AMI INVESTMENT MANAGEMENT
Registered Investment Advisor

Memo to: AMI Clients
From: AMI Investment Management
Re: SECURE Act
Date: January 7th, 2020

The SECURE Act was recently passed by Congress and signed into law by President Trump on December 20th. Although not as sweeping as the 2017 Tax Cuts and Jobs Act, the SECURE Act makes numerous updates to the rules around retirement plans and may be just as impactful particularly to those with substantial tax-favored retirement savings.

Key provisions include:

- Increasing the start date for Required Minimum Distributions (RMDs) from age 70 ½ to age 72
- Removing the age limit on IRA contributions (previously was age 70 ½)
- Eliminating the ability to stretch RMDs on inherited IRA accounts
- Penalty free withdrawals from retirement accounts up to $5,000 for birth/adoption expenses
- Assets in 529 college savings plans can now be used to pay up to $10,000 in student loans

RMD Changes

In a bit of good news, the Act increases the age for required minimum distributions[1] from 70 ½ to age 72. This means that retirement plan owners will not be *required* to take any money out of their IRAs or 401(k)s until they turn age 72[2]. This allows the money to grow tax deferred for an additional year and a half without having to withdraw it (thereby being taxed on it). Additionally, most married IRA owners select their spouse as the primary beneficiary and when the IRA owner passes away the IRA transfers to the surviving spouse's name. Under the SECURE Act the surviving spouse must also start required minimum distributions after reaching their own age of 72. This rule change applies to those individuals who turn 70 ½ in 2020 or later. For example, even though an individual turning 70 ½ in December 2019 will not yet be 72 in 2020, they will still be required to continue RMDs under the existing rules and to take an RMD for 2020 (and each year thereafter).[3]

[1] A required minimum distribution (RMD) is the amount of money that must be withdrawn from an IRA or 401(k) account by owners of retirement age. Retirees can and often do take more than the RMD. The amount of the RMD is determined by dividing the retirement account's prior year-end fair market value by the applicable distribution period or life expectancy.

[2] The first RMD must be taken by April 1st of the year after turning age 72. However, if you wait you effectively have two RMDs due in that year.

[3] Even though an individual turning 70 ½ in 2020 will not have to take an RMD for 2020, they may still use their IRA to make a Qualified Charitable Donation (QCD) of up to $100,000 for the year (after *actually* turning 70 ½ or later). Beginning in the year an individual turns 72, any amounts given to charity via a QCD will reduce the then-necessary RMD as well (while in the prior 1-2 years, it will simply allow the pre-tax IRA to be used for charitable contributions directly on a pre-tax basis).

Removal of Age Limit on IRA Contributions

Section 107 of the SECURE Act lifts the prohibition on Traditional IRA contributions when someone turns age 70 ½. Thus beginning in 2020 individuals of any age will be allowed to contribute to a Traditional IRA. The requirement that such individuals have “compensation” - which is generally from wages or self-employment - to make such contributions remains. So this change only affects those over 70 ½ who are still working and would like to fund their Traditional IRA.[4]

Elimination of the “Stretch” Provision

One of the most significant changes made by the SECURE Act is the elimination of the “Stretch” provision for most *non-spouse beneficiaries* of IRA accounts.[5] Under previous rules if a non-spouse inherits IRA assets they are able to stretch the RMDs out over their own life expectancy thereby reducing the amount they are required to take out each year. This stretch feature was incredibly helpful for children/grandchildren who inherit an IRA and don’t need the funds (or don’t want to incur additional taxable income during their working years) and there was no limit on the years the funds could be “stretched” while they were alive. Unfortunately, the SECURE ACT eliminated the lifetime stretch feature and most beneficiaries who inherit in 2020 and going forward will be subject to the new 10-Year Rule. Under this 10-Year Rule, the entire inherited retirement account must be emptied by the end of the 10th year following the year of inheritance though there are no distribution requirements during the 10 years. Thus, designated beneficiaries *will* have some flexibility when it comes to timing distributions from the inherited account(s) for maximum tax efficiency…as long as the entire account balance *has* been taken by the end of the 10th year after death.[6]

Adoption Allowance

Section 113 of the SECURE Act introduces a new exception to the 10% early distribution penalty from IRAs. Specifically, the exception allows up to $5,000 to be distributed penalty-free from an IRA or qualified plan (i.e. 401(k) or 403(b)) as a “Qualified Birth or Adoption Distribution”. To meet the requirements an individual must take the distribution from their retirement account at any point during the one-year period beginning on either the date of birth, or the date on which the adoption of an individual under the age of 18 is finalized. This means that those interested in adoption can’t use this rule to help with up front expenses but they can distribute the funds after the fact to “replenish” their bank account. In addition, the $5,000 limit applies to each birth/adoption so you can distribute $5,000 for each child born/adopted.

---

[4] The SECURE Act contains an anti-abuse rule that coordinates post 70 ½ Traditional IRA contributions with QCDs. Under the rule, any QCD will be reduced by the cumulative amount of total post-70 ½ IRA contributions (but not below $0) that have not already been used to offset an earlier QCD. Effectively ensuring that individuals don’t just ‘recycle’ post-70 ½ IRA contributions into subsequent QCDs.

[5] Note that this does not apply to spouses who inherit their partner’s IRA. This rule also only partially applies to minor children who inherit their parent’s IRA. For minor children they are required to take age-based required minimum distribution until they reach the age of majority, and then the 10 year rule kicks in.

[6] This presents unique planning opportunities. For example, say you inherit a $500,000 IRA at your own age 60 and you now have 10 years to liquidate the funds. If you plan to retire at 65 you may want to wait until you are fully retired to distribute any of the funds since you will likely be in a lower tax bracket after you are retired.

Phone: (260) 347-1281 · Fax: (260) 347-1282 · P.O. Box 247 · 710 North Krueger · Kendallville, IN 46755
www.AMIinvestment.com

Incentives for Small Business Retirement Plans

Some important provisions were also made for small businesses to further encourage use of employer retirement plans for their employees. Previously the IRS offered a credit of up to $500 for three years for startup costs related to establishing a small business retirement plan (defined as businesses with less than 100 employees) like a 401(k), 403(b), SEP IRA or SIMPLE IRA. Section 104 of the SECURE Act substantially increases the potential credit to the greater of:

- $500; or
- The lesser of:
    - $250 x the number of non-highly compensated employees (those earning less than $130,000 or less than a 5% owner) eligible to participate in the plan: or
    - $5,000

Additionally, the SECURE Act incentivizes employers to incorporate "auto-enrollment" into their employer sponsored retirement plans by offering an additional $500 credit. In general, auto-enrollment requires plans to treat participants as though they have elected for the employer to make contributions to the plan at a specified percentage of compensation, until notified by the participant to do otherwise. In other words, the employer assumes each eligible employee wants to participate until the employee tells the employer they don't want to (i.e. opting out). The credit is first available for tax years beginning in 2020, and can be claimed in the year the auto-enrollment option is first adopted by the plan, as well as the two following years (provided the provision continues to be maintained by the plan during those years). The Auto-Enrollment Option tax credit is based on when the enrollment option is added - not when the plan is created - meaning existing plans who elect the feature in 2020 and beyond are eligible.

Auto-enrollment has been extremely successful at increasing participation in company retirement plans and so has "auto escalation". Research shows that automatically increasing an employee's contribution rate increases the likelihood they will contribute more to their plan. Previously employers were required to stop automatic deferral increases at 10% of an employee's compensation and the SECURE Act increases that limit to 15%.

Non-Retirement Related Changes

While most of the SECURE Act was focused on improvements to retirement plans there were a few other noteworthy changes added to the legislation. Section 302 expands on several newer rules for 529 plans. Qualified Higher Education Expenses now include expenses for Apprenticeship Programs that include fees, books, supplies, and required equipment provided the program is appropriately registered and certified with the Department of Labor.

Additionally the SECURE Act introduces distributions for "Qualified Education Loan Repayments" as a qualified higher education expense. Such distributions may be used to pay the principal and/or interest of qualified education loans and are limited to a lifetime amount of $10,000 (not adjusted for inflation). Notably, in an anti-abuse coordination provision, any plan funds used to pay the interest on qualified student debt will render that interest paid ineligible for the above-the-line deduction for student loan interest. The $10,000 lifetime limit is a per-person

Phone: (260) 347-1281 · Fax: (260) 347-1282 · P.O. Box 247 · 710 North Krueger · Kendallville, IN 46755
www.AMIinvestment.com

limit, and in addition to using the funds in a 529 plan to pay for the 529 plan beneficiary's debt, an additional $10,000 may be distributed as a qualified education loan repayment to satisfy outstanding student debt for each of a 529 plan beneficiary's siblings. This change is effective retroactive to the beginning of 2019.

Lastly, the "Kiddie Tax" rules that were changed in the 2017 "Trump Tax Cuts" are now changed back to the previous rules prior to 2017. Any income subject to the Kiddie Tax rules is no longer taxable at Trust & Estates brackets and is now changed back to being taxed at their parents' marginal rate. This change is effective for 2020 but taxpayers can elect to retroactively apply the rules as far back as the 2018 tax year (which would result in filing an amended return).

Please let us know if you have any questions on these changes or would like to set up an appointment to further discuss.

Wishing you a Happy New Year and many blessings in 2020!

Mike, Jacob and Ryan

Phone: (260) 347-1281 · Fax: (260) 347-1282 · P.O. Box 247 · 710 North Krueger · Kendallville, IN 46755
www.AMIinvestment.com