Opportunities and Impacts of the SECURE Act

On December 20, 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed, which will impact retirement and estate planning for years to come. The changes have far reaching effects on IRAs, 401(k)s and other employer-sponsored retirement plans, 529 education savings plans, and include adjustments to a few income tax items that may be of interest to you. Many of the SECURE Act changes became immediately effective.

Expanding and Preserving Savings

More People Can Contribute to IRAs.

Reaching age 70 ½ no longer means you have to stop contributing to an IRA if you (or your spouse if you are married) are still working. IRA contributions can continue as long as you have earned income. In addition, graduate students with fellowship or stipend income and home healthcare workers, including foster parents, with "difficulty of care" payments can now treat that income as compensation for making traditional or Roth IRA contributions. Both of these new contribution features can be used for 2020 tax year contributions and beyond.

Required Minimum Distribution (RMD) Beginning Date Increased. In the past, you were generally required to begin distributions from IRAs and employer-sponsored retirement plans at age 70 ½. Now, if you were born on or after July 1, 1949, your required beginning date has been increased from age 70 ½ to age 72. However, if you were born on or before June 30, 1949, you are still required to start distributions at age 70 ½ even if

Key Highlights

Contributions to Traditional IRAs Are Permitted After Age 70 ½ if Working

Graduate Students and Home Healthcare Workers Can Make IRA Contributions Based on Income Earned

Required Minimum Distribution Age Increased to Age 72 for Individuals Born July 1, 1949 or Later; QCDs Remain at Age 70 ½

Enhancements to Lifetime Income Alternatives in Retirement Plans May Improve Retirement Readiness

Long-Term Part-Time Employees Will Soon Be Able to Participate in 401(k) and other Workplace Retirement Plans

you delayed your first distribution into 2020, *and* you must continue taking RMDs even if you are not age 72. ***Note:*** The age for making direct gifts to charities from your IRAs – known as qualified charitable distributions or QCDs – has not changed. It is still after attainment of age 70 ½ (six months past your 70th birthday). However, if you are making deductible contributions after age 70 ½, the tax-free amount of the QCD must be adjusted by the amount of the deductible contribution.

401(k) Savings May Be Turned into Lifetime Income to Help Prepare Participants for Better Retirement Readiness Outcomes. Although some additional guidance will be coming, the SECURE Act removes some of the barriers for plan sponsors to offer in-plan guaranteed income solutions to participants. It expands existing safe harbor provisions, lessening plan sponsor liability in the selection of a provider for guaranteed income solutions for a retirement plan. It also expands the portability of guaranteed income products offered within a plan. Now, if a plan terminates or decides to discontinue a guaranteed income product within the plan, participants will be eligible to distribute and roll over their lifetime income product to an IRA or another qualified retirement plan. Finally, benefit statements provided to participants of defined contribution plans must (at least annually) show their account balance in the form of a lifetime income stream. It is anticipated that the Secretary of Labor will develop model language and assumptions that plan sponsors can utilize for compliance with this provision.

Certain Long-Term, Part-Time Employees May Participate In 401(k) and Other Workplace Retirement Plans. It will be a few years before part-time employees become eligible, but in the future, if you work at least 500 hours a year for at least three years, you will have the opportunity to save for retirement at work. In the past, such employees would have been excluded from participation.

Planning Tips

As long as you (or your spouse, if married) are still working, contributions you make to your traditional IRAs either will be deductible or non-deductible based on your tax filing status, coverage by an employer plan and modified AGI. This will provide an opportunity to continue saving even while one spouse is retired.

However, because the tax-free value of a QCD will be eroded by deductible contributions to traditional IRAs after age 70 ½, make sure you consider carefully the coordination of these two tax benefits. Because tax-free QCDs can be taken in amounts up to $100,000 per year, the impact of a deductible $7,000 IRA contribution may be more limited. You can, of course, do both. It will just require tracking the total amount contributed after age 70 ½, so the proper adjustment to the QCD can be made. If you are married, you may also want to consider having one spouse make the deductible IRA contributions and the other spouse make the QCDs, so both the tax deduction and the income exclusion can be fully utilized.

Raising Tax Revenue by Limiting the Stretch IRA

Probably the most talked about change in the SECURE Act was intended to raise tax revenue by limiting the number of years beneficiaries have to distribute IRAs and retirement accounts.

Most Non-Spouse Beneficiaries Must Distribute Over 10 Years. Non-spouse beneficiaries that inherit retirement accounts from individuals who die in 2020 or later years will generally be limited to a 10-year payout of the retirement account instead of being able to stretch out distributions over their lifetimes. With the 10-year rule, there are no annual RMDs, only a requirement to completely distribute the account by the end of the 10th year.

Certain non-spouse beneficiaries are excluded and can continue life expectancy distributions. They are:

1) Disabled or chronically ill individuals,
2) Anyone who is not more than 10 years younger than the account owner, and
3) An account owner's minor children – but only until they reach the age of majority and then the 10-year rule applies.

Key Highlights

Inherited IRA and 401(k) Distributions Will Be Limited to 10 Years for Most Non-Spouse Beneficiaries

Surviving Spouse Alternatives Remain the Same

Luckily, nothing has changed for a surviving spouse or for beneficiaries that inherited a retirement account from individuals who died in 2019 or prior years who are already in a payout status. However, when the current beneficiary dies, the successor beneficiary must distribute over 10 years, regardless of their relationship to the current beneficiary.

Planning Tips

Schedule a beneficiary review with your financial advisor. Educating yourself on the changes is the first step to ensuring you are still comfortable with the beneficiary designations you currently have in place. Trust beneficiaries, in particular, will need attention and your tax and legal advisors should be consulted.

Converting your traditional IRA to a Roth IRA can be a good strategy to reduce the tax burden for heirs, as distributions from Roth accounts are generally tax-free. Keep in mind taxes must be paid in the year of conversion.

An alternative legacy planning strategy to a Roth conversion would be to begin taxable traditional IRA distributions to purchase life insurance. Life insurance policies offer a leveraged income tax-free death benefit to heirs. Life insurance requires medical underwriting to qualify, so the better the health, the better the value of the death benefit in relation to the premium paid.

Charitable beneficiaries of retirement accounts may once again come into favor. With a 10-year limit on most withdrawals, taxes a beneficiary pays on an inherited IRA and 401(k) may hit during the beneficiary's peak earning years. As an alternative to leaving retirement accounts to family and other assets to charity, you may want to consider the opposite approach.

529 Education Savings Plan Enhancements

Registered Apprenticeship Programs. A few years ago, 529 education savings plans were no longer exclusively considered "college" savings programs when they were expanded to include tuition payments for K-12 education. They have now been expanded again, and tax-free withdrawals can be to be used for registered apprenticeship programs for students who may not pursue a typical college degree

Student Loan Debt. 529 education savings plans can also now be used to help repay outstanding student loan debt. Up to $10,000 can be withdrawn tax-free to pay down outstanding loans for the student (or for any of the student's siblings).

Key Highlights

529 Education Savings Plans Can Be Used Tax-Free for Registered Apprenticeship Programs

Qualified Distributions Can Also Be Used for Repayment of Up to $10,000 of Outstanding Student Loan Debt for the Student (or Any Siblings)

Planning Tips

Allowing the repayment of student loan debt has long been a desired use of education savings plans and including the siblings of the students – who may have already graduated and were unable to use 529 savings for student loan debt in the past – is a great added benefit.

Expansion of 529 plans continues to widen the gap between 529s and Coverdell Education Savings Accounts (ESAs). If you have existing Coverdell Education Savings Accounts, you may want to consider rolling over your ESA into a 529 savings plan to expand what those savings can be used for.

Keep in mind that your state may not recognize these new uses as "qualified" distributions and that could have an impact on any prior state income tax deduction you have claimed. Make sure you consult with your tax advisor before taking advantage of these new features.

Other Income Tax Benefits

Penalty-Free Qualified Birth or Adoption Distributions are Now Available. Penalty-free withdrawals from IRAs and retirement plans will be available for qualified birth or adoption expenses in amounts up to $5,000. The withdrawal must be used within one year and can be repaid (rolled over) into the retirement plan without being subject to the typical 60-day rollover window. Adopted children under the age of 18, or disabled children of any age, can qualify but adopting the children of your spouse does not.

"Kiddie Tax" Rate Relief. If you have children with investment income subject to the kiddie tax, there's also some good news. A few years ago, the higher trust tax rates were required to calculate the tax owed. That has now been repealed. The kiddie tax rate reverts back to the higher of the child's or parents' marginal tax rates for unearned income in excess of two times the standard deduction. Moreover, you can go back and amend the last two year's returns to elect this treatment.

Medical Expense Deduction Floor Retained. The medical expense deduction floor was retained at 7.5% through the end of 2020. If no additional action is taken, it will increase to 10% in 2021.

Want More Information?

There are a lot of changes to navigate, but help is available. Contact your financial advisor to get more information on any of these changes that may affect your situation.