John Hancock

Advanced **Markets**

# Central Intelligence

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## President Biden Signs SECURE 2.0 Act Contained in 2023 Appropriations Act into Law

On December 29, 2022, President Biden signed the massive (4,155 pages) Consolidated Appropriations Act of 2023 which intends to fund the federal government at least through September 2023. Contained within the bill as “Division T” are 359 pages of new law and amendments to existing law entitled SECURE 2.0 Act of 2022 (“the Act”), which provisions relate significantly to qualified retirement planning and employee benefit plans. The Act extends and modifies the provisions of the SECURE 1.0 Act, so called, as we reported in *John Hancock Advanced Markets Central Intelligence* dated May and June 2019. Below, we summarize the provisions that will be of most interest to many of our regular readers. Obviously, this summary does not attempt to address all the provisions of the Act.

LIFE-5115 1/23

## Automatic Enrollment in 401(k) and 403(b) plans

Section 101 of the Act requires such plans to include automatic enrollment (with the ability for the employee to affirmatively opt out) at a minimum of 3% and a maximum of 10% and automatic escalation at one percentage point per year up to at least 10%. The requirement to include auto enrollment and auto escalation is effective for 2025. Plans in existence on the date of enactment (December 29, 2022) are generally exempt from the new requirements. The section contains exceptions for SIMPLE plans, government plans, church plans, employers with 10 or fewer employees, and new businesses that have not been in existence for three years.

## Gradual Increase in the Required Beginning Date for Mandatory Distributions from Qualified Plans

Under the current required minimum distribution ("RMD") rules, participants are generally required to begin taking distributions from their qualified retirement plan at age 72 (increased from age 70 ½ for 2020). The Act increases the RMD age from 72 to 73 in 2023 and to 75 in 2033. However, there is a drafting glitch under which it is unclear whether age 75 goes into effect in 2033 or 2034; it appears that the intent was 2033, but we will follow up on that. The 2023 effective date for age 73 is from the House bill but is nevertheless somewhat surprising since it will pose compliance challenges.

## Matching and Nonelective Contributions Permitted to be Made on a Roth Basis

The Act provides that employers may permit employees to elect for some or all of their vested matching and nonelective contributions to be treated as Roth contributions under a 401(k), 403(b), or governmental 457(b) plan. (This was expanded from the House bill which only allowed this election with respect to matching contributions.) This election is effective for contributions after the date of enactment.

## Require Plan Catch-up Contributions to be Roth

**The Act requires** that catch-up contributions for participants age 50 or older to be made on a Roth basis under 401(k), 403(b), and governmental 457(b) plans, but **only if** the employee's wages exceed $145,000 (as defined for Social Security FICA tax purposes) in 2024, indexed for inflation. If any participant in a plan has wages over $145,000 (as indexed), then the plan must allow every participant to make Roth contributions. Effective for taxable years beginning after 2023.

## Higher Catch-up Contribution Limit at Certain Ages

The Act increases the catch-up contribution limit for employees who are 60–63. The Act increases the catch-up contribution limit to **the greater of** (1) $10,000 (indexed for inflation) or (2) 150% of the regular catch-up limit for participants aged 50 and above. For example, if the regular published catch-up contribution limit is $7,500, then the increased rate for participants aged 60–63 would be $11,250 ($7,500 x 150%). The $3,500 limit for SIMPLE plans is increased to the greater of (1) $5,000 or (2) 150% of the regular SIMPLE catch-up. These provisions are effective for years after 2024.

## Rollover of Excess 529 Assets to a Roth IRA

The Act allows certain assets in a 529 qualified tuition program to be rolled over (trustee-to-trustee) tax-free to a Roth IRA maintained for the benefit of the beneficiary of the 529 account. Such rollovers are only permitted from 529 accounts that have been maintained for at least 15 years. The rollovers count as contributions for purposes of the limits on Roth IRA contributions, and the rollover is subject to the requirement that the Roth IRA owner have includible compensation at least equal to the amount of the rollover. However, the income limits on Roth IRA contributions do not apply. In addition, the rollover is limited to the aggregate amount contributed to the 529 account (plus earnings attributable thereto) before the 5-year period ending on the date the rollover occurs. Also, the rollovers from 529 accounts are subject to a lifetime limit of $35,000. Effective for 2024.

## Indexing IRA Catch-up Contribution Limit

Under current law, the limit on IRA contributions is increased by $1,000 (not indexed) for individuals who have attained age 50. The Act provides that the limit on IRA catch-up contributions be indexed in the same manner as the regular IRA contribution limit. Effective for 2024.

## Reduction of 50% RMD Penalty Tax to 25%

Failures by an individual to take minimum distributions are subject to a 50% excise tax. The Act reduces that tax to 25%. If a failure to take a required minimum distribution is corrected in a timely manner (by recognizing the tax on a timely filed return as described by the Act), the excise tax on the failure is further reduced from 25% to 10%. Effective for taxable years beginning after the date of enactment.

## Expansion of IRA Charitable Distribution Rule

Certain IRA distributions to a charity can be excluded from income up to $100,000 annually. The Act provides that the $100,000 figure be indexed for inflation and further expands the IRA charitable distribution provision to allow for one-time distributions to charitable gift annuities, charitable remainder unitrusts, and charitable remainder annuity trusts, subject to a limit of $50,000 (also indexed for inflation). These provisions are effective for distributions made in taxable years beginning after the date of enactment.

## Allowing SIMPLE and SEP Contributions to be Made on a Roth Basis

Before SECURE 2.0, SIMPLEs and SEPs were not permitted to offer a Roth option; instead, all contributions had to be made pre-tax. The Act allows (but does not require) employers to permit employees to elect Roth treatment of both employer and employee contributions. Effective for taxable years beginning after 2023.

## Additional Nonelective Contributions Permitted to SIMPLE Plans

Before SECURE 2.0, an employer sponsoring a SIMPLE plan could make matching contributions up to 3% of pay or nonelective contributions of 2% of pay, but no other employer contributions were permitted. Under the Act, an employer is now permitted to make up to a 10% nonelective contribution on behalf of all eligible employees, not to exceed $5,000 (indexed for inflation). Effective for taxable years beginning after 2023.

## Penalty Tax Exception for Terminally Ill Individuals

The Act provides an exception to the 10% early withdrawal tax in the case of a distribution made on or after the date on which such employee has been certified by a physician as having a terminal illness. For purposes of this provision, “terminally ill individual” means an individual who has been certified by a physician as having an illness or physical condition that can reasonably be expected to result in death in 84 months or less after the date of the certification. Effective for distributions after the date of enactment.

## Allow Spousal Beneficiaries to Treat Accounts as their Own

Under current law, spousal beneficiaries may elect to treat a deceased IRA owner’s IRA as their own for purposes of the RMD rules. The Act extends this treatment to spousal beneficiaries in plans. Effective for taxable years beginning after 2023.

## LTC Contracts Purchased with Retirement Plan Distributions

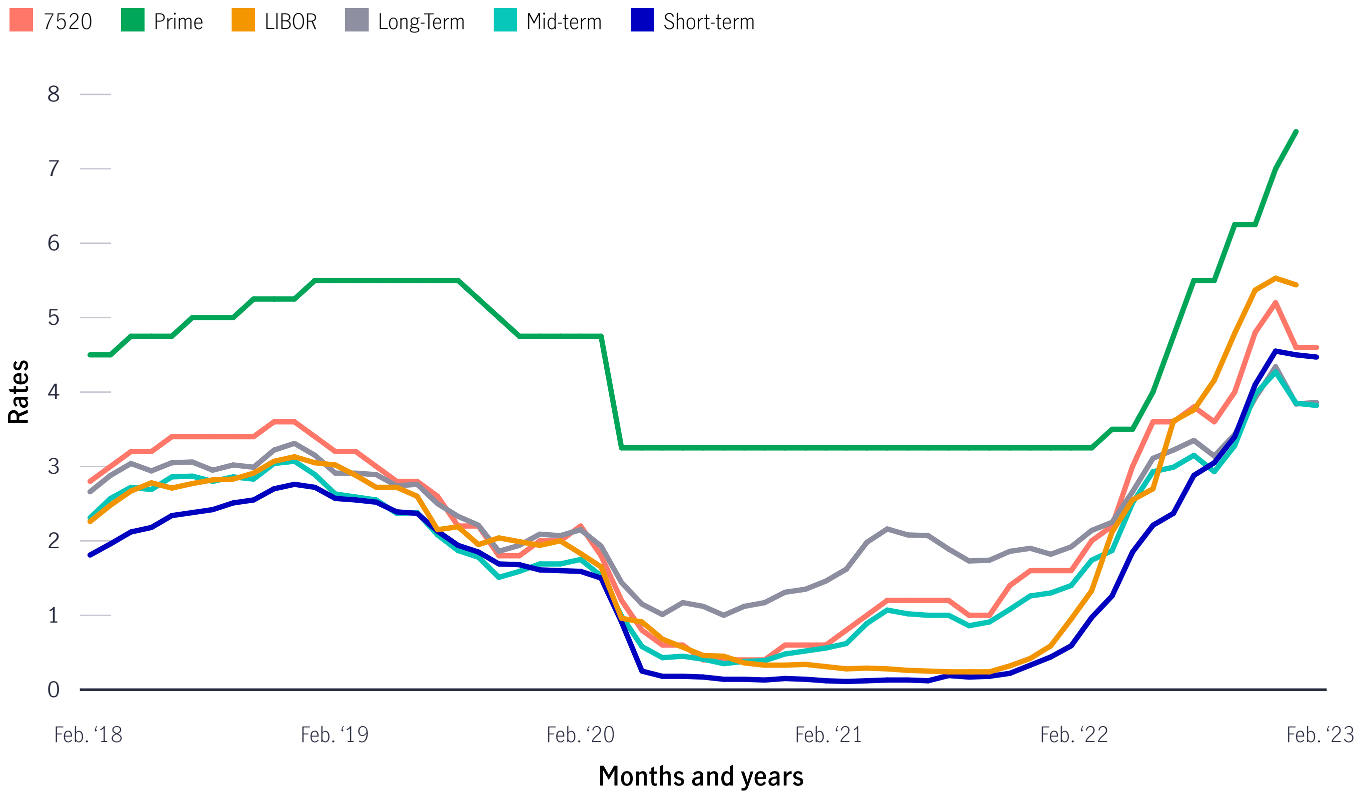
The Act provides that a defined contribution plan may allow qualified long-term care distributions. Qualified long-term care distributions are those distributions made during a taxable year that do not exceed the least of (1) $2,500 (indexed for inflation), (2) the amount paid by the employee during the taxable year for certain insurance coverage (generally, premiums), or (3) 10% of the present value of the employee’s vested benefit under the plan. This insurance coverage includes (1) a qualified long-term care insurance contract covering qualified long-term care services, and (2) coverage of an insured individual who may become chronically ill. The coverage must be for the employee or the employee’s spouse (or other family member of the employee as provided by regulation). The amounts paid can include premiums paid and may include charges for certain long-term care riders (provided certain conditions are met). Qualified long-term care distributions are includible in the participant’s taxable income in the year of the distribution. However, the Act provides an exemption from the 10-percent early withdrawal tax for such distributions, provided that specific requirements are met. A qualified long-term care distribution is not subject to mandatory withholding. Certain reporting requirements apply. Effective for distributions after the date that is **three years after the date of enactment**.

## Increases to SIMPLE contribution limit

The Act provides a higher SIMPLE contribution limit for employers with up to 25 employees. For such employers, the 2024 limit on employee contributions would be increased from $15,500 (2023) to 110% of the published regular limit for 2024 and then indexed for inflation. The catch-up limit for such employers is increased from $3,500 (2023) to 110% of the published regular limit for 2024 and then indexed for inflation. An otherwise eligible employer that grows beyond 25 employees would continue to be treated as having 25 employees for a two-year grace period.

# The following are historical graphs of various rates that are commonly used by the Advanced Markets Group

## Short, Mid, Long Term AFR, 7520, LIBOR, Prime Rates from Jan 2018 - Jan 2023




## Take a look at how rates compare this month to last month

| | Short-term AFR | Mid-term AFR | Long-term AFR | 7520 | LIBOR | Prime |
|---|---|---|---|---|---|---|
| **February '23** | 4.47% | 3.82% | 3.86% | 4.60% | —* | —* |
| **January '23** | 4.50% | 3.85% | 3.84% | 4.60% | 5.44% | 7.50% |

*February LIBOR and Prime rates not available based on publication date of this CI.

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