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Key Changes in 2019 Tax Law Affecting Retirement Rules

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SECURE Act

Major tax reform typically occurs only once every decade or so. But in the last weeks of 2019, Congress passed the second significant tax act within two years. While not as extensive as the Tax Cuts and Jobs Act (TCJA) of 2017, the new SECURE Act—signed into law in December 2019—sets the stage for sweeping changes to retirement accounts. In particular, it affects retirement account distributions; impacts retirement savings through individual retirement accounts (IRAs); and provides increased access to 401(k)s, especially for those working for smaller businesses.

SECURE Act: Key Changes

The changes most directly affecting high-net-worth investors include:

Elimination of "stretch" IRAs

Those who inherit IRAs and other retirement accounts such as 401(k)s—other than a spouse—will generally have to withdraw all their assets from the accounts within 10 years of the death of the original account holder. Under the prior law, beneficiaries were able to stretch withdrawals from inherited retirement accounts over their lifetimes.

The new law affects retirement accounts in which the owner dies after December 31, 2019. Heirs of retirement accounts in which the owner died before the end of 2019 continue to benefit from the previous law, such as receiving decades of income tax-free or tax-deferred.

While the distribution must be taken by year 10, the payouts do not have to be taken evenly over the 10-year period. For instance, a Roth IRA heir may want to postpone payouts until late in the 10-year period to earn maximum tax-free growth. Beneficiaries of traditional IRAs can defer payouts as well but taking a lump sum could trigger higher tax costs.

Several "eligible designated beneficiaries" are exempt from the 10-year rule:

- Surviving spouse of the account owner
- Heirs of accounts whose original account owner died before 2020
- Heirs no more than 10 years younger than the original owner
- Chronically ill or disabled heirs as defined by the IRS tax code
- Minor children of the account owner up to the age of 18 to 21 depending on the state, or 26 if the child is a student. Once of age, the heir will be required to fully distribute the retirement account within 10 years.

Required minimum distributions (RMDs) begin at age 72

Those who did not reach 70 ½ by the end of 2019 can delay taking required minimum distributions from their retirement accounts until age 72. Taxpayers may delay their first RMD until April 1 of the year *after* reaching their 72nd birthday.

Older Americans are now able to save longer, letting their retirement accounts grow an extra two years tax-free since they no longer have to begin taking RMDs at age 70 ½. This also gives taxpayers an additional two years to initiate a Roth IRA conversion without worrying about the impact of required distributions.

Qualified charitable distribution (QCD) remains at age 70 ½

The new law does not change the age an individual can make a qualified charitable distribution (QCD) from an IRA, which remains at age 70 ½. With the new RMD age limit raised, the SECURE Act creates a new 1 ½-year window where IRA distributions can be sent to a charity and qualify as a QCD.

SECURE Act: Key Changes (continued)

Other key changes of note for retirement planning from the SECURE Act:

- **Sets no age limit on IRA contributions**
  For tax years beginning in 2020, you can continue traditional IRA contributions past 70 ½ if you have earned income.

- **Annuity plans and options expanded**
  The act eased some of the legal risk of including annuities in 401(k)s, making it easier for plan sponsors to offer them.

- **401(k) plans enhanced**
  Maximum employee contribution is raised to 15% from 10% (except for the first year of participation); part-time employee plans are now available.

- **Expanded use of 529 college savings plans**
  Expenses for apprenticeship programs and up-to-$10,000 (lifetime amount) of student loan repayments are now considered a qualified withdrawal.

- **Penalty-free withdrawals from retirement accounts for birth or adoption of a child**
  Up to $5,000 per individual account can be withdrawn within one year of the adoption being final or birth of a child. If both parents have a retirement account, each can withdraw up to $5,000.

- **Help to small businesses to offer retirement plans**
  Small businesses receive bigger tax credits for setting up a retirement plan; new tax credit is available for an "auto-enroll" provision; pooled employer plans are now more accessible.

Other notable provisions and tax extenders included to keep in mind:

- **Mortgage insurance premium deduction, which expired in 2017, was reinstated**
  Taxpayers can deduct premiums, with changes effective for 2019 and 2020 tax years; 2018 returns can be amended to take advantage of the change.

- **Deduction for qualified tuition and related fees extended**
  The allowable deduction expired in 2017 but is now extended to 2020.

- **Medical expense deduction remains at 7.5% regardless of age**
  The floor was set to reach 10% in 2019. The SECURE Act allows taxpayers to deduct qualified medical expenses that exceed 7.5% of adjusted gross income for 2019 and 2020.

- **'Kiddie tax' (the tax on unearned income of certain children) reverts back to pre-TCJA, taxed at the parent's income tax rate**
  The TCJA had taxed that income at trust rates.

SECURE Act: Before & After

Before	After
Beneficiaries of retirement accounts in which the owner died *on* or *before* December 31, 2019, can "stretch" their distributions over their lifetime	Beneficiaries of retirement accounts in which the owner died *after* December 31, 2019, must take their payout within 10 years, with some exceptions
Required minimum distributions (RMDs) must begin at age 70 ½	Required minimum distributions (RMDs) must begin at age 72, unless you turned 70 ½ before January 1, 2020
Contributions to a traditional individual retirement account (IRA) end at age 70 ½	Contributions to a traditional individual retirement account (IRA) can continue past age 70 ½ as long as you have earned income. There is no age restriction on Roth IRA contributions. SECURE Act did not change that rule.
Qualified charitable distributions (QCDs) where a gift is made directly to a charity from an IRA begin at age 70 ½	Unchanged. Qualified charitable distributions (QCDs) where a gift is made directly to a charity from an IRA begin at age 70 ½

Next Steps

Given the most pertinent aspects of the new law summarized above, here are several potential next steps to consider:

- Review retirement account beneficiaries
- Review and/or revise trust language to align with your wealth transfer objectives
- Re-evaluate the benefits of a Roth IRA conversion
- Name a charitable remainder trust as a beneficiary of your retirement accounts to generate a stretched income stream
- Make a qualified charitable distribution (QCD) after reaching age 70 ½ to take advantage of the additional 1 ½-year window

To ensure your financial planning objectives are met and to discuss how the new rules apply to your plan, please contact your William Blair advisor.

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