WEALTH MANAGEMENT INSIGHTS

SECURE Act 2.0: Implications for Retirees and Retirement Savers

Schwab Center for Financial Research

Rob Williams, CFP®, CPWA®
Managing Director

Hayden Adams, CPA, CFP®
Director

Key Takeaways

- SECURE Act 2.0, signed into law Dec. 29, 2022, makes numerous changes that impact retirement savers and retirees.
- The new law raises the RMD age, increases retirement plan catch-up contributions, and provides enhancements to workplace retirement plans, along with many other changes.
- Below is an overview of the law's key provisions and possible implications for retirees, retirement savers, and their advisors.

Overview

In the final days of 2022, Congress passed a massive 4,155-page spending package that included SECURE Act 2.0, providing numerous improvements to retirement savings and distribution rules. For retirees and retirement savers, here are the law's key provisions and potential implications:

RMD age increases.

The age when retirees must begin drawing from tax-deferred retirement accounts increased from 72 to 73, effective Jan. 1, 2023. In 2033, the RMD age will increase again to 75.

Note: *Based on our current understanding, if you turned age 72 in 2022, you must take a RMD for 2022. If you did not take a RMD before Dec. 31, 2022, you have until April 1, 2023 to do so, but keep in mind you will also have to take your 2023 distribution this year, effectively creating two RMDs for 2023.*

Potential implication: This age increase provides flexibility to delay retirement distributions and invest longer. The increased flexibility may be helpful for some people. However, not all retirement savers, in our view, will benefit from deferring taxes to a later age. Delaying distributions for many retirees could result in larger distributions, and higher taxes overall, including a potential sudden jump at RMD age into a higher tax bracket.

We encourage retirees to work with a financial planner or advisor to create a retirement income and distribution plan and potentially smooth out their taxes by taking distributions from retirement accounts based on their tax bracket and potential tax bill.

Catch-up retirement contribution limits increase.

Beginning in 2025, the law will also allow workers aged 60 through 63 to make a larger catch-up contribution to certain retirement plans. For qualified plans, such as a 401(k) and 403(b), the additional limit will be 150% of whatever the regular catch-up amount is for a given year or $10,000—whichever is greater. For SIMPLE plans, the additional limit will be 150% of whatever the regular catch-up amount is for a given year or $5,000—whichever is greater. In addition, starting in 2024, all catch-up contribution limits will be indexed to inflation, including IRA catch-up contributions.

Potential implication: This change will allow older workers, particularly those who may be behind on their retirement savings, to make larger contributions to their tax-advantaged retirement accounts. Combined with an extension of the RMD age, investors could use the additional time to increase retirement savings and defer taxes.

Roth accounts become more prominent.

Prior to SECURE Act 2.0, catch-up contributions were allowed on a pre-tax basis (tax-deferred accounts) or after-tax basis (Roth accounts). Beginning in 2024, individuals with compensation over $145,000 (indexed to inflation) will only be able to make catch-up contributions to Roth accounts.

Effective in 2023, employers will also be allowed to match employee contributions to qualified retirement plans on a pre-tax or after-tax basis, where in the past they were only allowed to make pre-tax contributions. In addition, SEP and SIMPLE IRAs will be allowed to be designated for Roth contributions, when in the past this was not allowed.

Potential implication: This provision enhances the role of Roth accounts in retirement planning. If you believe you'll be in a higher tax bracket in retirement then you are now, this could be a good change. However, for some people with higher incomes, the catch-up contribution rules could mean they are forced to pay taxes at a higher rate today by converting to a Roth account when a tax-deferred account could make more sense from a tax perspective. This makes meeting with a wealth advisor more important than ever to ensure that contributions and distributions are made in the most tax-efficient manner possible.

Student loan payments get employer matching into a 401(k).

The new law allows employers, beginning in 2024, to treat qualified student loan payments as elective income deferrals for the purpose of an employer-matching contribution, making the choice between paying off student loans and participating in an employer-sponsored retirement plan easier for plan participants.

Potential implication: For those juggling large student loan debts and expenses, this provision could be a great benefit. Individual contributions into a 401(k), no matter how small, can add up over time, thanks to the power of compounding.

Qualified Longevity Annuity Contracts (QLACs) get a boost.

Prior to SECURE Act 2.0, the maximum that could be put into a QLAC was either $135,000 or 25% of the value of your retirement accounts, whichever was less. Beginning in 2023, the new law removes the 25% limit and increases the allowable QLAC amount to $200,000 (indexed to inflation).

> The RMD age increase provides flexibility to delay retirement distributions and invest longer. This may be helpful for some people. However, not all retirement savers, in our view, will benefit from deferring taxes to a later age.

Potential implication: Living longer than expected (longevity risk) is one of the main purposes of purchasing an income annuity. A QLAC, which is a way to purchase a deferred income annuity using retirement savings tax-efficiently, can help those who want to insure against longevity risk but want to wait until their mid-80s to tap into it.

The Qualified Charitable Distribution (QCD) limit increases.

A QCD allows IRA owners age 70½ and older to donate up to $100,000 each year to qualified charities through a non-taxable distribution from their IRA. The new law indexes the current $100,000 annual limit for inflation starting in 2024. In addition, beginning in 2023, the law allows a one-time QCD of $50,000 to charities via a charitable gift annuity, charitable remainder unitrust, and charitable remainder annuity trust.

Potential implication: This provision increases the opportunity to use QCDs to cover RMDs and help a good cause in the process. Though a QCD can be a good option for making charitable donations, those who are charitably inclined should consider meeting with a tax professional before initiating a QCD, since in certain situations giving appreciated assets could be the better option from a tax perspective.

Other changes:

- Effective Jan. 1, 2023, the 50% penalty for failing to take RMDs is cut to 25%. In addition, if the RMD issue is corrected in a timely fashion, the penalty is further reduced to 10%. (The law does not specifically define "timely" fashion.)

- From 2024 onward, there will no longer be a Roth 401(k) RMD for the original account owner.
- Improved coverage of long-term part-time workers in employer retirement plans.

Bottom line

SECURE Act 2.0 includes several provisions that could potentially help savers and retirees. It expands and encourages retirement savings through IRAs and qualified plans. As we consider what new opportunities this law offers for retirement savings in the future, take the time to assess where you stand today. Connect with a financial professional who can help you review your current strategy and discuss if any changes are appropriate.

The increase in catch-up contributions will allow older workers, particularly those who may be behind on their retirement savings, to make larger contributions to their tax-advantaged retirement accounts.

Rob Williams, CFP®, CPWA®

As Managing Director of Financial Planning, Retirement Income, and Wealth Management for the Schwab Center for Financial Research, Rob leads a team that develops research, insights, methodology, and training for Schwab clients, representatives, and advisors. These focus on financial planning and wealth management across an investor's life cycle, including saving for, preserving, and distributing assets in retirement.

Hayden Adams, CPA, CFP®

As Director of Tax and Financial Planning for the Schwab Center for Financial Research, Hayden provides analysis and insights on topics including income tax planning, tax-smart investing, asset allocation, and retirement withdrawal strategies for a range of Schwab clients and advisors.

Important disclosures

The policy analysis provided by the Charles Schwab & Co., Inc., does not constitute and should not be interpreted as an endorsement of any political party.

The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision.

All expressions of opinion are subject to change without notice in reaction to shifting market or economic conditions. Data contained herein from third party providers is obtained from what are considered reliable sources. However, its accuracy, completeness or reliability cannot be guaranteed.

Examples provided are for illustrative purposes only and not intended to be reflective of results you can expect to achieve.

This information does not constitute and is not intended to be a substitute for specific individualized tax, legal, or investment planning advice. Where specific advice is necessary or appropriate, Schwab recommends consultation with a qualified tax advisor, CPA, financial planner, or investment manager.

Roth IRA conversions require a 5-year holding period before earnings can be withdrawn tax free and subsequent conversions will require their own 5-year holding period. In addition, earnings distributions prior to age 59 1/2 are subject to an early withdrawal penalty.

Annuity guarantees are subject to the financial strength and claims-paying ability of the issuing insurance company.

Investing involves risk, including loss of principal.

This material is approved for retail investor use only when viewed in its entirety. It must not be forwarded or made available in part.

The Schwab Center for Financial Research (SCFR) is a division of Charles Schwab & Co., Inc.

The Charles Schwab Corporation provides a full range of brokerage, banking and financial advisory services through its operating subsidiaries. Its broker-dealer subsidiary, Charles Schwab & Co., Inc. (member SIPC), offers investment services and products, including Schwab brokerage accounts. Its banking subsidiary, Charles Schwab Bank (member FDIC and an Equal Housing Lender), provides deposit and lending services and products. Access to Electronic Services may be limited or unavailable during periods of peak demand, market volatility, systems upgrade, maintenance, or for other reasons.

SCFR 0123-30LX

Brokerage Products: Not FDIC Insured ▪ No Bank Guarantee ▪ May Lose Value

charles
SCHWAB

Own your tomorrow.