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PCA Planning Commentary

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The SECURE Act - Part Two

"Nothing is sure but death and taxes"

Note: This is the second of a three-part overview of the SECURE Act. Part 1 focuses on the changes to IRA distribution planning that will impact many individuals' family income and estate tax planning strategies. Part 2 will provide an overview of the benefits individuals may receive as a result of the act, and Part 3 will review changes that impact employers who seek to provide valuable retirement benefits for employees.

Benefits to Individuals

The SECURE Act includes several provisions designed to benefit American workers and retirees.

- People who choose to work beyond traditional retirement age will be able to contribute to traditional IRAs beyond age 70½. Previous laws prevented such contributions. (There are currently no age-based restrictions on contributions to a Roth IRA.)

- Retirees will no longer have to take required minimum distributions (RMDs) from traditional IRAs and retirement plans by April 1 following the year in which they turn 70½. The new law generally requires RMDs to begin by April 1 following the year in which they turn age 72. This change is an extra 18 months individuals can let their retirement funds grow before being forced to tap into them.

- Part-time workers age 21 and older who log at least 500 hours in three consecutive years generally must be allowed to participate in company retirement plans offering a qualified cash or deferred arrangement. The previous requirement was 1,000 hours and one year of service. (The new rule applies to plan years beginning on or after January 1, 2021.)

2002 Life Expectancy Tables - Time for Change?

- An individual's Required Minimum Distributions (RMD) are based on life expectancy tables that were developed using mortality rates in 2002. In August 2018, President Trump signed an executive order directing the IRS to examine the life expectancy tables and determine if they should be updated.

- Life expectancies have increased since 2002, and in early

- November 2019 the IRS issued proposed regulations with new, updated life expectancy tables. The tables would reduce RMDs accordingly.

- The new life expectancy tables would apply to all accounts that have RMDs, including IRAs, employer retirement plans (especially 401(k)s), annuities and more.

- The public has an opportunity to comment on the proposed regulation. The IRS then reviews the comments and makes any changes it deems appropriate.

- Although subject to change, the IRS expects that the proposed tables will be effective for distribution calendar years that begin on or after January 2, 2021.

- New laws make it easier for employers to offer lifetime income annuities within retirement plans. Such products can help workers plan for a predictable stream of income in retirement. In addition, lifetime income investments or annuities held within a plan that discontinues such investments can be directly transferred to another retirement plan, avoiding potential surrender charges and fees that may otherwise apply.

- Qualified employer plans are prohibited from making loans through credit cards and other similar arrangements. We see this as a benefit, as this change will help to ensure that plan loans are not used for routine or small purchases, thereby preserving retirement savings.

- Amounts paid to individuals in the pursuit of extended study (i.e., graduate or post-doctoral study or research) would be treated as compensation for purposes of making IRA contributions, so affected students could begin saving for retirement sooner.

- Individuals can now take penalty-free early withdrawals of up to $5,000 from their qualified plans and IRAs due to the birth or adoption of a child. (Regular income taxes will still apply, so new parents may want to proceed with caution.)

- 529 account assets can now be used to pay for student loan repayments ($10,000 lifetime maximum).

- 529 account assets can now be used to pay for costs associated with registered apprenticeships.

    - To be considered a qualified 529 plan expense, the apprenticeship program must be registered and certified with the Secretary of Labor under section 1 of the National Apprenticeship Act. The Department of Labor provides a search tool to find out if a particular apprenticeship program is eligible.

College Funding Planning - Opportunity for Grandparents

The expansion also presents an opportunity for grandparents who want to help a grandchild pay for college without affecting financial aid eligibility.

•Distributions from a grandparent-owned 529 plan are considered untaxed student income on the Free Application for Federal Student Aid (FAFSA) and can reduce a student's financial aid package by up to 50% of the value of the distribution.

•Grandparents can avoid this by waiting until January 1 of the student's sophomore year of college (when it will no longer affect untaxed income on the FAFSA) to take a 529 plan distribution or wait until the student graduates to pay down their student loans.

- The so-called "Kiddie Tax" reverts to the tax rates that were in effect prior to the Tax Cuts and Jobs Act of 2017.

    - The Tax Cuts and Jobs Act of 2017 changed the Kiddie Tax, which taxed a child's unearned income at the tax rates of the child's parents. Starting in 2018, however, the Kiddie Tax was based on the much higher tax rates for estates and trusts.

    - This significantly increased the tax rates that apply to the taxable portion of college grants, scholarships and fellowships and to military survivor benefits of Gold Star families. It also caused low- and middle-income children to be taxed at much higher rates than their parents.

    - The SECURE Act repeals the change to the Kiddie Tax, reverting to the rules that were in effect before 2018. This change is effective for tax years that begin after December 31, 2019. However, the legislation allows taxpayers to elect to have the change apply retroactively to the 2018 and/or 2019 tax years. Taxpayers will probably have to file amended federal income tax returns to claim a refund of the excess tax.

Conclusion

The recently passed SECURE Act brings many benefits to both individuals and employers. However, as a means of funding the $1.4 trillion spending package, Congress has curtailed the ability for most individuals to defer paying income tax on their retirement accounts over the lifetime of their beneficiaries. Taxes will be due sooner, and in many cases, at a higher rate. The Act makes profound changes to retirement, education, and estate planning. Individuals and business owners should seek the advice of their professional financial and tax planners to ensure they make any necessary adjustments to accommodate the latest changes to tax legislation.

Please contact the financial planning team at Pallas Capital Advisors to discuss the SECURE Act or any other aspect of your financial planning objectives.

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