North American Management
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PLANNING NOTE

How the SECURE Act May Impact Retirement and Estate Plans

The Omnibus Budget Act that Congress passed and President Trump subsequently signed into law in late 2019 includes new tax-law changes and extenders that may impact both retirement savers and heirs in 2020 and beyond. The legislative changes included SECURE (Setting Every Community Up for Retirement Enhancement) Act reforms to individual retirement account (IRA) and defined-contribution plan rules that had been debated in Congress since last spring — the most significant retirement-plan legislation to pass in a more than a decade. SECURE's provisions, many of which went into effect on January 1, 2020, include the following (among others):

1) Non-spousal IRAs inherited after 2019 now have to be fully distributed in 10 years. The old distribution formula, which allowed non-spousal beneficiaries to "stretch" required minimum distributions (RMDs) over their own life expectancies, no longer applies. Under the new rules starting on January 1, 2020, if an owner of an IRA or 401(k) passes away and leaves the accounts to a beneficiary other than a spouse, the beneficiary will have ten years after the year of death to distribute the entire account. (These distributions can be scheduled in the manner the beneficiary prefers — that is, with no RMDs— so long as they're fully distributed by the end of the tenth year following death. Also exempted from the ten-year provisions are minor children up to the age of majority, individuals within ten years of age of the deceased, the chronically ill, and the disabled.) This rule doesn't apply to accounts inherited from owners who died before 2020. Those inheritors can still use the life-expectancy distribution rules.
2) The first year for RMDs on most retirement accounts is now age 72, not 70.5. If the account owner turned 70.5 by the end of 2019, their required RMD beginning date is set, and they are required to begin taking RMDs at age 70.5.
3) Starting in 2020, there is no longer an age limit for Traditional IRA contributions. As with existing Roth IRA contribution rules, account owners can contribute beyond age 70.5. That being said, whether such contributions are deductible or non-deductible will still depend on other factors including income, filing status, earned compensation, and active status in a qualified plan.
4) There are rule changes in how defined contributions plans are administered, including allowing multi-employer plans to band together to offer retirement benefits to workers, enhancements and inducements to get more part-time and lower-income workers to participate, and easier transfer of plans containing annuity contracts.

The somewhat harsher treatment of inherited IRAs goes along with recent court decisions that treat these accounts as non-retirement accounts. Investors often think of their balances in IRAs, 401(k)s, and similar accounts as assets to be passed along. However, the laws granting them tax-deferred status were passed with the intention of enhancing retirement security during one's lifetime, not passing along wealth to heirs. This is a reminder that Congress will sometimes look at whether tax-advantaged vehicles are being used as they were intended. Legislators, also tasked with raising taxes, probably had not meant to create tax-deferred accounts that could sit untaxed for a century. Once the estate tax was reduced in 2018, however, that was the outcome, due to the doubling of the lifetime exemption which is now $11.58 million per individual.

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The ten-year schedule with no RMDs may require rethinking retirement plans that can be inherited. Any provisions other than basic spouse and children plans need reconsideration. Some of the more common reasons: Any plan directed to a trust needs to be reviewed to see if it goes to unnecessary lengths to have younger beneficiaries, or whether it's worth rewriting to allow income to stay in the trust. Very young beneficiaries might be better served by being left other assets. A large retirement account could be redirected into a Charitable Remainder Trust and paid out over a lifetime. Roth conversions are still worth considering. It may well be that your current plan is still good and taking a second look will settle any lingering doubts.

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The extender tax measures, along with other changes, are more favorable to taxpayers:

- There is a 7.5% floor on medical-expense deductions for 2019 and 2020. The increase to 10% has been delayed until 2021.
- The mortgage-interest deduction of mortgage insurance premiums has been extended to 2018, 2019, and 2020.
- The tuition deduction and several energy credits have been extended.
- Parents are allowed to make penalty-free withdrawals up to $5,000 from their 401(K)s to help with the costs of having or adopting a child.
- There are more qualified distribution options for 529 plans, including apprenticeship programs, student loan payments up to $10,000 over a lifetime, and payment of qualified expenses incurred by the siblings of the designated beneficiary.

One of the new provisions eliminates the application of trust income rates to calculate the tax on children's unearned income. The rule has reverted to using the parental marginal rate starting in 2020. For 2018 or 2019, the taxpayer can elect to use either calculation, and 2018 tax returns can be amended.

We'd be happy to work with your tax professionals to position your retirement and other assets to take advantage of the more favorable provisions of the SECURE Act, and to limit any potentially negative effects. As a critical first step, I'd recommend that we review your beneficiary designations to make sure they line up with your intended goals. Please contact your Wealth Advisor at any time to discuss any questions or concerns about the new tax-law changes.

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