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THE SECURE ACT—HOW DOES IT AFFECT YOUR RETIREMENT ACCOUNTS?

On December 20, 2019 Congress and the President signed the **S**etting **E**very **C**ommunity **U**p for **R**etirement **E**nhancement (**SECURE)** Act. Unlike the plethora of bills passed since then to stimulate the economy, **this bill has no sunset date and is not a one-year law like the CARES Act.**

There were several favorable changes and several not so favorable depending on your circumstances. We will highlight the major changes that affect most taxpayers.

Change #1—The age of RMDs (required minimum distributions) has changed.

In the past, RMDs were required to start in the calendar year a person turned 70 ½ years of age. This was the case for retirement accounts such as traditional IRAs, SEPs, and SIMPLEs (**not** Roth IRAs). It includes most 401Ks, 403Bs, 457s and other company plans unless you are still working for the company (there are exceptions if you own part of the company). But, under the SECURE Act, if you turn 70 ½ in 2020 or later, your RMD starts the year you turn 72 years of age. (Remember from a previous email that the RMDs for 2020 have been suspended. So, really, starting in 2021 and following years, if you are at least age 72, you have an RMD.)

Change #2—Stretch IRA severely limited.

If an IRA or retirement account owner died in 2019 or prior and had a "designated beneficiary" (this means a person) inheriting the IRA, the person inheriting the IRA could "stretch" the IRA and take the proceeds over their lifetime. This allowed an older person to leave their IRA to a young person and that young person could "stretch" the IRA payments out over many, many years. This could allow much of the inherited IRA to continue to grow tax deferred for decades creating wealth for the beneficiary. Under the SECURE Act, if a person dies in 2020 or later, most beneficiaries are no longer able to "stretch" the IRA over their lifetime but must withdraw the funds by the end of the 10th year after the year of death. So, if the death is in 2022, all must be withdrawn by 2032. (The few exceptions are explained later in the article.) No minimum amount must be withdrawn each year, but the entire account needs to be withdrawn by the 10th year.

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Example: Granny Smith funded her retirement for years and only took her RMDs when she had to. She invested in technology stocks (Steve Jobs was the CEO) and her IRA grew to be worth several bushels of money. Granny's designated beneficiaries of her IRA were Mr. Graven Stein (age 55) and Ms. Honey Crisp (age 45) If Granny had died in 2019 or prior, Graven could have stretched his share of the inherited IRA over 29.6 years and Honey could have stretched her share over 38.8 years. But, as always, it took Granny a long time to ripen with old age and she didn't pass away until 2020, so both Mr. Stein and Ms. Crisp have to empty the inherited IRAs within 10 years, or by 2030. How do like them apples?

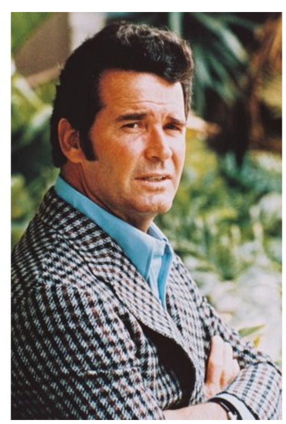
Change #3—Taxpayers with earned income can contribute to an IRA even after age 70 ½.

Prior to the SECURE Act, it was impossible for someone who was 70 ½ or older to fund a traditional or Roth IRA. But, for tax years 2020 and forward there is no age limit. The only requirement is "earned income" (think W-2 or self-employed income) subject to all the limits of phaseouts of any other taxpayer no matter their age.

Change #4—Any taxpayer over 70 ½ that funds a deductible IRA will reduce their ability to make a tax-free Qualified Charitable Distribution (QCD) by the same amount.

A taxpayer who is age 75 and working could have an RMD and an IRA contribution. But, to prevent taxpayers who have an RMD from using the tax-free "IRA to charity" rule to satisfy an RMD and also get a tax deduction for an IRA contribution, the law reduces the amount of tax-free qualified charitable distributions (QCDs) from an IRA to charity for every dollar the taxpayer deducts for IRA contributions from age 70 ½ forward.

Example: Jim Rockford continued to work as a private investigator well into his mid-70s and had an RMD from his IRA of about $12,000 a year. Since he didn't need the money, he would direct his IRA to give the $12,000 every year directly the Pontiac Firebird Preservation Society, a 501C(3) charity. But, in 2020 he contributed $7000 to a deductible IRA. Only $5000 of the $12,000 to the charity will be excluded from tax. The net effect was that only $12,000 escaped tax, just like before, but the $7000 he just contributed to his IRA might eventually be taxed and possibly increase his RMD in future years. When you only make $200 a day plus expenses, that's not a good thing. **Is there a solution?**



Mr. Rockford's good friend Angel suggested he fund a Roth IRA instead. Unlike past schemes, Angel was correct. If Rockford funded a Roth IRA instead of deductible IRA, his Roth IRA would grow tax free and he could avoid paying taxes on all $12,000 of his RMD since it went directly to charity. Roth IRAs have no RMDs and $12,000 still was excluded from tax. This made watching the waves from his trailer in a parking lot on the shore of Malibu even better.

Back to Change #2. With the elimination of the stretch IRA in most cases, this raises some questions.

Question #1: Are there any exceptions to the 10-year rule?
Yes, but the beneficiary must be an Eligible Designated Beneficiary (EDB).
Who does this include? This includes
1) a surviving spouse. The surviving spouse can treat the IRA as their own and use their life expectancy per IRS tables (similar to the old rules).
2) minor child(ren). They can use the "stretch IRA" rules until the age of majority (usually 18, but 21 in some states) unless they are still a student. If still a student, they can continue to use the "stretch IRA" rules until the year they leave school or turn 26, whichever comes first. So, this can stretch the IRA distributions for more than 10 years, but only until the child turns 35 years old at the most. This only works for children, not grandchildren.

Example: Fred Flintstone died in a terrible accident at the quarry and his daughter, Pebbles, inherited his IRA at the age 12. She will take an RMD based on her life expectancy (70.8 years) until she either turns 26 or stops being a full-time student. Pebbles went to college and majored in Papyrus Studies and graduated at the age of 24. Starting with the age of 24, she now goes from taking an RMD based on the life expectancy tables to having to withdraw the funds anytime she wants before more than 10 years have elapsed, or the year she turns 34. So, in essence, she has stretched the IRA out over 22 years. When she explained her strategy to her tax accountant Mr. Abacus, he exclaimed "yabba dabba doo".
3) a disabled individual if a designated beneficiary. But there are strict IRS rules. In addition, be careful as some inherited assets, such as an IRA, might restrict benefits for the disabled individual if they are on public assistance.
4) chronically ill individuals (waiting for IRS clarity on what this means)
5) individual not more than 10 years younger than the IRA owner. So, if the owner of an IRA dies at age 40 and the EDB is age 30 or older, they can still stretch the IRA over their lifetime.

Question #2: I have an extremely large IRA and if my beneficiary has to clear it out in 10 years, that means much of my IRA will go to taxes. What are some alternatives to avoid the big tax hit?
The main answer might be to have your spouse as your primary beneficiary. But then your spouse would probably ask the same question eventually.

A second alternative would be to leave your IRA to charity where they would get the proceeds but avoid the tax on the distribution since they are a tax-exempt organization.

Another alternative would be to have multiple beneficiaries. For example, if a taxpayer had 3 children and left the IRA to all three children as designated beneficiaries, that means the IRA could be drained over 30 tax years (10 tax years for each child, thus 30 tax returns).

Another alternative would be to do a combination of the above, leave some to charity and some to designated beneficiaries. These are areas to explore with your financial advisor and/or estate planning attorney.

ACTION ITEMS
Below is a list of some things to think about and perhaps do in the next few weeks.

ACTION ITEMS
1) Review the beneficiaries of all of your retirement accounts, including IRAs, Roth IRAs, 401Ks, 403Bs, etc. Do it now!!
2) Review post-death IRA planning with your financial advisor
3) Review post-death planning with your estate lawyer, if applicable
4) Review planning options that you discussed with your financial advisor and your estate lawyer with DeMartini & Associates before making any major changes.

As always, if you have any questions, please contact us.

Rick, Len, and Ashlee