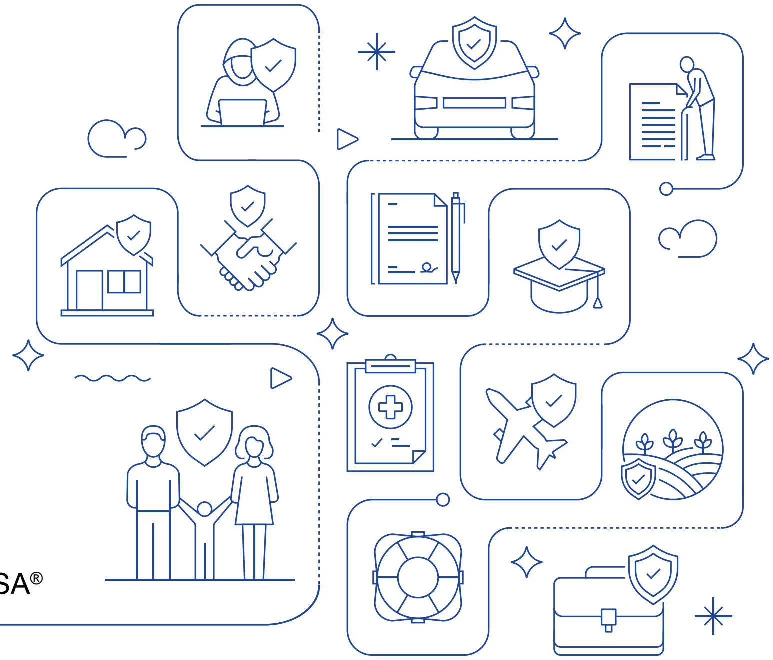

Stay Ahead of the Curve – What's New for 2024

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With many retirement-related changes over the last four years, it's a small wonder that you may find it challenging to keep up. The most impactful of the original SECURE was the wipeout of the stretch for most non-spousal beneficiaries to a less-than-desirable 10-year payout period; the upside was that the long-familiar 70 ½ required minimum distribution start date for traditional IRAs and for most qualified plan participants was pushed back to age 72. But then came the son of SECURE. Less unsettling in terms of potential strategy pivots than the repeal of the stretch but more daunting in the number of retirement-related provisions (92, to be exact), the challenge for financial and tax professionals is keeping up with the effective dates. Spanning from pre-Act to 2028, its reach spans almost a decade.[1]

As with any significant piece of retirement legislation, ambiguity in language generally leads to a need for clarification in the form of future IRS guidance. Fortunately, guidance has come in some areas, leaving others awaiting clarification. This month's article highlights what hit the docket in 2024 that may impact your planning strategies with the clients you serve while providing insight into the clarification we have gotten thus far from the IRS regarding gray areas. This edition is designed to keep you informed while providing a reason to reach out to ensure your clients take advantage of newly available strategies to better prepare for and navigate retirement. As always, ensure you're partnering with your clients' tax and legal advisors regarding their specific situations.

So, what's new for 2024? Here are the highlights.

Roth-Related Changes

529-to-Roth Rollovers: Undoubtedly one of the most often-asked-about provisions of SECURE 2.0, this provision became effective on January 1, 2024. But not without some ambiguity that still awaits clarification. Here is what we do know:

1. A maximum of $35,000 may be rolled to a Roth IRA per 529 beneficiary in a lifetime (note: it appears to be per beneficiary, so a parent with 529 plans set up for multiple children should be able to execute Roth IRA rollovers per child).
2. The 529 must be open for at least fifteen years; however, it is unclear whether changing beneficiaries of the 529 plan or moving to a new 529 plan would reset the fifteen-year period.
3. Contributions and earnings on those contributions within the last five years may not be rolled into a Roth IRA.

4. Rollovers are subject to the annual contribution limit and are offset by any Roth or Traditional IRA contributions made for the same calendar year. For example, a 529 beneficiary who makes a $3,500 IRA contribution in 2024 may only roll $3,500 from his 529 in 2024 to not exceed the $7,000 limit.
5. The 529 plan beneficiary must have compensation in any year a 529 plan to Roth rollover is executed, but no income limit applies to prohibit the rollover.

Bottom Line: This provision offers a salvage technique for clients with unused 529 plan savings accounts to avoid paying income tax and a 10% withdrawal penalty on the earnings.[2]

No More RMDs for Designated Roth Accounts: Before 2024, designated Roth accounts in qualified retirement plans mandated that lifetime Required Minimum Distributions (RMDs) be taken from Roth accounts, including 401(k) and 403(b) s. However, this requirement has been eliminated, ensuring parity with Roth IRAs, which have never required lifetime RMDs. This change removes the need to roll designated Roth accounts to Roth IRAs, as was required to circumvent the pre-2024 RMD obstacle.

Enhancements to 10% Early Withdrawals

"Personal Emergency" Withdrawal: This year, SECURE 2.0 adds a new exception to the 10% early withdrawal list of exceptions for an expense to meet "unforeseeable or immediate financial needs relating to personal or family emergencies."[3] The maximum allowable withdrawal is $1,000 and is limited to one per calendar year. Further, no such withdrawal may be made for three years unless the prior withdrawal has been repaid or subsequent contributions to the IRA or plan of at least the amount of the prior emergency withdrawal has been made back to the plan. Note that employers are not required to permit emergency withdrawals.

Bottom Line: The nature of the emergency seems very loose in definition and requires no certification, making it easy to qualify for but also nominal at only $1,000.

"Pension-Like Emergency Savings Accounts": Not to be confused with the above-mentioned personal emergency withdrawals, Section 127 of SECURE 2.0 adds an opportunity for short-term savings accounts to be linked to retirement plans such as 401(k) and 403(b) plans with a maximum limit of $2,500 for non-highly compensated employees only. Contributions must be made on a Roth basis, and withdrawals are exempt from the 10% early withdrawal penalty. Implementation of these accounts is at the employer's discretion.

Domestic Violence Exception: Victims of domestic abuse (occurring within 12 months of the withdrawal) by a spouse or domestic partner, defined as "physical, psychological, sexual, emotional, or economic," may withdraw up to $10,000 or 50% of the vested account balance (in the case of a defined contribution plan) or an IRA. The withdrawal may be repaid within three years, and the victim may self-certify as eligible for such distribution.[4]

72(t/q) Partial Transfers/Rollovers Permitted: Before 2024, a partial transfer or exchange of an IRA or non-qualified annuity currently under a series of substantially equal series of periodic payments (SOSEPP) would have been considered a modification and triggered a retroactive assessment of the penalty plus interest. Section 323 clarifies that a partial transfer, rollover, or 1035 exchange will not constitute a modification if the "aggregate distributions from the contracts continue to satisfy the requirements" of the SOSEPP.

Plan-Related Changes

Additional SIMPLE Plan Employer Contribution Permitted: In addition to the standard match of up to 3% of pay or 2% non-elective contribution, employers are permitted to contribute the lesser of 10% of employee compensation or $5,000 (indexed).[5]

Increased Limits for Some SIMPLE Plans: For employees with 25 or fewer employees who received $5,000 in compensation in the preceding calendar year, the annual deferral limit is increased to 110% of the 2024 limit, including the catch-up contribution. For example, a 55-year-old participant, Susan, may contribute a maximum of $21,450 in 2024, 10% above the regular deferral limit of $16,000 plus the age 50 catch-up contribution of $3,500. An employer with 26-100 employees can provide the higher deferral limits only if the employer matches at 4% or makes a 3% nonelective contribution.[6]

Mid-Year Switch from SIMPLE to Safe-Harbor: Employers can replace a SIMPLE plan with a safe-harbor 401(k) mid-year with pro-rated limits based on the switch date. Before this provision, a SIMPLE plan could be the only plan offered by an employer. The provision also lifts the 2-year penalty tax that would otherwise apply to a rollover into a 401(a) or 403(b) plan if the switch is made.

Student Loan Matching Program: A qualified student loan payment made by an employee in repayment of a qualified education loan may be treated as an elective deferral, subject to the plan limitations, and may be used for employer matching contributions. The employer may rely on the employee's annual certification that such loan repayments have been made.[7]

IRS Issues Notice 2024-02 to Clarify Some Gray Areas

As mentioned, with 92 provisions, it's no surprise that some provisions left gray areas needing IRS clarification. IRS recently released IRS Notice 2024-02 to address some, but certainly not all, of these areas.

Clarification on Terminal Illness Exception: A new exception to the 10% early withdrawal penalty for terminal illness under SECURE 2.0 became effective in 2022. Terminal illness under the Act is defined as an illness "reasonably expected to result in death within 84 months". No limit is placed on the amount that can be withdrawn from a workplace retirement plan or IRA, and the funds can be repaid within three years.

Notice 2024-02 clarifies that the physician who certifies the terminal illness must be a Doctor of Medicine or Osteopathy legally authorized to practice medicine in the state and must include a narrative describing the condition and the expectation of death within seven years. The Notice clarifies that an employer is not required to offer the terminal illness withdrawal under the plan's terms; however, an employee may use an in-service financial hardship withdrawal and file for an exception to the 10% penalty by filing an IRS Form 5329. The same form may be used to apply the exception to an IRA distribution used for terminal illness that is not already coded as an exception to the penalty on the IRS Form 1099-R.

Roth SEP and SIMPLE IRAs Reporting and Model Documents: SECURE 2.0 made several Roth-related changes, including a widely discussed provision allowing Roth contributions to both SEP and SIMPLE IRAs, effective in 2023. However, because many questions regarding proper implementation remained without formal guidance, it is unlikely that employers took advantage of the Roth versions in 2023. The Notice clarifies that employers may use the current IRS model plan documents for Roth contributions until the IRS can amend the current versions adding Roth language.

The Notice also confirms that a Roth salary reduction contribution made to a SIMPLE IRA on behalf of an employee should be reported on the employee's W-2 as wages in the year that the contribution would have otherwise been received as income. The deferral is subject to FICA and FUTA, just like a pre-tax elective deferral. A Roth employer contribution to either a SEP or SIMPLE IRA is included in the employee's income for the taxable year in which the contribution is made to the Roth SEP or Roth SIMPLE IRA, even if intended for another tax year. For example, if a Roth SEP contribution is made for 2023 by April 15, 2024, the contribution is includible as income in 2024, despite the contribution being made for 2023. Further, employer matching or nonelective contributions must be reported on IRS Form 1099-R by the IRA custodian and are taxable to the employee in the year they are contributed.

To read more about these and other guidance issued in Notice 2024-02, visit https://www.irs.gov/pub/irs-drop/n-24-02.pdf.

The Jury is Still Out – Post-Death Confusion

While the Notice clarified some outstanding questions, the guidance was far from comprehensive. Further guidance will be required to continue to shed light on gray areas. Notably absent was any discussion of whether the 10-year rule for beneficiaries of decedents dying after their required beginning date would need to comply with the "at least as rapidly rule" in years 1-9 before liquidating the inherited account by 12/31 of the 10th year. The IRS has waived RMD failure penalties for beneficiaries impacted by the conflicting language through 2023. And so, we wait to see what 2024 will bring.

SECURE 2.0 also added another spousal beneficiary option to the mix for deaths after 2023. Before 2024, spousal beneficiaries had essentially two options:

1. Perform a spousal rollover and treat the IRA as the surviving spouse's own IRA, taking future RMDs based on the surviving spouse's age using the Uniform Lifetime Table. This is the most often-used option.

2. Treat the deceased spouse's IRA as an Inherited IRA, with the ability to delay RMDs until the deceased spouse would have reached his/her required beginning date (RBD). RMDs to the surviving spouse would be based on the single life expectancy table using the surviving spouse's age. Choosing the Inherited IRA option would generally be used to avoid either the 10% early withdrawal penalty for a young widow or widower or to delay required distributions in the case of an older surviving spouse wanting to delay income.

3. Beginning for deaths in 2024 or later, if Option #2 is chosen (the Inherited IRA route), the surviving spouse must make an election to delay RMDs to when the deceased spouse would have reached his/her RBD and then would use the age of the deceased spouse and the Uniform Lifetime Table to calculate those RMDs. If no election is made, it appears the way the provision is written that withdrawals must begin the year following death, the same as a non-spousal eligible designated beneficiary.

Whether this new spousal election was intentional or ran afoul is anyone's guess. The 10-year rule is now four years in the rearview mirror, yet ambiguity remains; this alone speaks to the complexity of a constantly evolving retirement landscape that challenges every financial service professional to keep up. This is a critical time for those preparing for and navigating retirement and the financial professionals who serve them. Opportunities abound to take advantage of strategies available in 2024 and beyond and avoid pitfalls by getting ahead of changes that could potentially impact present and future retirement strategies.

We will continue to highlight these changes and updates as we receive them so that you can better serve your customers. If you have any questions about this content or a client or prospective client, please contact us. We are here to help you!

Sources:

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