The SECURE Act Affects Retirement and Tax Planning for Individuals

On December 20, President Trump signed into law the Setting Every Community Up for Retirement Enhancement (SECURE) Act. It was part of the Further Consolidated Appropriations Act federal spending package.

In general, the SECURE Act is intended to expand opportunities for individuals to increase their retirement savings and to simplify the administration of retirement plans. Here are some changes that are most likely to affect individuals, including some that aren't related to retirement savings.

No More Age Limit for Traditional IRA Contributions

Before the SECURE Act, you couldn't make contributions to a traditional IRA for the year during which you reached age 70½ or any later year. (There is no age restriction on Roth IRA contributions.)

The SECURE Act repeals the age restriction on contributions to traditional IRAs for tax years beginning after 2019. So, starting in the 2020 tax year, you can make contributions after reaching age 70½ if you have taxable compensation.

The deadline for contributing for your 2019 tax year is April 15, 2020. However, you can't make a contribution for 2019 if you were age 70½ or older as of December 31, 2019. The age limit on traditional IRA contributions isn't officially lifted until tax year 2020.

Important: Be aware that any deductible IRA contributions made for the year you reach age 70½ and later years can reduce your annual qualified charitable distribution (QCD) allowance. After reaching age 70½, you can make qualified charitable contributions of up to $100,000 per year directly from your IRA(s).

Effective for QCDs made in a tax year beginning after 2019, the $100,000 QCD limit for that year is reduced (but not below zero) by the aggregate amount of deductions allowed for prior tax years due to elimination of the age restriction for traditional IRA contributions under the SECURE Act.

Later Start Date for RMDs

Later in life, you generally must begin taking annual required minimum distributions (RMDs) from tax-favored retirement accounts, such as traditional IRAs, SEP accounts and 401(k) accounts. Then you must pay the income tax on those distributions. (Note that you don't have to take RMDs from any Roth IRAs set up in your name.)

Before the SECURE Act, the initial RMD was for the year you turn age 70½. You could postpone taking that initial payout until as late as April 1 of the year after you reached that age — but that option would require two RMDs in that year:

1. An RMD for the previous year by the April 1 deadline, and
2. Another RMD for the current year by December 31.

For each subsequent year, you must take another RMD by December 31.

The SECURE Act increases the age after which you must begin taking RMDs from 70½ to 72. This favorable change applies only to individuals who reach age 70½ after December 31, 2019. So, if you'll turn 70½ in 2020 or later, you won't need to start taking RMDs until after you've attained age 72.

However, if you turned 70½ in 2019 or earlier, you're unaffected by this change. This means that, if you turned 70½ in 2019 and haven't yet taken your initial RMD for 2019, you must take that RMD by no later than April 1, 2020, or face a 50% penalty on the shortfall. Then you must take your second RMD — which is for the 2020 tax year — by December 31, 2020.

Important: The SECURE Act retains a key exception to the RMD rules: People who still work as employees after reaching the RMD age and don't own over 5% of the entities that employ them can postpone taking RMDs from their employers' plans until after retirement.

Penalty-Free Early Distributions for Births and Adoptions

You generally must include in your taxable income for the year distributions received from:

- Qualified retirement plans,
- Section 403(b) tax-sheltered annuity plans,
- Eligible Section 457(b) state or local government deferred compensation plans, or
- IRAs.

Unless an exception applies, the taxable portion of distributions received before age 59½ is also hit with a 10% early distribution penalty.

Under the SECURE Act, qualified birth or adoption distributions aren't subject to the 10% early distribution penalty. These distributions are made during the one-year period beginning on either 1) the date when an eligible child of the account owner is born, or 2) the date when the legal adoption of an eligible adoptee of the account owner is finalized. The term "eligible adoptee" is any individual (other than a child of the account owner's spouse) who hasn't attained age 18 or is physically or mentally incapable of self-support.

Important: The maximum penalty-free distribution for any eligible birth or adoption is $5,000. This limit is apparently applied on an individual-by-individual basis. So, when married individuals both have retirement accounts, each spouse can apparently receive a $5,000 penalty-free qualified birth or adoption distribution.

Non-Tuition Fellowship and Stipend Payments

IRA contributions for the year generally can't exceed your net self-employment income or your compensation (as defined by the tax law). If you're married, you also can count your spouse's self-employment income or compensation.

Under the SECURE Act, for tax years beginning after 2019, taxable amounts paid to an individual to aid the pursuit of graduate or postdoctoral study — such as a fellowship, stipend, or similar payment — count as compensation for IRA contribution purposes.

Liberalized Rules for Tax-Free Section 529 Plan Distributions

Section 529 plans are state-sponsored programs. You can make contributions to a Sec. 529 account to:

- Cover the designated account beneficiary's qualified higher education expenses, or
- Prepay their qualified higher-education expenses.

Distributions to cover the beneficiary's qualified higher education expenses are federal-income-tax-free. Tax-free Sec. 529 account distributions also can be used to cover up to $10,000 of annual qualified expenses to attend public, private or religious elementary or secondary schools.

The SECURE Act allows federal-income-tax-free Sec. 529 account distributions to cover:

- Costs associated with registered apprenticeships, and
- Up to $10,000 of qualified student loan principal or interest payments.

These changes apply to distributions made after December 31, 2018.

Important: The limited deduction for student loan interest allowed by Internal Revenue Code Section 221 is disallowed to the extent the interest was paid with a tax-free Sec. 529 account distribution.

Restrictions on Retirement Plan Loan Borrowings

Subject to tax-law limitations, employer-sponsored qualified retirement plans can make loans to plan participants. Some plans have allowed employees to access their plan loans using a credit card or similar mechanism.

Under the SECURE Act, for plan loans made after December 20, 2019, loan amounts can't be distributed through credit cards or similar arrangements without causing the distributed amounts to be treated as deemed taxable distributions.

Increased Penalty for Failure to File Federal Returns

The SECURE Act increases the penalty for failure to file affected federal tax returns to the lesser of:

- $400, or
- 100% of the amount of tax due.

This unfavorable change applies to returns that are due after December 31, 2019, including any extensions. Before this change, the dollar limit for returns due in 2020 was scheduled to be $330.

Pre-TCJA Kiddie Tax Rules Are Reinstated

The so-called "kiddie tax" rules were designed to prevent wealthy families from shifting unearned income (typically from investments) to younger generations to lower a family's overall tax bill. These rules can potentially apply until the year an affected young adult reaches age 24.

Before the Tax Cuts and Jobs Act (TCJA), an affected child's or young adult's unearned income was taxed at the marginal federal income tax rate of the *parents* if that rate was higher than the rate the child or young adult would otherwise pay.

Under the TCJA, for tax years beginning after 2017, an affected child's or young adult's unearned income was taxed at the rates paid by *trusts and estates*. That change could cause the kiddie tax to be much more expensive when an affected child or young adult has substantial unearned income.

However, Congress became concerned that the TCJA change unfairly increased the federal income tax bills of certain children and young adults, including those who are survivors of deceased military personnel, first responders and emergency medical workers. In effect, the SECURE Act retroactively repeals the TCJA kiddie tax change. It reinstates the pre-TCJA kiddie tax calculation, so it's once again based on the parents' marginal tax rate.

The kiddie tax repeal provision is generally effective for tax years beginning after 2019. But you also can choose to apply the repeal provision to tax years that began in 2018 and/or 2019. Consult with us to determine whether 1) to file amended 2018 returns for affected children and young adults, and 2) to factor this change into their 2019 returns.

Tip of the Iceberg

The SECURE Act includes a lot of important tax changes, including highly technical changes that are beyond the scope of this article and some that affect employers that offer retirement benefits. If you want more information about the SECURE Act changes and how they might affect you, consult with us.

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