ED SLOTT'S ELITE IRA ADVISOR GROUP℠

THE SECURE ACT
HERE'S WHAT IT MEANS FOR YOU:

On December 20, 2019, a $1.4 trillion spending bill was signed into law in order to keep the government running. Tucked away inside this mammoth piece of legislation was the Setting Every Community Up for Retirement Enhancement (SECURE) Act. This new law includes significant changes to retirement accounts. How will it affect you and your retirement savings? Here are some highlights.

Age Limit Eliminated for Traditional IRA Contributions

Beginning in 2020, the new law eliminates the age limit for traditional IRA contributions (formerly 70½). If you or your spouse are still working, you can continue to contribute to a traditional IRA, regardless of your age.

This change will not only expand opportunities to save with a traditional IRA, it will also allow older individuals with taxable compensation to take advantage of the backdoor Roth IRA conversion strategy. This strategy had previously been off the table for many due to age limits on traditional IRA contributions.

RMD Age Raised to 72

If you were born on or after July 1, 1949 and do not need your retirement account funds for living expenses, or if you do not like the idea of the tax bill that comes along with your required minimum distributions (RMDs), the SECURE Act gives you a slight reprieve. The new law raises the age for beginning RMDs to 72 for all retirement accounts subject to RMDs. IRA owners age 70½ in 2020 catch a break and will not have to take their first RMD for 2020. Their required beginning date is delayed until April 1 of the year following the year they reach age 72.

Unfortunately, if you reached age 70½ in 2019, you cannot take advantage of this new rule. You must still take your RMD for 2019 by April 1, 2020 and must take an RMD for each year thereafter.

Delaying the age for RMDs increases the "sweet spot" for retirement planning. The "sweet spot" is that period of time when retirement account distributions can be taken penalty-free (after age 59½) and before RMDs are required (formerly age 70½ and now age 72). You have complete flexibility during this expanded period to take advantage of historically low tax rates for distribution planning and Roth conversions.

QCDs Still Available at Age 70½

There is good news if you are an IRA owner or beneficiary who is charitably inclined. Qualified charitable distributions (QCDs) are an increasingly popular option for those looking to use the standard deduction and still get a tax break for a charitable contribution. While the SECURE Act delays the age that RMDs must start until age 72, it maintained the age for QCDs at 70½.

If you are thinking about making deductible contributions to a traditional IRA at age 70½ or older and are also considering a QCD, proceed with caution. Congress has come up with a complicated formula that can limit the amount of the tax break available for a QCD. Consider avoiding this mess and making a Roth IRA contribution instead.

New Exception to the 10% Penalty for Birth or Adoption

When you take a distribution from a retirement account and are under age 59½, that is considered an early distribution. A 10% penalty will apply unless there is an exception. Beginning in 2020, the SECURE Act adds a new 10% penalty exception for births or adoptions. The exception applies to both IRAs and employer plans. It is limited to $5,000 for each birth or adoption. To qualify, the distribution must be taken within one year from the date of birth or when the adoption in finalized.

A married couple can each take a $5,000 distribution penalty-free from their retirement plans following the birth or adoption of a child. There is no requirement that the distributions be used for birth or adoption expenses.

The birth or adoption distribution amount can be repaid at any future time (re-contributed back to a retirement account).

Remember, even though the withdrawal is penalty free, it is still taxable. This will lessen the amount available for spending. Your retirement account is meant for retirement and should be the last resort for any use other than just that.

Expanded Benefits for 529 Plans

The SECURE Act expands 529 education savings accounts to cover costs associated with registered apprenticeships and up to $10,000 of qualified student loan repayments (including those for siblings).

The effective date for this provision is retroactive and includes distributions taken after December 31, 2018.

Fellowship and Stipend Payments Now Available for IRA Contributions

The SECURE Act brings new retirement savings opportunities for some students. Beginning with IRA contributions for 2020, the definition of "compensation" is expanded to include taxable fellowships and stipends for graduate or postdoctoral students. This will enable these students to make IRA contributions based on those payments.

Due to the age of most graduate and postdoctoral students and the limited value of an IRA deduction for most of them, these students may want to consider making Roth IRA contributions rather than traditional IRA contributions.

Foster Care Workers Can Now Make Retirement Contributions

Foster care workers can exclude from taxable income certain "difficulty-of-care" payments from their employer. Under the SECURE Act, foster care workers can now use those funds to make certain IRA and employer plan contributions.

The new rule applies to 2020 IRA contributions. For plan contributions, it applies retroactively to plan years beginning after December 31, 2015.

More Annuities in Employer Plans

There are several provisions of the SECURE Act designed to make it easier for employer plans to offer annuities to participants.

What does this mean for you and your 401(k) plan? You may see more annuity investment options in your employer plan as well as increased portability options for annuities beginning in 2020. Remember, if you are interested in lifetime income protection and are eligible to roll the company plan funds over to an IRA, you might be better served rolling over your funds to your IRA and working with your own financial advisor to select the product that is best for your retirement income needs. If you are interested in an annuity, an IRA rollover may provide you with more customized product choices than the limited employer plan choices.

Kiddie Tax Relief

The SECURE Act does away with a change Congress made to the "kiddie tax" as part of the Tax Cuts and Jobs Act (TCJA) that required unearned income of children to be taxed at the rate for estates and trusts. This change resulted in unexpectedly large tax bills for many. Instead, under the SECURE Act, children's unearned income will revert back to being taxed at their parents' top marginal rates, as was the case prior to TCJA. This provision generally is effective for tax years beginning after December 31, 2019, but you are able to elect to have it apply retroactively for 2018 and 2019.

Good Bye, Stretch IRA

Beginning for deaths after December 31, 2019, the stretch IRA is replaced with a 10-year rule for the vast majority of beneficiaries. The rule requires accounts to be emptied by the end of the tenth year following the year of death. There are no annual RMDs. Instead, the only RMD on an inherited IRA is the balance at the end of the 10 years after death. The new 10-year rule applies to beneficiaries of both traditional IRAs and Roth IRAs.

What if you are the beneficiary of an IRA inherited prior to 2020? For deaths in 2019 or prior years, the old rules remain in place. This means you can continue the stretch if you are the beneficiary of one of these grandfathered accounts. However, any beneficiary named on the inherited account as a successor beneficiary will be subject to the 10-year rule under the SECURE Act.

Eligible Designated Beneficiaries

Does the 10-year rule apply to all beneficiaries? Not quite. There are five classes of "eligible designated beneficiaries" who are exempt from the 10-year post-death payout rule and can still stretch RMDs over life expectancy. These include surviving spouses, minor children (but not grandchildren), disabled individuals, the chronically ill, and beneficiaries not more than ten years younger than the IRA owner.

Eligible designated beneficiaries can still stretch their inherited IRA over their life expectancy. But once they no longer qualify, the 10-year rule applies. For example, a minor child (but not a grandchild) qualifies under the SECURE Act as an eligible designated beneficiary and can stretch RMDs from an inherited IRA until the age of majority (age 18 in most states) or up to age 26 if still in school. At that point, the 10-year term payout rule applies.

Impact on Trusts

The elimination of the stretch IRA for most beneficiaries and replacement with the 10-year payout rule also includes most trusts. Many trusts will no longer work as planned under the new rules and could result in either large taxable distributions if IRA funds are paid to trust beneficiaries or high trust tax rates if the funds remain in the trust.

If you named a trust as your IRA beneficiary, your plan needs an immediate review and probable overhaul. After the SECURE Act, leaving your Roth IRA to a trust instead of your traditional IRA may be a much better strategy.

Good Advice is Essential

The SECURE Act has changed the game when it comes to retirement and estate planning. How will it affect you? You may have some new opportunities to make IRA contributions or be able to access your retirement funds without penalty. You may be able to delay taking RMDs a little bit longer.

Give some serious consideration to how the elimination of the stretch for most beneficiaries will impact you. Reconsidering your beneficiary designation for your IRA, converting traditional IRAs to Roth IRAs, and increasing the use of life insurance are all strategies to evaluate in the wake of the SECURE Act.

Do you have questions about your own situation? The SECURE Act means that now more than ever, good advice is essential. A qualified financial advisor can help guide you through all the new rules and ensure you are best positioned to take advantage of the breaks while avoiding the pitfalls.

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