SECURE 2.0 Eases RMD Obligations

Generally, it's advantageous to keep funds in your retirement accounts for as long as possible. Indeed, the longer you refrain from withdrawing funds, the longer they have to continue tax-deferred growth.

However, you must begin taking required minimum distributions (RMDs) from employer-sponsored retirement plans, such as 401(k) plans, and IRAs when you reach a specific age. The good news is that the SECURE 2.0 Act, a follow-up to the Setting Every Community Up for Retirement Enhancement (SECURE) Act, can help you save more for retirement, which, in turn, may provide you more wealth to share with your loved ones.

Timing Of RMDs

The amount of your RMDs depends on the value of your accounts on the last day of the prior year. For example, your RMDs for 2023 are based on your account balances as of December 31, 2022. The IRS has created tables for calculating RMDs, but you can also use an online calculator or have your financial advisor perform the calculations for you.

Be aware that RMDs are taxed at ordinary income tax rates. Currently, the top tax rate is 37%.

Previously, the required beginning date (RBD) for employer-sponsored plan participants or IRA owners was April 1 of the year following the year in which you turned age 70½. However, the SECURE Act pushed the RBD to age 72, beginning in 2020. Therefore, if you turned age 72 in 2022, you had to take RMDs from qualified plans and IRAs by April 1, 2023.

Keep in mind that the RMD rules continue to apply for each succeeding tax year with a deadline of the last day of the year. Accordingly, if your first RMD was for 2022, and you decided to wait until April 1, 2023, you'll have two RMDs for this year. That is, the RMD from 2022 that you deferred, plus your 2023 RMD, which has to be taken by December 31, 2023.

Looking ahead, if you've not yet reached your RBD, be sure to consider whether it'll be more advantageous to 1) take your first RMD in the year in which you reach your RBD, to avoid being taxed on two distributions in the following year, or 2) defer your first RMD, to take advantage of the one-time planning opportunity. Further, the decision for the first RMD is not an all-or-nothing proposition. You can take a portion of the RMD in the "regular" year and the rest by April 1 of the following year.

What happens if you fail to take RMDs in a timely fashion? The IRS may pile on a hefty tax penalty on top of the regular income tax that you already owe. Prior to the new law, the penalty was equal to 50% of the RMD amount (or the difference between this amount and any payment).

RMDs Under SECURE 2.0

Not only does SECURE 2.0 postpone the RBD for some individuals, it reduces the penalty for failing to comply with the RMD rules. Under the new law, the RBD is increased to age 73, up from age 72 as required by the initial SECURE Act. This change is effective for the 2023 tax year. Thus, if you turn age 72 this year, you don't have to start taking RMDs until 2024, which means that you effectively have until April 1, 2025. However, if you already reached age 72 by the end of last year, you must continue taking RMDs in 2023.

SECURE 2.0 boosts the RBD even higher, all the way up to age 75, beginning in 2033. Barring subsequent legislation, individuals who turn 63 or less this year will qualify.

The new law also reduces the penalty for failure to take an RMD when due, from 50% to 25% of the amount you should've withdrawn. And the penalty is reduced further, to 10%, for taxpayers who correct a missed RMD on a timely basis. Fortunately, there are mechanisms to eliminate the penalties altogether, so if you find that you've missed a prior RMD, contact your tax advisor for details.

Other SECURE 2.0 Provisions

In addition to rule changes regarding RMDs, SECURE 2.0 makes several other retirement savings improvements. For example, currently, if you're age 50 or older, you can make catch-up contributions of $1,000 per year to IRAs and $7,500 per year to most employer-sponsored plans (different limits apply to SIMPLE plans). Beginning in 2024, the catch-up amount for IRAs, which has been stuck at $1,000 for years, will be adjusted for inflation.

Employer-plan participants also will soon be able to increase their catch-up contributions. Beginning in 2025, participants age 60 through 63 will be able to increase their contributions by the greater of $10,000 (adjusted for inflation) or 150% of the regular catch-up amount. Note, however, that highly compensated participants (those who earned more than an inflation-adjusted $150,000 in the previous year), will no longer be permitted to make catch-up contributions on a pretax basis. Starting in 2024, these contributions must be made to a Roth account.

Employer-matching contributions also get some improvements. Starting this year, plans may allow employees to receive matching contributions as after-tax Roth contributions. Also, plans can treat certain student loan payments as contributions for matching purposes.

Practical Advice

Don't be caught napping on RMDs. If you're required to take RMDs before January 1, 2024, make the necessary arrangements to accommodate any possible glitches. Otherwise, thanks to SECURE 2.0, you can continue to accumulate earnings within your employer-sponsored retirement plan or IRA on a tax-deferred basis.

SIDEBAR: Relief For Roth 401(k) Plan Owners

You don't have to take lifetime required minimum distributions (RMDs) from a Roth IRA, but this benefit wasn't previously available to Roth

401(k) plan participants. The SECURE 2.0 Act does away with this distinction. Under the new law, lifetime distributions from Roth 401(k)s are no longer mandatory.

However, this change doesn't take effect until 2024. Therefore, if you have a Roth 401(k) account and you've attained your required beginning date, you must take an RMD for the 2023 tax year.

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