New Retirement Planning Law Is a 'Mixed Bag'

The SECURE Act Shakeup

by Alexandra Armstrong, CFP, CRPC, and Christopher Rivers, CFP, CRPC

Our last article was the first in a series on how to choose a financial planner and navigate the financial planning process. Since that time, a significant tax bill was passed in Congress and we thought it best to address those changes now. We'll get back to the nuts and bolts of financial planning with the next column.

On Dec. 20, 2019, the Setting Every Community Up for Retirement Enhancement (SECURE) Act was signed into law (*see cover story on page 38*). The act contains 29 provisions, encompassing many aspects of financial planning and retirement saving that will have far reaching impact on investors and their heirs.

As of this writing the print is barely dry on the new act and once final Treasury guidance is released this year, nuances in interpreting this new law will become clearer. Until then, we're left to interpret the law's effects based on the language of the law itself. Below we address what the SECURE Act entails and who it affects, as well as provide suggestions on how to plan for the changes that have been instituted.

Key Provisions of the SECURE Act

Repeal the prohibition of retirement contributions after the account owner reaches age 70½.

- **Delay the age for required minimum distributions** (RMDs) from 70½ to 72.
- **Eliminate the lifetime "stretch" IRA option**, requiring non-spousal beneficiaries of IRAs to deplete the inherited balance within 10 years of the decedent's death (with exceptions; see below for more details).
- **Permit penalty-free withdrawals** of up to $5,000 from retirement accounts to help pay for childbirth or adoption expenses.
- **Expand permitted expenses for 529 college savings plans** to include apprenticeships, as well as up to $10,000 of qualified student loan repayments for the beneficiary and $10,000 for each of the beneficiary's siblings (an aggregate lifetime limit, not an annual limit).
- **Reinstate the "kiddie tax"** to pre-Tax Cuts and Jobs Act rates.
- **Allow graduate students to count stipends** and nontuition fellowship payments as compensation for individual retirement account contribution purposes.

For taxpayers, the act is a mixed bag. Many of the provisions adopted into the Internal Revenue Code as part of the SECURE Act allow individuals more time for tax-deferred savings and growth before distributions are required. But the SECURE Act also includes requirements designed to account for this loss of revenue by accelerating the withdrawal and taxation of inherited retirement accounts.

The Age Limit on IRA Contributions Is Repealed

The act lifts the prohibition on IRA contributions after age 70½. Interestingly, these were the only retirement accounts with the limit, as participants in employer plans such as 401(k) or 403(b) plans already had the ability to contribute past age 70½. In 2020 and beyond, you may contribute to an IRA at any age, provided you have earned income.

Required Minimum Distributions Begin at Age 72

Reflecting the changing nature of retirement, the act pushes back the onset of required distributions from retirement accounts from age 70 to age 72. Anyone born on July 1, 1949, or later, can thus skip the distribution they would have had to take in 2020, and begin taking distributions in 2021. Notably, those who took their first RMD at age 70½ last year, and who will be 71 this year, do NOT get to skip 2020. If you had begun taking RMDs prior to 2020, you must continue to take them in 2020 and beyond.

This is not the only change coming to RMDs. Separate from the SECURE Act, the life expectancy tables that determine the amount you are required to take each year are likely to change. In November, the Internal Revenue Service issued proposed regulations that modestly lower the required distribution amount each year, reflecting longer life expectancies. While not final, the new tables are expected to be put in force in 2021.

The Kiddie Tax Changes…Again

The last major tax act (the TCJA of 2017) imposed a stricter tax schedule on unearned income for minors, subjecting that income to the same brackets applied to trusts. Two short years later, the kiddie tax is reverting to its old form. Thus, the child's first $1,100 of unearned income is tax-free. The child's next $1,100 of unearned income is taxed at the child's tax rate (0% in most cases), while any income above the combined $2,200 is taxed at the parent's tax rate.

Complicating matters further, taxpayers can elect to use this new treatment for 2019 and even retroactively back to 2018 as well. Thus taxpayers who have children with substantial custodial accounts should consider filing amended returns for 2018, as well as electing to use the new kiddie tax treatment for 2019 income.

Loss of the "Stretch" IRA Option

Although there are many ways in which the SECURE Act will change how individuals save for retirement, the provision with the greatest effect is the elimination of the lifetime "stretch" option for IRAs. Prior to the SECURE Act, individual beneficiaries were entitled to stretch out the withdrawal of an inherited retirement account based on an IRS table tied to their life expectancy.

Beneficiaries are now required to withdraw their entire inherited retirement account within 10 years of the original owner's death. The beneficiary does have leeway to decide on what schedule the money is withdrawn within that 10-year period. Thus there may be opportunity for careful tax planning around timing when you realize the income from the inherited IRA.

There are also some exceptions to this rule. The individuals who remain entitled to the lifetime "stretch" option include:

- **The surviving spouse;**
- **A child who hasn't reached the age of majority** (the account would need to be distributed within 10 years of reaching the age of majority);
- **Disabled individuals;**
- **A chronically ill individual;**
- **An individual who is not more than 10 years younger** than the deceased; and
- **Beneficiaries of IRA owners** who died before Dec. 31, 2019.

In addition, plans maintained via a collective bargaining agreement and governmental plans, such as 403(b) and 457 plans sponsored by state and local governments, and the Thrift Savings Plan aren't impacted until Jan.1, 2022.

In most instances, withdrawal of a beneficiary's retirement account over a 10-year period (rather than over the course of his or her lifetime) will result in substantially less tax-deferred growth, as well as more taxes due on withdrawal from the account. To help mitigate the potential negative ramifications of these changes, several strategies will likely become more popular when planning for the loss of the "stretch" IRA option.

> "Individuals may want to explore whether taking a withdrawal from the retirement account to pay premiums on a life insurance policy is more advantageous than leaving the retirement account to beneficiaries."

Roth Conversions

With tax rates at historic lows and uncertainty surrounding their future, you may want to talk to your CPA about Roth conversions. The ramifications of converting a traditional IRA to a Roth IRA are beyond the scope of this article, but we will cover them in-depth later this year. In short, converting a traditional IRA to a Roth IRA would result in the account owner paying income tax now, so that beneficiaries may avoid being taxed rapidly, at higher rates, on distributions in the future. This is an especially applicable strategy if the beneficiaries are in a higher tax bracket than the account owner.

Going forward, account owners should be sure to ask these key questions before making a Roth conversion:

- **Will the individual need the money** within five years of conversion?
- **Will the individual be in a higher** or lower tax bracket in the future? Are the beneficiaries expected to be in a higher tax bracket?
- **Where will the individual get the money** from to pay the taxes owed because of the conversion?

Life Insurance

Individuals may want to explore whether taking a withdrawal from the retirement account to pay premiums on a life insurance policy is more advantageous than leaving the retirement account to the beneficiaries. Beneficiaries typically receive life insurance money tax-free. Depending on the insurability of the individual, the total death benefit payable to the beneficiaries may exceed what they receive as beneficiary of an IRA.

Qualified Charitable Distribution (QCD)

Notably, while the act increased the age when RMDs must start from 70½ to 72, it left the age requirement for QCDs intact at 70½. QCDs are likely to become more advantageous after the SECURE Act because IRAs will become a less attractive inherited asset. Therefore, tax-free distributions from the IRA may be more beneficial than gifting nonqualified appreciated assets, which could pass to beneficiaries at a stepped-up basis at your death.

Account owners will need to coordinate with their CPA if they're planning to contribute to their IRA after age 70½, as such contributions may affect the QCD treatment.

Trusts

It's imperative that individuals who named a trust as the beneficiary of an IRA prior to the implementation of the SECURE Act review their current estate plan with an attorney to determine how the SECURE Act may affect

Continued on Page 40

What Else Needs to Change

Financial planning has become overly complex. There are too many varieties of tax-deferred accounts, each with their own specific contribution and withdrawal quirks. It's absurd that workers have to choose between health savings accounts, different kinds of IRAs, 401(k)s, 529 college saving plans and tax-deferred life insurance polices when many of them have overlapping withdrawal provisions and confusing penalties. At some point, there should be one consolidated tax-deferred savings account available to all Americans. That would make it easier for individuals to plan for and adjust to new circumstances. A consolidated tax advantaged plan would likely provide more flexibility for the government to adjust contribution and withdrawal limits as needed.

What Hasn't Changed

The SECURE Act contains some welcome changes, though many heirs and their estate planners might be disappointed to lose the stretch IRA strategy. New annuitization options may reduce the risk of outliving our money, but our need to accumulate a large pool of assets for retirement hasn't changed at all. America needs to save and invest wisely.

We all have different retirement expectations, needs and resources. There's no catch-all target savings amount that can cover everyone. But it's frightening to know that the median retirement savings for 35-44 year olds was recently only $37,000. And with savings accounts earning only fractions of 1% and the Federal Reserve targeting inflation at 2%, we can't be complacent about where we put our retirement savings either. Earning a high rate of return is just as important as putting aside as much as you can. Regularly investing into high quality growth stocks, or funds, if you're investing in a 401(k), while using other asset classes to manage risk remains one of the best ways to grow wealth.

It's challenging to forecast the long term impact of the SECURE Act, but here are some guesses. Annuities will see banner growth in assets under management, but the market will demand more focused, transparent and far cheaper products. The multiple employer plan structure will make it possible for small companies to offer sophisticated retirement plans while saving money from economies of scale.

As more employers offer retirement plans, the ones that don't will find it increasingly difficult to attract outstanding job applicants. Even after the cost savings, expense averse employers might rely even more heavily on independent contractors, who wouldn't be eligible to participate in a company retirement plan. And one final reminder: Tax laws are complicated enough. New rules can make them even more challenging. Some of the changes included in the SECURE Act still need to be interpreted or implemented by government agencies, so it's essential you check with your tax and other wealth advisers before you make any changes.

FINANCIAL PLANNER

Continued from p. 15

the distributions from the IRA to the trust. In some instances, trusts drafted prior to the SECURE Act may be obsolete, resulting in a distribution pattern that works against the original intent of the trust.

Estate Planning

It may make sense for account owners to revise their estate plan to take a more comprehensive "asset-by-asset" approach, rather than to continue splitting assets by percentage. For example, the account owner might earmark IRA assets to be distributed to minors or individuals in lower tax brackets and designate a larger proportion of nonretirement assets to those with higher incomes.

Secure Your Future

As more information becomes available regarding the interpretation of the SECURE Act, it's important to continue to review all aspects of your financial plan and beneficiary elections to ensure that you understand how you and your family may be affected.

Be sure to reach out to your financial adviser and your accountant to discuss how to plan for 2020 and beyond.

Alexandra Armstrong is a CERTIFIED FINANCIAL PLANNER professional and Chartered Retirement Planning Counselor and founder and Chairman Emeritus of Armstrong, Fleming & Moore, Inc., a registered investment advisory firm located at 1800 M St. N.W., Suite 1010-S, Washington, D.C. 20036-5813, 202/887-8135.

Christopher Rivers, a CERTIFIED FINANCIAL PLANNER professional and Chartered Retirement Planning Counselor and co-author of this article is a principal of Armstrong, Fleming & Moore, Inc. Securities are offered through Commonwealth Financial Network, member FINRA/SIPC.