The SECURE Act

The Setting Every Community Up for Retirement Enhancement Act of 2019, better known as the SECURE Act, which originally passed the House in May of 2019, was approved by the Senate on December 19th of 2019.

This is part of an end-of-year appropriations act and accompanying tax measure, and signed into law on December 20th of 2019 by President Donald Trump. The bill includes significant provisions aimed at increasing access to tax-advantaged accounts and preventing older Americans from outliving their assets.

There are a few key provisions regarding Required Minimum Distributions and inherited IRAs that should be considered.

The Age for Required Minimum Distributions Has Increased

The age at which retirement plan participants need to take their RMDS has been pushed back from 70 1/2 to 72. Individuals who turn 70 1/2 on 1/1/2020 or later will not have to begin taking RMDs until April of the year following the year in which they turn 72. Individuals who have turned 70 1/2 prior to the end of 2019 are not affected.

Examples

Mary's birthday is July 20th and she turns 70 1/2 on January 20th of 2020. Will she need to take RMDs in 2020?

No, because Mary turned 70 1/2 after the start of 2020, she will not need to take RMDs until April of the year after she turns 72. Mary will turn 72 on July 20th of 2021. She will need to begin taking RMDs by April of 2022.

Mark's birthday is June 20th and he turned 70 1/2 on December 20th of 2019. Will he need to take RMDs in 2020?

Yes, because Mark turned 70 1/2 before the end of 2019, he will need to take his first RMD by April of 2020, the year after the one in which he turned 70 1/2.

Stretch IRAs have been Curtailed

A Stretch IRA is an estate planning strategy that extends the tax-deferred status of an inherited IRA when passed on to a non-spouse beneficiary. Prior to the SECURE Act, a non-spouse beneficiary of an IRA could stretch out distributions from the account for the remainder of his or her life. The SECURE Act has eliminated this ability unless certain exceptions are met.

Under the new rules of the SECURE Act, non-spouse beneficiaries of an inherited IRA are required to withdraw the balance of the account within 10 years. The clock begins on January 1st the year after which the original IRA account owner passes away. The distributions can be taken with any frequency. The balance can be withdrawn all at once in the first year or all at once in the last year. Distributions can be sporadically taken out over the 10 years. The account must be zeroed out at the end of the 10-year period.

The SECURE Act is effective for those who have inherited an account with which the account owner passed away after the end of 2019. The SECURE Act does not affect spouses.

Annuities inside 401(k) Plans

The SECURE Act includes provisions modifying and streamlining compliance requirements for offering an annuity option inside certain employer-sponsored retirement plans.

This means new annuity options may begin to be offered in employer plans in addition to options commonly available prior to the Act. This will enhance access to lifetime income for retirement savers.

Examples

Steve recently inherited an IRA from his father. His father passed away on January 2nd of 2020. The IRA has an account balance of $500,000. Can Steve stretch the distributions out to receive them for the remainder of his life?

No. Because Steve's father passed away after the start of 2020, Steve is subject to the new rules in the SECURE Act. Steve must withdraw the IRA account balance to zero within 10 years starting on January first in the year after which his father passes away (2021). The IRA account balance must be zero by the end of 2030. He can take all $500,000 out immediately, all of it in 2030, or any amounts during the years between as long as there is nothing in the account at the end of 2030.

Stephanie recently inherited an IRA from her grandmother. Her grandmother passed away on December 14th of 2019. The IRA has an account balance of $500,000. Can Stephanie stretch the distributions out to receive them for the remainder of her life?

Yes. Because Stephanie's grandmother passes away before the end of 2019, she can utilize the Stretch IRA strategy. Stephanie can take RMDs from the account based on her life expectancy.

If a non-spouse beneficiary has already been using a Stretch IRA strategy prior to the end of 2019, they may continue to do so.

Additionally:

- The Act includes a provision allowing for the rollover to an IRA of a workplace annuity option if the sponsor no longer offers the guaranteed income product and/or annuity.
- Plan sponsors will be required to include a new lifetime income disclosure illustrating a plan participants monthly payment if they utilized a stream of lifetime income.

Estate planning tips for those with large IRA balances

Insurance

For a Traditional IRA account holder who is subject to Required Minimum Distributions, the life insurance approach is one way to ease the tax burden for their non-spousal beneficiaries. If the account holder does not need the RMD withdrawls for expenses, they can take a portion of the RMD and use it to pay the premium of a life insurance policy and name their non-spousal IRA beneficiary as the beneficiary of the death benefit on the life insurance policy. When the account holder passes away, the death benefit is paid tax-free to the beneficiary.

Roth Conversion

Roth conversion strategy is one method that they can use to ease the future tax burden on their non-spouse beneficiary. The account owner would have to pay the taxes now (on the amount converted), but those assets would then be passed along to the beneficiaries via a Roth IRA instead of a Traditional IRA. The beneficiary would then be able to withdraw those funds tax-free.

Charity

For IRA account owners over the age of 70 1/2 (this age did not change with the SECURE Act), they can maximize their annual charitable contributions. These qualified charitable distributions (QDC) are excluded from the account owner's taxable income and they will also lower the value of the taxable IRA when it is passed on to their non-spousal beneficiary.

For IRA account owners who would like to support the non-spouse beneficiary while also benefiting a charity, a charitable remainder trust may be a good option. The IRA account owner can create and fund a trust that will be funded with the IRA's assets after the account owner's death. The trust can then create a regular income stream for the non-spousal beneficiary that can be distributed over a certain amount of time or the beneficiary's lifetime. The assets are only taxed when they are withdrawn. When the beneficiary passes away, the remaining assets in the IRA will be distributed to the designated charity.

Example

Roth Conversion: This is especially important for account owners with large IRA balances. Dave has an IRA with an account value of $1,000,000. He has named his 32-year-old son, John, as beneficiary. If Dave were to pass away in 2020, John would inherit the IRA and must withdraw the $1,000,000 within the next 10 years. Those withdraws will be added to his taxable income each year likely pushing him into the next tax bracket.

If Dave decides to gradually convert his Traditional IRA into a Roth IRA, he will pass the converted dollars on to John in a vehicle that allows John to withdraw the money tax-free. Thus, not adding taxable income.

Other provisions in the SECURE Act

- IRA contributions can now be made after the age of 70 1/2. As long as they are still working, employees can contribute to their own or their spouse's IRA after they've reached the age of 70 1/2.
- Long-term, part-time workers are now able to join their company's 401(k) plan. Employees that work over 1,000 hours in one year, or over 500 hours in 3 consecutive years are now able to participate in their employers 401(k) plan.
- Small business employers (100 employees or less) will receive a maximum tax credit of $5,000 ($250/ non-highly compensated employee) when they establish a retirement plan. If the retirement plan has automatic enrollment, an additional $500 tax credit is available.
- Account owners are able to withdraw up to $5,000/parent penalty free from their retirement plan upon the birth or adoption of a child. This will be free from the 10% early withdrawal penalty but will still be subject to ordinary income taxes.
- 529 plan funds can be used to pay down student loan debt.
- Small-business owners can now more easily establish multiple employer plans (MEPs) by allowing unrelated employers to join together in the creation of a plan. The employers no longer have to be related by common ownership or by being in the same industry among other options.

If you have questions on how the SECURE Act will affect your financial situation, please do not hesitate to reach out to a financial professional.

Tax Smart Network
435 Lancaster St., Suite 3C
Leominster, MA 01453

978.276.9145
info@taxsmartnetwork.com

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