The new SECURE Act makes changes to retirement saving

Key things to know and planning strategies to consider

After a long delay, the SECURE Act (which stands for "Setting Every Community Up for Retirement Enhancement") has now been signed into law by President Trump. The Act makes some significant changes for retirement account planning. Some of the key provisions impacting individuals include:

RMDs moved back to age 72.
Required Minimum Distributions (RMDs) from traditional IRAs, 401(k) and other qualified retirement accounts generally have been required to begin when you turn age 70½. The SECURE Act pushes the initial year of RMDs back to age 72 for everyone born July 1, 1949 or later. So if you do not need to access your retirement accounts for cash flow needs you can now let your retirement funds grow tax-deferred an extra 1½ years before being required to start taking distributions.

Elimination of "Stretch" IRAs for non-spouse beneficiaries.
The SECURE Act eliminates the current rules that allow non-spouse IRA beneficiaries to "stretch" RMDs from an inherited retirement account over their own lifetimes which potentially allowed retirement funds inherited by children or grandchildren to grow tax-deferred for decades. Instead, all funds from an inherited IRA (or other retirement account) received as a result of a death occurring after December 31, 2019 must now be distributed to non-spouse beneficiaries within 10 years of the IRA owner's death. There are no RMD requirements within those 10 years, but the entire balance must be distributed by the expiration of the 10th year. These new RMD rules do not apply to retirement accounts inherited by a non-spouse beneficiary as a result of a death occurring on or before December 31, 2019.

Surviving spouses who inherit a retirement account of a deceased spouse will still be permitted to "roll over" those accounts into their own names and delay taking RMDs based on their life expectancy until they turn age 72. Distributions over the lifetime of a non-spouse beneficiary will also still be allowed if the beneficiary is a minor, disabled, chronically ill or not more than 10 years younger than the deceased account owner. For minors, the exception only applies until the child becomes an adult and then the 10 year distribution requirement takes effect.

No age restrictions on IRA contributions.
The SECURE Act repeals the previous rule that prohibited contributions to a traditional IRA by workers age 70½ and older. Now you can continue to contribute to a traditional IRA if you decide to continue working into your 70s. There also continues to be no age-based restrictions on contributions to a Roth IRA.

Penalty-free withdrawals for adoption or birth of a child.
The SECURE Act allows up to $5,000 to be withdrawn from a retirement account within one year following the birth or adoption of a child without the usual 10% early-withdrawal penalty. For married couples, each spouse can withdraw up to $5,000 from their retirement accounts penalty free. Income taxes will still be owed on the distributed funds.

Grad student fellowship/stipend payments treated as compensation.
Under the SECURE Act, aid amounts paid to students in pursuit of graduate and post-doctoral study or research (such as fellowships, stipends or similar payments) will now be treated as compensation for purposes of making IRA contributions. This will allow students who may not have work related earnings to begin saving for retirement while still pursuing advanced degrees.

Continued

Rick Kollauf is Vice President and Director of Business Advisory & Estate Planning with BMO Private Bank. He is a CPA and an Accredited Estate Planner. Rick has over 33 years of experience in the advisory services industry.

Stephen White, CFP®, is the BMO Private Bank Regional Leader of Wealth Planning for the Northern and Central States Region based in Milwaukee, Wisconsin. Steve has over 20 years of experience in the financial services industry.

Planning considerations

The SECURE Act makes some significant changes to retirement accounts. Key planning considerations include:

Roth conversions.
Roth IRAs may be more attractive now. One option to reduce the impact of future taxes would be to convert traditional IRA funds into a Roth IRA. You would pay the taxes now but your beneficiaries' future withdrawals would be tax-free. Tax rates may be going up in the future so you might be paying less in tax now with conversions rather than what your beneficiaries may pay in the future.

Charitable donations.
Consider using RMDs from your IRA to make qualified charitable distributions (QCDs) and using your retirement accounts to fund charitable bequests rather than using your other assets for such gifts. Taking advantage of a QCD once you reach your RMD age to fund your charitable giving is especially beneficial if you no longer are able to itemize deductions for income tax purposes because of the recent significant increase in the standard deduction. QCDs are not included in your adjusted gross income which can also potentially reduce your Medicare tax amount. Unlike an individual, a charity will not pay income taxes on retirement funds it receives so funding charitable bequests with retirement account assets and using your other assets to fund bequests to your children, grandchildren or other individual beneficiaries will produce the best overall income savings.

Spend IRA funds and bequeath taxable investments.
Depending upon tax brackets, it may be beneficial for you to use your retirement accounts to fund your cash flow needs during your lifetime and preserve your taxable investment accounts to pass on to your heirs. Your stocks and other securities will receive a tax basis adjustment to their values as of the date of your death, meaning all prior appreciation will escape tax and your beneficiaries will only realize gain on a subsequent sale on the increase in value after your death. Your beneficiaries will also be free to sell such securities whenever they wish and time sales to take into consideration taxes, rather than being forced to withdraw IRA assets within 10 years making it more challenging to plan for a favorable tax outcome.

Review estate plan.
You should consider having your estate plan reviewed if you have named a trust as a beneficiary of your retirement accounts to avoid potential unintended consequences resulting from the new 10-year distribution rule under the SECURE Act. Many trusts that are intended to receive retirement funds are structured to be "conduits" meaning that any retirement account distributions received by the trust are immediately distributed to the beneficiary. While this can be favorable for income tax purposes because of the high tax rates trust are subject to, it may result in a beneficiary receiving substantial amounts at a younger age than possibly intended. Some trusts also provide for the potential accumulation of retirement account distributions which can have adverse tax consequences. Trust provisions should be reviewed to ensure that your trustees are afforded flexibility to manage retirement account distributions in the most beneficial manner.

Reassess IRA distribution strategies.
As you approach your RMD age, consider whether it will be beneficial as part of your overall wealth planning to delay taking distributions from your retirement accounts until age 72 to fund your cash flow needs. Alternatively, consider whether making withdrawals from your retirement accounts earlier in retirement to take advantage of lower tax brackets may provide overall long-term tax savings.

The SECURE Act changes to retirement savings should be evaluated in light of your complete financial picture and long-term wealth plan. Working with your trusted advisor to determine how these changes personally impact your planning may help avoid potential pitfalls and identify tax savings opportunities.

BMO Wealth Management