THE SILLER & COHEN REPORT

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RETIREMENT PLAN CONCEPTS FOR 2020

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Retirement Plan Concepts for 2020

As 2019 came to an end, few could have predicted what 2020 would bring. The global COVID-19 pandemic has had a far-reaching impact which has affected not just our health, but rippled through our economies, our workplaces, and our personal lives. It has also led to new legislation, some of which has impacted retirement and tax planning.

Recap of 2020

Legislation that has impacted retirement and tax planning in 2020, includes:

January 1, 2020 – The Setting Every Community Up for Retirement Enhancement (SECURE) Act became effective. With everything that's happened since, it's all too easy to completely forget that this law was even passed. Some of the SECURE Act's most significant changes include:

- Required Minimum Distribution (RMD) age raised to 72.
- Age limit eliminated for traditional IRA contributions.
- Annuities more readily available in employer plans.
- Stretch payments on inherited IRAs eliminated for all but an entirely new class of "Eligible Designated Beneficiaries" (we'll go through this in further detail later in the article).

March 20, 2020 – The Treasury Department and IRS extend the federal income tax filing due date from April 15 to July 15, 2020. This, in turn, extends the deadline for making prior-year contributions to Roth and Traditional IRAs.

March 27, 2020 – The Coronavirus Aid, Relief and Economic Security (CARES) Act is signed into law. This is an over $2 trillion stimulus bill, one of the largest in history. Additionally, the law includes the following provisions regarding retirement accounts:

- Waives required minimum distributions (RMDs) for 2020.
- Creates Coronavirus-related distributions (CRDs), which allow certain eligible individuals to access retirement dollars penalty-free.
- Expands company plan loan rules.

June 19, 2020 - IRS releases Notice 2020-50 which increases the number of individuals eligible to take CRDs, allowing more people to take tax-advantaged distributions from their retirement plans.

June 21, 2020 – IRS extends the rollover deadline for repaying unwanted 2020 RMDs to August 31, 2020. They also allow Inherited IRA RMDs to be repaid to the accounts from which they were taken. Finally, the one-rollover-per-year rule is waived for those who took multiple RMD payments in 2020.

Stretch IRA Benefit Eliminated for Most

One of the most significant provisions of the SECURE Act was the elimination of the stretch IRA for millions of IRA beneficiaries. The term stretch refers to the time period in which inherited IRA funds must be withdrawn. As you may know, funds withdrawn from an inherited IRA are taxable as ordinary income in the year of withdrawal, so the ability to stretch distributions (take as little per year as possible over as many years as possible) is very valuable for many inherited IRA owners.

In the past, the stretch IRA allowed inherited IRA owners to stretch their distributions out over their own life expectancy. However, the SECURE act changed all that. Now, for most IRA beneficiaries, all inherited funds must now be withdrawn within 10 years of the original IRA owner's death. Beginning for deaths in 2020, this ten-year rule applies to any designated beneficiaries who are not considered "Eligible Designated Beneficiaries" under the SECURE Act. Who is considered an Eligible Designated Beneficiary? The list includes:

- Spouses
- Minor children of the IRA owner
    - Note that this exception only applies while the children are minors. Once they reach the age of majority, they must distribute the remaining IRA balance by the end of the 10th year after they reach the age of majority.
- Chronically ill and disabled individuals
- Beneficiaries who are not more than ten years younger than the IRA owner

These lucky few are not subject to the new ten-year rule.

Another group of beneficiaries who can still use the stretch are those who inherited IRAs prior to 2020. Anyone who inherited an IRA in 2019 or earlier would still be able to use all of the old rules for required distributions, including the stretch. These beneficiaries are grandfathered under the SECURE Act. However, it's important to note that even if the original beneficiary is allowed to use the stretch, any successor beneficiary who inherits after 2019 must use the ten-year payout rule.

Example: Assume Sam inherits an IRA from his aunt in 2017. He has been using the stretch and taking distributions over his life expectancy. His successor beneficiary is his daughter Kim. Sam dies in 2020. Kim would be subject to the ten-year payout rule because she inherited the IRA in 2020.

The partial elimination of the stretch IRA has a significant impact on beneficiary planning for many IRA owners.

Note: This would be a very good time to review your beneficiary designations and ensure they still make sense, particularly if you have trusts listed as your beneficiaries. If you're a non-eligible beneficiary inheriting an IRA, careful income tax planning should be done to ensure you minimize the tax burden that this asset creates.

Businesses Given Extra Time to Establish New Retirement Plans

One of the lesser known, but quite important provisions hidden within the SECURE Act is a provision which gives businesses extra time to establish certain new tax-qualified retirement plans.

Prior to the SECURE Act, a new retirement plan had to be adopted by the last day of the employer's tax year. Keep in mind, once the plan was adopted, businesses were always allowed extra time to make retroactive employer contributions for the year, including the plan's first year. The employer contribution deadline is the due date (including extensions) of the company's federal tax return.

Under the SECURE Act, the adoption deadline has been made the same as the funding deadline for certain employer plans. So, businesses may establish certain new plans for the prior tax year as long as they do so by the due date of their federal tax return (including extensions). This only applies beginning with the 2020 tax year, so businesses may not retroactively adopt a plan for 2019 (the plan would have to have been in place by 12/31/19).

Interestingly, this new deadline for qualified plans is in line with what the deadline has always been for setting up new SEP IRAs.

So which types of plans qualify for the new deadline? The new rule applies only to plans that are entirely employer funded, such as profit-sharing plans and pension plans. It does not apply to 401(k) plans. Because of the timing rules for 401(k) deferral elections, a new 401(k) plan effective in one year cannot be established after the end of that year.

The new rule gives companies extra time to make adoption decisions. This is significant because, for many companies, their financials are not available until the year is over. The new deadline may allow more businesses to make informed decisions, giving them a better chance to benefit from the tax deduction and retirement savings advantages provided by these plans.

Exceptions to the 10% Early Distribution Penalty for IRAs

Under normal circumstances, IRAs are best left untouched until retirement, as is typically intended by an account owner when he or she begins funding the account. However, in challenging economic times like these, many individuals may be forced to take distributions before retirement age. As you may know, tapping your IRA before reaching age 59 ½ could expose you to a 10% early distribution penalty, on top of the income taxes that you will owe on the distribution. However, there are some exception to this rule, which may spare you the 10% penalty if one applies to you.

Death of Original Account Owner

Distributions taken from an inherited IRA following the death of the original IRA owner are not subject to the 10% penalty. This exception applies no matter the age of the deceased IRA owner or the age of the beneficiary.

Birth or Adoption

This is a new exception added by the SECURE Act and beginning in 2020. IRA owners who have had or adopted a baby may take up to $5,000 out of their IRA without exposure to the 10% penalty. To qualify, the distribution must be taken within one year from the date of birth or when the adoption in finalized.

First Home Purchase

First time home buyers may take funds from their IRA without exposure to the 10% penalty. For purposes of this exception, the definition of first-time home buyer is someone who has not owned a home for the past two years. The buyer of the home may be the IRA owner, or any one of the following family members of the IRA owner:

- Spouse
- Child or Grandchild
- Parent or Grandparent

Deductible Medical Expenses

IRA owners may take distributions from their IRAs to cover deductible medical expenses without paying the 10% penalty. The amount taken from the IRA must not exceed the IRA owner's deductible medical expenses for the year. The medical expenses can be for the IRA owner, a spouse or a dependent. Importantly, the IRA owner does not have to itemize deductions on their tax return in order to be eligible for this exception.

Disability

Individuals who are disabled may take distributions from their IRAs without paying the 10% early distribution penalty. To meet the definition of disabled for this purpose, the IRA owner must be unable to engage in any gainful activity because of a physical or mental condition. The disability must be total and permanent.

Higher Education

If an individual takes a distribution from their IRA for qualified higher education expenses, the 10% early distribution penalty does not apply. Such expenses include post-secondary tuition, fees, books, supplies and required equipment. The education expenses must occur in the same year as the IRA distribution.

Health Insurance for the Unemployed

If an individual takes a distribution from their IRA to pay for health insurance when unemployed, the 10% early distribution penalty does not apply. The insurance can be for the IRA owner, a spouse, or dependents.

72(t) Payments

IRA owners may set up a series of payments from an IRA and avoid the early distribution penalty. These payments are sometimes called 72(t) or substantially equal periodic payments. To qualify, the payments must be calculated in a very specific way and must be taken at least annually. If there is a modification of the payments before the individual reaches age 59 ½ or before five year have passed, the 10% penalty will be assessed retroactively on all distributions already taken prior to age 59 ½ under the payment plan.

Reservist Distributions

A reservist who is called to active duty after September 11, 2001 for more than 179 days or for an indefinite period of time may take penalty-free distributions from their IRA. The distribution must be made no earlier than the date the reservist was called to active duty and no later than the end of the active duty period. Also, the IRA owner can repay part or all of these distributions to an IRA within a two-year period after the active duty period is over.

Conclusion

As we enter the final stretches of 2020, quite a lot has changed already this year. If you have any questions about how these rule changes affect your financial planning, please contact our office. We are happy to assist.

Source: The Slott Report

What's New at Siller & Cohen: 3rd Quarter 2020

Speaking Events

- Randy Siller recently presented at The Resource Group's annual meeting, which was conducted virtually this year. He presented a number of case studies focusing on financial planning and investment management.

Staff Updates

- We would like to congratulate Fran and Valentina Narkaj on their marriage, on June 21st, 2020.