# The SECURE Act: What Investors Need to Know

Congress has passed new retirement legislation that has wide-ranging effects on retirement savings for many Americans.

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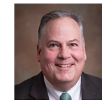

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**KEY POINTS:**

- Provisions of the SECURE Act affect both individuals saving for retirement as well as defined contribution plans.
- The Act eases restrictions in areas such as required minimum distributions and Traditional IRA contributions for older Americans, but limits "stretch" distributions from Inherited IRAs.
- The SECURE Act has several other provisions, including ones related to education savings, that may affect more limited groups of investors.

The Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act or Act) was signed into law December 20, 2019, with most provisions taking effect in January 2020. The Act includes wide-ranging changes to the retirement savings landscape, which affect individuals who are in or preparing for retirement. Defined contribution (DC) retirement plans, such as 401(k) plans, are also affected. Although the SECURE Act did not require people to take action before year-end, there are financial planning implications that we think some investors may want to consider sooner rather than later.

The Act made three changes that we believe will be most significant to large numbers of individuals.

## 1. THE STARTING AGE FOR REQUIRED MINIMUM DISTRIBUTIONS (RMDs) HAS BEEN EXTENDED FROM 70½ TO 72.

The change now enables investors with individual retirement accounts (IRAs) or retirement plan account balances to delay taking distributions if they don't need the money for spending. This means they will be able to further postpone taxes on withdrawals while continuing to benefit from any tax-deferred growth of the assets.

### Actions that we believe people approaching or early in retirement may want to consider:

- Revisit your retirement income and withdrawal strategy to consider tax efficiency. If you won't have reached 70½ by the end of 2019, the new RMD age gives you more flexibility. Remember, though, that minimizing your taxes early in retirement may not be the best strategy if it requires you to take larger RMDs at a higher tax rate later.
- The SECURE Act also may give you more time to execute a Roth conversion strategy before you have to begin taking RMDs. Roth conversions

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increase your tax bill in the year of conversion but allow you to take tax-free withdrawals later. They are not for everyone, but if they do make sense, you may be able to convert more of your tax-deferred assets to Roth assets (in total, over time) without beingpushed into a higher tax bracket.

## 2. THE MAXIMUM AGE FOR TRADITIONAL IRA CONTRIBUTIONS HAS BEEN REPEALED.

Before the SECURE Act, individuals over age 70½ could not contribute to Traditional IRAs. That was more restrictive than for Roth IRAs and DC plans. As of January 1, 2020, individuals of any age with earned income can contribute to Traditional IRAs. People whose spouses have earned income also can take advantage of spousal IRA contributions.

This change means that some individuals may have both IRA contributions and RMDs in the same year. The ability to take qualified charitable distributions (which can be used to satisfy RMDs) is reduced if deductible IRA contributions are made after age 70½.

**Issue we think retirees over age 70½ may want to review with a retirement specialist or tax advisor:**

If you're earning income after age 70½ in 2020 or later, it might make sense to contribute to a Traditional IRA. However, if you're eligible for Roth contributions and your income is relatively low, contributing to a Roth IRA might be preferable.

## 3. THE ABILITY TO STRETCH DISTRIBUTIONS FROM INHERITED IRAS OR DC PLAN ACCOUNTS OVER TIME HAS BEEN LIMITED.

Before the SECURE Act, someone inheriting an IRA or DC plan account could generally take RMDs over their expected lifetime. For some non-spouse beneficiaries, that could "stretch" out the distributions for many decades, extending the benefit of an IRA's or DC plan account's tax deferral. Going forward, however, the accounts of IRA owners and DC plan participants who die after December 31, 2019, will generally need to be fully distributed to beneficiaries within 10 calendar years.

Beneficiaries excluded from this rule include surviving spouses, disabled or chronically ill individuals, or those less than 10 years younger than the DC plan participant/IRA owner. For beneficiaries who are minors, the 10-year period to fully distribute the account starts when they reach the age of majority.

**Issues we think IRA owners or DC participants may want to review with a retirement specialist or tax and/or estate planning advisor:**

- Choosing young beneficiaries (such as grandchildren) solely to stretch out IRA distributions over a long period is now a less valuable strategy. Other approaches might be preferable to achieve your estate planning goals.
- It may be more important than in the past to keep beneficiaries' tax rates in mind when making those designations. An IRA distributed over 10 years could result in significant tax liabilities for a beneficiary in a high bracket. That's especially true if the income pushes the beneficiary into an even higher bracket or if the 10-year distribution period coincides with their peak taxable earnings.
- Leaving different types of accounts to different beneficiaries potentially could reduce the overall income tax burden for your family. Remember, though, to coordinate your beneficiary designations with the rest of your estate plan.
- Pay particular attention to trusts as beneficiaries of retirement assets. A structure you established under the old law could be unnecessary or even detrimental going forward.

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In addition to the three significant changes referenced above, the SECURE Act includes several other provisions that may affect more limited groups of investors.

### Education-related provisions

- A 529 account beneficiary's student loan payments now are considered qualified education expenses, up to a $10,000 lifetime maximum. Therefore, money withdrawn for that purpose will be tax-free. This could potentially benefit people who have excess 529 assets after a beneficiary's graduation. In addition, some 529 plan contributors could potentially benefit from state tax breaks on new contributions, then use the funds for loan payments. Keep in mind, though, that treating the payment as a qualified expense likely reduces the amount you can take as a student loan interest deduction.
- Graduate students now can count taxable fellowship or stipend payments as compensation that is contributable to an IRA. That's a very specific situation, but it potentially could help some students get an earlier start on saving for retirement.

### New retirement plan rules that may be relevant for some individuals

- In the year after the birth or adoption of a child, IRA owners can take penalty-free withdrawals, up to $5,000 per child. Employers also have the option to allow such withdrawals from retirement plans. An individual and spouse can each take a $5,000 withdrawal per child. While we believe that most investors are better off letting their retirement assets grow, rather than withdrawing them to meet other needs, this provision has the potential to benefit some people at a critical stage of life.
- Most DC plans now are required to allow participation for employees who work more than 500 hours per year for three straight years. While it can be difficult for part-time workers to save, this could create additional wealth accumulation opportunities for some employees. For example, if allowed by the employer, part-timers may benefit from company matching contributions.
- Small business owners may lower their tax bills by taking advantage of an increased credit for establishing a plan (including SEPs and SIMPLE IRAs) and a new credit for maintaining plans (401(k)s and SIMPLE IRAs) that include eligible automatic contribution arrangements.

Finally, the SECURE Act also has many provisions related to DC plans. These measures are intended to benefit individuals, though less directly—and less imminently—than the changes outlined above.

- In addition to the small business provisions previously described, the Act reduces barriers to the creation of pooled employer plans (PEPs).
- The SECURE Act includes multiple provisions to facilitate the use of annuities in retirement plans. This is largely uncharted territory for retirement plans, so we encourage plan sponsors and participants to consult advisors before making any decisions in this area.
- Employers that use qualified automatic contribution arrangements (QACA) can now set the maximum employee deferral as high as 15% of pay (up from 10%). The new limit applies after the first year in which an employee is automatically enrolled. Since we recommend that most people aim to save at least 15% of income for retirement, we view this as a welcome change that could potentially help some employees get to that level automatically.

### Conclusion

Overall, the SECURE Act includes meaningful changes that should have a

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positive impact on retirement savings for many Americans. While some individuals will not be largely affected, we believe people with significant retirement assets or those who are working into their 70s should take time to consider the effects of the law.

In our view, the most time-sensitive aspect of the Act for individuals is the limit on stretching out Inherited IRA and DC plan distributions. The law's passage in December did not leave much time to revise estate plans before its provisions take effect. Investors may want to consult with their tax and/or estate planning advisors to review their existing beneficiary designations and estate plans, as well as evaluate whether they can take advantage of the new flexibility to delay RMDs until age 72.

*A 529 college savings plan's disclosure document includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing. You should review the 529 plan offered by your home state or your beneficiary's home state and consider, before investing, any state tax or other state benefits, such as financial aid, scholarship funds, and protection from creditors that are only available for investments in such state's 529 plan.*

Earnings on a distribution not used for qualified expenses may be subject to income taxes and a 10% penalty. Please note that the availability of tax or other benefits may be conditioned on meeting certain requirements such as residency, purpose for or timing of distributions, or other factors, as applicable.

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