Breaking down the SECURE Act

In December, Congress passed a new bill called the **S**etting **E**very **C**ommunity **U**p for **R**etirement **E**nhancement Act, aka the **SECURE Act**. Besides proving that Congress can make an acronym out of almost anything, the bill – which goes into effect on January 1, 2020[1] – makes some important changes to various rules on saving for retirement. Many of these changes are positive, in the sense that they should make it *easier* for people to save *more* for *longer*. However, the SECURE Act also eliminates a popular estate planning tactic that many Americans have used to help their family after they pass away.

To help you understand the SECURE Act and how it may affect your finances, we've written this special letter. There's a lot to unpack here, so please take a few minutes to read about these changes. Most are fairly simple, actually, but if you have any questions or concerns, please let us know. Even though you are not a client of ours, remember that we are always available to help provide financial clarity. In our opinion, that's one of the most important things any person can have.

In the meantime, we wish you and yours a Happy New Year! We hope the year 2020 is a great one!

Sincerely,

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Important Provisions of the SECURE Act

Before we dive in, understand, that the SECURE Act is over 20,000 words long. (And in fact, the Senate had to tuck it away in a much, *much* larger appropriations bill to pass it.) That means there isn't room to cover *every* provision of the new law, and many won't apply to you anyway. So, what follows is a brief overview of the major changes that could affect your finances.

Are you ready? Then take a deep breath as we go over…

CHANGES TO THE IRA "STRETCH" PROVISIONS[2]

For years, one of the most popular estate planning strategies was the use of **Stretch IRAs**. When a parent or grandparent dies, they can leave their IRA to their children, grandchildren, or other heirs. Under the old rules, these beneficiaries could take distributions from their inherited IRA based on their official life expectancy. This allowed them to "stretch out" the value of the IRA – and the tax advantages that come with it – for a longer period. For example, if a 50-year old with a life expectancy of 85 inherited her mother's IRA, she could stretch out her distributions over the next 35 years.

Now, non-spousal beneficiaries who inherit an IRA in 2020 or beyond can no longer do this. Instead, inherited IRAs fall under the new "10-Year Rule". This means that all the money in the IRA *must* be

withdrawn by the end of the 10th year following the year of inheritance. At that point, the beneficiary must pay taxes on that money.

Note that the rule does *not* require the beneficiary to take withdrawals *during* the 10-year period if he or she doesn't want to. That's important! Deciding when to take withdrawals should be based on several factors, including the beneficiary's current financial situation, how close they are to retirement, and when they plan on taking Social Security benefits.

Something else to note: The new 10-Year Rule does not apply to spouses, disabled and chronically ill beneficiaries, and minors. For the last group, the exception lasts until the child reaches the "age of majority", which is 18 to 21 depending on the state. Once they reach that age, the 10-Year Rule kicks in.

Make no mistake: This new rule will have a profound impact on beneficiaries, especially those who are younger and could otherwise have waited decades before making withdrawals (and paying taxes on those withdrawals). For this reason, if you are either planning to bequeath an IRA to your beneficiaries, or are expecting to inherit one yourself, consider scheduling a consultation with us about your options. We want to do everything we can to help you and your heirs maximize your retirement savings while minimizing your tax burden.

CHANGES TO REQUIRED MINIMUM DISTRIBUTIONS FOR IRAS[2]

Speaking of maximizing your retirement savings…

Another change the bill makes is to lengthen the time people can contribute to their IRAs. Currently, retirees can only contribute to an IRA up to age 70½. Once they hit this milestone, they are required to begin making withdrawals. (These are called **required minimum distributions**, or RMDs.) Under the SECURE Act, that age would increase to 72. That means retirees have an additional 18 months to benefit from the tax advantages that come with IRAs.

Note: This change only applies to those who turn 70½ in 2020 or later. Even people who turned 70½ in December of 2019 would still have to take an RMD for 2020.

That's it for this provision. See? We told you some of the changes were simple.

OTHER IRA CHANGES[2]

Here's another simple change. Under the old rules, contributions to a traditional IRA were prohibited once a person reached the year they turned 70½. No longer. Now, *anyone*, even those older than 70½, can keep contributing to their IRA so long as they continue to work.

Here's an example. Jane turns 70½ in 2020 but decides she wants to continue working. So rather than withdraw money from her IRA, she decides to make a tax-deductible contribution to it instead. While Jane must still take RMDs once she turns 72, she decides to keep making contributions every year until she actually retires, as the math still works in her favor.

Obviously, this change only benefits those who continue working into their seventies. And even then, it may not always make sense to keep contributing to your IRA. But it's always nice to have options!

Another change is for new parents. Under current law, a person must be 59½ years old to make withdrawals from a traditional IRA. If they withdraw money earlier than that, they must pay a penalty of 10% on the amount you took out. There *are* a few exceptions, such as if they need the money to pay large medical bills, buy a home, or manage a disability. But, generally speaking, the government wants the money inside a retirement account to be saved *for* retirement.

Under the SECURE Act, new parents can now withdraw funds penalty-free to help cover birth and adoption expenses. This is especially helpful for younger parents who have high deductible insurance plans. There is a $5,000 cap on withdrawals, though, and they need to be made within one year of the birth or adoption.

CHANGES TO 401(K)S[2]

The SECURE Act brings many changes to 401(k)s, but most are for businesses to worry about. There is one change you should know about, though, and it involves annuities.

A type of insurance product, many annuities offer a monthly stream of income, sometimes for life. This can make them attractive for retirees. Historically, few 401(k)s contained annuities. The SECURE Act makes it easier for employers to offer this as an option.

The reason we mention this is because you should *get a second opinion* before putting your money in an annuity. Choosing the right annuity can be difficult, as there are many types and features, and some annuities come with high costs. So, while an annuity may be right for some people, that doesn't necessarily mean it's right for you.

If you have questions about this, let's chat! We'd be happy to provide you with a second opinion.

CHANGES 529 PLANS[2]

For many Americans, paying off student loans is a difficult financial burden.

To help pay for their loved ones' higher education, some parents and grandparents use 529 plans. Any funds invested in a 529 plan can be used to help pay for college expenses, like room and board or tuition. The best part is that the funds are exempt from federal taxes, and often state taxes, too, so long as they're used solely for education expenses.

Under the SECURE Act, parents with 529 plans can make a tax-free withdrawal of up to $10,000 to help pay off their child's student loans. This $10,000 limit is *per person,* not per plan, which means another $10,000 can be withdrawn to help pay the student debt for each of a 529 plan beneficiary's siblings.

If you have invested in a 529 plan for a child or grandchild with lots of student debt to pay off, let's talk to see if it makes sense to take advantage of this.

CONCLUSION

As you can see, the SECURE Act is loaded with changes and provisions for those saving for retirement. So, again, if you have any questions or concerns, please don't hesitate to contact us for a free consultation!

In the meantime, remember that we're here to help you work toward your financial goals. Please let us know if there's ever anything we can do – in 2020 and beyond.

Happy New Year!

Sources

[1] Anne Tergesen, "Congress Passes Sweeping Overhaul of Retirement System," *The Wall Street Journal,* December 19, 2019. https://www.wsj.com/articles/senate-spending-bill-includes-significant-changes-to-u-s-retirement-system-11576780736

[2] Text of "SETTING EVERY COMMUNITY UP FOR RETIREMENT ENHANCEMENT" (page 1532), *Senate Appropriations Committee,* December 16, 2019. https://www.appropriations.senate.gov/imo/media/doc/H1865PLT_44.PDF