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PDV *OBSERVATIONS*

A Quarterly Newsletter for PDV Clients and Friends

The SECURE Act

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The Setting Every Community Up for Retirement Enhancement (SECURE) Act was passed into law on December 20, 2019, producing significant changes for retirement accounts. Other areas such as savings for education are also affected. Below we discuss the most significant ways in which the SECURE Act will affect your retirement/education savings and what you should consider doing based on the new changes.

Removal of maximum age for Traditional IRA contributions

Old law:

You are not allowed to contribute to a Traditional IRA once you have reached age 70 ½.

New law:

For Traditional IRA contributions made for tax year 2020 or after, the age limit has been removed. As long as you have earned income, you can make a contribution to your Traditional IRA.

Things to consider:

You should continue contributing to your Traditional IRA as long as you are working and can afford to put money away. While the deductibility of such contributions will depend on whether you are also covered by a retirement plan at work, you will still benefit from deferring taxes on any earnings from such contributions.

Increase in starting age for Required Minimum Distributions

Old law:

You are mandated to start taking the required minimum distributions (RMD) from your Traditional IRA and other qualified retirement plan accounts like 401(k) accounts once you have reached age 70 ½.

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New law:

The beginning age for RMD for Traditional IRA and other qualified retirement plan accounts is raised to 72 for individuals who attain age 70 ½ after December 31, 2019.

Things to consider:

The effective date of the new law can be easily misunderstood, potentially causing you to miss RMDs and get hit with a 50% penalty. To be clear, if you were born between July 1, 1948 and June 30, 1949 (i.e. you turned 70 ½ in 2019), your first RMD is determined according to the old law and is due by April 1, 2020. If you were born on or after July 1, 1949, the new law applies to you, in which case your first RMD will be due by April 1 of the year after you have reached age 72.

Generally, you should always delay taking withdrawals from your retirement accounts to the longest extent permitted by tax law. By doing so, you can let your retirement accounts grow tax-deferred until the required distributions hit. The new law provides the opportunity for more time for such tax-deferred growth.

Modifications to RMD rules for beneficiaries

Old law:

Generally, if you inherited an IRA or a defined contribution plan account such as a 401(k), you could stretch your required distributions and the associated tax payments over your life expectancy.

New law:

For IRAs or defined contribution plan accounts inherited from deceased account owners who pass away after December 31, 2019, the beneficiaries are generally required to fully withdraw the inherited account balances within 10 years after the death of the deceased account owner. There is no set schedule for required distributions during the 10-year period. Exception to the new 10-year rule applies when the beneficiary is one of the following:

- surviving spouse of the deceased account owner
- child of the deceased account owner who has not reached majority (but this exception no longer applies and the 10-year rule kicks in when the child reaches majority)
- disabled
- chronically ill individual
- individual who is not more than 10 years younger than the deceased account owner

Things to consider:

Because under the new law most beneficiaries will have to draw down the inherited IRAs or defined contribution plan accounts completely within 10 years (as opposed to stretching the RMDs over the beneficiaries' own life expectancies that will likely exceed 10 years in most cases), the withdrawals throughout the 10-year period will likely be larger than what they would have been under the old law. This is especially true for inherited accounts with large balances. As a result, beneficiaries will likely have to pay higher taxes and sooner as a result of the new law. The time horizon for tax-deferred growth of the inherited accounts is also substantially cut back for most beneficiaries.

After taking into account the tax effect, most beneficiaries will likely receive less inherited money under the new law than they would have under the old law. Since this can negatively affect most IRA and defined contribution plan account beneficiaries, you should review and make sure your beneficiary designations are consistent with your intended goals under the new law. It would be advisable to consult a tax advisor to investigate other possible methods that mitigate the negative tax impact and still accomplish your legacy objectives.

For those of you with Traditional IRAs, you may also want to look into whether converting your Traditional IRA money to Roth IRA money (which requires paying taxes on the converted taxable amount) will be worthwhile, since distributions to beneficiaries of Roth IRAs are tax-free (provided the five-year account holding period has been met).

Expansion of 529 plans distribution usage

Old law:

Distributions from 529 plans are tax-free as long as they are for funding qualified expenses. Qualified expenses under the old law include costs required for enrolling or attending an elementary school, secondary school, other eligible post-secondary education institution, college or university. Certain expenses are subject to additional limitations, such as the limit of up to $10,000 per year, for tuition expenses per beneficiary at private, public or religious elementary, middle and high schools.

New law:

Beginning in 2019, qualified expenses for 529 plan distributions are expanded to cover principal and interest payments on any qualified education loan. Such loan repayments are subject to a lifetime limit of $10,000.

Things to consider:

For college graduates with student loans, you can take up to $10,000 from your 529 plan to pay off your student loans.

Penalty-free withdrawals from retirement plans for child birth or adoption

Old law:

Subject to a few exceptions, the taxable portion of any early distributions from qualified retirement plan accounts such as Traditional IRAs and 401(k) accounts (i.e. distributions that you take before you reach age 59 ½) is subject to a penalty of 10% additional tax. The exceptions under the old rule cover several situations, such as if you are taking the distributions for qualified higher education expenses or first home purchase, but the exceptions do not cover expenses related to child birth or adoption.

New law:

Beginning in 2020, there will be no 10% penalty for amounts up to $5,000 of qualified birth or adoption distributions for each individual. Such distributions must be made during the 1-year period beginning on the date on which the child is born or on which the adoption is finalized. Eligible adoptees include individuals who have not attained age 18 or who are physically or mentally incapable of self-support.

Things to consider:

You are now allowed to withdraw up to $5,000 from your 401(k) account or IRA without the 10% tax penalty to help with the expenses of an additional family member. The $5,000 limit is at the individual level. This means if you and your spouse both have IRAs or eligible retirement accounts, you and your spouse each can withdraw up to $5,000 for a combined total of $10,000. Before you do this, you should be aware that the portion of your distributions consisting of pre-tax contributions is still subject to income taxes. Also, you will be giving up the opportunity of growing such retirement assets tax-deferred.

This article is not an exhaustive summary of all the major changes produced by the SECURE Act. There are additional provisions in the SECURE Act that might affect you. Given the SECURE Act involves many complex changes that can significantly impact your tax and estate planning, it is important for you to consult with your tax advisor and estate planning attorney on what is best for your situation under the new laws.