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2020 Ushers in Significant Change for Retirement Accounts

Article By:

Douglas S. Robson

Howard J. Rubin

James R. Robinson

At the end of 2019, the "Setting Every Community Up for Retirement Enhancement Act," or the SECURE Act, was signed into law, with one of its goals being to increase opportunities for individuals to improve their savings.

Not all of the changes are favorable, however, and may impact an individual's approach to retirement and tax planning. As a result, individuals with significant retirement accounts should consider reviewing their current plan to determine if a different approach is desired.

Here is a brief overview of the more significant changes affecting individuals:

No Maximum Contribution Age

Previously, contributions to traditional Individual Retirement Accounts (IRAs) could no longer be made once an individual reached age 70 ½. With many Americans now working past a traditional retirement age, Congress wanted to remove the age restrictions to retirement savings. Starting in 2020, individuals of any age may make contributions to an IRA, so long as they have compensation – typically earned income from wages or self-employment.

Required Minimum Distributions Starting at Age 72

Prior to 2020, an individual was required to begin taking required minimum distributions (RMDs) from his or her retirement plan or IRA once reaching age 70 ½ (the age requirement which was first set in the 1960s). In light of increasing life expectancy, the age for taking an RMD after Dec. 31, 2019, for those individuals who will reach age 70 ½ after that date, has been raised to age 72.

Elimination of IRA Stretch Planning for Certain Individuals

One of the most impactful changes resulting from the SECURE Act is the treatment of inherited IRAs and inherited Roth IRAs. Minimum distribution rules for inherited IRAs and 401(k)s prior to the Act allowed the designated beneficiaries to elect to take the RMDs from such accounts either based on the life expectancy of the owner or of the beneficiary (depending on the owner's age upon death). By not having to take a lump sum distribution, the beneficiaries were able to "stretch" out the distributions and income tax liability over several years, while allowing the funds to continue to grow tax-deferred.

The Act now provides that for IRA owners and plan participants who die after 2020, the majority of non-spouse beneficiaries will be required to take a distribution of the entire account within 10 years following the owner's death, thereby eliminating much of the benefit of "stretching" out the income tax burden and of utilizing retirement accounts as an effective wealth transfer. The Act's provisions also apply to inherited Roth IRAs, but the distributions from a Roth IRA are not taxable. Moreover, once funds are distributed from an inherited IRA or an inherited Roth IRA, the earnings on the money required to be withdrawn are no longer tax-deferred. There are a few exceptions to the 10-year requirement, including designated beneficiaries who are: (i) the surviving spouse; (ii) a minor child; (iii) a chronically ill individual; or (iv) an individual who is not more than 10 years younger than the owner or plan participant.

Expanded Use of 529 Plans

Qualified tuition programs, known as 529 plans, are established by a state or state agency to which taxpayers may make contributions on behalf of a designated beneficiary. The contributions grow tax-free, and distributions from a 529 plan to a beneficiary are excludable up to the amount used to pay for qualified higher education expenses. Prior to 2020, such higher education expenses included tuition (including a portion of elementary and secondary school tuition), fees, books, and some room and board costs. The new provisions now allow for tax-free distributions to be made from 529 plans to cover the expenses of registered apprenticeships and student loan repayments. The effective date is retroactive to Dec. 31, 2018, and distributions can be made to cover costs associated with participation in an apprenticeship program. Distributions may also be made up to $10,000 to pay the principal or interest on a qualified education loan of the designated beneficiary or sibling of the designated beneficiary.

No Penalty for Use of Retirement Plans to Cover Birth or Adoption Expenses

Generally, early distributions from a retirement plan must be included in the participant's income and be subject to a 10% early withdrawal penalty. There are certain exceptions that apply, for instance, when distributions are needed in case of financial hardship. In 2020, participants can also begin taking distributions up to $5,000 from their plans to cover expenses related to the birth or adoption of a child, without penalty. This amount is per person, so it can be doubled for a couple covering such expenses.

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