THE SECURE ACT: WHAT YOU SHOULD KNOW

Congress addresses previous weaknesses and issues related to retirement savings plans with the new SECURE Act, which is now in effect.

Overview

On Dec. 20, 2019, President Trump signed into law the Setting Every Community Up for Retirement Enhancement (SECURE) Act as part of a year-end appropriations package. This bill is designed to help employers sponsor more effective retirement plans for their employees and update some individual retirement plan rules. The provisions of the SECURE Act went into effect on Jan. 1, 2020.

"To a large extent, the SECURE Act is a hodgepodge of a lot of little retirement policy initiatives that have been on the minds of policymakers for the last several years." [1]

Retirement Plan Contributions

Historically, one of the problems with retirement plans is that contributions are limited each year; unlike taxable accounts, which allow you to generally invest as much as you like. That's because retirement plan contributions are tax deductible, and the IRS doesn't want to lose substantial tax revenues. In fact, government rules and regulations have made retirement accounts overall rather complex and difficult for people to understand, contributing to lower savings rates.

However, today's longer life expectancies coupled with poor savings rates have created a retirement funding crisis for many Americans. By loosening the rules and guidelines, the government believes helping workers save more of their own money will make them less reliant on government entitlement programs. As such, the SECURE Act eliminates the prior age limit on traditional IRA contributions. Previously, you could no longer contribute to a traditional IRA beyond age 70½. Now, however, you may keep contributing as long as you're earning income — up to the annual limit ($7,000 in 2020 for individuals age 50 or older).

Retirement Plan Distributions

The SECURE Act also offers changes on the withdrawal side of retirement plans. Along with the fact that people are working longer and living longer in retirement, various rules have been changed to enable them to keep money invested longer and permit more opportunities for penalty-free distributions based on certain circumstances.

Delayed Required Minimum Distributions

Until now, investors in traditional IRAs, 401(k)s and other defined-contribution plans had to take a required minimum distribution (RMDs) each year starting at age 70½. The SECURE Act now allows plan participants to delay taking those distributions until age 72. This change applies only to people who turn 70½ after Dec. 31, 2019.

The delay can be significant in terms of the potential for further tax-deferred growth. For example, consider an investor earning 5% each year on a $500,000 portfolio. The difference between starting RMDs at 72 versus 70½ would be $33,500 more by the time he turned age 89.[2]

While not related to the SECURE Act, be aware that the IRS has proposed updates to the life expectancy tables that are used to calculate RMDs. Once finalized, these changes will be more reflective of today's longer life expectancy assumptions and will presumably lower the required distribution amount. This will enable more money to remain in the account to take advantage of growth opportunity. This change is not expected to go into effect until 2021.

Changes to the "Stretch" IRA

The Stretch IRA is an advantage bestowed to non-spouse beneficiaries who inherit an IRA or employer-sponsored retirement plan. While the benefit still exists, the SECURE Act makes it somewhat less advantageous.

Previously, the non-spouse beneficiary could stretch out the account's distributions throughout his or her own lifetime, leaving more money in the account to continue growing. Now those distributions are limited to 10 years beginning the first year following the year of the plan owner's death, meaning the annual distributions are larger and growth opportunity is curbed. The new law requires that the full balance of the inherited retirement plan must be distributed by Dec. 31 of the 10th year following the IRA owner's death. This change enables the IRS to receive income taxes paid out on that invested money much sooner than before.

New Child

Most withdrawals from tax-advantaged retirement plans are subject to a 10% penalty when made before age 59½. The SECURE Act offers a couple of new instances that waive that penalty, although income taxes will still be imposed on amounts withdrawn. Plan members may now withdraw up to $5,000 within a year of the birth or adoption of a child for related expenses.

Disaster Relief

The other penalty-free withdrawal option is to cover expenses brought on by a disaster, as long as the participant lives in a presidentially declared disaster area. This type of distribution does not have an annual limit but is subject to a lifetime cap of $100,000. Note, too, that plan participants are allowed to spread the tax burden on this type of distribution throughout the succeeding three years. They also have the option to repay all or a portion of the money withdrawn for a disaster back into the plan (within three years).

Employer-Sponsored Retirement Plans

401(k) Annuity Option

According to a 2019 Employee Benefits Survey, only 7% of employers reported offering a lifetime income option as part of their defined-contribution plans.[3] A lifetime income option, such as an in-plan annuity, enables the plan participant to use the account's assets to purchase an out-of-plan annuity contract. While many experts agree that annuities provide a reliable stream of income for retirees, employers have been reluctant to add this option to their retirement plans due to liability concerns.[4]

Specifically, they worry about being sued for breach of fiduciary duties if the annuity provider is unable to fund the income guaranteed in the annuity contract. However, the SECURE Act provides a safe harbor with new rules. For example, employers are now protected from liability as long as they select an annuity provider that meets the following minimum requirements for the prior seven years:

- Licensed by the state insurance commissioner to offer guaranteed retirement income contracts.
- Filed audited financial statements in accordance with state laws.
- Maintained statutory requirements for reserves of all states where the provider operates.

The SECURE Act also requires employers to issue an annual 401(k) statement with an estimate of the monthly retirement income each plan participant would receive based on their current lump-sum balance of their in-plan annuity. In addition, the new act permits employees to transfer their in-plan annuity to another 401(k) plan or an IRA without incurring fees or surrender charges when they take another job or retire.

Increase Auto-Enrollment Cap

Another way the SECURE Act helps Americans save more for retirement is by allowing employers to increase the cap on automatic payroll contributions from 10% to 15% of an employee's paycheck. While employees have the ability to opt out of increasing their contributions, automatic features have been shown to improve both participation and savings rates among employer retirement plans.[5]

Part-Time Employee Participation

The SECURE Act now requires employers to offer their defined-contribution plans to long-term part-time (non-union) workers. Going forward, employees who have worked a minimum of 500 hours each year for three consecutive years and are age 21 or older will be offered the opportunity to participate in the company retirement plan. Be aware, however, that employment time accumulated before 2021 will not be counted.

Small-Business Retirement Plan Incentives

Small businesses have always been at a disadvantage when it comes to sponsoring retirement plans for employees. Not only are there substantial upfront expenses, but there are ongoing administrative fees for maintenance, not to mention the cost of matching contributions.

The SECURE Act helps address some of these obstacles with new rules regarding the cost of operating a plan, administrative liabilities and extending retirement plan offerings. The following are key SECURE Act provisions for small-business employers:

- Increase the small business tax credit by $500 to a maximum $5,000 to offset retirement plan startup costs.
- Offer an additional $500 tax credit per year for three years for plans that initiate auto-enrollment for new hires.
- Give employers additional time to issue year-end profit-sharing contributions to employee plans from the end of the calendar year to the company's tax filing due date.
- Enable employers to submit a consolidated Form 5500 for defined-contribution plans managed by a common plan administrator to reduce administrative costs.
- Permit unrelated small employers to collectively open a multiple-employer 401(k) plan (MEP), also known as a pooled employer plan (PEP) to decrease the administrative costs and duties relative to offering individual employer plans. Participating MEP employers are no longer required to be in the same industry.

Education Savings Plans

One other change worth mentioning for investors is that the SECURE Act now allows beneficiaries of 529 college savings accounts to use those funds for repayment of student loans and the costs of apprenticeship programs. However, note that when proceeds are used to pay student loans, the interest charged on those loans is not eligible for a deduction in that tax year.

Final Thoughts

It is possible that one or more of the changes enacted by the SECURE Act may have an impact on your savings, retirement, tax and/or estate plans — or those of your beneficiaries. As such, we recommend that you work with your financial advisor in collaboration with a tax advisor and/or estate planning attorney to help determine the act's potential impact on your portfolio.

[1] Stephen Miller. Society for Human Resource Management. Jan. 7, 2019. "SECURE Act Alters 401(k) Compliance Landscape." https://www.shrm.org/ResourcesAndTools/hr-topics/benefits/Pages/SECURE-Act-alters-401k-compliance-landscape.aspx. Accessed Jan. 7, 2020.
[2] Ibid.
[3] Ibid.
[4] Lee Barney. PlanSponsor. Dec. 10, 2019. "Plan Sponsors Have Multiple Options for Creating Income Streams for Participants." https://www.plansponsor.com/in-depth/plan-sponsors-multiple-options-creating-income-streams-participants/. Accessed Jan. 7, 2020.
[5] Lee Barney. PlanSponsor. Dec. 4, 2017. "Combination of Auto Features Improves Retirement Savings." https://www.plansponsor.com/combination-auto-features-improves-retirement-savings/. Accessed Jan. 7, 2020.