The SECURE Act Modifies Several Retirement Plan Requirements

The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act) was passed as a part of the Further Consolidated Appropriations Act signed into law on December 20, 2019. The SECURE Act makes important changes to the requirements for retirement plan funding and distributions, as well as modifying other tax provisions including the kiddie tax rules. While most of the SECURE Act's provisions expand opportunities for individuals to increase their savings, the legislation includes one change that will require some taxpayers to update their estate plans. Below is a more detailed look at several of the act's changes that are the most likely to affect individuals in 2020 and beyond.

Increase in Required Minimum Distribution Age

Under prior law, individuals were generally required to begin taking required minimum distributions (RMDs) from their employer plans or traditional IRAs by April 1 of the year following the year in which they turned 70 ½. The SECURE Act increases the required minimum distribution age from 70 ½ to 72. This provision applies to distributions required to be made after December 31, 2019, with respect to individuals who attain age 70 ½ after that date.

Example: John, who has not begun taking distributions from his IRA, was born on August 7, 1949. Because he will turn 70 ½ after December 31, 2019, he can delay taking his first required minimum distribution until 2022, the year following the year in which he will turn 72.

Repeal of Maximum Age for IRA Contributions

The SECURE Act also modifies the rules for contributions to traditional IRAs. Under pre-act law, individuals were prohibited from making contributions to traditional IRAs after reaching the age of 70 ½. The new law removes this prohibition; that is, individuals over the age of 70 ½ are now eligible to contribute to traditional IRAs provided they have earned income. This change, effective for contributions made for tax years after 2019, places traditional IRAs on equal footing with Roth IRAs and employer plans, which do not have an age restriction on contributions.

Example: Katherine, who is over the age of 70 ½, has earned income in both 2019 and 2020. The due date for tax year 2019 contributions is April 15, 2020, but she cannot make a 2019 contribution in 2020. Any IRA contributions made during 2020 must be designated as tax year 2020 contributions.

Elimination of "Stretch IRAs" for Certain Beneficiaries

Unlike most of the other changes made by the SECURE Act, the partial elimination of so-called "stretch IRAs" is not a wholly taxpayer-friendly provision. Previously, individuals were eligible to spread out distributions from an inherited IRA or employer-provided retirement plan over their remaining life expectancy. For certain trusts named as the designated beneficiary of an IRA or

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retirement plan and having only individuals as beneficiaries, distributions could be taken over the remaining life expectancy of the oldest beneficiary. This type of inherited IRA, commonly referred to as a stretch IRA, allowed beneficiaries (especially younger ones) to reduce their tax burden by spreading distributions over many years and thereby avoid being pushed into a much higher tax bracket.

Under the new law, retirement accounts inherited from individuals dying after December 31, 2019 must generally be distributed within ten years after the year of death but are no longer subject to an annual required minimum distribution; in other words, the entire balance can be distributed as a lump sum in year ten. This rule applies unless the beneficiary is an "eligible" designated beneficiary, a category that includes surviving spouses, minor children, chronically ill individuals and other individuals not more than ten years younger than the account owner. For these eligible designated beneficiaries, the "stretch IRA" treatment is allowed until the beneficiary dies or the minor child beneficiary reaches the age of majority, at which point the remaining account balance must be distributed within ten years.

Example 1: Paul dies in 2020 and leaves his IRA to his son Ben, who has reached the age of majority. Because Ben is not an eligible designated beneficiary, the balance in the IRA must be paid out to Ben by the end of the tenth year following Paul's death.

Example 2: Amanda dies in 2020 and leaves her 401(k) plan to her sister Anna, who is six years younger than Amanda. Since Anna is not more than ten years younger than Amanda, she is an eligible designated beneficiary, and the balance in the 401(k) can be distributed over Anna's remaining life expectancy.

Planning Considerations: A shorter period for inherited retirement account distributions could have significant tax ramifications and result in non-eligible designated beneficiaries being pushed into a higher tax bracket. Individuals with sizable retirement account balances may need to reconsider their beneficiary designations in light of the new rules and proactively consider ways to minimize the tax burden on their beneficiaries. One potential strategy is splitting the primary beneficiaries on your IRA. Another is to convert the account into a post-tax Roth IRA by paying tax currently on the balance in the retirement account. Roth conversions can be done gradually over several years and will allow the beneficiaries to receive distributions tax-free. Charitably-minded taxpayers may consider naming a charitable remainder trust (CRT) as an IRA beneficiary, with a child named as the income beneficiary of the CRT.

In the past, many estate planners recommended the use of so-called "conduit" trusts, which allowed distributions to be stretched over the life expectancy of the oldest trust beneficiary. However, the SECURE Act wreaks havoc on conduit trusts, particularly for minors and children. Now, if the conduit trust has a non-eligible designated beneficiary, upon the death of the account owner the retirement plan will need to be distributed to the beneficiary within ten years. These and other beneficiary designations may no longer achieve the tax and nontax goals that were originally intended and should be reviewed and updated as necessary.

Kiddie Tax

The so-called "kiddie tax" is a tax on children under the age of 19 (or children who are full-time students under the age of 24) who have unearned income, such as interest and dividends, exceeding a threshold amount. Before the Tax Cuts and Jobs Act of 2017 (TCJA), this tax was imposed at the parents' tax rate, provided that the parents were taxed at a higher rate than the child. The TCJA overhauled the kiddie tax by causing the unearned income of the child to be taxed using the highly compressed rate brackets applicable to trusts and estates, thereby making the parents' tax situation irrelevant.

Due to concerns that this change was unfairly affecting certain children, including survivors of deceased military personnel who were receiving government payments, the SECURE Act repealed the TCJA changes to the kiddie tax. As a result, children subject to this tax will once again be taxed at their parents' tax rate. This change is effective for 2020 and subsequent tax years, but taxpayers may make an election to apply it retroactively to tax years 2018 and 2019.

Planning Tip: Taxpayers who are subject to the kiddie tax should evaluate whether the TCJA or pre-TCJA rules will result in a lower tax liability for the 2018 and 2019 tax years. An amended return can be filed to claim a refund for the 2018 tax year if the kiddie tax was higher under the TCJA rules.

Additional Provisions

The SECURE Act made several other changes that are effective as of January 1, 2020, including the following:

- **Section 529 plan distributions:** distributions from Section 529 plans can now be used to pay for certain expenses incurred in connection with apprenticeship programs and to make principal or interest payments on qualifying student loans.
- **Retirement plan withdrawals for birth or adoption:** up to $5,000 can be distributed penalty-free from a retirement account to pay for expenses related to the birth or adoption of a child.
- **Fellowships and stipends as compensation for IRA purposes:** taxable fellowships and stipends received by graduate and postdoctoral students are now treated as compensation for purposes of determining an individual's allowable IRA contributions, thereby enabling these students to begin saving for retirement without delay.

Contact Us

If you have questions regarding the changes made by the SECURE Act and how they will affect your personal or business tax situation, please contact your Bennett Thrasher tax advisor by calling 770.396.2200.