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The SECURE Act and Its Impact

December 2019 | Ryan Smith | rsmith@dopkins.com

Congress just agreed to a bipartisan appropriations bill that will help keep the government from shutting down. The just-signed, 1,773-page, $1.4 trillion 2020 spending bill means many Americans may need to rewrite their retirement plans. Attached to the spending bill, that Congress just agreed to, is a piece of legislation called the Setting Every Community Up for Retirement Enhancement Act (SECURE Act), which passed the House with a 417-3 vote earlier this summer.

The passage of the SECURE Act came as a bit of a surprise as it appeared to be disrupted during the fall. Now, towards the end of the year, Congress is changing major tax laws implicating 2019 and especially 2020 going forward. "The most significant piece of retirement legislation in a decade is a reality, after all," says Brian Graff, CEO of the American Retirement Association.

Here are seven major pieces of the SECURE Act that are worth closer examination:

1. Removal of "Stretch" Inherited IRA Provisions

The most important provision of the SECURE Act, removal of the "stretch" RMD provisions, is a tax revenue generator, meaning a tax hike on many Americans. This goes into effect Jan. 1, 2020, assuming President Trump signs the bill into law. The removal of the required minimum distribution (RMD) provisions for stretch IRAs for many beneficiaries will cause chaos for certain types of trusts written prior to this bill.

Instead of being able to stretch RMDs out over the life of a beneficiary, many will have to take all RMDs of a retirement account by the end of year 10 after an account owner passes away. For the beneficiary, this can push higher RMDs into the prime working years and highest tax years of a beneficiary's life. This change will accelerate the depletion of inherited accounts for many large IRAs and retirement plans.

2. Increase Required Minimum Distribution Ages

Today the law requires that most individuals take out required minimum distributions (RMDs) from their retirement accounts once you reach age 70.5. The SECURE Act would delay this requirement to age 72. The RESA Act currently in front of the Senate seeks to push RMD requirements even further back to age 75. This, coupled with pending IRS rules around RMD factors, will reduce the amount of money retirees need to withdrawal each year in retirement due to the RMD rules. Other suggested changes to RMD rules have included allowing smaller accounts, such as those under $100,000, to be exempt from withdrawal requirements for the owner of the account.

3. Removal of Age Limitation on IRA Contributions

For years there has been a rule that essentially discouraged retirement savings in IRAs for people who continued to work later in life. The SECURE Act now allows those working past 70.5 to contribute to IRAs, which matches the rules for 401(k)s and Roth IRAs. This also opens the door for a lot of planning strategies like additional back-door Roth IRAs later in life.

4. Increase Small Employer Access to Retirement Plans

The bill makes some significant changes to a variety of retirement rules. It expands the ability to run multiple employer plans and make the process easier overall. It essentially allows small employers to come together to set up and offer 401(k) plans with less fiduciary liability concern and less cost than exists today. The goal here is to try to expand small employers' capability to offer some form of retirement savings to employees. The SECURE Act will take another stab at this huge issue as many small employers offer no retirement savings options at all, leaving the issue solely to the individual.

5. Increase Annuity Options Inside Retirement Plans

There is also an update to the safe harbor provision for plan sponsors to select annuity providers in order to offer in-plan annuities inside of a 401(k). Today, many 401(k)s stay away from annuities, in part because of concerns about liability in picking an annuity provider for the plan. The new rules would ease this liability concern to some degree, potentially opening up the path for more annuities to be offered inside of retirement plans.

6. Tax Credit for Automatic Enrollment

One section of the bill adds a new tax credit of $500, for three years, to help some smaller employers encourage automatic enrollment into their retirement plan. This small credit could help offset some of the costs of operating a plan at the beginning. Automatic enrollment has seen great success in increasing plan participation by employees.

7. Lifetime Income Disclosure for Defined Contribution Plans

The bill requires that defined contributions plans deliver a lifetime income disclosure to participants at least once every 12 months. This lifetime income disclosure would essentially show how much income the lump sum balance in the retirement account could generate. The methodology for calculating lifetime income is still in the works. Additional disclosures and information on assumptions used would also have to be provided to participants.

While the SECURE Act makes positive change and takes a step forward, it does not clearly advance the retirement security of those in most need of a boost.

Furthermore, the potential tax burdens of faster distributions of inherited retirement accounts will increase the need for proper estate planning and potentially more strategic Roth conversions during the life of the account owner, adding additional complexity to retirement and estate planning.

This bill will make an impact almost immediately, with many provisions going into place in 2020. Financial advisors need to understand the effect it will have on their strategies. Attorneys need to review their trusts and estate planning documents. CPAs need to understand the long-term tax implications. Consumers need to know if they need to update their retirement and estate plans. For any questions please reach out to your investment advisor or tax professional.

For more information, please contact:

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Ryan provides financial solutions to individuals, trusts and businesses. His services include guidance to clients regarding financial planning, investments and portfolio analysis.

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