THE SECURE ACT

SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT ACT OF 2019

By John Marold, JD CTFA

OVERVIEW

On Dec. 20, 2019, the "Setting Every Community Up for Retirement Enhancement Bill of 2019", or SECURE Act, was signed into law by President Trump. The new law represents one of the most comprehensive pieces of legislation to impact retirement plans in over a decade.

Effective January 1, 2020, the SECURE Act makes significant changes to retirement plan distribution rules, small employer retirement plan options, 529 plans, as well as modernizing many other long-standing rules that apply to qualified plans and IRAs. The new law not only makes planning crucial but requires review of existing arrangements, and in many instances, flexibility will be critical. This article is intended to be a not all-inclusive highlight to some of the most pertinent changes that will facilitate discussions with your Advisors.

SECURE ACT – HIGHLIGHTED PROVISIONS

Loss of the Stretch IRA - Modifications to Required Minimum Distribution Rules

Before the SECURE Act, upon the death of the qualified plan participant or IRA owner, any "designated beneficiary" could elect to transfer the retirement plan assets into a "stretch IRA" (or inherited IRA). The stretch IRA permitted the designated beneficiary to preserve the tax-deferred growth of the investments and gradually withdraw annual required minimum distributions (RMD) over the beneficiary's own life expectancy.

The SECURE Act significantly reduces the number of designated beneficiaries who may use stretch IRAs. For qualified plan participants and IRA owners dying after Dec. 31, 2019, the law replaces the life expectancy payout option with a 10-year mandatory distribution rule.

Exceptions: An "eligible designated beneficiary" (EDB), however, is an exception to the new 10-year mandatory distribution rule. An EDB may still use a slightly modified form of the stretch IRA. An EDB is defined as follows: 1) a surviving spouse, 2) a minor child, 3) a disabled or chronically ill person, or 4) a person not more than 10 years younger than the deceased qualified plan participant or IRA owner.

Points To Discuss With Your Advisor:

In light of the fact that the SECURE Act has all but eliminated the stretch IRA option for many beneficiaries, qualified plan participants and IRA owners may want to consider more effective planning options during their lifetime to achieve their tax and/or estate planning goals.

- Beneficiary Income Tax Planning: All distributions from retirement plans are subject to state and federal ordinary income tax rates. If you have children that are or will be in a higher income tax bracket, then withdrawing more from your qualified plans during lifetime may result in assets taxed at lower rates.
- Roth Conversion: Converting all or part of a traditional qualified plan to a Roth IRA may be a more compelling option than in the past. Although Roth conversions have an upfront tax cost, once the tax payer passes away inherited Roth IRA distributions are tax-free. Partial Roth conversions can be made every year in order to spread out the tax cost and minimize the up-front payment impact.
- Life Insurance Strategies:
  - If distributions from a qualified plan or IRA are not needed to supplement income, then purchasing life insurance with retirement plan assets may be a solution to create a tax free pool of assets as the proceeds from a life insurance policy will pass to the beneficiary income tax free. Moreover, if the policy is purchased by another person or an Irrevocable Life Insurance trust (ILIT), then the life insurance proceeds may not be subject to estate taxation upon your death. Premiums may be subject to gift tax if they are paid on behalf of the beneficiary.
  - Life insurance purchased through coordinated distributions from a qualified asset may also be used to supply the surviving spouse beneficiary with a pool of cash to pay for the Roth conversion income tax or to hedge mortality on a Roth conversion to reach the "break even" point; the point at which the tax paid on conversion is outweighed by the benefits of conversion.
- Charitable Planning Strategies: Retirement plan assets are ideally suited to satisfy philanthropic goals as after death distributions to a charitable beneficiary are tax-free and provide an estate tax deduction. Charitable Remainder Trusts (CRT) can provide an income stream to a family member while leaving a balance to a qualified charity. CRTs may be designed to "restore" a stretch IRA by creating a deferral period that may be longer than the new 10-year rule. Qualified Charitable Distributions (post 70 ½ max. $100k direct to charity) remain an important and viable tax savings strategy.
- Changing Landscape for the Trust Beneficiary of a Retirement Plan: If you have a trust as beneficiary of your qualified plan or IRA, then changes to your estate plan may be necessary to curtail the adverse impact of the SECURE Act's 10-year mandatory distribution rule. There are two types of trust beneficiaries approved by IRS rules and regulations: the conduit trust and the accumulation trust.
  - "conduit trust" A conduit trust requires a trustee to take required minimum distributions from a trust-owned inherited retirement plan and pass them along immediately to the conduit trust beneficiary. The trustee has no power to withhold the distribution even if the beneficiary is facing major creditor problems or disqualification from needs-based government benefits.

    The new law accelerates the depletion of the inherited retirement account. For example, a 47-year old conduit trust, non-spouse beneficiary could receive inherited IRA distributions over a 37-year period. Due to the SECURE Act, that same beneficiary must now receive the entire balance within a 10-year period. If your existing estate plan includes a conduit trust, then consult your estate planning attorney to see if the conduit trust still addresses your legacy goals. If not, a conduit trust may be able to be amended in a way that matches up with your estate planning objectives.

- "accumulation trust" may offer a partial solution to the conduit trust problem. With an accumulation trust, the trustee has the power to withhold (or accumulate) retirement plan distributions inside the trust even if the inherited retirement plan must be withdrawn within a 10-year period. By giving the trustee control over the amount and appropriate time to make a trust distribution, the funds remain well-protected inside in the trust until whatever time the trustee deems appropriate.

- Spray Trusts: If beneficiary income tax planning is a primary concern, "spray trusts" are designed to spread trust distributions across many beneficiaries. Although beneficiaries would receive smaller distributions from the trust, they would receive less taxable income.

- Spousal Rollover: The new 10-year mandatory distribution rule does not apply to a surviving spouse beneficiary. The surviving spouse may choose to roll over his or her deceased spouse's retirement plan assets into an IRA in their own name. Depending upon family circumstances, the surviving spouse may want to consider disclaiming all or a portion of the deceased spouse's qualified plan in favor of children. For tax optimization purposes, the children may be in a lower tax bracket. If the surviving spouse partially disclaims, this effectively allows the younger contingent beneficiary to withdraw over two 10-year periods, one for each deceased parent.

Increase in Age for Required Minimum Distributions (RMDs)

Under the old law, participants generally started withdrawing required minimum distributions (RMDs) from their retirement plan in the year in which the participant turns 70-½. The SECURE Act increases the age of commencement for required minimum distributions from 70-½ to age 72. Unfortunately, this new beginning date for RMDs will not apply to individuals who have already turned 70-½ before Jan. 1, 2020.

Repeal of Maximum Age for Traditional IRA Contributions

Prior to 2020, an individual was unable to make traditional IRA contributions beyond the year in which the individual turns age 70-½. Starting this year, the maximum age for making IRA contributions is eliminated. Even after required minimum distributions start at age 72, a traditional IRA participant with earned income may still make a contribution to their IRA and take advantage of tax-deferred growth.

Points To Discuss With Your Advisor:

- Make a Contribution If you are turning 70-½ in 2020, then you will not need to take a required minimum distribution from your qualified plan or IRA until you reach age 72. Consider making a contribution to your traditional IRA if you have earned income. For 2020, the standard plus catch up IRA contribution limit is $7,000 for participants aged 50 years and older

Expansion of Section 529 Plans

Starting in 2020, Section 529 plans would permit distributions of up to $10,000 of qualified student loan repayments. Moreover, an additional $10,000 can be used to pay off qualified student loan repayments for each of the 529 plan beneficiary's siblings. Note: The $10,000 is a maximum lifetime amount and not an annual limit.

Points To Discuss With Your Advisor:

- 529s are Better than Ever: The Tax Cuts and Jobs Act of 2017 expanded Qualified Higher Education Expenses to include up to $10,000 of 529 plan funds to be used annually for kindergarten through 12th grade expenses. In addition to the qualified student loan repayment, the SECURE Act further expands 529's by providing that Qualified Higher Education Expenses include expenses for certain Apprenticeship Programs.

Penalty-free Withdrawals for Individuals in Case of Birth or Adoption

Withdrawals from a retirement plan made prior to reaching age 59-½ are generally subject to the 10% penalty for early distributions. The act creates a new exception to the early distribution penalty for up to $5,000 ($10,000 per couple) for a "qualified birth or adoption" distribution. A qualified birth or adoption distribution must be made during the one-year period beginning on the date child was born or on which the adoption was finalized. An "eligible adoptee" is defined as any individual (other than a child of the taxpayer's spouse) who has not attained age 18 or is physically/mentally incapable of self-support.

Other Provisions relating to administration and businesses: The Secure Act also created a number of benefits for businesses and participants adding some tax breaks, accessibility and removing some administrative hurdles:

- Allows long-term part-time workers to participate in 401(k) plans. Employees who work either 1,000 hours throughout the year or have three consecutive years with 500 hours of service.
- Allows more annuities to be offered in 401k plans, reduction of liability and expansion of options for plan sponsor.
- More tax friendly and administratively easier for small businesses: Increased tax credits, extensions of time, more flexible safe harbor rules. Increases the cap under which they can automatically enroll workers in safe harbor retirement plans, and administratively easier for pooling multiple employer plans.

CONCLUSION

For many people, retirement plan assets will comprise a significant portion of the overall legacy to their heirs. The passage of the SECURE Act represents a great time to re-examine retirement plan beneficiary designations and your estate planning documents. Accordingly, we encourage you to get together with your tax counsel and Wealth Advisor to more fully examine the impact of this new law on your overall financial, estate and retirement plans. If you have questions about the effect of one or more of these changes on your personal situation, please contact your Wealth advisor.

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