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SECURE 2.0: Understanding Changes and Challenges to the New Catch-Up Provision

The SECURE 2.0 Act of 2022 ("SECURE 2.0"), signed into law by President Biden on December 29, 2022, and effective January 1, 2023, builds on and expands upon the most wide-sweeping retirement legislation passed in the US under the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019. SECURE 2.0 consists of 92 new IRS and retirement plan changes to the SECURE Act of 2019.

Catch-Up Provision Changes

Employed taxpayers may be familiar with the ability to make "catch-up" contributions to a qualified retirement plan after reaching age 50, in addition to making contributions within specified limits. Starting in 2024, catch-up contributions to a 401(k), 403(b), or government 457(b) plan must be made as an after-tax Roth contribution by a plan participant who received Federal Insured Contribution Act (FICA) income greater than $145,000 (indexed for inflation) in the preceding year. Beginning January 1, 2024, Section 603 of SECURE 2.0 requires that after-tax dollars be used to make catch-up contributions in a Roth account for plan participants. Although these employees would no longer be able to take a tax deduction for catch-up contributions, up to an extra $7,500 for 2023, such contributions will grow tax-free and can be withdrawn tax-free during retirement.

Potential Issues

Several issues relating to Section 603 have been raised, ranging from a legislative "drafting error" to the time sponsors and recordkeepers need to update their systems to comply operationally with Section 603, which may delay or even prevent its implementation. With respect to the legislative drafting error, the American Retirement Association (ARA) first identified a drafting error in Section 603 in January 2023, just a few days after SECURE 2.0 had been signed into law by President Biden. The drafting error involves a key subparagraph—specifically, Subsection 402(g)(1)(C)—that was accidentally deleted from Section 603 by the legislative body in its haste to provide a conforming amendment to the legislation that could be signed into law.

Subsection 402(g)(1)(C) provided the ability to make catch-up contributions. Because this section of the tax code was removed, the ability to make catch-up contributions (pretax or Roth) beginning January 1, 2024, is now in question. The concern and unintended consequence is that without Subsection 402(g)(1)(C), Congress inadvertently, but technically, made any catch-up contributions illegal. To express its true legislative intent on the matter, Congress sent a letter to the Treasury Department at the end of May stating that this potential outcome was not Congress' intent and that it would correct the error. Congress has yet to fix its mistake.

Meanwhile, because details are unclear as to how Section 603 can be implemented operationally, the ARA and more than 200 large employer retirement plan sponsors, recordkeepers, and payroll providers have sent a joint letter to the Treasury Department requesting a two-year delay for implementing Section 603 after-tax catch-up requirements before this provision of SECURE 2.0 becomes effective in 2024. Commenting on this joint letter sent to the Treasury Department, the National Association of Plan Advisors informed its members that "if relief from Section 603 compliance is not granted before the Fall 2023, many plan sponsors will be, as a practical matter, forced to eliminate all catch-up contributions in their retirement plans, at least until they get updated systems in place."

Conclusion

Section 603 of SECURE 2.0 and its required tax on catch-up contributions for employees earning $145,000 or more per year must be resolved in a tight time frame. Nevertheless, you can take advantage of many planning opportunities under the SECURE Act of 2019 and SECURE 2.0 to optimize and preserve your retirement wealth. Reach out to our advisors at Calamos Wealth Management to learn more about how we can help navigate the potential changes.

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