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LAGOS WEALTH ADVISORS
BUILDING, PROTECTING AND PERPETUATING FAMILY WEALTH

ADVISOR'S BULLETIN

WHAT'S IN THIS MONTH'S NEWSLETTER

WHAT EVERY LIFE INSURANCE PROFESSIONAL NEEDS TO KNOW ABOUT THE SECURE ACT: PART 1

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A MESSAGE FROM MICHAEL W. LAGOS, CFP®

Dear Strategic Advisor:

On December 20, 2019, President Trump signed a spending package into law, part of which included the SECURE Act (Setting Every Community Up for Retirement Enhancement).

The SECURE Act contains provisions relevant to financial professions and their clients, including:

- Allows those 70½ or older with earned income to make contributions to traditional individual retirement accounts (IRAs).
- Delays the time that minimum distributions must begin from a qualified account from the year in which the taxpayer turns age 70½ to age 72.
- Shortens the potential stretch time for a nonspouse named beneficiary of a qualified account or IRA.
- Creates incentives for small businesses to set up automatic enrollment in retirement plans for its workers.
- Allows small businesses to join multiple employer plans, where they can band together with other companies to offer retirement accounts to employees.
- Creates an incentive for qualified plans to invest in annuities.
- Section 529 plan distributions may be made tax-free to pay off up to a total of $10,000 of college loan debt.

In addition to the changes included in the SECURE Act, the overall spending package had a few more. In this issue of *Advisors Bulletin*, we will discuss the provisions of the spending package most relevant to life insurance professionals EXCEPT for those related to inherited account rules. Next month we will cover the new stretch provisions of the Act.

Much about the new law will be affected by IRS regulations and technical corrections that could follow later this year. Stay tuned for the latest developments.

Regards,

Michael W. Lagos, CFP®

WHAT EVERY LIFE INSURANCE PROFESSIONAL NEEDS TO KNOW ABOUT THE SECURE ACT: PART 1

SECURE ACT

IRA Contributions After 70½

Under the old rules a taxpayer was no longer eligible to contribute to a traditional IRA once the individual hit the year in which she turned 70½. Under the SECURE Act, a person may contribute to a traditional IRA so long as she has earned income, regardless of age. This is true even if the person is already taking RMDs.

For those who have been prevented from making traditional IRA contributions because of age in the past, the change means it may be possible to make deductible IRA contributions.

This change seems favorable, but there is a potential downside. If a taxpayer makes one or more deductible IRA contributions after the age of 70½, those contributions will impair the person's ability to perform a tax-free qualified charitable distribution (QCD).

A QCD generally is a nontaxable distribution made directly by the trustee of an IRA to an organization eligible to receive tax-deductible contributions. The taxpayer must be at least age 70½ when the distribution is made.

The maximum annual exclusion for QCDs is $100,000. Any QCD in excess of the $100,000 exclusion limit is included in income as any other distribution.

The SECURE Act says this about QCDs:

> The amount of distributions not includible in gross income by reason of the preceding sentence for a taxable year shall be reduced (but not below zero) by an amount equal to the excess of—
>
> (i) the aggregate amount of deductions allowed to the taxpayer under Section 219 for all taxable years ending on or after the date the taxpayer attains age 70½,
>
> (ii) the aggregate amount of reductions under this sentence for all taxable years preceding the current taxable year.

What does that mean? In the year beginning with the one in which the taxpayer turns 70½, the person must keep track of all deductible traditional IRA contributions. If any such contributions are made, they are treated as taxable distributions first out of any QCDs.

Here's an example:

> Susan was born on June 1, 1950, and she will turn 70½ in 2020. She has earned income, and she makes deductible traditional IRA contributions for 2020 and 2021—a total of $14,000. In 2022, Susan directs the custodian of her IRA to make a QCD of $50,000 to her church. The first $14,000 of the distribution is not treated as a QCD and will be included in Susan's income as a taxable distribution. If Susan is otherwise eligible, she may be able to deduct the $14,000 as an itemized charitable contribution. The other $36,000 of gift is excluded from income. The entire $50,000 gift goes toward satisfying her 2022 IRA RMD.

> If Susan makes no more deductible IRA contributions, her future QCDs will all be pretax, as she will have recaptured her post-70½ IRA deductions.

Those with earned income who have reached the year in which they turn 70½ will need to carefully consider whether to make a deductible IRA contribution, as it may interfere with their QCD intentions.

Another IRA Contribution Liberalization

LIFETIME MINIMUM DISTRIBUTIONS NOW BEGIN AT AGE 72

Speaking of RMDs, the year in which a taxpayer must begin minimum distributions is now the calendar year in which she turns 72—rather than 70½.

The still-working delay of RMD rule has remained unchanged. Employees who have reached age 72 but are still working for an employer and do not own 5 percent or more of the company may delay RMDs until the year in which they separate from service.

Those who attained age 70½ in 2019 or earlier under the old minimum distribution rules must continue those distributions in 2020 and beyond. Here's an example.

> Stanley turned 70½ in 2019 and has not yet taken his first RMD from his IRA. He must do so by April 1, 2020. His second RMD is due by December 31, 2020.
>
> Oliver turned 70½ in January 2020. His first RMD will be due for calendar year 2021, the year in which he will turn 72. If he chooses, he may wait until April 1, 2022 to take that first RMD.

To make matters more complicated, the IRS has published new life-expectancy tables which will be used to calculate RMDs beginning in 2021. In general, those tables will allow taxpayers to take smaller distributions than those required under the current tables (which still must be used in 2020). The proposed regulation can be found at 84 Federal Register 60812 and online at https://www.govinfo.gov/content/pkg/FR-2019-11-08/pdf/2019-24065.pdf.

However, to calculate 2019 and 2020 minimum distributions, the existing tables must still be used.

Pension Plan Rule Changes

The SECURE Act makes changes to qualified plans that will affect many of our clients.

SPECIAL NEW CHILD RULES

The Act creates a new exception to the pre-59½ penalty tax for distributions of up to $5,000 from an IRA or employer plan referred to as "Qualified Birth or Adoption Distribution."

To qualify, the account owner must take a distribution during the one-year period beginning on either

(1) date of birth or
(2) date on which the adoption (individual must be under age 18) is finalized.

The provision also allows the individual that took the distribution to repay the distribution back to the plan or IRA in the future. There is apparently no time limit under which the repayment to the plan may be made.

ANNUITIES

Many employers have avoided including lifetime income annuities as qualified plan investment options out of fear that the carriers would not be able to honor the financial commitments under the annuity contracts. The SECURE Act provides that a qualified plan administrator can select an annuity to be owned by the plan—under its prescribed method—without fear of being sued if the carrier becomes insolvent.

MULTIEMPLOYER QUALIFIED PLAN LIBERALIZATION

A major provision of the SECURE Act allows unrelated small employers to join together to offer pension benefits to the employees of all the companies. The new rule is expected to have the greatest impact with regard to Section 401K plans.

These provisions of the law will become effective beginning in 2021. The hope is that the IRS and

the Department of Labor will provide detailed guidance by then so that plan providers can help closely held businesses use the strategy.

There are three potential advantages to a small business in pursuing a multiemployer plan:

1. Economies of scale
2. Plan administration can be transferred to the provider
3. Some fiduciary responsibility can be transferred to the plan provider

SMALL BUSINESS TAX CREDITS

The SECURE Act creates a new tax credit of $500 for small businesses which automatically enroll all employees in employer-sponsored qualified deferral-based retirement plans. An employee can still opt out of participation, but the refusal to participate must be done by an affirmative act.

The new law also increases the potential income tax credit available to small business owners who implement a new qualified plan that includes non-owner employees. In the past the maximum tax credit was $500 for each of the first three plan years. The new maximum credit available is $5,000 for the first three years.

LONG-TERM PART-TIME EMPLOYEES MUST BE INCLUDED—EVENTUALLY

Under the old law employers can generally exclude employees from participating in most qualified plans if they have not worked at least 1,000 hours in a plan year. Part-time employees—even those who have worked for an employer for a long time—could be excluded.

The new rule is that employees must also be eligible to participate in the plan if they have worked at least 500 hours in at least three consecutive years.

Part-timers' hours are not counted until 2021, so the earliest year the new provision will be effective is 2024.

EXTENDED DEADLINE FOR IMPLEMENTING SOME RETIREMENT PLANS

The SECURE Act amends the December 31 implementation deadline for certain kinds of qualified plans. Beginning in 2020, employers may adopt plans that are solely employer funded up to the due date (including extensions) of the employer's return.

Section 529 Plan Rule Changes

In the past, Section 529 plan distributions could be made tax-free to cover most direct costs for higher education expenses. Qualified expenses have included tuition, books, fees, and supplies. If a student was enrolled at least half-time at a higher education institution, qualified expenses also included room and board. However, student loan repayments—even if the original loan was used for higher education purposes—were not considered to be qualified expenses.

As a result of the SECURE Act, Section 529 plan account beneficiaries may now withdraw up to $10,000 tax-free for payments toward qualified education loans. The $10,000 lifetime limit applies to each Section 529 plan beneficiary.

The earnings portion of distributions used to repay the taxpayer's student loans will reduce the maximum potential $2,500 student loan interest deduction.

Kiddie Tax Reversion

Before the Tax Cuts and Jobs Act (TCJA), the kiddie tax rules taxed a portion of an affected child or young adult's investment income at the parent's marginal federal income tax rate. Unearned income above a certain threshold—$2,200 for 2019 (and 2020)—is subject to the kiddie tax.

For tax years beginning after 2017, the TCJA changed the rate at which the child's investment income was taxed to at the rates paid by trusts and estates. That change caused the kiddie tax to be potentially more expensive when a child had substantial unearned income.

The Secure Act has repealed the trust-based tax rate for all affected children. In 2020 and beyond, the calculation is again based on the parent's marginal tax rate.

A taxpayer may also choose to apply the repeal to 2018 and 2019 taxes in the event the new Secure Act rate reduces the kiddie tax liability. For most of those who pursue that retroactive change, that means filing an amended return for the years in question.

EXTRA CHANGES

In addition to the rules altered by the SECURE Act, the broader spending package also contained some provisions relevant to financial professionals.

Plan Document Delay

While employer-sponsored plans must start administering the changes with regard to beneficiary stretch and age 72 RMDs imposed by the SECURE Act immediately, the deadline to amend most plan documents to reflect those (and other) changes is January 1, 2022.

For governmental and collectively bargained plans, the deadline to amend plan documents is January 1, 2024.

Extension of Medical Expense Deduction Threshold to 7.5 Percent Through 2020

We thought the medical expense threshold for 2019 was 10 percent. The provisions of the spending package changed that, retroactively reducing the threshold back to 7.5 percent for 2019 and prospectively for 2020.

In order to claim the medical expense deduction, an individual must itemize expenses rather than claiming the standard deduction. Since the standard deduction has been increased as a result of the Tax Cut and Jobs Act—it's $24,800 in 2020 for a married couple filing jointly—fewer taxpayers are itemizing their deductions.

For those who do itemize, medical expenses are deductible in 2019 and 2020 for those expenses in excess of 7.5 percent of adjusted gross income. In 2021, the threshold is scheduled to increase to 10 percent.

IRA Contribution Liberalization

In the past, fellowship or training grant income payable to college graduate students was not eligible to be contributed to an IRA or Roth. The spending package has changed that rule, and graduate students may now consider nontuition stipends earned income for Roth and traditional IRA contribution purposes.

CONCLUSION

As with most other new federal legislation, a few opportunities are created by the parts of the spending package we have covered in this newsletter, including:

1. **While RMDs will now begin in the year a taxpayer turns 72, QCDs are still available beginning at age 70½.** This is true whether the traditional IRA is owned by the original taxpayer or it is inherited. Financial professionals have an opportunity to tell the QCD story to anyone who has an IRA, is older than 70½ and makes regular charitable gifts—regardless of RMD obligation.
2. **Business-owning clients with full administration qualified plans, especially 401K plans, now have an extra reason to consider making annuities part of the investment mix.**
3. **Because of the retroactive changes to the kiddie tax, it may make sense to visit our high-income clients to help them evaluate whether they can save money by amending prior years' returns.**
4. **We have a reason to visit our best clients to describe how the provisions of the SECURE Act might affect them.**

The SECURE Act has made significant changes some of the rules that affect our best clients. With new provisions on IRA eligibility, inherited stretch, qualified plan administration, and Section 529 distributions, nearly all age groups have a chance to be impacted.

Financial professionals need to closely study the provisions of the SECURE Act that are relevant for their particular clients.

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IN THIS ISSUE OF ADVISOR'S BULLETIN

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PART 1

Building Protecting and Perpetuating Family Wealth

LWA strives to develop and maintain sound financial plans designed to achieve our client's wealth accumulation, preservation and transfer objectives, with the goal of preserving their wealth for multiple generations. We provide these services in a confidential and consultative manner, building life-long relationships based upon education, trust, communication and service.

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