Episode 121: Secure Act 2.0

Patti Brennan: Hi, everybody. Welcome to "The Patti Brennan Show." Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Today's episode is part of the #AskPattiBrennan series. This series is really for those of you who may have questions. These are the questions that people are asking us over and over again, and every once in a while, we throw in an episode with questions that people aren't asking us, but probably should.

Today, we're going to be talking about a law that was just passed at the end of 2022, and nobody's talking about it. It's really important because it's going to affect everyone's retirement planning. By the way, it's got a lot of nuggets in there in other areas as well. As I begin, I first and foremost want to give credit to Jeff Levine who wrote a piece for Michael Kitces.

Michael Kitces is one of those people in our industry that many of us just go to. He's got a great website. Advisors, professionals log onto the Kitces website to get the content that we all need. Jeff Levine wrote a piece, 35-page blog, all on the Secure Act 2.0.

Today, I'm just going to hit some of the highlights. My notes are four pages, I'm not going to hit all of them, but I will address the things that I think you might want to hear about.

First and foremost, the headline change because of this new law is that anyone or everyone who is subject to required minimum distributions now has a whole new set of rules.

First and foremost, for those people who were born after 1960, you do not have to start taking RMDs at age 72, you can wait until age 75. Those people who were born in the decade prior have to start taking RMDs at age 73. That's the headline change you may have heard that, really important for everybody to know.

There are a significant number of changes as it relates to surviving spouses. The old rule is when a spouse dies, that IRA or that 401(k) is automatically rolled over into the surviving spouse's name. We don't do that anymore. There is now an analysis that needs to be made to determine whether or not that should be put into a separate IRA that it would be subject to a whole different set of rules.

It really has impact on the beneficiaries of that IRA. For example, instead of being subject to the 10-year rule, if we do this right, they may be able to take distributions out over their entire lifetime. For those of you who may have grandchildren, that's a big deal. A lot of changes.

A lot of changes as it relates to Roth. For those of you who may earn over $145,000 per year, and you want to do the catch-up contribution, well, good news, bad news. You can do the catch up contribution, but it must go into a Roth. What if your company doesn't offer the Roth? You're off the hook. You can only do with it what you can. It's a very interesting part of this law in terms of what you’re able to do, or what you should do.

Now, I'm going to throw two words at you, optional and optimal. Going forward, company matches can now go into the Roth account. Prior law was all company matches had to go into a pre-tax account so now you have the option, but optional does not mean optimal.

Doesn't mean everybody listening to this podcast should be doing that Roth option. In many cases, that is not in your best interest. Talk to your advisor and have them run the numbers to determine what's going to be better for you. That's all that really matters. That's an important change.

The other thing is, same thing goes with SEP plans and SIMPLE plans. For those of you who maybe self-employed, these are neat, little retirement accounts that you can set up for yourself, very low cost, very easy, almost no record keeping. You can now set these plans up, and do it as a Roth, as well. Again, it's not a recommendation, you should first talk to your advisor. It's just nice to have that option.

Here's a little nugget that no one was expecting. For those of you who may have young children or older children, a lot of people are worried about how to fund college education. We talk about 529 plans.

529 plans are a fantastic option for people to save for college. The downside is you don't want to overfund it because if it's not used for college, there's a 10 percent penalty and the gains are taxed at ordinary income, which is much higher typically than capital gains. There's a downside to overfunding a 529.

The nugget that was in the Secure Act 2.0 is that if there is a residual balance in a 529 plan, that money can be distributed into a Roth IRA tax-free, no penalty for that beneficiary. That's pretty cool. Now this account is subject to that $6,500 per year limit in terms of Roth IRA contributions, but at least you're not getting penalized for being a good saver for college. Keep that in mind.

Now, I'm thinking, "Wow, this is a great option. How about we just throw bunch of money into a 529 plan, and then put it into a Roth?" Congress is one step ahead of me and you. You can't do that.

What they also said in this law is that contributions within the last five years and those earnings are ineligible to go into the Roth. We’ve got to be careful. One important caveat to this provision is that the 529 plan had to have been in existence for 15 years. For families, younger families with young children, you may not have much money to fund a 529 plan. Doesn't matter. Open it up anyway because that starts the 15-year clock. Always keep in mind that anybody can add money to a 529 plan, but again, you want to get that clock started.

Now, the one thing that's a little disappointing is that there is a lifetime max of $35,000. The most you can move from the 529 into a Roth IRA is $35,000. Kind of wish it was higher, wish it was indexed for inflation. I will also say that if it's done right over a young child's lifetime, a baby's lifetime, you'd be shocked at the compounding that can occur. That can grow into a million-dollar account.

Now it might buy a loaf of bread, by then, it's still a million bucks that that child wouldn't have had had you not done all that.

As I alluded to before, there are a ton of changes that really have an impact on the planning that is done for surviving spouses. I'm not going to go into all the nitty gritty details because there are a lot of them.

I just want to raise that flag for all of you listening. There may be times -- whether you have an advisor or you don't -- when it might sense to an have extra set of trained eyes to take a look at everything. This would be one of those times. This would be a catalyst. Certainly at the first step, sit down with a qualified attorney, a great accountant, and maybe a financial advisor.

It may not sound like a big deal, but the catch-up contribution is now indexed for inflation. There is a weird provision that comes into play in 2025 that allows people who are ages 60, 61, 62, and 63 to have that catch up contribution limit increased to $10,000. That's a big deal.

What Congress is trying to do is for those people and those families who may be feeling a bit behind in their retirement planning to give those people an incentive, an opportunity to start stashing money even though they might feel like it's too late.

I'm here to tell you guys, it is never too late. I've been doing this for over 30 years. It is never, ever too late. There's always something that can be done. Don't give up. Just get good advice. Be real about things. There's always a solution. By the way, Congress is trying to give you some of those solutions themselves.

Under current law, ABLE accounts for those people who are disabled can be established for people who were disabled before the age of 26. It's kind of a funky law, and these are really attractive accounts in the right situation, but age 26, what about everybody else who may be disabled? That's a really difficult thing for anyone, or parents, or family members.

Long story short, they are changing the age where you can set up an ABLE account starting in the year 2026. This is one of these things we just got to keep on top up to age 46. There is a little bit of relief, and there are limits to ABLE accounts. I'm not going to go through all the nitty gritty details. Just again I'm giving you a couple of flags to wave to say if this applies to you, talk to somebody.

I would say to all of you that probably as important as the things were included in Secure Act 2.0 were some of the things that were omitted. Things that Congress warned were going to be in this new law and weren't. They are significant for most of you who are listening and watching today.

For example, the Secure Act 2.0 did not limit the use of a backdoor Roth. This is a big deal. It doesn't matter how much money you make, you can make a contribution to an after-tax IRA, leave it in the account and then immediately convert it into a Roth IRA. A lot of people depending on your income level, can't do Roth IRA contributions mostly because they have an available 401(k).

Now, everyone can have a Roth. If you are interested in saving for retirement, I will also tell you a Roth IRA is probably the best thing that you can leave to the next generation. Think about funding an after-tax IRA and doing the backdoor Roth. They did not place any limits on who can do a Roth conversion.

You could be one of those people who are making $3 million a year, and if you have an IRA or a 401(k) and you want to convert it into something that grows tax-free, have at it. You're welcome to do it. In many cases, that makes a lot of sense.

Again, talk to your professionals, your tax advisor, your financial advisor because that creates a taxable event in the year of the conversion, and ideally you want to take that tax money out of other funds. That's where it's a real home run.

A Roth conversion is a wonderful tool also for those of you who want to leave a legacy. It's one of the best things that you can give to the next generation.

The other thing that was omitted, that Congress has been talking about, are for those people who have certain balances in their retirement accounts, and those balances have just grown and grown and grown to significant seven-plus figure amounts.

There was a proposal, that would have required balances in excess of a certain amount to be distributed out. That's it, you're done. That was not included in this law and I'm so happy that it wasn't because it really penalizes people who were good savers and good investors. Was it included? Probably won't be, based off of what I'm hearing behind the scenes.

They did not change the age where you can do QCDs. For those of you who are charitably inclined and want to start doing that before the age of 72, you can still do it at 70 and a half.

Probably the most significant and important omission in the Secure Act 2.0 was no clarity regarding how inherited IRAs are supposed to be distributed using the 10-year rule. Let me explain to you why that's so important.

Under current law, when someone inherits a retirement account, whether it's an IRA, a 401(k), a Roth, or regular - that account has to be distributed within 10 years, but there was no direction in terms of, "OK, do we have to take out 1/10th per year? Do we have to take it out based on a particular formula?" No formula. No nothing.

All year long, Congress was talking about putting that prevision in the Secure Act 2.0 and waiving the penalties on those people who didn't take out any money the first two years because again, Secure Act 2.0 was passed a couple of years ago.

People have received their inherited IRAs may not have needed or wanted the money, and didn't want to pay the tax on it. They just left it there with the understanding that as long as it was drained out of the account within that 10-year period of time, they're golden, they're fine. IRS didn't like that. They want people to start taking that money out over a period of time.

It was very surprising that there was absolutely no direction given to those people or their advisors in terms of what they need to do to comply with the law. At this point, we are still waiting for the instruction. Given the fact that we don't have any, we're taking it on a case-by-case basis.

For example, in some cases it may make sense not to take any money out because that individual is going to retire in five years. The first five years of their retirement, we'll just go to the inherited IRA first, and get it out within that 10-year period of time. There are lots

of different ways to apply the prior law, but make it customized that really works in your situation.

We were worried, we were thinking that we were not going to be able to do that anymore. We're going to continue to do that until we're told otherwise.

That is the most important thing I think I want to share with you is that each one of you watching and listening is unique. You're a snowflake. What's going to work for you? What are your goals? What's important to you about your money? What do you want to have happen? What do you need to have happen?

Then, you construct realistic prudent strategies that can work over time. Do they work every time? Maybe not. Work over time because you know what? It's called planning for a reason. It's a verb. It's not a noun. It's not something that you set and forget, and never look at anymore because as we are learning today, there are new laws that are passed that are going to impact your situation.

Again, some of this is optional, but we are all looking for optimal.

I'm Patti Brennan, Key Financial Wealth Management With Wisdom & Care. Thank you so much for tuning in today's show. If you have any questions, log onto our website at keyfinancialinc.com.

Again, I really appreciate your time, your energy, and for all of you who continue to watch and share these podcasts with the people that you care about most. Take care, have a great day.