Money Talks by Dave Helscher

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The $1.4 trillion spending package enacted on December 20 included the Setting Every Community Up for Retirement Enhancement (SECURE) Act. Only Congress could come up with this name. The SECURE Act represents the most sweeping set of changes to retirement legislation in more than a decade. Many of the provisions offer opportunities for individuals and small business owners, there is a drawback for investors with significant assets in traditional IRAs and retirement plans. These individuals will want to revisit their estate-planning strategies to prevent unexpectedly high tax bills. Many of the provisions are effective on or after January 1, 2020.

It 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 70 ½. 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 70 ½. The new law generally requires RMDs to begin by April 1 following the year in which they turn age 72. For those already required to take RMDs, have already attained age 70 ½, the previous law applies. Part-time workers age 21 and older who log at least 500 hours in 3 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. The new rule applies to plan years beginning on or after January 1, 2021.

Perhaps the change requiring the most urgent attention is the elimination of longstanding provisions allowing non-spouse beneficiaries who inherit transitional IRA and retirement plan assets to spread distributions, and the tax obligations associated with them, over their lifetimes. This ability to spread out taxable distributions after the death of any IRA owner or retirement plan participant, over what was potentially such a long period of time, was often referred to as the “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 IRAs. This is also true for IRA trust beneficiaries, which may affect estate plans that intended to use a trust to manage inherited IRA assets.

In addition to possibly reevaluating beneficiary choices, traditional IRA owners may want to revisit how IRA dollars fit into their overall estate planning strategy. For example, it may make sense to consider the possible implications of converting traditional IRA funds to Roth IRAs, which can be inherited income tax free. Although Roth IRA conversions are taxable events, investors who spread out a series of conversions over the next several years may benefit from the lower income tax rates that are set to expire in 2026.

Individuals can now take tax 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. Taxpayers with high medical bills may be able to deduct unreimbursed expenses that exceed 7.5% in 2020 of their adjusted gross income. Individuals may withdraw money from their qualified retirement plans and IRAs tax penalty-free to cover expenses that exceed this threshold, although regular income taxes will apply. The threshold returns to 10% in 2021.

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