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The SECURE Act and Your Retirement Savings

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The Setting Every Community Up for Retirement Enhancement (SECURE) Act was enacted in December 2019 as part of a larger federal spending package. This long-awaited legislation expands savings opportunities for workers and includes new requirements and incentives for employers that provide retirement benefits. At the same time, it restricts a popular estate planning strategy for individuals with significant assets in IRAs and employer-sponsored retirement plans.

Here are some of the changes that may affect your retirement, tax, and estate planning strategies. All of these provisions were effective January 1, 2020, unless otherwise noted.

Benefits for retirement savers

Later RMDs. Individuals born on or after July 1, 1949, can wait until age 72 to take required minimum distributions (RMDs) from traditional IRAs and employer-sponsored retirement plans instead of starting them at age 70½ as required under previous law. This is a boon for individuals who don't need the withdrawals for living expenses, because it postpones payment of income taxes and gives the account a longer time to pursue tax-deferred growth. As under previous law, participants may be able to delay taking withdrawals from their current employer's plan as long as they are still working.

No traditional IRA age limit. There is no longer a prohibition on contributing to a traditional IRA after age 70½ — taxpayers can make contributions at any age as long as they have earned income. This helps older workers who want to save while reducing their taxable income. But keep in mind that contributions to a traditional IRA only defer taxes. Withdrawals, including any earnings, are taxed as ordinary income, and a larger account balance will increase the RMDs that must start at age 72.

Tax breaks for special situations. For the 2019 and 2020 tax years, taxpayers may deduct unreimbursed medical expenses that exceed 7.5% of their adjusted gross income. In addition, withdrawals may be taken from tax-deferred accounts to cover medical expenses that exceed this threshold without owing the 10% penalty that normally applies before age 59½. (The threshold returns to 10% in 2021.) Penalty free early withdrawals of up to $5,000 are also allowed to pay for expenses related to the birth or adoption of a child. Regular income taxes apply in both situations.

Tweaks to promote saving. To help workers track their retirement savings progress, employers must provide participants in defined contribution plans with annual statements that illustrate the value of their current retirement plan assets, expressed as monthly income received over a lifetime. Some plans with auto-enrollment may now automatically increase participant contributions until they reach 15% of salary, although employees can opt out. (The previous ceiling was 10%.)

More part-timers gain access to retirement plans. For plan years beginning on or after January 1, 2021, part-time workers age 21 and older who log at least 500 hours annually for three consecutive years generally must be allowed to contribute to qualified retirement plans. (The previous requirement was 1,000 hours and one year of service.) However, employers will not be required to make matching or nonelective contributions on their behalf.

Annuity Options under Defined Contribution Plans. The SECURE Act provides for the following two changes in order to encourage the use of annuity options in defined contribution plans:

- Safe Harbor for Selecting Providers: The SECURE Act provides a safe harbor for plan fiduciaries electing to include annuity options. (Effective immediately upon passage of the SECURE Act.) Specifically, the safe harbor protects fiduciaries when selecting insurers for a guaranteed retirement income contract from liability due to the insurer’s inability to fulfill its financial obligations under the terms of the contract. In order to benefit from the protection, fiduciaries need to take steps to ensure that the chosen insurance provider meets the requirements prescribed in the SECURE Act. This includes following a thorough search process, obtaining certain written representations from the insurer, and confirming that fees and commissions are reasonable. It is also advisable for fiduciaries to periodically monitor the suitability of the insurer and annuity product with respect to the plan.

- Portability: If an annuity option ceases to be offered under a current qualified defined contribution plan, the SECURE Act allows for (i) direct rollovers of such investments to other employer-sponsored retirement plans or IRAs or (ii) distributions of such investments to the participant in the form of a qualified plan distribution annuity (in either case, regardless of whether distributions would otherwise be permitted under the plan). This preserves a participant's annuity investments without additional surrender fees and charges.

Goodbye stretch IRA

Under previous law, nonspouse beneficiaries who inherited assets in employer plans and IRAs could "stretch" RMDs — and the tax obligations associated with them — over their lifetimes. The new law generally requires a beneficiary who is more than 10 years younger than the original account owner to liquidate the inherited account within 10 years. Exceptions include a spouse, a disabled or chronically ill individual, and a minor child. The 10-year "clock" will begin when a child reaches the age of majority (18 in most states).

This shorter distribution period could result in bigger tax bills for children and grandchildren who inherit accounts. The 10-year liquidation rule also applies to IRA trust beneficiaries, which may conflict with the reasons a trust was originally created.

In addition to revisiting beneficiary designations, you might consider how IRA dollars fit into your overall estate plan. For example, it might make sense to convert traditional IRA funds to a Roth IRA, which can be inherited tax-free (if the five-year holding period has been met). Roth IRA conversions are taxable events, but if converted amounts are spread over the next several tax years, you may benefit from lower income tax rates, which are set to expire in 2026.

Expansion of Section 529 Plans

The SECURE Act expands 529 education savings accounts to cover costs associated with registered apprenticeships and up to $10,000 of qualified student loan repayments (including those for siblings). This provision is effective for distributions after December 31, 2018.

Benefits for small businesses

In 2019, only about half of people who worked for small businesses with fewer than 50 employees had access to retirement benefits.[1] The SECURE Act includes provisions intended to make it easier and more affordable for small businesses to provide qualified retirement plans.

The tax credit that small businesses can take for starting a new retirement plan has increased. The new rule allows a credit equal to the greater of (1) $500 or (2) $250 times the number of non-highly compensated eligible employees or $5,000, whichever is less. The previous credit amount allowed was 50% of startup costs up to $1,000 ($500 maximum credit). There is also a new tax credit of up to $500 for employers that launch a SIMPLE IRA or 401(k) plan with automatic enrollment. Both credits are available for three years.

Effective January 1, 2021, employers will be permitted to join multiple employer plans (MEPs) regardless of industry, geographic location, or affiliation. "Open MEPs," as they have become known, enable small employers to band together to provide a retirement plan with access to lower prices and other benefits typically reserved for large organizations. (Previously, groups of small businesses had to be related somehow in order to join an MEP.) The legislation also eliminates the "one bad apple" rule, so the failure of one employer in an MEP to meet plan requirements will no longer cause others to be disqualified.

If you have questions about how the SECURE Act may impact your finances, this may be a good time to consult your financial, tax, and/or legal professionals.

1) U.S. Bureau of Labor Statistics, 2019