Answers to Advisors' Most **Commonly Asked Questions** About the SECURE Act

Find the answers to the most commonly asked questions about the SECURE Act

- The SECURE Act marked a dramatic shift in retirement income planning, particularly in three major areas.

Most importantly, the SECURE Act changed the distribution rules around IRAs and other retirement accounts.

The most notable of these changes now requires inherited IRAs and 401(k) s to be distributed over 10 years unless one of the exceptions is met. The legislation also pushed out the beginning age for RMDs to age 72 from 70.5 and removed the age limit to contribute to IRAs.

The SECURE Act also made major changes to employer-sponsored retirement plans like 401(k)s.

The bill:

» Adds a tax credit for small businesses that set up retirement plans.

» Adds a tax credit for employers that add an automatic enrollment provision.

» Allows multiple employers to come together in one 401(k) plan, a multiple employer plan, starting in 2021.

The SECURE Act also changed lifetime income options in retirement plans.

The bill:

- » Requires that plans show how much income your savings can generate in retirement.
- » Makes it easier for employers to add annuities into retirement plans.
- » Improves the portability of annuities from one account to another if you can't keep your annuity in your retirement account.

Who is Affected

What event(s) triggers the SECURE Act to take effect?

You're affected by the SECURE Act if:

- » You own an IRA or retirement account
- » You have not started taking RMDs from your retirement accounts
- » You are set to inherit a retirement account
- » You want to continue to save in IRAs
- » You want to give to charity in retirement

Who is exempt from the SECURE Act's 10-year provision?

The SECURE Act laid out a number of people exempt from the SECURE Act's 10-year provision: surviving spouses, disabled individuals, the chronically ill, those not more than 10 years younger than the deceased, and children of the deceased.

Are there exceptions to the 10-year provision based on the amount of money in the account?

No. There was a different version of the SECURE Act in the Senate that would have laid on some account minimums to be subject to the 10 year distribution, but that language was never added to the SECURE Act. As such, all IRA and defined contributions accounts of any size are subject to the rule.

Can anything be done to circumvent the SECURE Act's 10-year provision? If so, what?

There is nothing to circumvent the rule. However, there are planning strategies to mimic or plan around the implications of the rule.

First, you can do Roth conversions to mitigate the tax implications that might arise from leaving a large taxable IRA to heirs with high incomes. Second, you can use non-qualified annuities or life insurance as a way of protecting assets and generating tax-favored income streams for life to heirs. Lastly, you can also use charitable remainder trusts (CRTs) as an IRA beneficiary to generate a charitable deduction, to leave a lifetime income stream to a beneficiary, and to leave significant assets to a charity of your choosing.

This strategy can result in you passing more wealth in some cases to your heir than a 10-year stretch IRA would and could also increase total wealth passed over when considering the charitable gift too. In short, you are passing the taxes over to the charity instead of having them all go to the government.

Grandfathering Provisions

The SECURE Act went into effect on January 1, 2020. If a client with an IRA died in 2019, would the beneficiary be grandfathered into the old rules and able to extend RMDs over their life expectancy?

Yes. The most important thing to remember about the grandfathering provisions is the date of death of the original IRA owner. If the owner died before January 1, 2020, the old stretch rules apply.

Does an IRA that was established by December 31, 2019 also need to be funded by December 31, 2019 to avoid the SECURE Act's 10-year provision?

No. The inherited IRA did not need to be established or funded by the end of 2019 to be grandfathered into the pre-SECURE Act stretch provisions. It is all about the date of death of the owner.

Does the SECURE Act's 10-year provision apply to a beneficiary who started receiving payments prior to January 1, 2020?

If you started receiving inherited beneficiary distributions from an IRA prior to the passage of the SECURE Act nothing changes. This person would follow the pre-SECURE Act distribution rules.

Calculating RMDs Under Delayed Age Requirement

The SECURE Act delays the requirement that most people start taking out RMDs from their retirement at age 72 (previously age 70.5). Can those who started their RMDs at 70.5 under the previous rules stop and postpone until their 72nd birthday?

No. Anyone who reached age 70.5, and is retired, by the end of 2019 has had their required beginning date set. This means they owe an RMD for 2019 and will need to continue taking RMDs. So, if they started before 2019, they cannot postpone in 2020 and up until their 72nd birthday. Missed RMD penalties are huge, 50%, so don't let clients miss these RMDs.

Will you still be able to delay RMDs until April 1 of the year after you turn 72? If so, would two distributions be allowed in the year you turn 73?

Yes. Once the SECURE Act's RMD rule kicks in, when an individual reaches age 72, they must start taking RMDs by April 1 of the following year. The general rule regarding RMDs is they have to be taken by Dec. 31 of each year.

Remember, taking two RMDs in a year could increase your tax burden, because both distributions are taxable. While you have until April of the following year to take your first RMD, it might make more sense to take it in the same year you turn 72.

If you delay an RMD until April 1 of the year after you turn 72 and therefore take two distributions in one year, how would those distributions be calculated?

Let's say you reach age 72 in 2022, but push out your first RMD until April 1, 2023. Your RMD due for 2022, is calculated by looking at the ending account value on December 31, 2021. Your second RMD, due December 31, 2023, is calculated by looking at the account value on December 31, 2022. In other words, the calculation for the RMD you push to April 1 the following year is still calculated as if it was due by the end of December 31, 2021.

How does the SECURE Act impact RMDs and retirement savings planning for someone saving in an IRA after age 70.5?

The SECURE Act removed the rule that disallowed direct savings and contributions into traditional IRAs after age 70.5 As such, those working in retirement or after 70.5 can contribute to an IRA as deductible or non-deductible. If you owe an RMD, it is based on prior year account value, so contributing this year to an IRA, won't impact the calculation of the RMD until the following year. However, it is important to note that deductible IRA contributions after age 70.5 could now offset your ability to do QCDs as the SECURE Act added an anti-abuse provision regarding post-70.5 deductible IRA contributions.

Spouses

Spouses are not affected by the 10-year provision. So should they keep the inherited IRA in the name of the decedent or roll it into their own account?

The short answer is: It really depends. If you keep an IRA in the name of the decedent there could be situations where you use the deceased individual's remaining stretch first or go to 10 years, depending on death of owner. However, best case would be to roll or change the name on the account to the surviving spouse in most cases if you are trying to avoid a 10 year or shortened distribution period. In some situations, if the surviving spouse is under 59.5, it can make sense to leave the account in the deceased spouse's name for a time period to avoid penalty taxes in case of distribution needs.

10-Year Provision and Successor Beneficiaries

What happens if the primary beneficiary dies within 10 years of the account holder, before the account has been exhausted? Does the successor beneficiary need to exhaust the account to fulfill the original 10-year provision, or does the 10-year provision reset?

Under the 10-year rule this gets pretty simple in most cases. The reality is the only thing that really matters is when the original owner dies, sometimes the type of beneficiary matters too (i.e. was it a spouse under age 72).

(ANSWER CONTINUED ON NEXT PAGE)

Generally speaking, in the future if the beneficiary does not fall into one of the exempt eligible designated beneficiary categories, the IRA needs to be distributed within 10 years. In other words, a successor beneficiary does not get additional time to exhaust the account.

Let's say an IRA owner dies, and their daughter takes over the account with a 10-year distribution period. After five years, the daughter dies, leaving the account to her son. The grandson, son of the recently deceased first beneficiary (the daughter of the IRA owner) will continue distributions as if he was the daughter. As such, there are five years remaining to distribute the remainder of the IRA assets.

However, let's say you inherited the IRA prior to 2020 and this beneficiary was receiving stretch treatment. However, when they die after January 1, 2020, in most cases, the successor beneficiary (the beneficiary of the beneficiary) will now be subject to a 10 year distribution period.

If you are thinking of using a trust to pass income to a beneficiary under the pass-through rules, what is the best way to review needed language for amending trusts to conform with the new law?

It's important to review the trust language that relates to the beneficiary's access to IRA funds. If the trust was set up to protect against spendthrift issues (the spending habits of the beneficiary), or to protect against creditor issues, the trust language might limit distributions from the IRA to the required minimum distribution each year to the beneficiary. If this is how it is drafted, remember that under the new 10-year rule, there is no RMD in years one through 9 – only in year 10. So we likely want to make sure more access is allowed than the SECURE Act's RMD rule.

Even when trusts have other language it can be an issue. Sometimes the trust language might allow for additional distributions based on need or as otherwise provided in the trust. However, this language can be vague or unclear, resulting in issues down the line between beneficiaries and the trustee.

Qualified Charitable Distributions

How does the SECURE Act affect Qualified Charitable Distributions (QCDs), particularly as it relates to age requirements?

QCDs as it relates to age 70.5 did not change. You can do a QCD starting at age 70.5 if you own an IRA or an inherited IRA. However, any QCD done at age 70.5 will not offset an RMD for those that do not have to begin RMDs until age 72. You cannot offset future RMDs by your past distributions.

That being said, the SECURE Act created an anti-abuse provision designed to offset the benefits of deducting contributions in an IRA after 70.5 and QCDs. Essentially, any deductible amount you do after 70.5 into an IRA offsets any QCDs you attempt in the future. There are still some questions around this rule that IRS guidance will hopefully clear up.

Trusts

How will the SECURE Act impact existing Irrevocable IRA Trusts? What about those that are not yet funded?

Irrevocable trusts still need to be reviewed. The language around access to IRA funds, RMDs, and beneficiaries should all be examined. Some trusts give additional access to funds in the IRA above and beyond RMDs, but are these restrictive? Are they clear? Or are they open to argument and fighting or disagreement between the beneficiary and the trustee later on?

Annuities

Does the legislation allow a non-spousal beneficiary to purchase a single life annuity with their inherited IRA? What about a 401(k) with annuity option?

A non-spousal beneficiary could not purchase a single life annuity with an inherited IRA and get around the 10 year rule. There are some issues with non-spouse beneficiaries on annuities – any qualified annuity that is newly purchased after 2020 will have to meet the 10-year rule in the IRA or 401(k). Companies are still figuring out how they would deal with this, but the insurance companies will need to come up with a fix, which might be a 10-year payout option or a lump sum cash-out feature.

The SECURE Act created a new law allowing more annuity sales in 401(k)s. Will this hamper rollovers or sales?

The SECURE Act did make a big change easing up the rules for 401(k) fiduciaries to add insurance and lifetime income products like annuities into the investment platform. However, the bill also added a new rule easing up the rules around the portability, the ability to transfer without tax issues, of annuities from a 401(k) to an IRA. This rule should make it easier than ever to move annuities from qualified plans to IRAs. The expectation is that we will see more annuities inside retirement plans over the next few years. Make sure you understand the investment options inside of your plan and whether an annuity as an investment option fits your needs.

Estate Planning

How would the SECURE Act impact a large taxable estate with a large traditional IRA? Would you consider Roth conversions?

The SECURE Act does have a big impact on estate planning, but it is not directly related to the federal estate tax rules. Instead, it forces us to reexamine the most efficient way to pass total wealth to the next generation. If you have a taxable estate you will want to consider ways to minimize federal estate taxes through life insurance or Roth conversions. Roth conversions can be very helpful for the beneficiary as they distributions won't likely be taxable.

Additionally, you might want to consider how charitable giving can impact the estate and reduce taxes and increase total wealth passed over. Charitable remainder trusts can provide a lot of value as the beneficiary of a taxable IRA if the owner wants to provide lifetime income to a beneficiary and give to a charity, while reducing estate taxes. This can be a very effective strategy in those situations, but the IRA owner needs to be charitably inclined.

Multiple employer plans

The SECURE Act added new rules about multiple employer plans. What do I need to know about these?

The SECURE Act added new rules easing the ability for small employers to start or join a multiple employer plan. This essentially means that over the next few years you will see the rise of MEPs, like a 401(k) with super low costs where smaller employers can join without having to design the whole plan. This should allow more small business owners the ability to offer these plans to their employees at a low cost and ease of use. However, these won't hit the market until 2021, but small business owners should keep these on the side of their mind heading into next year as it could be a great way to add value to your employees.

Childbirth, Adoption and Childcare Provision

Does the SECURE Act allow IRA owners to use funds for childcare, childbirth costs, and adoption costs?

The SECURE Act created a new way for IRA owners to tap into their IRA and avoid the 10% 72(t) penalty tax on the distribution prior to age 59.5. Each spouse, assuming they have their own IRA can take out up to $5,000 for any birth or adoption. The $5,000 is not a lifetime limit but a per birth or adoption limit.

The distribution is allowed if the individual makes it during the one-year period beginning on the date the child is born or is legal adopted and under the age of 18 or physically or mentally in-capable of self-support.

What is most interesting about this provision is that it does not appear that you need to show medical costs of $5,000. It is designed to allow for $5,000 if you have a child, no expenses shown needed. But remember, the distribution only qualifies for the exception if it is taken after the child is born, not before. There are rules about correctly reporting your child on federal income tax returns, however, to get the exception. Lastly, the bill also has a provision where you can repay this money in later years back into the account.

Distributions From 529 Education Savings Accounts

How does the SECURE Act impact 529 distributions for student loan payments?

The SECURE Act expands 529 education savings accounts to cover the 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. However, if the student loan interest was deductible it must be offset by any amount that was paid by the 529 distribution.

Enforcement

How will the IRS track the new 10 year distribution period?

The U.S. personal income tax system is generally a self-reporting system. The IRS has trouble tracking lots of things – they would likely know you have an IRA and reportable distributions. But remember, if you fail to take out RMDs, there is a 50% penalty tax on top of your tax rates. If you kept it past the 10 years and they found out, that would basically forfeit the account with income and penalty taxes combined.

What documentation would serve as "proof" to the IRS under any audit situation that the successor beneficiary is abiding by the rules of stretch?

The IRS rules around a successor beneficiary – the person who inherits an inherited IRA – are complicated. First, you start with titling of the IRA. The IRS requires the successor beneficiary and the original beneficiary to be listed on the account title. This helps the IRS track the applicable RMDs and distribution period. Remember, you do not get to reset the RMD calculation. Instead, you continue to follow the original beneficiary's RMDs and calculation.

The U.S. tax system puts the burden of proof on the taxpayer not on the government. RMDs especially fall onto taxpayers to prove and track. ■