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F.I.T. Focus – January 2020

The SECURE Act and What It Means for You

In case you missed it, *The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act)* was quietly signed into law in the latter part of December. The act made several significant changes to how Individual Retirement Accounts (IRAs) and employer-sponsored retirement plans are governed, created provisions to encourage the adoption of retirement plans by small businesses, and impacts several non-retirement areas, such as 529 plans and the Kiddie Tax. While the act contains provisions that affect a multitude of situations, we are going to focus on the rules that we believe have the most immediate potential impact and the broadest level of applicability for most individuals, families, and business owners.

- ***Elimination of the "Stretch" IRA*** – Of all of the provisions within the SECURE Act, the elimination of the "Stretch" IRA has been deemed to be one of the most significant changes. A "Stretch" IRA previously allowed non-spouse beneficiaries of IRAs and defined contribution plans to *stretch* required taxable distributions over the *beneficiary's* life expectancy. The ability to "stretch" distributions was attractive, as an heir could take smaller required distribution amounts, defer more income tax and allow the account balance to grow on a tax-free basis over a long time.

  Starting in 2020, non-spouse heirs who inherit an IRA will now be subject to the "10-Year Rule," which requires that all the assets are distributed from the IRA by the end of the 10TH year following the year of inheritance. Beneficiaries will not be required to distribute a specific amount each year, providing some flexibility into how much and when distributions can occur to maximize tax efficiency, but the entire account balance must be distributed in 10-years. While the "10-Year Rule" does not apply to spousal or other "Eligible Designated Beneficiaries," the elimination of the "Stretch" may have tax and estate planning implications for many in the years ahead. It will pay to review beneficiary designations and how any trusts you set up for estate purposes, maybe impacted given the change.

- ***Required Minimum Distributions (RMDs) Moved to Age 72*** – Required Minimum Distributions (RMDs), which forced IRA holders to take a taxable distribution from their account after they turned age 70 ½, has now been pushed back to age 72. While not a massive change, it is potentially beneficial for those who do not need to take the taxable distribution, allowing them to delay the inevitable taxes for a few years longer. Similar to current law, the first distribution needs to be withdrawn from the account in the year after the account holder turns 72. Importantly, the change only applies to those individuals who turn 70 ½ in 2020 and beyond.

- ***IRA Contributions Now Allowed Past Age 70 ½ for Those With Earned Income –*** While required distributions will now occur at age 72, Traditional IRA *contributions* can now be made beyond age 70 ½, which was not allowed before the SECURE Act. Importantly, contributions are only allowable for those who have compensation from an earned income via either wages or self-employment.

- ***Qualified Charitable Distributions (QCDs) Can Still Be Made at 70 ½*** - Qualified Charitable Distributions (QCDs) allow IRA holders who are 70 ½ to distribute money from an IRA, directly to a qualified charitable organization. The benefit of a QCD is that the distribution to the charity is not taxable as a normal distribution. An additional benefit is that the amount of the QCD counts against the amount of the required minimum distribution in a given year. While

the age for taking RMDs is now age 72, QCDs are still allowable at age 70 ½. In effect, this allows for 1-2 years of pre-tax charitable contributions from an IRA before an RMD is required.

- ***Qualified Birth or Adoption Distribution of $5,000 Without 10% Penalty –*** While early distributions from an IRA (pre age 59 ½) are subject to a 10% penalty, in addition to any income taxes due, there are several exceptions to the 10% penalty. The SECURE Act added a new exception for a Qualified Birth or Adoption distribution of up to $5,000. The exception applies on an individual basis (for each parent) and for each child born/adopted, after the qualifying event. Interestingly, it appears that the distribution can be re-paid later into the plan where the distribution originated or into an IRA.

- ***529 Plans Can Now Repay Student Loans Up To $10,000 –*** 529 plans help to pay Qualified Education Expenses, defined as college tuition, fees, books, supplies, and equipment required for attendance of a student at an eligible educational institution (including K-12). Notably, the SECURE Act has expanded the list to include "Qualified Education Loan Repayments" as a Qualified Education Expense. The new law allows for distributions to pay principal and interest for qualified educations loans, up to a lifetime amount of $10,000. As a bonus, an additional $10,000 of distribution can pay outstanding student debt for *each* of the beneficiary's siblings.

- ***The Kiddie Tax Goes Back to Pre-2018 Rates –*** The "Kiddie Tax" is a tax on unearned income for certain children who own assets, for example, in a custodial account. Before 2018, any income subject to the Kiddie Tax was subject to the parent's marginal tax rate. The Tax Cuts and Jobs Act of 2018 changed the law to make that income subject to trust tax rates, which led to modest savings for some but more onerous taxes for others with more significant income. The SECURE Act has reversed that change so that now unearned income will be taxed once again at the parent's marginal tax rate. The reversion goes into effect in 2020, but taxpayers can retroactively apply it to tax years 2018 and 2019, if sensible and worthy of filing an amended return.

- ***Small Businesses Eligible for Increased Tax Credits for Establishing a Retirement Plan and/or Auto-Enrolling Participants*** – If you are a small business owner and have been thinking about starting a retirement plan (401(k), 403(b), SEP IRA, SIMPLE IRA), the SECURE Act has made it more attractive to do so. Historically, small businesses were able to claim a $500 tax credit for up to 3-years to offset plan startup costs. The new law has upped the potential ante by allowing employers to claim a credit (for three years) for the greater of $500 or $250 multiplied by the number of non-highly compensated employees eligible to participate in the plan, up to a maximum of $5,000. So, if you have five non-highly compensated employees, you can claim a credit of $1,250 ($250 x 5). As an additional incentive, for new or existing plans that adopt a feature to auto-enroll their participants in the plan, another $500/year for three years can be claimed. *The SECURE Act also* allows for plan sponsors to include annuities as an option inside of a 401(k).

While the list above is by no means exhaustive, we believe it represents the most relevant of the changes adopted as part of the new law. The changes will likely prove beneficial for some, and maybe less so for others, but it pays to understand them and how they may impact your financial, estate, tax and retirement distribution needs in the months and years ahead.

If you have any questions regarding this report, please contact us at info@atwob.com or 914.302.3233

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