Second Quarter 2020

Time to Rethink Your Retirement Plan Strategy

December 20, 2019, the passage of the SECURE Act - *Setting Every Community Up for Retirement Enhancement Act* set in motion the most substantial rule changes for retirement accounts in 13 years. Designed to expand retirement plan access and increase lifetime income options in retirement plans, the SECURE Act also changed required distribution rules for retirement plans. These changes will dramatically impact estate plans for individuals with substantial IRA balances who were looking forward to providing children and grandchildren with funds for their future retirement.

Any retirement accounts inherited prior to January 1, 2020, are grandfathered under the pre-SECURE Act rules. The changes discussed below only impact accounts inherited AFTER December 31, 2019.

The following is a brief summary of some key changes that will impact retirement account holders.

Benefits for Retirement Account Holders

The age at which account holders are required to begin making required minimum distributions (RMDS) increases to 72 for those who had not reached the RMD age of 70½ prior to December 31, 2019. This also applies to required minimum distributions to spouses, who inherit an IRA where the deceased owner was under 70½ on December 31. As with the old rules, account owners must take their first RMD by April 1 of the year following the year in which they turn 72.

Accountholders who continue working and have earned income can continue to make contributions to their requirements accounts regardless of how long they live. Before, one was not able to make contributions after age 70½ with the exception of Roth IRAs.

The SECURE Act allows retirement accountholders to withdraw up to $5,000 from tax-deferred retirement accounts following the birth or adoption of a child without paying the 10% early-withdrawal penalty. Income tax is still owed on the distribution. Married couples can each take a $5,000 withdrawal from his or her own account, penalty free.

Inherited Retirement Accounts Must Be Distributed in 10 Years

Up until December 20, individuals could count on the ability to “stretch” the value of their retirement assets out over future generations. Withdrawals from an account left to a child or grandchild could be distributed over the expected lifetime of the individual. With the exception of four specific categories, retirement accounts inherited after December 31, 2019 must be distributed within 10 years.

Exceptions to the 10-year Rule

1. A surviving spouse
2. A beneficiary under the age of majority
3. A chronically ill or disabled beneficiary
4. A beneficiary no more than 10 years younger that the decedent

As under current law, surviving spouses can defer distributions until their deceased spouse would have reach the age of minimum required distributions. Once a minor beneficiary reaches the age of majority as defined by her or her state of residency, the 10-year rule takes effect.

Because 401K and IRA withdrawals (with the exception of Roth accounts) are taxed at the individual's personal tax rate, distributions from an inherited account could occur during the individual's highest earning years and push their tax rate into a higher bracket. For minors, a substantial inheritance could become available when they are least prepared to manage a sudden influx of money.

The Trust Trap

To counter having a young beneficiary receive access to considerable money when they may have minimal experience handling money, some estate plans set up trusts as the beneficiary. Under the new rules this can backfire. The income tax brackets for trusts and estates are narrower than those of individuals. In 2020, the top 37% tax rate for trusts and estates begins at $12,950. Because the trust would have to recognize as income all of the inherited IRA within 10 years, much of the inheritance could be lost to taxes before the individual reaches his or her majority.

In the view of the SECURE Act authors, retirement accounts were designed to help individual savers, not future generations. Plus, shortening the period of time in which inherited assets must be distributed increases taxes over the short-term, providing financing for the act's other features.

Education Savings Account Changes

The use of 529 education savings accounts was expanded to cover costs associated with registered apprenticeships; homeschooling; up to $10,000 of qualified student loan repayments (including those for siblings); and private elementary, secondary, or religious schools. State tax treatment of withdrawals varies for private elementary, secondary or religious schools and withdrawals may be subject to specific state taxes.

Government Employees Have a Two-Year Window to Comply

403(b) and 457 plans for government workers and the Thrift Savings Plan for federal employees are subject to the same changes, however, these account holders have two extra years in which to comply with the new law's Stretch IRA elimination.

Rethinking Your Estate Plans

If you fully anticipate spending all of your retirement account funds before you die, these changes may have little, if any impact. If you have accumulated substantial tax-deferred retirement plan assets that you had expected to include in your estate, it may be beneficial to sit down with your financial advisor and rethink your estate plans.

1. Do you need to change your retirement plan beneficiaries?
2. If passing retirement account assets on to future generations is no longer as desirable, should you adjust the amount you current contribute to IRA and 401k plans?
3. Is it more beneficial to spend down retirement plan assets on living expenses and charitable contributions and leave taxable accounts to your heirs, where value will be stepped up to current market value at your death?
4. Should you delay beginning distributions from your retirement accounts until age 72 or continue adding contributions after age 72?
5. Should trusts be modified to hold non-retirement account assets or do retirement accounts still make sense?
6. If your goal is to provide heirs with long-term income, should your estate feature more investments based on cash flow?
7. If you inherit a retirement account after January 1, 2020, what is the best way to allocate your distributions to minimize taxes and maximize the amount you receive? Unlike under earlier law, you are not required to begin distribution upon inheriting the account or within five years. Distributions can be made in years when taxable income will at its lowest (i.e. offsetting a loss) as long as the account is emptied within 10 years of inheriting.

There are a number of additional SECURE Act changes to retirement plans, most aimed at increasing access to retirement account investing on both individual and employer levels…but these need to be the subject of another article.

The preceding information is intended as a limited overview of the "Division O: Setting Every Community Up For Retirement Enhancement" of the "Further Consolidated Appropriations Act, 2020." It is not intended as investment or tax advice. Consult with your tax advisor and/or financial consultant before making any changes in your estate plan or retirement accounts.

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