Recent Passage of the SECURE Act

During a period of congressional bickering, a bipartisan Congress passed one of the more extensive legislative retirement reforms in recent years. The SECURE Act was signed into law by the President on December 20th and it became effective January 1, 2020. The SECURE Act legislation stands for "Setting Every Community Up for Retirement Enhancement" and it enacts numerous provisions that are intended to strengthen the retirement security of taxpayers across the country. The legislation will have a significant impact on how taxpayers plan for their retirement for 2020 and beyond. The following content outlines the more significant individual income tax changes brought on by the legislation.

No "Stretch" IRAs

One of the more notable changes resulting from the SECURE Act is the elimination of the "stretch" provision in regards to required minimum distributions (RMD) for non-spouse beneficiaries of inherited IRAs and other retirement accounts. Under previous law, beneficiaries who did not inherit their IRAs or retirement accounts from a spouse were in some cases permitted to withdraw the RMDs over the span of their lifetime, which could result in an income deferral of a several years to several decades. The SECURE Act now requires that these beneficiaries withdraw all assets of the account within ten years from the account owner's date of death. There are no RMDs within these ten years, however, the entire account must be liquidated by the end of the ten-year period.

While the general rule under the SECURE Act is the ten-year rule, there are certain groups of beneficiaries (deemed Eligible Designated Beneficiaries) for which the rules do not apply. These groups consist of a) spousal beneficiaries, b) disabled beneficiaries, c) chronically ill beneficiaries, and d) individuals who are not more than 10 years younger than the decedent. Also, the Act provides an exclusion for certain minor children of the decedent, but only until they reach the age of majority.

For the Eligible Designated Beneficiaries, the old law will still apply. The Eligible Designated Beneficiaries continue to have the option to take distributions over their life expectancy.

Change in the Required Minimum Distribution Age

Another notable change enacted by the SECURE Act is the increase to the RMD start date. Under previous law, holders of qualified accounts such as 401(k) or IRAs had to begin receiving distributions once they turned age 70 ½. The SECURE Act bumps that age up to 72. However, there are provisions enacted for those individuals whose age falls in between. For those taxpayers who turned age 70 ½ in 2019, they must still withdraw their initial RMD by April 1, 2020. Taxpayers who are expected to turn age 70 ½ in 2020 will not be required to take a distribution until they are 72.

Qualified Charitable Distributions (QCDs)

The SECURE Act did not make any changes to the date that individuals may use their IRAs to make QCDs. For example, if an individual turns age 70 ½ in 2020 and is not be required to take a RMD, they can still use their IRA to make a QCD up to the $100,000 limitation. Thus, they would not be required to wait until turning age 72. It is important to note, an individual must have reached the age of 70 ½ prior to taking their first QCD to qualify.

Allowance of IRA contributions

The SECURE Act lifts the prohibition on making traditional IRA contributions once a taxpayer turns age 70 ½. Beginning in 2020, taxpayers of any age with earned income will be permitted to contribute to a traditional IRA.

Expansion of availability of Annuities for 401(k) Plans

The SECURE Act eases the rules for employers offering a 401(k) plan around how they choose an annuity provider. This law change shifts some of the risks from the employers over to the annuity companies. The annuities are now portable, meaning if you leave your job you can roll over the 401(k) annuity that you had with your former employer to another IRA or 401(k) account and avoid surrender charges and fees.

Return to the prior "Kiddie Tax" laws

The Kiddie Tax applies to the unearned income of a child that is greater than $2,200. Under prior law, the Tax Cuts & Jobs Act of 2017 (TCJA) changed the Kiddie Tax rates to match the trust income tax rates, which could potentially be much higher than the parent's income tax rate. This process resulted in an unintended increased tax burden on those returns. The SECURE Act fixes this Kiddie Tax glitch and unwinds the TCJA provisions. The change reverts the structure back to the prior law, which is based on the parent's tax rates.

Qualified 529 Plan Distributions Expanded

Beginning 12/31/18, taxpayers will be able to distribute up to a limit of $10,000 (lifetime per taxpayer) from qualified 529 plans to pay towards qualified education loans. However, there is no double-dipping allowed when it comes to federal education benefits. Any student loan interest paid for with the tax-free 529 plan earnings would not be eligible for the student loan interest deduction. Furthermore, the $10,000 lifetime limit applies to a beneficiary and each of their siblings. Thus, a parent with multiple children could take a distribution for each child.

In addition, 529 Plan distributions can now be used to pay for registered apprenticeship programs, trade schools and vocational programs. Previously ineligible, these items now qualify as eligible expenses under the SECURE Act.

IRA Distributions can now be used for Childbirth or Adoption

For tax years 2020 and beyond, the SECURE Act allows penalty-free distributions for funds used for a qualified birth or adoption. Distributions can come from a qualified retirement plan, a Section 403(b) tax-sheltered annuity plan, an eligible 457(b) deferred compensation plan, or an IRA. The taxable income will be reported on your return, however, if you are under age 59 ½ (an early distribution) the 10% premature distribution penalty will not apply. Taxpayers will be allowed to receive $5,000 each (a limit of $10,000 for a married couple) if the funds are used for a qualified birth or adoption. Distributions must occur within 1 year of the date of birth or date the adoption is finalized to qualify for this provision.

Additional Extender Legislation

Congruent with the passing of the SECURE Act, there were a few additional “extender” provisions enacted late in 2019 with the passing of the “Taxpayer Certainty and Disaster Relief Act of 2019”. Both the mortgage insurance premium deduction, and the deduction for qualified tuition and related expenses were reinstated and made effective through 2020. In addition, the ‘hurdle rate’ for deducting qualified medical expenses returns to 7.5% for both 2019 and 2020.

If you are interested in discussing these provisions further, or any other component of the SECURE Act, please contact your SilverOak Advisor or call 952-896-5700.

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