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Retirement Planning Insights
(special edition)

In This Issue

Special Update

- The SECURE Act

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Legislative changes will soon impact your retirement accounts

On December 20, 2019, President Trump signed into law the Setting Every Community Up for Retirement Enhancement Act of 2019 (the "SECURE" Act). The Act makes a few substantial changes to retirement accounts such as traditional tax-deferred IRAs, 401(k)s and 403(b)s. Most of its provisions go into effect on January 1, 2020. The Act contains about 30 different items, but only four which I feel are most likely to impact you and your retirement planning:

Increase to the RMD beginning age

With all tax-deferred retirement accounts, you need to eventually start taking withdrawals - and paying tax on them - even if you don't need the money. These mandatory withdrawals are called Required Minimum Distributions ("RMDs"). Currently, you need to take your first RMD by April 1 of the year *after* the year you turn 70 ½. You then need to take subsequent RMDs by every December 31 thereafter.

The SECURE Act increases the RMD beginning age from 70 ½ to 72.
If you turn 70 ½ before January 1, 2020, you'll fall under the current rules and will need to take your first RMD by April 1, 2020. If you turn 70 ½ on January 1, 2020 or later, you'll fall under the SECURE Act rules and won't need to take your first RMD until April 1 of the year *after* the year you turn 72.

On the surface, the year and a half increase is not significant. Nonetheless, it gives additional time in which to carry out some long-term tax minimization planning. The period between when you stop working and when you reach RMD age is what I like to call the "tax planning window." In this window of time, there are some valuable tax planning techniques to potentially take advantage of.

Doing Roth conversions or withdrawing from tax-deferred accounts to enable you to delay and permanently increase Social Security benefits could have favorable long-term impacts. Furthermore, prudent tax planning may help you avoid having to pay additional surcharges on Medicare premiums.

Removal of age limit on eligibility to contribute to a traditional IRA

Currently, beginning in the year you turn 70 ½, you can no longer contribute to a traditional tax-deferred IRA.

The SECURE Act removes this age restriction entirely. However, in order to be eligible to contribute, the IRS will still require you to have "earned income"…wages or self-employment income.

Contact Us

www.tenonfinancial.com

hello@tenonfinancial.com

T: 732-902-0066

Tenon Financial LLC
33 Wood Ave South, Suite 600
Iselin, NJ 08830

The age restriction will be removed effective January 1, 2020. Even if you're already older than 70 ½ and therefore not currently able to contribute to a traditional IRA, you'll no longer be bound by an age limit starting in January.

This change is not monumental, but it's helpful if you're over 70 ½, still working and wish to continue to save money in an IRA.

Restricted usage of the inherited account "stretch" provision

When the owner of a retirement account dies, the IRS typically requires the beneficiary to withdraw a minimum amount of money from the inherited account every year. Currently, the beneficiary can "stretch" these mandatory distributions over his or her life expectancy. For example, a 40-year-old can take withdrawals from an inherited account over the course of 43.6 years.

The SECURE Act eliminates the stretch provision for *most* beneficiaries and instead requires the entirety of the inherited account to be distributed within 10 years. The stretch provision will continue to apply only for the following beneficiaries:

- the account owner's spouse
- disabled persons
- chronically ill persons
- persons who are less than 10 years younger than the account owner
- the account owner's children, but only up until they reach the "age of majority," which ranges between 18-21 depending which state the child lives in. After reaching the age of majority, the remainder of inherited account must be fully distributed within 10 years

For inherited accounts where the original owner died prior to January 1, 2020, the current rules will continue to apply and beneficiaries will still be able to stretch out distributions over their life expectancy. For inherited accounts where the original owner dies on January 1, 2020 or later, the SECURE Act rules will apply.

The removal of the stretch provision could have significantly adverse tax impacts, particularly for beneficiaries of large retirement accounts. Beneficiaries are often adults who are in their peak earning years. Because of their high earnings, such beneficiaries are already in relatively high tax brackets.

Under stretch rules, beneficiaries could minimize the additional taxable income from inherited accounts by dividing up the withdrawals over a few decades. Under the SECURE Act, 100% of the inherited account will need to be withdrawn - and taxed - within 10 years. This ultimately means a larger portion of inherited retirement accounts will be lost to taxes as opposed to kept by heirs.

While the industry is still digesting this change and figuring out the most effective way to adapt, there will undoubtedly be major changes to estate planning as it relates to transfers of wealth. For example, if account owners are in lower tax brackets than their heirs-to-be, it may make sense to proactively shift more of the taxable income to the account owner prior to eventually passing it on to the beneficiaries. Roth conversions are one way to achieve this.

Easier access to annuities within 401(k) plans

Currently, most 401(k) plans don't allow participants direct access to annuities. Annuities are insurance products which, in their most simple form, allow for the conversion of savings into a lifetime stream of payments. They can be a very valuable tool to turn a nest egg into lifetime income. However, insurance companies often create and aggressively market annuities which are unnecessarily complicated and expensive.

401(k) providers are legally required to act as fiduciaries on behalf of their plan participants. This means providers must always act in participants' best interest…or risk getting sued for breach of fiduciary duties. Given the complexities and high fees of many types of annuities, 401(k) providers generally altogether avoid them to protect the participants (and themselves).

The SECURE Act provides a fiduciary "safe harbor" to 401(k) providers with regards to their diligence and selection of annuity providers. The safe harbor essentially relaxes the liability taken on by 401(k) providers when allowing annuities inside the plan. This, in theory, means more 401(k) plans will begin to offer annuities alongside their current menus of investment options such as mutual funds.

It will take time for 401(k) providers to get comfortable with the SECURE Act changes and the processes around allowing insurance companies to begin selling annuities inside the plans. As such, you may not see any annuity options inside your 401(k) for a while.

While the fiduciary safe harbor is well-intentioned (i.e. it will make it easier for 401(k) participants to turn their nest eggs into lifetime income), I fear it may open the door to annuity providers potentially overselling certain products even when those products aren't in the best interest of plan participants. 401(k) participants *MAY* benefit from having access to annuities but insurance companies *WILL DEFINITELY* benefit from having access to 401(k) participants…

If you have any questions about the SECURE Act and how it may impact your retirement, don't hesitate to e-mail me at **andy@tenonfinancial.com** or call me at 732-902-0066. Thanks!

-Andy

Andy Panko, CFP®, RICP®, EA
Owner of Tenon Financial