The Secure Act

Setting Everyone Up for Confusion?

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The Setting Every Community Up for Retirement ("SECURE") Act has been a hot topic since it was signed into law on December 20, 2019. This paper is intended to highlight some of the changes that are likely to have an impact on our clients. In many instances, the prior, pre-SECURE Act law still applies to some individuals, while the SECURE Act applies to others.

Increased Age for RMDs

A Required Minimum Distribution ("RMD") is the minimum amount that must be withdrawn from an Individual Retirement Account ("IRA") by owners of retirement age. RMDs do not apply to Roth IRAs, because those are funded with after tax dollars.

Under the pre-SECURE Act law, Required Minimum Distributions ("RMD") began in the year the owner turned 70½. The owner had until April 1 of the following year to take his first RMD payment. The prior law is still in effect for those IRA owners who turned 70½ in 2019 or earlier. For example, George turns 70½ on June 19, 2019. He must take his first RMD payment by April 1, 2020.

The SECURE Act increases the beginning age of RMDs to 72. For IRA owners who do not fall under the prior law, their RMD payments will not begin until the year they turn 72. The payment extension of April 1 of the following year remains. For example, Susan turns 70½ on January 2, 2020. Susan falls under the SECURE Act rules, so her RMD payments will not begin until the year she turns 72.

Remember, under either law, if the first RMD is taken in the following year, the current year RMD payment still needs to be taken prior to December 31. For example, George is required to take his first RMD payment prior to April 1, 2020 and takes such payment on January 31, 2020. George still needs to take his 2020 RMD payment before December 31, 2020.

An account owner can take distributions from his IRA prior to age 72, but it will not be considered a RMD, until he reaches such age.

Qualified Charitable Distributions

A Qualified Charitable Distribution ("QCD") is a distribution from an IRA made directly to an eligible charity, bypassing the owner of the account. An "eligible" charity is one who can receive tax-deductible contributions under IRS rules. If an owner takes a distribution from his IRA and then gives the money to a charity, it does not qualify as a QCD. The QCD amount is not taxed, but a charitable deduction cannot be claimed.

The SECURE Act maintains the ability of an IRA owner to make a QCD, upon reaching age 70½. Beginning in the year the owner turns 72, amounts given to charity via a QCD will reduce the RMD. The annual maximum contribution also remains at $100,000.

Elimination of Maximum Contribution Age

Under the prior law, an IRA owner had to be under the age of 70½ to make deductible contributions to a traditional IRA, even if still earning wages.

The SECURE Act repeals the maximum contribution age for traditional IRAs. Deductible contributions can be made, as long as the owner has wages or self-employment earnings.

Most traditional IRA rules remain making it possible for an owner to turn 72, work and make contributions, while being required to take RMDs.

Elimination of Stretch IRA Rules for Inherited IRAs

Under the pre-SECURE Act law, which is still in effect for owners dying in 2019 or earlier, the beneficiary was able to "stretch" the balance of the inherited IRA over the beneficiary's life expectancy. This rule covered most individuals and trusts.

The SECURE Act eliminates these rules for inherited IRAs, whose owners die in 2020 or later. This new rule requires the balance of an inherited IRA to fully distribute to individuals or trusts by the end of the tenth calendar year, following the year of the owner's death. There are no distributions requirements, as long as the full balance is distributed by the end of the timeframe. For example, an IRA owner dies in 2020 and leaves his IRA to his adult children. The distribution clock starts in 2021 (the year after death) and the IRA must fully distribute by December 31, 2031.

Eligible Designated Beneficiaries There are five exempt individuals who may "stretch" the IRA distributions based on their life expectancy. They are also referred to as "eligible designated beneficiaries."

- Surviving spouse of IRA owner
- Disabled individual,
- Chronically ill individual,
- Individual not more than ten years younger than the IRA owner, and
- Child of IRA owner, but only until child reaches age of majority.

Surviving Spouse The rules do not change for IRAs left to the owner's surviving spouse. It may be rolled over into the surviving spouse's own IRA, it can be kept as a separate inherited IRA using the surviving spouse's life expectancy, or it can be distributed using the 10-year rule.

Disabled Individual Under the Internal Revenue Code ("IRC") §72(m)(7), "an individual shall be considered to be disabled if he is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or to be of long-continued and indefinite duration." The individual must provide proof of their disability. A disable individual can use the life expectancy rule and stretch the IRA over his life expectancy.

Chronically Ill Individuals Under IRC §7702B(c)(2), a chronically ill individual has been certified by a licensed healthcare practitioner as unable to perform at least two activities of daily living for a period of at least 90 days due to loss of functional capacity, or requiring substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. A chronically ill can use the life expectancy rule.

Individual Less Than 10 Years Younger An individual not more than 10 years younger than the IRA owner can use the life expectancy rule. Such individual can include a younger sibling, friend, or other family member, as long as he is not more than 10 years younger.

Minor Child of Owner A minor child of the IRA owner, not a grandchild, can use the life expectancy rule until the child reaches to the age of majority. Upon reaching the age of majority, the beneficiary must take the balance of the IRA by the end of the 10th year.

The definition of "majority" is not clear and needs further guidance. Under state law, age of majority can be 18 or 21. In Ohio, the age of majority is 18. ORC §3109.01. Under IRC regulations, a child may be treated as not having reached majority if he has not completed a "specific course of education" and is under the age of 26. Clarification is needed for what qualifies as a "specific course of education."

Designated Beneficiaries Designated beneficiaries are individuals or trusts who are specifically named on the IRA Beneficiary Designation forms, but do not qualify as one of the five exempted individuals listed above. Designated beneficiaries must follow the 10-year rule.

Trusts Under the SECURE Act, the treatment of trusts as an IRA beneficiary will depend on the type of trust and its beneficiary.

A conduit trust is a "see through" trust, which directs the trustee to distribute the RMD, received by the trust from the inherited IRA, to the trust beneficiary, who must be an individual. If the trust beneficiary is one of the five exempted beneficiaries listed above, the trust will be considered an eligible trust and can use the life expectancy rule based on the beneficiary's life. For minors, the trust is eligible for the use of the life expectancy rule prior to the minor reaching the age of majority but will need to follow the 10-year rule upon the beneficiary reaching the age of majority.

An accumulation trust receives the RMD from the inherited IRA and the trustee can hold the RMD and accumulate it with other trust principal. If the beneficiary of an accumulation trust is the surviving spouse, child, or person less than 10 years younger, the trust follows the 10-year rule. If the trust beneficiary qualifies as disabled or chronically ill, the trust can use the life expectancy rule.

Please contact your attorney to review your trust documents and IRA beneficiary designations to ensure it still accomplishes your estate plan.

Miscellaneous

Penalty-Free Withdrawals for Birth or Adoption Expenses

The SECURE Act adds a new exception to the 10% penalty for pre-59½ withdrawals. An owner of a Qualified Retirement Plan or IRA can withdraw up to $5,000 to help defray costs for birth or adoption. A distribution from the plan to an individual is eligible if made during the one-year period beginning on the date the child is born or the adoption is finalized.

An eligible distribution is exempt from the 10% early withdrawal penalty, but is still a taxable distribution.

Kiddie Tax

The "kiddie tax" taxes certain unearned income of a child as if it was the parents' income. The Tax Cuts and Jobs Act of 2017 ("TCJA") change the tax rates for the "kiddie tax" to apply the ordinary and capital gain rates applicable to trusts and estates. These tax brackets are highly condensed and reach the maximum rates at $12,750 for 2019.

The SECURE Act revokes the TCJA changes and returns the "kiddie tax" treatment to the pre-TCJA rules of using the parents' income tax brackets.

Additional Eligible Higher Education Expenses for 529 Plans

The SECURE Act added tax-free treatment for additional eligible higher education expense distributions made from a 529 Plan. Distributions for a registered apprenticeship program's required fees, books, supplies, and equipment now qualify for tax-free treatment. In addition, qualified education loan repayments of up to $10,000 are eligible for tax-free treatment. Note that the deduction for student loan interest is reduced by the distributions for loans that are treated as qualified higher education expenses.

Conclusion

As with any new laws, we anticipate further guidance, regulations, and changes in the coming year. However, it is not too early to contact your attorney or CPA to review your estate plan and the impact of the SECURE Act on it. The LCNB Trust Department is happy to work with you, your attorney and CPA to help you accomplish your retirement and estate planning goals.

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