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What Every Financial Advisor Needs To Know About The SECURE Act Of 2019

By **Prudential**

On May 23, the House of Representatives voted 417-3 to pass the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). A similar, almost identical bill called the Retirement Enhancement and Savings Act (RESA) is in the Senate. Both bills have broad bipartisan support and are aimed at two things. First, to encourage more businesses to offer a retirement plan to their employees. Nearly half of all working Americans don't have the ability to contribute to a retirement plan at work. Second, to encourage employees to save more for retirement. If signed into law, the SECURE Act will be the first major retirement-related legislation since the passage of the Pension Protection Act of 2006.

Here are the changes in store, should the legislation pass:

Increased tax credits. Under the SECURE Act, small businesses can receive a tax credit for retirement plan start-up costs up to $5,000. An additional tax credit of $500 a year for three years will be available if the plan offers automatic enrollment. This plan feature, which was first introduced with the passage of the Pension Protection Act of 2006, will automatically enroll employees into the plan unless they affirmatively elect out of participation. Automatic enrollment has proved to increase both plan participation and savings rates among employees.

Multiple employer plans. The SECURE Act would permit unrelated small businesses to share the administrative and financial burden of establishing and maintaining a retirement plan. Currently, multiple employer plans (MEPs) are only available to employers in a common industry. Furthermore, there is a concern that a breach in one employer's fiduciary duty could spoil the plan for other participating employers. The Act would open up MEPS to unrelated businesses and shield employers from the breach of another's administrative duties.

Allow long-term part-time employees to participate in retirement plan. Currently, employers can exclude part-time employees that work less than 1,000 hours per year. The SECURE Act will expand employee coverage to those that have worked at least 500 hours per year for the past three consecutive years.

Delay required minimum distribution (RMD) date. Currently, plan participants and IRA owners must begin taking distributions at age 70½. The SECURE Act would delay RMDs until age 72. This provision recognizes that life expectancy has increased since the first RMD rules were created in 1986.

Repeal age limitations for IRA contributions. The legislation recognizes that more Americans are living longer and working past normal retirement age. As a result, the SECURE Act will permit those over age 70½ to contribute to a traditional IRA.

Annuities and lifetime income options. The SECURE Act includes several provisions that would encourage employers to offer guaranteed lifetime income options in their retirement plans. Few retirement plans offer an annuity option to their participants largely due to plan sponsor concerns about their fiduciary responsibility in selecting an annuity provider. The legislation would simplify some of the compliance and fiduciary rules by offering a safe harbor provision for annuities. It would also require the plan sponsor to provide plan participants an annual disclosure that estimates the monthly payment an employee will receive at retirement. Furthermore, employees will be permitted to roll the annuity from their plan to an IRA when they retire by way of an in-service withdrawal. Considering over 90 percent of IRA owners over age 70½ only take their RMD, these provisions may encourage retirees to spend more of their retirement savings on themselves while helping them maintain a financially secure lifestyle in and through retirement.

Eliminate "stretch" IRAs. To help pay for the legislation, the SECURE Act will require beneficiaries to completely withdraw inherited IRAs and retirement plans within 10 years and pay the resulting tax liability. The 10-year rule would not apply to some beneficiaries such as surviving spouses, disabled individuals, minors and those who are not more than 10 years younger than the account owner. Since retirement accounts make up the largest share of many Americans' net worth, proponents of the bill anticipate this will raise $15.7 billion. This is probably the most controversial provision in the legislation and will likely affect several common retirement planning strategies:

Roth conversions. The overall appeal of Roth IRAs and Roth 401(k) accounts will not be affected by this legislation. As a matter of fact, more consumers may convert taxable retirement accounts to Roth to take advantage of the lower tax rates due to the Tax Cuts and Jobs Act (TCJA) of 2017, hedge against the higher taxes in the future when TCJA sunsets after 2025, and to tax-diversify their retirement savings. However, many high-net-worth individuals are converting to Roth IRAs for legacy planning purposes. For those that are unlikely to spend all their retirement assets while alive, a common strategy is to convert some of their retirement savings to a Roth IRA, thereby allowing their beneficiaries to inherit an account that will continue to grow tax-free as well as provide tax-free income over their lifetime. Requiring withdrawal within 10 years makes this estate planning strategy less appealing from a tax perspective. Why pay taxes on the Roth conversion if the subsequent tax-free growth potential is severely limited?

Life insurance. The loss of "stretch" may encourage wealthier Americans to consider more comprehensive estate planning strategies with their retirement assets. Now that more beneficiaries are likely to inherit a larger up-front tax bill, life insurance can help alleviate some of that cost. The life insurance proceeds can be used to pay for some or all the tax liability caused by the inherited retirement account. Furthermore, it may now make more sense for the account owner to withdraw more of their retirement assets that they do not otherwise need for retirement purposes and leverage life insurance to provide a tax-free legacy to their heirs. In addition to repositioning taxable assets to a tax-free vehicle, life insurance is generally easier to use to fund a trust than retirement assets.

Review IRA trusts. Many attorneys like to use trusts to facilitate the effective transfer of wealth, including retirement assets. Although the IRS generally requires the assets to be paid to the trust within five years after the death of the account owner, a trust drafted to be a "look through" trust will permit the IRA to be "stretched" to the trust over the life expectancy of the oldest trust beneficiary. With the prospect of "stretch" being eliminated, a careful review should be conducted as to whether these IRA trusts still make sense—especially when considering IRA distributions could be taxed at a much higher rate. Should the trust receive and retain retirement assets for the future benefit of the trust beneficiaries, IRA distributions could be taxed at 37 percent as soon as the income exceeds $12,750. By comparison, individual taxpayers do not reach the 37 percent tax rate until their income exceeds $500,000.

Charitable remainder trusts (CRTs). Naming CRTs as beneficiaries of retirement assets may be an appealing alternative to the "stretch" IRA. The retirement assets will be distributed to the CRT and the trust will then make an annual distribution to the owner's children each year for the rest of their lives calculated on a fixed percentage of trust assets. Upon the death of the lifetime trust beneficiaries, the children, the remainder will go to charity. The retirement assets will be included in the owner's estate but will get a charitable contribution deduction in an amount determined based on interest rates and the ages of the children at that time. Furthermore, the CRT isn't taxed on either the distribution from the retirement account or the income it earns. While the children will likely owe taxes on the distributions from the CRT, the CRT assets will continue to grow tax deferred. This type of strategy is obviously more complex and a seasoned tax professional should be consulted to help determine if this makes sense for a given circumstance.

While the SECURE Act is still taking shape in Congress, changes to retirement plans and retirement planning are likely to happen, and every financial advisor should consider how these changes are likely to impact their clients. FA

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