Wealth Planning Update

SECURE Act Overview:
How This Legislation Affects You

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Derek Dockendorf
Senior Wealth Planner
Wells Fargo Private Bank

Key takeaways:

• The Setting Every Community Up for Retirement Enhancement Act (SECURE Act), signed into law on December 20, 2019, affects a large segment of the population.

• Notable legislative changes resulting from the SECURE Act include the ability to contribute to an IRA past age 70½ and not being obligated to take required minimum distributions until age 72 (currently 70½).

• Most beneficiaries who inherit an IRA after January 1, 2020, will be required to withdraw the inherited IRA within 10 years. Previously, a beneficiary was able to stretch payments over his or her lifetime (stretch IRA).

• This is the most significant piece of retirement legislation since 2006. It also covers (but is not limited to) penalty-free distributions for childbirth and adoption fees, increased annuity options for 401(k)s, and expansion of 529 plans.

What this may mean for you:

• Many aspects of saving for retirement and timing of distributions are affected by this legislation, including determining whether to continue contributing to an IRA past age 70½, whether to take distributions before you reach age 72, and if you should address your estate plan in light of the elimination of the stretch IRA.

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Overview

On December 20, 2019, one of the largest pieces of retirement plan legislation in over a decade was signed into law. The Setting Every Community Up for Retirement Enhancement Act (SECURE Act) was the largest piece of retirement legislation since the Pension Protection Act of 2006. While the SECURE Act will put in place a number of taxpayer-friendly provisions intended to help Americans prepare and save for retirement, a few key provisions may have adverse effects for other taxpayers.

To help understand some of these key provisions that may affect you, the report is broken into two sections: retirement-related changes and non-retirement-related changes. We will outline what has changed, who it affects, and what actions you may want to consider taking as a result of the SECURE Act.

Retirement-related changes

Limitation of the stretch IRA provision:

What’s changed? Under the current law, required minimum distribution (RMD) rules for an inherited IRA allowed a designated beneficiary to receive distributions over his or her life expectancy. Spreading distributions over the beneficiary’s lifetime may result in a lower annual tax liability while allowing the investments to remain in the tax-advantaged IRA with growth potential.

Under the SECURE Act, a beneficiary who inherits an IRA in 2020 and thereafter must withdraw the funds from the IRA within 10 years of the IRA account holder’s death. This provision will affect estate planning approaches for IRA owners who plan to leave their IRAs to their children as well as how beneficiaries manage the tax implications of their inherited IRAs.

For certain designated beneficiaries, the 10-year rule will not apply, and these beneficiaries can take distributions over their lifetimes. These eligible designated beneficiaries include:

- Spousal beneficiaries
- Disabled beneficiaries
- Chronically ill beneficiaries
- Individuals who are not more than 10 years younger than the decedent
- Certain minor children (of the original retirement account owner), but only until they reach the age of majority (when they reach the age of majority, they will be subject to the 10-year rule)

The 10-year rule applies to both traditional IRAs and Roth IRAs as well as defined contribution retirement plans. Even though Roth IRA distributions are generally not (or may not be) taxable, the inherited Roth IRA must still be completely distributed by the end of the 10th year following the year of inheritance.

Who’s affected? All IRA and Roth IRA account owners who pass away starting in 2020 and beyond and the beneficiaries on those accounts will be affected.

Planning considerations. If you own an IRA, you should review your beneficiary designations in conjunction with your estate plan to confirm they are in line with your overall goals and objectives. If you have created or plan to create an irrevocable trust to be the beneficiary of your IRAs, it is important to note that the trust likely will not be an eligible designated beneficiary and will most likely be required to follow the 10-year rule. You should work closely with your attorney, as there may be provisions in the trust document that may prevent the IRA distributions from passing to the intended beneficiary of the trust, thus exposing those distribution dollars to the high taxes that trusts and estates often pay.

If charitable giving is something you are considering as part of your estate plan, keep in mind that naming charitable organizations as beneficiaries is a tax-efficient way to satisfy your charitable intent.
RMDs now begin at age 72:

What’s changed? The SECURE Act raises the RMD starting age to 72, which means individuals have until April 1 of the year following the year they turn age 72 to take their first RMD.

Who’s affected? This section affects individuals turning 70½ after December 31, 2019. Individuals who reached age 70½ on or before December 31, 2019, must start and/or continue taking RMDs at age 70½.

Planning considerations. Moving back the RMD by a year and a half opens up a lot of options for individuals to consider. For instance, if you are planning to retire a few years before being required to start taking distributions from IRAs, there could be an opportunity to use the lower-income years (when a wage is no longer being received) and either accelerate IRA distributions or consider Roth IRA conversions. Using either strategy would allow you to accelerate income into the low-tax years while also potentially reducing future RMDs.

If you are approaching 70½ and expected to make a qualified charitable donation (QCD) from your IRA, you may still do so, as the age for QCDs has not changed. QCDs are not taxed as income (nor do you receive a tax deduction) and can be a tax-efficient way to gift to a charity. Furthermore, because any distributions reduce the IRA balance, QCDs reduce future RMDs.

Repeal of maximum age for traditional IRA contributions:

What’s changed? The SECURE Act repeals the restriction that previously prevented contributions to traditional IRAs by an individual who has reached age 70½. Now there is no age limitation on the ability to make contributions to a traditional IRA; however, that contribution is still subject to the same rules regarding whether your contribution will be tax deductible.

Who’s affected? This affects people age 70½ or older. If a traditional IRA is your only retirement vehicle, you may continue to make contributions after age 70½.

Planning considerations. You should consider whether the contribution is tax deductible and your current cash flow before determining whether you want to continue to pay into your IRA past the age of 70½. Keep in mind that even if you are still working, you will need to take RMDs starting at age 72. If you are making contributions to a traditional IRA after age 72, the contributed amount will be included in the year-end balance that is used to calculate the next year’s RMD. When considering making a contribution to a traditional IRA, you need to consider cash flow, tax deductions, and the impact on future RMDs.

Penalty-free distributions for childbirth and adoption expenses:

What’s changed? The SECURE Act created a new exception to the 10% early withdrawal penalty. The exception allows up to $5,000 to be distributed penalty-free from an IRA or from a qualified plan as a qualified birth or adoption distribution.

Who’s affected? Those affected are individuals who take a 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. You still owe income tax on the distribution, unless you repay the funds.

Planning considerations. If you have costs associated with childbirth or adoption, you may consider taking a distribution from your retirement account to help cover some or all of those costs. The distribution must occur after the qualifying event and would help replenish cash previously used. The $5,000 limit is “with respect to any birth or adoption” (not a lifetime aggregate amount) and applies on an individual basis.
Annuity information and options expanded:

What’s changed? The SECURE Act expanded the information disclosures and portability options for lifetime income and annuity-type products in 401(k) plans.

The SECURE Act requires benefit statements to be provided at least annually that disclose and illustrate the monthly payments participants would receive if the total account balance were used to provide a lifetime income stream, including a qualified joint and survivor annuity and a single life annuity. The SECURE Act also increased the portability options for lifetime income and annuity assets that are part of the employer’s 401(k) plan investment choices.

Who’s affected? Individuals who have annuity-type products and choices as investment options as part of their employer’s 401(k) plan are affected. They now have the ability to port their lifetime income asset via a direct trustee-to-trustee transfer to another employer-sponsored plan or IRA.

Planning considerations. You should review your 401(k) plan investment options to see if they are currently invested in a lifetime income or annuity-type asset. You also may want to consider monitoring employer correspondence regarding 401(k) investment options and choices. Staying informed and being able to act accordingly if investment changes are made will help you avoid unpleasant options, such as liquidating the annuity.

Other changes:

There are other retirement-related changes that are important to be aware of, including those that affect qualified retirement plans. The details of these changes are beyond the scope of this piece but should be discussed with your tax professional and your advisor if applicable.

- Incentives for small businesses to start a retirement plan
  - Expands pooled multiple employer plans
  - Increases small employer start-up cost tax credits
- Incentives to increase savings
  - Creates automatic enrollment tax credit
  - Increases automatic escalation cap for employee deferrals
  - Eases safe harbor 401(k) election rules
  - Provides retirement plan access to part-time employees

Non-retirement-related changes

Expansion of Section 529 plans—student loans and apprenticeships:

What’s changed? The SECURE Act further expanded the definition of qualified higher education expenses to include expenses for apprenticeship programs (including fees, books, supplies, and required equipment) and qualified education loan repayments. Qualified education loan repayments are distributions that may be used to pay the principal and/or interest on qualified education loans, limited to a lifetime maximum amount of $10,000 (not adjusted for inflation). This change is effective retroactively to the beginning of 2019.

Who’s affected? Those affected are individuals with 529 plans who have children/family members looking to participate in an apprenticeship program or children/family members who have accumulated student loans and are looking for another source of funds to help pay those student loans.

Planning considerations. If you have a 529 plan, review how the plan beneficiary is using the funds and the activities that they are looking to pursue. Plan beneficiaries who do not plan to attend college but want to develop a trade skill can now use 529 plan funds to join an apprenticeship program.
For plan beneficiaries who have accumulated student loans and are looking for assistance to pay the student loans down or pay them off entirely, taking a qualified education loan repayment from a 529 plan could provide a great benefit. Distributions from a 529 plan are capped at a lifetime amount of $10,000. The $10,000 lifetime limit is a per-person limit, and in addition to using the funds in the 529 plan to pay for the plan beneficiary’s debt, an additional $10,000 may be distributed to satisfy the outstanding student loan debt for each of the 529 plan beneficiary’s siblings.

Please consider the investment objectives, risks, charges and expenses carefully before investing in a 529 savings plan. The official statement, which contains this and other information, can be obtained by calling your financial advisor. Read it carefully before you invest. The availability of tax or other benefits may be conditioned on meeting certain requirements.

Kiddie tax amendment:

What’s changed? Under the Tax Cuts and Jobs Act, the unearned income of children was taxed at the higher rates that were applicable to trusts and estates. The SECURE Act amends that provision to tax unearned income of children to pre-Tax Cuts and Jobs Act treatment, taxing the child’s unearned income at the child’s parent’s marginal tax rate. The kiddie tax change is effective for tax years beginning after December 31, 2019, but taxpayers may elect to apply the changes for the tax year that began in 2018, 2019, or both.

Who’s affected? Individuals with children who have unearned income are affected. Unearned income includes interest, dividends, capital gains, and rents.

Planning considerations. Starting in 2020, the unearned income of children will be taxed at the child’s parent’s marginal tax rate. If you have children who have substantial unearned income in 2019, you may want to consider applying the new kiddie tax rules on your 2019 tax return. Going back to 2018, if your child’s unearned income was taxed at the higher trust and estate rates, work with your tax professional to evaluate the potential tax savings of amending the 2018 tax returns to determine whether it makes sense to elect to tax your child’s 2018 unearned income at your marginal tax rate. If it makes sense, you will need to file an amended tax return.

Summary

As with any piece of legislation, especially one with this many changes, it is important to work with your tax professionals and advisors to define and prioritize your objectives. Your advisors can help you understand which solutions and strategies may be the most appropriate for your specific circumstances based on the changes brought about by the SECURE Act.

Establishing a plan with your local wealth planning professional can help you make appropriate adjustments, avoid potential pitfalls, and keep you on track to reach your long-term objectives.
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