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SECURE 2.0 may affect your retirement and estate plans

The original Setting Every Community Up for Retirement Enhancement Act (SECURE Act), enacted in 2019, was a significant law related to retirement savings. In the spring of 2022, with an eye toward building on the reforms in that law, the U.S. House of Representatives passed the Securing a Strong Retirement Act. Despite strong bipartisan support, the bill stalled. Then, the U.S. Senate introduced its own retirement legislation, dubbed the Enhancing American Retirement Now Act.

SECURE 2.0 incorporates provisions from both bills and includes sweeping changes for qualified plans and IRAs — some already in effect — including these aspects with significant estate planning implications.

RMDs

The first SECURE Act generally raised the age at which you must begin to take required minimum distributions (RMDs) — and pay taxes on them — from traditional IRAs and other qualified plans, from 70½ to 72. SECURE 2.0 increases the age to 73, starting January 1, 2023, which applies to those born in 1951 or later. And beginning January 1, 2033, the age increases to 75, which applies to those born in 1959 or later. This change allows people to delay taking RMDs and paying tax on them.

The penalty for failing to take timely RMDs was severe. Under prior law, you had to pay 50% of the required amount (less any amount actually withdrawn). SECURE 2.0 cuts it to 25% of the amount due, beginning in 2023. Even better: The penalty is reduced to 10% if you pay up within two years of the due date.

Catch-up contributions

The tax law already provided a boost to retirement savings late in life through the "catch-up contribution" provision for most defined contribution plans. Notably, an individual age 50 or older can make a catch-up contribution, up to a specified annual limit, in addition to a regular contribution.

For example, the regular 401(k) plan contribution limit for 2023 is $22,500. And the catch-up contribution limit is $7,500 for a maximum total of $30,000. But some retirement-savers can boost contributions still further under SECURE 2.0.

The law also changes the taxation of catch-up contributions, as of January 1, 2024, which could reduce the upfront tax savings for those who max out their annual contributions. Catch-up contributions will be treated as post-tax Roth contributions. Previously, you could choose whether to make catch-up contributions on a pre- or post-tax basis. An exception is provided for employees whose compensation is $145,000 or less (indexed for inflation).

Further, beginning January 1, 2025, individuals who are ages 60 to 63 can make catch-up contributions to 401(k) plans and SIMPLE plans up to the greater of $10,000 or 50% more than the regular catch-up amount. The increased amounts are indexed for inflation after 2025.

Qualified charitable distributions

Individuals age 70½ or older can take advantage of special tax rules for qualified charitable distributions (QCDs). Briefly stated, you can transfer up to $100,000 directly from your IRA to a 501(c)(3) charity with no tax consequences. In other words, a transfer of up to $100,000 is tax-free, but the donation isn't deductible. That doesn't matter if you're claiming the standard deduction instead of itemizing.

The $100,000 limit for QCDs applies to each individual. Thus, a married couple can transfer up to $200,000 tax-free. Best of all, QCDs count toward RMD obligations.

Now, under the new law, you can also make a one-time QCD transfer of up to $50,000 through a charitable gift annuity or charitable remainder trust (as opposed to directly to the charity). The law also indexes for inflation the annual IRA charitable distribution limit of $100,000.

Hardship distributions

Normally, you owe a penalty tax if you take distributions from a qualified plan or IRA prior to age 59½, unless you qualify for a special tax law exception (e.g., distributions due to a disability). The penalty is equal to 10% of the amount withdrawn on top of the regular income tax on a distribution.

However, beginning in 2024, SECURE 2.0 authorizes a penalty-free withdrawal of up to $1,000 a year for an unforeseeable or immediate financial need relating to personal or family emergencies. The distribution may be repaid within three years and subsequent distributions are banned until repayment is made.

Finally, the new law gives plan participants an opportunity to contribute to an emergency savings account (ESA) up to a maximum of $2,500, beginning in 2024. ESA contributions are made via a Roth contribution. The first four withdrawals per plan year aren't subject to any charges and unused amounts are portable.

Time for a review

With the many changes under SECURE 2.0, you shouldn't waste any time reviewing your retirement and estate plans and revising them as needed. Your estate plan advisor can help you understand what needs to be revised. •

More Highlights of SECURE 2.0

Here are a few additional key provisions of SECURE 2.0 not addressed in the main article:

- A surviving spouse of a plan participant can elect to be treated as an employee for required minimum distribution purposes.
- Employees must be automatically enrolled in qualified plans adopted after 2024, subject to limited exceptions.
- Employers may elect to provide matching 401(k) plan contributions based on student loan obligations.
- The retirement-saver's credit is replaced, effective after 2026, with a 50% government match of up to $2,000.
- Unused funds in a Section 529 account can be rolled over into a Roth IRA, up to a lifetime cap of $35,000, without tax or penalty.
- An employer may offer small financial incentives (such as gift cards) to increase employee participation in retirement plans.
- The government will create a "lost and found" database for retirement accounts.

Glossary of estate planning terms

Estate planning has a language of its own. While you may be familiar with common terms such as a will, a trust or an executor, you may not be as certain about others. For quick reference, here's a glossary of terms you're likely to come across in your estate planning documents.

Administrator: An individual or fiduciary appointed by a court to manage an estate if no executor or personal representative has been appointed or the appointee is unable or unwilling to serve.

Ascertainable standard: The legal standard, typically relating to an individual's health, education, support and maintenance, that's used to determine what distributions are permitted from a trust.

Attorney-in-fact: The individual named as the agent under a power of attorney to handle the financial and/or health affairs of another person.

Codicil: A legally binding document that makes minor modifications to an existing will without requiring a complete rewrite of the will.

Community property: A form of ownership in certain states in which property acquired during a marriage is presumed to be jointly owned regardless of who paid for it.

Credit shelter trust: A trust established to bypass the surviving spouse's estate to take full advantage of each spouse's federal estate tax exemption. It's also known as a bypass trust or A-B trust.

Fiduciary: An individual or entity, such as an executor or trustee, designated to manage assets or funds for beneficiaries and is legally required to exercise an established standard of care.

Grantor trust: A trust in which the grantor retains certain control so that it's disregarded for income tax purposes and the trust's assets are included in the grantor's taxable estate.

Inter vivos: The legal phrase used to describe various actions (such as transfers to a trust) made by an individual during his or her lifetime.

Intestacy: If a person dies without a legally valid will, the deceased's estate is distributed in accordance with the applicable state's intestacy laws.

Joint tenancy: An ownership right in which two or more individuals (such as a married couple) own assets, often with rights of survivorship.

No-contest clause: A provision in a will or trust that ensures that an individual who pursues a legal challenge to assets will forfeit his or her inheritance or interest.

Pour-over will: A will used, upon death, to pass ownership of assets that weren't transferred to a revocable trust.

Power of appointment: The power granted to an individual under a trust that authorizes him or her to distribute assets on the termination of his or her interest in the trust or on certain other circumstances.

Power of attorney (POA): A legal document authorizing someone to act as attorney-in-fact for another person relating to financial and/or health matters. A "durable" POA continues if the person is incapacitated.

Qualified disclaimer: The formal refusal by a beneficiary to accept an inheritance or gift or to allow the inheritance or gift to pass to the successor beneficiary.

Qualified terminable interest property (QTIP): Property in a trust or life estate that qualifies for the marital deduction because the surviving spouse is the sole beneficiary during his or her lifetime. The assets of the QTIP trust are therefore included in the estate of the *surviving* spouse, that is, the spouse that is the beneficiary of the trust, not the estate of the spouse that created the trust.

Probate: The legal process of settling an estate in which the validity of the will is proven, the deceased's assets are identified and distributed, and debts and taxes are paid.

Spendthrift clause: A clause in a will or trust restricting the ability of a beneficiary (such as a child under a specified age) to transfer or distribute assets.

Tenancy by the entirety: An ownership right between two spouses in which property automatically passes to the surviving spouse on the death of the first spouse to die.

Tenancy in common: An ownership right in which each person possesses rights and ownership of an undivided interest in the property.

Keep in mind that this is just a brief roundup of several key estate planning terms. If you have questions about their meanings or others, contact your estate planning advisor. •

Does your estate plan account for generation-skipping transfer tax?

Does your estate plan call for making gifts to your grandchildren or other loved ones more than one generation below you? Or, perhaps to nonrelatives more than 37½ years younger than you? If so, your plan must address not only gift and estate tax, but also generation-skipping transfer (GST) tax. Beware: The GST tax is among the harshest and the most misunderstood and complex in the tax code.

Understanding the GST tax exemption

The GST tax enjoys an annual inflation-adjusted lifetime exemption in the same amount as the lifetime gift and estate tax exemption (currently, $12.92 million). However, the GST tax works a bit differently. For example, while the gift and estate tax exemption automatically protects eligible transfers of wealth, the GST tax exemption must be allocated to a transfer to shelter it from tax.

The tax code contains automatic allocation rules designed to prevent you from inadvertently losing the exemption, but it's dangerous to rely on these rules. In some cases, the exemption isn't automatically allocated to transfers that may trigger costly GST taxes. And in others, the exemption is automatically allocated to transfers that are unlikely to need its protection, resulting in wasted exemption amounts.

3 types of GST tax triggers

To ensure that wealth is taxed at each generational level, the GST tax applies at a flat 40% rate — in addition to otherwise applicable gift and estate taxes — to transfers that skip a generation. The tax applies to transfers made to "skip persons," including your grandchildren, other relatives who are more than one generation below you and unrelated people who are more than 37½ years younger than you.

There's an exception, however, for a grandchild whose parent (your child) predeceases you. In that case, the grandchild moves up a generation and is no longer considered a skip person.

Three types of transfers may trigger GST taxes:

1. "Direct skips" — transfers directly to a skip person that are subject to federal gift and estate tax,
2. Taxable distributions — distributions from a trust to a skip person, or
3. Taxable terminations — for example, if you establish a trust for your children, a taxable termination occurs when the last child beneficiary dies and the trust assets pass to your grandchildren.

As noted above, the GST tax doesn't apply to transfers to which you allocate your GST tax exemption. In addition, the GST tax annual exclusion — which is similar to the gift tax annual exclusion — allows you to transfer up to $17,000 per year to any number of skip persons without triggering GST tax or using up any of your GST tax exemption.

Beware of automatic allocation tax traps

Ordinarily, to allocate GST tax exemptions, you must affirmatively elect to do so on a timely filed gift tax return. If you neglect to do so, however, you may be saved by the automatic allocation rules.

These rules, which are intended to protect you against inadvertently losing exemptions, automatically allocate the exemptions to direct skips as well as to transfers to

"GST trusts." The definition of a GST trust is complicated. Essentially, it's one that lays the necessary foundation for a strong possibility that the trust will benefit your grandchildren or other skip persons down the road.

Often, the automatic allocation rules ensure that GST tax exemptions go where they'll do the most good. But in some cases, they may work against you.

Leave GST tax planning to the experts

If you're considering gifts to, or for the potential benefit of, your grandchildren or other skip persons, consult with your estate planning advisor. The rules regarding allocation of the GST tax exemption are complex, and mistakes can be costly. •

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You haven't coordinated beneficiary designations with your will

Perhaps you drafted your will years ago and it references many of your existing assets, including retirement plan accounts and life insurance policies. But you also have paperwork on file with the applicable financial institutions. And you might have recently modified your beneficiary designations on those financial documents to reflect certain life events, such as births, deaths and divorces, but failed to make the updates to your will.

Under these circumstances, you're now in a position where your will says one thing and your retirement plan and life insurance documents say another regarding beneficiaries. So which controls?

For starters, the beneficiary designations listed in your retirement plan and life insurance documents supersede what's stated in your will. But that doesn't mean that a conflict can't lead to confusion and family turmoil. In the worst-case scenario, one party might mount a legal challenge.

What's more, you may not be laying a foundation for the eventual results you intended.

It's easy to slip up or forget to change vital information.

However, you can avoid problems by staying on top of matters. Coordinate your will with other legally binding documents. If you decide to modify your will, keep the specifics about retirement plans and life insurance policies to a minimum or omit them entirely.

At the same time, update your retirement plan and life insurance documents to accommodate your changing circumstances. For instance, you might revise the language if you've welcomed a new child or grandchild into the world or if your adult child has divorced and remarried.

Finally, this is not a one-and-done proposition. Review the documents periodically to ensure they remain up-to-date.

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