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SECURE Act Changes for IRA Owners

The Setting Every Community Up for Retirement Enhancement (SECURE) Act signed into law on December 20, 2019 made changes intended to enhance or preserve retirement security, a number of which affect IRA owners. Amongst these changes is an enhanced contribution opportunity for IRA owners, a delayed start age for Required Minimum Distributions (RMDs), and a new distribution provision for families. And while changes to beneficiary IRA distribution methods also mean that beneficiaries who inherit an IRA after 2020 may have more flexibility than before in how to distribute an inheritance, IRA owners may want to carefully consider any tax implications of the new distribution schedules since in many cases the assets will be required to be fully distributed much earlier than they would have been before the SECURE Act changes.

Beneficiary IRA Distributions

Since 2002, beneficiaries of IRAs have long been familiar with a complex set of rules and calculations for determining minimum distributions that must be distributed from an IRA inheritance each year. This concept commonly referred to as the “stretch IRA” which typically paid distributions based on a life expectancy time period has been available to beneficiaries except where a requirement to pay distributions within a 5-year period applied. IRA owners who inherited assets prior to 2020 may continue receiving distributions based on these life expectancy or 5-year (when applicable) terms.

Starting with IRA owners who pass away in 2020 and later, IRA beneficiaries will generally be required to deplete the IRA by the end of the 10th year containing the anniversary of the IRA owner’s death. There is, however, an exception to this 10-year rule which allows for beneficiaries who are considered “eligible designated beneficiaries” to continue to “stretch” the inherited IRA over a set life expectancy. The following beneficiaries are considered “eligible designated beneficiaries.”

- **Surviving spouse**
  Surviving spouse beneficiaries may move assets into an IRA in his or her own name, or into an inherited IRA and generally begin taking annual minimum distributions over the spouse beneficiary’s own single life expectancy. These annual minimum distributions generally commence the year the deceased IRA owner would have turned age 72. Depending on the age of the surviving spouse, this method is often less favorable than establishing an IRA in the spouse’s own name (IRA Rollover).
- **An individual who is a minor child of the IRA owner**
  A minor child of the IRA owner who inherits an IRA may generally be eligible to take annual minimum distributions based on the minor’s own single life expectancy. Once the minor reaches the age of majority, the IRA must generally be distributed by the end of the 10th year following that birthday.
- **A nonspouse beneficiary no more than 10 years younger than the IRA owner**
  Nonspouse beneficiaries who are not more than 10 years younger than the IRA owner (including those who are older) may take distributions using the term certain life expectancy method.
- **Individuals considered disabled or chronically ill**
  An individual who is disabled (under Internal Revenue Code section 72(m)(7)) or is considered chronically ill (under IRC section 7702B(c)(2)) is generally eligible to take minimum annual distributions over his/her own single life expectancy. Once that beneficiary passes away, the IRA must generally be distributed by the end of the 10th year following the death of that beneficiary.
- **Trusts established for beneficiaries that include a disabled or chronically ill individual**
  IRA owners who have or may wish to name beneficiaries who are disabled or chronically ill, or trusts benefiting these individuals as IRA beneficiary, should carefully review the new trust beneficiary provisions. With careful planning, trusts that benefit these individuals can be designed to extend their payment benefits even when other beneficiaries are named in the trust. If you have questions or concerns regarding the extent to which these changes might impact your heirs, you should consider meeting with an attorney or estate planning specialist to determine what, if any, changes may be warranted with regards to your legacy planning.

Certain trusts established in whole or part for the benefit of a disabled or chronically ill individual may generally qualify to use the life expectancy method to calculate distributions instead of the 10-year rule. To qualify, the trust details must be carefully constructed. If the trust is established for multiple beneficiaries but divides the assets into separate trusts for each beneficiary immediately upon the death of the IRA owner, the portion allocated to the disabled or chronically ill individual may generally be distributed using the life expectancy method. A trust that first benefits a disabled or chronically ill individual, and only pays to other beneficiaries after the death of that individual, generally may also qualify to use this method. If there are multiple primary trust beneficiaries but the trust does not meet these requirements, the IRA will generally be required to be paid out within 10 years following the death of the IRA owner.

Trust Beneficiaries

Some IRA owners may have named trusts as IRA beneficiaries with the expectation that the life expectancy payment method would preserve trust benefits over time. This may have been done through income provisions that payout the RMD each year, or accumulation provisions that maintain these RMD payments within the trust until the benefits are paid under the trust terms. Yet other IRA owners may have named trusts for grandchildren as beneficiary of their IRAs expecting that benefits will be maintained over longer life expectancies than if they had named trusts for their children as beneficiary of their IRAs. Because these benefits will generally now be required to be paid out within 10 years, the design of the trust instrument and which children and/or grandchildren are recipients of these trusts should be carefully reviewed in light of the changes to the required beneficiary distribution rules.

Required Minimum Distributions Now Start at Age 72

Age 70½ has long been a milestone set in the minds of baby boomers as when retirement begins, since this is the age that the IRS requires distributions to start being paid from IRAs and some qualified retirement plans. These Required Minimum Distribution (RMD) rules apply to traditional, SEP, and SIMPLE IRAs, as well as to qualified plans for employees who have separated from service. Under the SECURE Act, these RMDs do not need to begin until age 72. IRA owners who turned 70 on or before June 30, 2019 have no reprieve – even if they are not yet age 72 in 2020 they must still continue receiving RMDs. However, IRA owners born after June 30, 1949 can wait until 72 to begin taking these distributions. The first distribution may be delayed until April 1 of the year following attainment of age 72, but in that case a second distribution must still be distributed during year two. Starting with the second year and each subsequent year, each distribution must be distributed annually by December 31st.

IRA Contributions Past Age 70 ½

With RMDs being required at age 70 ½, it has been a natural age at which the law begins prohibiting contributions to traditional IRAs. Plenty of IRA owners who are still working and can contribute to Roth IRAs or defer salary to their 401(k) and SIMPLE IRA plans have wondered why the traditional IRA was off limits. With the passage of the SECURE Act, beginning with the 2020 tax year, IRA owners may contribute to a traditional IRA regardless of age as long as the IRA owner has earned income. This is true even after RMDs are required at age 72.

Distributions for Birth or Adoption

There are a number of exclusions to the 10% premature distribution penalty that apply to taxable withdrawals from IRAs and qualified plans prior to age 59 ½. Beginning January 1, 2020, a new exclusion now permits taxpayers to distribute up to $5,000 from retirement plans (including IRAs) free from the IRS premature distribution penalty for the birth or adoption of a child. This $5,000 limit on Qualified Birth or Adoption Distributions applies on a per taxpayer and per birth/adoption basis. In order to qualify, the distribution must be taken within one year of the birth or adoption. For adoptions, the adoptee must be under 18 or physically or mentally incapable of self-support. In addition to waiving the 10% early premature distribution penalty on Qualified Birth or Adoption Distributions, the SECURE Act also provides that such distributions can be repaid to an IRA in the future.

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