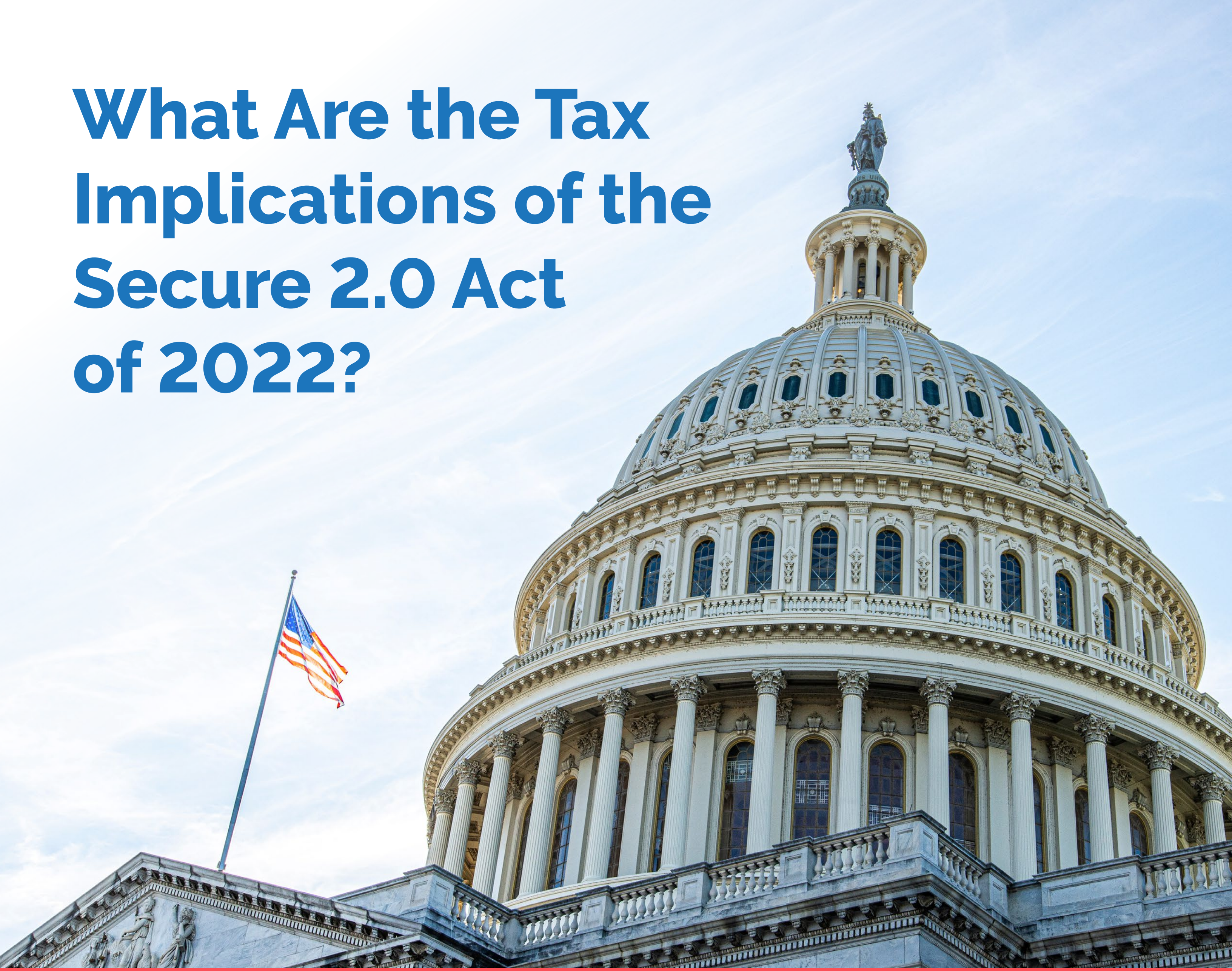
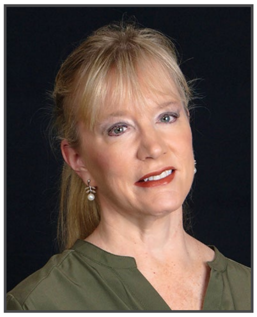
What Are the Tax Implications of the Secure 2.0 Act of 2022?



Not every CPA offers financial planning services, but all help clients navigate the tax liability associated with retirement investments. When lawmakers pass legislation that affects those accounts, firms across the country eagerly await the inevitable publication of IRS guidance.

Congress made significant changes to retirement plans in 2019, when the Setting Every Community Up for Retirement Enhancement (SECURE) Act was enacted into law. This legislation expanded retirement coverage by addressing restrictions and creating new opportunities for workers to participate.

In December 2022, Congress passed the SECURE 2.0 Act—which, as the name suggests, builds on those reforms. This latest legislation targeting retirement reform includes provisions that expand retirement plan coverage and make retirement plans easier to navigate.



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How does SECURE 2.0 expand retirement plan coverage?

The mechanisms SECURE 2.0 employs to expand retirement plan coverage include enhancing existing tax credits, creating new tax credits, and reducing plan restrictions. One of the significant enhancements involves the Retirement Plans Startup Costs Tax Credit.

TAX CREDITS

Eligible small businesses now have even more incentive to create a retirement plan for employees: beginning in tax year 2023, the startup credit will be increased to 100% of administrative costs (up from 50%) when creating a Simplified Employee Pension (SEP) plan, SIMPLE IRA, or other qualified plan for employers with up to 50 employees. Worth up to $5,000 per year, qualifying small businesses can claim this credit for three years after rolling out their chosen retirement plan.

If the plan does not have defined benefits, there is an additional credit available to these small businesses that is worth a percentage of what they contribute on behalf of employees, which tapers off after the second year of implementation:

- 100% in years one and two
- 75% in year three
- 50% in year four
- 25% in year five
- 0% in subsequent years

SECURE 2.0 also creates a new tax credit for small businesses that enroll military spouses in a defined contribution plan. Starting in tax year 2023, employers can claim a maximum of $500 for three years for each military spouse who has been made eligible for the retirement plan within two months of hire, eligible for matching and nonelective contributions, and 100% vested in employer contributions. The credit is calculated as the sum of $200 per military spouse and 100% of all employer contributions up to $300.

One of the tax-credit changes slated to take effect after December 31, 2026, involves the Saver's Match. Rather than being a nonrefundable credit that is available to low- and moderate-income taxpayers who contribute to an IRA, SECURE 2.0 replaces it with a federal matching contribution that is deposited into a qualifying retirement account.

REDUCED PLAN RESTRICTIONS

SECURE 2.0 notably takes aim at the required minimum distribution age, prescribing two increases over the next ten years. Starting on January 1, 2023, taxpayers do not have to take mandatory retirement plan distributions until they turn 73. In 2033, the age for RMDs will be pushed back to age 75.

The legislation also continues the work of increasing access to employer-provided retirement plans that began in 2019. Starting in tax year 2023, taxpayers who employ nannies and housekeepers are now allowed to provide SEP plans to those workers.

Another change involves the 403(b) retirement plans generally offered to educators and non-profit workers. These plans can now participate in multiple-employer retirement plans (MEPs) and pension equity plans (PEPs), significantly broadening the available investment options. This change is also accompanied by the removal of the "one bad apple rule," so only the employer who makes prohibited transactions will face a penalty.

To help businesses encourage workers to join employer-provided retirement plans, the restriction against small, immediate financial incentives has been lifted. This change lets employers offer de minimis financial incentives that aren't paid for with plan assets, like gift cards.

How does SECURE 2.0 make retirement plans easier to navigate?

The rules governing retirement plans can make it more difficult for taxpayers to save enough money for life after work, and the associated penalties directly impact those savings. The following SECURE 2.0 reforms include rule simplifications, penalty reductions, and other changes to retirement plans.

RULE SIMPLIFICATIONS

SECURE 2.0 also provides flexibility for retirement savings. Taxpayers can now use up to $22,000 from a retirement plan—penalty free—if they become the victim of a federally declared disaster. This distribution is recognized as gross income over a three-year period, and it can be repaid to a tax-preferred retirement account.

However, unexpected expenses do not always result from a natural disaster. When taxpayers decide they need to take a hardship distribution, the process will now be a little easier: SECURE 2.0 allows employees to self-certify that they are facing a hardship. Lawmakers say that this change was inspired by the success of the temporary coronavirus-related self-certification rules.

The new Emergency Savings Account can also help taxpayers face unexpected expenses without having to withdraw funds from a retirement account. Acting as a short-term supplement to long-term retirement plans, these accounts cap employee contributions at $2,500—after which point, funds can be sent to a Roth IRA. When an emergency arises, account holders can make up to four tax-free withdrawals.

PENALTY REDUCTIONS

The penalty for failing to take required minimum distributions (RMDs) from traditional IRAs, SEP IRAs, SIMPLE IRAs, and other retirement plans has historically been 50% of the amount that was not withdrawn. SECURE 2.0 lowers this amount to 25%, and the penalty can now be reduced to 10% if timely corrected.

The legislation also addresses the premature distributions penalty for taxpayers who are determined to be terminally ill. After January 1, 2023, these individuals can now begin receiving early retirement plan payments without incurring the additional 10% tax normally applied to distributions made before reaching age 59½.

Further, SECURE 2.0 immediately addresses the partial annuitization penalty. Rather than requiring that taxpayers calculate an annuity held by a retirement account separately when determining the amount of an RMD, taxpayers can instead choose to aggregate those portions. Lawmakers say this reduces the risk of having higher RMDs than comparable retirement plans that do not hold an annuity.

OTHER CHANGES

Taxpayers saddled with student debt will now have an easier time saving for retirement. Businesses can treat qualifying student loan payments as retirement contributions for the purpose of making matching contributions. Likewise, this rule applies to governmental employers paying into plans like the 457(b).

In addition to helping employees save for retirement, SECURE 2.0 includes a provision designed to encourage solopreneurs to create employer-provided retirement plans for themselves. Starting January 1, 2023, sole proprietors and single-member LLCs who create a new 401(k) between the end of the taxable year and their tax-filing date can fund it with employer contributions up to the employer's tax filing date and receive employee contributions up to the date of the employee's filing date in the first year.

Where can I learn more about the tax obligations for retirement plans (and earn CPE)?

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> *Excellent course, as usual. I am always amazed to learn something new after doing taxes for 34 years.*
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> **- LORRAINE**

ABOUT THE AUTHOR

Ann Campbell joined Drake Software in 2021 as a Tax Software Trainer. She is a Certified Public Accountant licensed to practice in California and North Carolina with many years of experience as a tax preparer using Drake Tax®. Ann has previously worked as a CFO and Controller in various industries, and she was one of four finalists for the Plastics News CFO of the Year 2019 award. Ann is a graduate of the Wharton School at the University of Pennsylvania. Watch Ann discuss the tax implications of the SECURE 2.0 Act on the Accounting Insider Podcast by Insightful Accountant.