New Spending Package Includes Sweeping Retirement Plan Changes

The $1.4 trillion spending package enacted on December 20, 2019, included the Setting Every Community Up for Retirement Enhancement (SECURE) Act. The SECURE Act represents the most sweeping set of changes to retirement legislation in more than a decade.

While many of the provisions offer enhanced opportunities for individuals and small business owners, there is one notable drawback for investors with significant assets in traditional IRAs and retirement plans. These individuals will likely want to revisit their estate-planning strategies to prevent their heirs from potentially facing unexpectedly high tax bills.

All provisions take effect on or after January 1, 2020, unless otherwise noted.

If you have any questions or would like to speak with someone from the Rockland Trust Investment Management Group please don't hesitate to contact us.

IMPLICATIONS TO INDIVIDUALS

Elimination of the "Stretch IRA"

Perhaps the change requiring the most urgent attention is the elimination of longstanding provisions allowing non-spouse beneficiaries who inherit traditional IRA or retirement plan assets to spread distributions — and therefore the tax obligations associated with them — over their lifetimes. This ability to spread out taxable distributions after the death of an IRA owner or retirement plan participant, over what was potentially such a long period of time, was often referred to as a "stretch IRA". The new law, however, generally requires any beneficiary who is more than 10 years younger than the account owner to liquidate the account within 10 years of the account owner's death unless the beneficiary is a spouse, a disabled or chronically ill individual, or a minor child. This shorter maximum distribution period could result in unanticipated tax bills for beneficiaries who stand to inherit high-value traditional IRA and retirement balances. This is also true for IRA trust beneficiaries, which may affect estate plans that intended to use trusts to manage inherited IRA assets.

Important Note: This is a great time to review your retirement account beneficiary designations. If you named your trust as the beneficiary of your retirement account, we recommend that you revisit your estate plan and retirement account beneficiary designations with your advisor to determine how IRA dollars fit into your strategy and to ensure that it remains in line with your goals. Trust beneficiary designations could be unfavorably impacted by the SECURE Act.

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Benefits to Individuals

On the plus side, the SECURE Act includes several provisions designed to benefit American workers and retirees.

- People who choose to work beyond traditional retirement age will be able to contribute to traditional IRAs beyond age 70½. Previous laws prevented such contributions
- Retirees will no longer have to take required minimum distributions (RMDs) from traditional IRAs and retirement plans by April 1 following the year in which they turn 70½. The new law generally requires RMDs to be taken by April 1 following the year in which they turn age 72
- Taxpayers with high medical bills may be able to deduct unreimbursed expenses that exceed 7.5% (in 2019 and 2020) of their adjusted gross income. In addition, individuals may withdraw money from their qualified retirement plans and IRAs penalty-free to cover expenses that exceed this threshold (although regular income taxes will apply). The threshold returns to 10% in 2021.
- 529 account assets can now be used to pay for student loan repayments ($10,000 lifetime maximum) and costs associated with registered apprenticeships

Suggested Strategies to Consider

- Explore a Roth IRA conversion strategy. A Roth IRA grows tax-free and can be withdrawn tax-free by a qualified owner (over age 59½ and established for five years, with a few exceptions). The conversion would require paying ordinary income tax on the amounts that you convert to a Roth IRA during that year. However, if the IRA must be drained by your heirs over a 10-year period, it might be better to pay the tax now as we are in a very low tax environment.
- Inherited IRAs are required to be liquidated within 10 years. These withdrawals could be income taxed at the highest federal and state rates leaving your beneficiaries to lose up to 37% of the value of the IRA. To offset this tax, consider a cost efficient, tax free Second-to-Die Life Insurance policy to cover the tax due on the Inherited IRA. The premium can be covered by a fraction of the Required Minimum Distributions.
- An alternative tax savings approach could be a tax free life insurance policy on the IRA owner. This would allow the surviving spouse to convert to a Roth IRA upon the death of the owner, and avoid future taxation for the surviving spouse AND the beneficiaries. This strategy allows the entire account balance to remain in the Roth IRA and a chance for the premium to be covered by a portion of the Required Minimum Distributions.
- Consider adding the next generation as beneficiaries. As an example, if there are two children in a family and each child had two children, the distributions could be split by six beneficiaries over 10 years resulting in 60 tax years, thus reducing the tax burden for any one person in any given year.

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- For those who are over 70½ as of 12/31/19, and receiving required minimum distributions that are not needed for spending goals, consider making a qualified charitable distribution (QCD). Doing so will avoid the distribution being taxed as income. The current limit on the donation is $100,000. One caveat to this benefit is that if you contribute during the time prior to the QCD but after RMDs started, the contribution will be taxed during the year you take the deduction
- If you are approaching retirement, consider deferring taking distributions from an Inherited IRA for the first five years and take it evenly over the last five years during retirement when you are likely to have a lower income.

IMPLICATIONS TO RETIREMENT PLAN SPONSORS

The SECURE Act also provides assistance to employers striving to provide quality retirement savings opportunities to their workers. Among the changes are the following:

- The tax credit that small businesses can take for starting a new retirement plan has increased. The new rule allows employers to take a credit equal to the greater of (1) $500 or (2) the lesser of (a) $250 times the number of non-highly compensated eligible employees or (b) $5,000. The credit applies for up to three years. The previous maximum credit amount allowed was 50% of startup costs up to a maximum of $1,000 (i.e., a maximum credit of $500).
- A new tax credit of up to $500 is available for employers that launch a SIMPLE IRA or 401(k) plan with automatic enrollment. The credit applies for three years.
- New laws make it easier for employers to offer lifetime income annuities within retirement plans. Such products can help workers plan for a predictable stream of income in retirement. In addition, lifetime income investments or annuities held within a plan that discontinues such investments can be directly transferred to another retirement plan, avoiding potential surrender charges and fees that may otherwise apply.
- Part-time workers age 21 and older who log at least 500 hours in three consecutive years generally must be allowed to participate in company retirement plans offering a qualified cash or deferred arrangement. The previous requirement was 1,000 hours and one year of service. Employers may exclude these employees for nondiscrimination testing purposes. (The new rule applies to plan years beginning on or after January 1, 2021.)
- Employers now have easier access to join multiple employer plans (MEPs) regardless of industry, geographic location, or affiliation. "Open MEPs," as they have become known, offer economies of scale, allowing small employers access to the types of pricing models and other benefits typically reserved for large organizations. (Previously, groups of small businesses had to be affiliated somehow in order to join an MEP.) The legislation also provides that the failure of one employer in an MEP to meet plan requirements will not cause others to fail,

and that plan assets in the failed plan will be transferred to another. (This rule is effective for plan years beginning on or after January 1, 2021.)

- Auto-enrollment safe harbor plans may automatically increase participant contributions until they reach 15% of salary. The previous ceiling was 10%.
- Individuals can now take penalty-free early withdrawals of up to $5,000 from their qualified plans and IRAs due to the birth or adoption of a child. (Regular income taxes will still apply, so new parents may want to proceed with caution.)
- Added flexibility in determining if the plan chooses to be administered as a “Safe Harbor” 401(k) Plan for the year

The SECURE Act is new legislation and its implications vary person to person. The tactics described in this document along with other strategies should be carefully considered before they are implemented. We find the best outcome is when we collaborate with estate planning and tax professionals to optimize each client’s situation. We would welcome the opportunity to coordinate that conversation and explore the SECURE Act’s implication to you, your family and your goals.

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