TFC FINANCIAL
The Financial Counselors

FINANCIAL PLANNING UPDATE
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OUR VIEW

Under the new law, workers with earned income can contribute to a Traditional IRA regardless of their age.

The SECURE Act & Impacts on Retirement Planning

On the heels of the sweeping reform of the Job Cuts & Jobs Act passed in December 2017, another law was passed at the end of 2019 that has implications for many taxpayers called the SECURE Act (Setting Every Community Up for Retirement Enhancement).

Most of the provisions in the new law took effect on January 1, 2020 and many of the areas impacted are retirement related. We've summarized a few of the most relevant highlights from the law as they relate to the following areas:

- Retirement Savings
- Retirement Plan Distributions
- College Savings Plans
- Medical Expenses
- Other Provisions

Retirement Savings

A few provisions in the SECURE Act aim to increase retirement savings and attempt to address the problem of an underfunded retirement for many Americans.

Removal of IRA Contribution Age Limits: Under the previous law, no traditional IRA contributions were allowed after age 70 ½ (even if a person was still working). Under the new law, workers with earned income can contribute to a Traditional IRA regardless of their age.

Increased Access to Retirement Plans and Expanded Plan Options: Provisions in the new law have increased the tax incentives for small businesses to establish retirement plans for their employees. Additionally, some longer-term part-time employees (who were previously ineligible to enroll in employer retirement plans) will now be allowed to do so if they work at least 500 hours a year, for 3 years starting in 2020. The new law also gives tax incentives to retirement plans who adopt auto-enrollment for their participants. This credit is available for both new and existing plans. They also increased the maximum default percentage for 401(k) auto-enrollment from 10% to 15%. Finally, annuity options are expected to become more readily available within retirement plans, thus expanding options for guaranteed lifetime income for retirees.

Retirement Plan Distributions

The most sweeping changes of the new law impact the distribution options from retirement plans. These changes impact those heading into retirement and those who plan to leave retirement plans to the next generation. Additionally, a new IRA distribution exception was added for account owners under age 59 ½.

For anyone turning age 70 ½ in 2020 and beyond, their first required minimum distribution from their retirement accounts won't be mandated until age 72.

Distributions Starting at Age 72 (Instead of at Age 70 ½): For anyone turning age 70 ½ in 2020 and beyond, their first required minimum distribution from their retirement accounts won't be mandated until age 72. For anyone who is already 70 ½, he or she will maintain the current mandatory annual distributions per the IRS table.

Inherited IRA for Non-Spouses: Under the previous rules, the annual distributions for an inherited Traditional IRA were calculated based on the life expectancy of the beneficiary (thus continuing with tax-deferred growth and extending the life of the account). This was also known as a "Stretch IRA". Starting in 2020, newly inherited IRA accounts will need to be fully distributed to the beneficiary in the 10th year after it was inherited.

Although the 10-year distribution timeline restricts the opportunity for long-term tax-deferred growth and makes many existing estate plans not work as intended, it does offer other planning opportunities. Mainly, the new rule for inherited IRAs no longer mandates annual distributions. Instead, the distributions can be made at any interval, as long as the account is fully distributed (and taxes are paid) at the end of 10 years. For individual beneficiaries, a distribution strategy can be developed based on the income bracket and cash needs of the beneficiary. For Trust beneficiaries, developing a strategy may be more complicated, so it's important to re-examine the specific language in any Trust document named as an IRA beneficiary to determine how it will change the current estate plan.

Certain beneficiaries will still be allowed to use the previous distribution rules and spread the IRA distributions out over their life expectancy. These exceptions to the 10-year rule include accounts inherited by spouses, disabled or chronically ill beneficiaries, individuals who are not more than 10 years younger than the decedent or certain minor children [1].

No Change to Qualified Charitable Distributions: For anyone looking to donate to qualified charities from his or her Traditional IRA, this can still be done starting at age 70 ½.

Starting in 2020, newly inherited IRA accounts for non-spouse beneficiaries will need to be fully distributed to the beneficiary in the 10th year after it was inherited.

New IRA Distribution Exception: Taking distributions from a Traditional IRA before age 59 ½ results in those distributions being taxed as ordinary income as well as being subject to a 10% early withdrawal penalty. To avoid the 10% penalty, the reason for the distribution must fall under one of the limited exceptions as defined by the IRS. The 2019 law added a new exception, whereby new parents can withdraw up to $5,000 from their Traditional IRA for childbirth or adoption expenses without paying the 10% penalty.

College Savings Plans

Funds set aside for qualified education expenses (in 529 College Savings Plans) received a few additional options in the 2019 tax law.

Apprenticeship Expenses & Limited Loan Payments Added: New in 2020, distributions can be made from a 529 plan to cover expenses related to Apprenticeship Programs as well as in a limited capacity to pay student loan debt in a limited capacity. Each beneficiary of a 529 plan can now take a $10,000 distribution to make a qualified education loan repayment (limited to one time per beneficiary).

Medical Expenses

Medical Expense Threshold Lowered: A topic that is relevant to anyone with high medical expenses is the threshold over which you can deduct unreimbursed medical expenses. For 2019 and 2020, the threshold is 7.5% of your adjusted gross income (AGI), which is down from 10% in 2017.

Income incurred by a minor child over $2,200 per year is taxed at the parents' top marginal tax bracket and not at trust income tax rates.

Other Provisions

Taxes on Children's Income Reverts to Previous Rules: The 2019 tax act reversed the changes made in the 2017 Tax Cuts & Jobs Act regarding income to a minor child. Moving forward, income incurred by a minor child over $2,200 per year is taxed at the parents' top marginal tax bracket and not at trust income tax rates.

Key Take-Aways

As 2020 unfolds, it's a useful time to revisit your retirement and estate planning strategies and determine how the new SECURE Act may affect you.

We recommend that you consult your TFC financial advisor, CPA and/or estate planning counsel as you work to develop your personal financial strategy and adhere to the new laws. The IRS is continuing to release further guidance on these and other topics related to the SECURE Act of 2019.

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Footnotes:

1. A minor child who inherits a Traditional IRA will be allowed to stretch the distributions using their life expectancy table until they reach the age of majority (which is age 18 in many states). At the age of majority, he/she will then be subject to the 10-year distribution timeline.