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Something Old, Something New… Pending and Proposed Legislation You Should Know

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Financial professionals who don't follow what's happening in Washington are missing a huge opportunity because it's a shuffle that's often hard to keep up with. Plus, it's one your clients may need guidance navigating in the near future.

Yes, some retirement-related legislation is on Congress' agenda, with passage likely in 2022. Meanwhile, the IRS already has published highly anticipated proposed regulations with a major plot twist that reiterates how vital it is to stay up to date when considering your clients' retirement planning efforts.

SECURE Split

The Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law in December 2019.[1] Among its significant changes were deferring the start of required minimum distributions (RMDs) from age 70 ½ to 72 and replacing the former life expectancy-based stretch IRA with a 10-year distribution period for most non-spousal designated beneficiaries. The Act also removed the age restriction on traditional IRA contributions for people who continue to work beyond age 70 ½ and added measures to encourage small employers to adopt workplace retirement plans for their employees.

Of the SECURE provisions mentioned above, perhaps the most substantive (and unsettling) were the new rules that now apply to designated beneficiaries of qualified plans and IRAs. If death occurred after 2019, certain eligible designated beneficiaries (EDBs) are exempted from the new regime, so they maintain the right to stretch RMDs over their lifetimes. Those EDBs are:

- Surviving spouses.
- Minor children of the owner, until reaching the age of majority. For this purpose, proposed regulations issued in February 2022 revise the definition of a minor to a child under the age of 21, in most cases. Once they cease being minors, the ten-year rule applies.
- Chronically ill or disabled individuals as defined under a strict definition of disability.
- Individuals not more than 10 years younger than the deceased. That would include an older beneficiary.

The SECURE Act made no distinction as to how the decedent's age would impact the practical application of the ten-year rule. A non-EDB must empty the inherited account by 12/31 of the year containing the tenth anniversary of the account owner's death. Many tax professionals assumed that no RMDs would be necessary until the final deadline.

However, on February 23, 2022, the IRS released proposed regulations indicating that the ten-year rule has a split personality.[2]

- Suppose the decedent died at or beyond the required beginning date (RBD) for RMDs. In that case, a non-EDB must take RMDs in calendar years 1-9, beginning with the year after death, based on the designated beneficiary's life expectancy. In most cases, the RBD is April 1 of the year following the year the account owner reaches age 72.
- If the decedent died before their RBD, no RMDs are due in years 1-9.
- Either way, a non-EDB must deplete the residual balance by 12/31 of year 10.

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For example, suppose Brian is the sole beneficiary of his grandmother's Traditional IRA. His grandmother died in 2021 at the age of 98. Under previous guidance under the SECURE Act, Brian would have no annual RMDs, and he could let her IRA continue to grow, tax-deferred, and distribute the entire account by 12/31/31. Instead, the new proposed regulations require Brian to begin annual RMDs based on his life expectancy by 12/31/22 and continue through 12/31/30. Whatever remains in the account would have to be distributed to Brian no later than 12/31/31.

(Brian must also satisfy his grandmother's final RMD for 2021, assuming she had not taken that RMD before her death last year.) Incidentally, if this were a Roth IRA, no final RMD for grandma would have been due since Roth IRAs are not subject to lifetime RMDs nor would Brian have to take RMDs in years 1-9. He would simply have to distribute all the proceeds by 12/31/31.

Note that the previously assumed rules under the SECURE Act still apply if Brian's uncle died one day after his grandmother in 2021, at age 68, leaving his IRA to Brian. Here, Brian could delay any RMDs from his uncle's IRA until the 12/31/31 deadline and not be required to make any withdrawals in the years leading up to that deadline.

Therefore, the newly proposed regulations can be confusing for non-EDBs of decedents who died in 2020, at or after their RBD. Under the new proposed regulations, these non-EDBs may have missed a required distribution in 2021. Fortunately, the IRS has stated that individuals are not subject to the new guidance in 2021 and could rely on a "good faith interpretation" of the SECURE Act.

Note: Another category of beneficiaries exists, referred to as a non-designated beneficiary. Think estate or non-qualifying trust, in this instance. If the decedent dies before their required beginning date, the non-designated beneficiary must deplete the account by 12/31 of the year containing the fifth anniversary of death. Death after the RBD would require annual RMDs based upon the remaining single life expectancy of the deceased.

Comments on February's proposed regulations will be accepted through May 25, 2022. Until further guidance is issued, financial professionals might encourage patience for clients who are non-EDBs of retirement accounts owned by decedents who had been subject to RMDs. Later this year, the questions raised by the proposed regulations may be answered so affected beneficiaries will know whether to correct a missed 2021 RMD or start taking annual RMDs in 2022.

Second Secure

Even as 2019's SECURE Act is being regulated and compliance practices are revised, 2022's "SECURE 2.0" (H.R. 2954) is sailing smoothly. On March 29, 2022, the bill passed the House of Representatives by a vote of 414-5, showing broad bipartisan support.[3] Press reports indicate similar success in the Senate could follow, although the provisions could differ from those in the House version.

Assuming Senate passage and subsequent reconciliation, SECURE 2.0 could be signed into law by President Biden later this year. Such legislation would build on its predecessor to encourage individuals to increase savings for their own retirement.

What's in SECURE 2.0 so far? Key provisions in the House version include:

- Gradual increases in the starting age for RMDs: The RBD would increase to age 73 in 2023 for individuals who attain age 72 after 12/31/22; to age 74 beginning in 2030 for individuals who turn 74 after 12/31/29 and to age 75 beginning in 2033 for individuals who reach age 75 after 12/31/32. Delaying RMDs will provide more opportunities for potential tax-deferred investment growth.
- Expansion of automatic enrollment in 401(k) and 403(b) retirement plans: Most companies with such plans would be required to automatically enroll newly eligible employees

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at a minimum rate of 3% of pay. An employee earning $40,000 would be auto-enrolled at $1,200 of contributions a year, for example, with the option to contribute more. Auto-enrollment would go from 3% to 4%, 5%, etc., each year, to a maximum of 10%.

Employees could still choose to lower their plan contributions or opt-out altogether. The hope is that more employees would participate in their retirement plans with larger contributions than they would without an auto-enrollment feature.

The effective date would begin after December 31, 2023. Exceptions would apply to companies with ten or fewer employees and those less than 3 years old.

- Treatment of student loan repayments as elective deferrals: This provision would permit employers to make matching contributions to employees' 401(k), 403(b), SIMPLE IRA, and 457(b) accounts for paying down higher education debt.

Suppose Ellen Ford is paying down her student debt, $10,000 a year, but is not putting any money into her company's 401(k) plan. By certifying that she is paying down debt, Ellen could get a company match on her $10,000 spent on loan repayments, subject to the same rules that apply to matches on 401(k) contributions from her co-workers' salaries. The match would go into a 401(k) account in Ellen's name.

- Larger tax credit for new small-company pension plans: The credit would increase from 50% to 100% of startup costs for companies with up to 100 employees, capped at $1,000 per employee. Currently, companies with up to 50 employees can get this credit.

- Enhanced catch-up clauses for older plan participants: In 2022, employees 50 or older can make a $6,500 "catch-up" contribution to qualified retirement plans like 401(k)s and 403(b)s, on top of the $20,500 limit for younger participants. SECURE 2.0 would raise the catch-up to $10,000.

For SIMPLE IRAs, the catch-up for older employees would increase from $3,000 to $5,000. These catch-up contribution limits would also be indexed for inflation. The same inflation indexing would be applied to other IRA contributions, now set at $1,000.

- Speedier participation for part-timers. Under the 2019 SECURE Act, employers were required to permit long-term part-time employees the ability to participate in their 401(k) plan after 3 years, assuming an individual had worked at least 500 hours in each of those years. SECURE 2.0 would reduce the requirement to 2 years, enabling more part-time employees to participate.

- Broader Roth opportunities. Just as Roth elections are permitted in 401(k) and 403(b) plans, Roth SIMPLE IRAs and Roth SEP IRAs could be created. Such accounts would accept after-tax contributions with the potential for entirely tax-free distributions in the future. This SECURE 2.0 provision also would allow plan participants to elect and receive employer contributions, including matching contributions, in these Roth accounts. Under current law, employer contributions are made on a pre-tax basis only.

In a related provision, SECURE 2.0 would require that all catch-up contributions to qualified retirement plans be made as Roth contributions, effective for plan years after 2022. Currently, employees can choose whether any catch-up contributions go into Roth or traditional pre-tax accounts.

Keep in mind that these provisions in the House version of SECURE 2.0 might not be included in a bill approved by the Senate, as described here. Nevertheless, such provisions—or something similar may appear in a 2022 law that will impact retirement planning going forward. Stay tuned for further developments.

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Sources:

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

[2]https://public-inspection.federalregister.gov/2022-02522.pdf

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

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