opportunities to save for retirement by gradually increasing the RMD age and increasing savings opportunities for individuals nearing retirement, among other related provisions. On the other hand, the BBB framework is designed to collect more taxes from high earners with extremely large retirement accounts. As such, the retirement changes in BBB could be plugged into virtually any future legislation needing to show revenue-raising results.

Action Plans

The possibility that the changes to retirement accounts proposed in BBB will become law one day should be considered by taxpayers with both high income and large amounts in retirement plans. Possible steps to consider include:

- Convert after-tax dollars in IRAs or employer retirement plans to Roth accounts in 2022 before any proposal to eliminate this opportunity becomes law.
- Develop a Roth conversion strategy. This might include a series of annual conversions designed to keep the amounts involved within a relatively modest tax bracket each year. Clients who are heavily concentrated in pre-tax savings and who may be defined as high-income earners under the BBB framework may be prime candidates for this approach.
- Discuss the benefits of Roth elections in 401(k), TSP, 403(b), and 457 plans that permit them.
- Consider implementing backdoor Roth and mega backdoor Roth strategies in 2022. These maneuvers may be eliminated as soon as 2023.
- Reveal the changes proposed in SECURE 2.0. Encourage clients to take advantage of opportunities currently in place to save as well as any additional methods that may come from future legislation.

Sources:

[1]https://www.congress.gov/bill/116th-congress/house-bill/1994

[2]https://www.congress.gov/bill/117th-congress/house-bill/2954

[3]https://www.irs.gov/pub/irs-drop/n-21-61.pdf

[4]https://www.congress.gov/bill/117th-congress/house-bill/5376/text

[5]https://www.finance.senate.gov/imo/media/doc/12.11.21%20Finance%20Text.pdf

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