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WEALTH WISDOM

MONTHLY FINANCIAL INSIGHTS

Welcome

Welcome to "NEIRG Wealth Wisdom: Monthly Financial Insights," your go-to source for insightful and educational content on various financial topics. Designed for the informed investor, our goal is to empower you with clear and concise knowledge, helping you stay ahead in the complex financial world.

Understanding the Impact of SECURE Act 2.0: RMD Adjustments and 529 Plan Flexibility

The SECURE Act 2.0, a significant update to retirement and education savings rules, introduces critical changes that offer greater flexibility and opportunity for investors. This brief explores two pivotal provisions of the Act: modifications to Required Minimum Distributions (RMDs) and enhancements to 529 Plan rollovers. These changes not only extend the age for RMDs, providing tax deferral benefits but also introduce a novel option for rolling over 529 Plan funds into Roth IRAs, addressing the rigidity in educational saving plans. We will dissect these

provisions to understand their practical implications for clients and the potential strategies they unlock.

Two Key Provisions from SECURE Act 2.0

Required Minimum Distributions:

Perhaps the simplest change stemming from the SECURE Act 2.0 was an increase in the age when required minimum distributions (RMDs) begin. As of January of 2023, clients do not need to take RMDs from their qualified accounts until age 73. This will further increase to age 75 beginning in January 2033, meaning clients who were born after 1960 will be able to wait until age 75 before taking RMDs. This change allows clients who do not need to take withdrawals for cash flow purposes to keep their assets in their accounts longer and continue deferring the taxation of their funds.

Additionally, the penalty for missing an RMD has also been reduced. Before the SECURE Act 2.0, the penalty for failing to satisfy an RMD was 50% of the missed RMD amount (plus applicable income tax). This penalty has been reduced to 25% of the missed RMD (plus applicable income tax). The penalty can be reduced to 10% of the RMD amount if the distribution is taken in full by the end of the second year following the year it was due.

529 Plan Rollovers

One of 529 plans' biggest limitations is the rigidity required for qualified distributions. A major benefit of 529 accounts is that qualified distributions are tax-free. Unfortunately, distributions are only "qualified" if they're used for "qualified higher education expenses" which include tuition, fees, books, supplies, and equipment required to enroll or attend a level of education beyond high school. While the Tax Cuts and Jobs Act expanded the definition of qualified expenses to include K-12, withdrawals for non-secondary education are capped at $10,000 per year. Not all states currently comply with these updated guidelines. Withdrawals from 529 plans that are not for qualified expenses are subject to income tax as well as a 10% penalty on the earnings.

For many clients, this rigidity combined with uncertainty about a child attending college leads them to shy away from 529 plans. Instead, many clients use less tax-advantageous strategies to save for college which can result in a less-than-optimal after-tax result.
One of the key provisions of the SECURE Act 2.0 effective in 2024 is 529 plan rollovers to Roth IRAs. This provision is designed to mitigate some of the uncertainty about contributing to a 529 plan when a child's future educational plans aren't yet decided; however, there are a few significant hurdles and limitations:

- 529 plans can only be rolled over to a Roth IRA that is owned by the beneficiary of the 529 plan.
- To be eligible for a rollover, the 529 plan must have been open for at least 15 years before the rollover.
- Contributions made in the last 5 years are not eligible to be rolled over.
- Beneficiaries can only roll over $35,000 in their lifetime from a 529 plan to a Roth IRA

· Annual rollovers are limited to the applicable annual IRA contribution limit.

Here's a quick case study illustrating how this new provision can work:

John Smith owns a 529 plan with his son, Jim, as the beneficiary. John started the 529 plan when Jim was 2 years old and contributed until Jim was 16. Jim is now 22 years old and is a successful electrician with no plans to go to college. The 529 plan has a balance of $35,000 in it. Starting in 2024, Jim can roll $7,000 per year for the next 5 years into a Roth IRA. During that period, Jim **cannot** make additional Roth IRA contributions from his income, and any residual balance once Jim exhausts his lifetime limit cannot be rolled into a Roth IRA for Jim's benefit. At that point, John could elect to change the beneficiary to another family member.

For our clients, this change creates substantial opportunity on two fronts:

1. Increase comfort contributing to 529 plans for either future education expenses or to jump-start a beneficiary's retirement savings.
2. Provides clients with 529 plan balances and no pending college expenses an opportunity to continue growing their funds in a tax-free manner.

Please reach out to your advisor at NEIRG if you would like to learn more!

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