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THE NEW SECURE ACT & YOUR IRA

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The New SECURE Act & Your IRA

by David Silver

In December of 2019, the SECURE Act was added to one of the year-end appropriation bills and was passed by Congress. This act (Setting Every Community Up for Retirement Enhancement) became law effective on January 1, 2020. The Act includes various provisions, but one particular provision will have a significant effect on the estate plans for people with large amounts of funds in tax-deferred retirement plans (like an IRA, 401k, 403b, etc).

A quick and simplified explanation of tax-deferred retirement plans like an IRA: These are savings plans in which a worker contributes pre-tax money. The worker does not pay taxes on the money put into an IRA, and does not pay taxes on the interest earned or growth of the IRA. However, all money eventually taken out of the IRA by the worker is counted as income for that year on the worker's income tax return. If the worker withdraws all of the IRA in one year, it could amount to a very large income tax bill that year. Workers may begin withdrawing from their IRA without a penalty at age 59 and ½, and they are required to withdraw at least a minimum amount starting at age 72 (the age was 70 and ½ prior to the SECURE Act). A tax-deferred account can only be owned by one individual. If a worker dies and leaves a tax-deferred account to a spouse, the tax-deferred account is treated as if it was always owned by the spouse (the SECURE Act does not change this).

The reason the SECURE Act may have a big impact on estate plans is how it treats non-spouse inherited tax-deferred accounts. Before the SECURE Act, if a non-spouse inherited a tax-deferred account (i.e. a child), and that person did not want to take all the money out immediately (which would be considered income on their yearly taxes), then that person could stretch out the withdrawals over their lifetime. This would enable the child to stretch out the tax impact of the withdrawals over a long time period. However, the SECURE Act requires the non-spouse to withdraw all of the funds from the tax-deferred account within 10 years (the SECURE Act contains some exceptions for disabled individuals and a delay while a child is a minor). If the non-spouse inherits a large tax-deferred account, this could result in a significant portion of the funds being needed to pay for income taxes.

The SECURE Act does not change any rules for inherited tax-deferred accounts from workers who died before 2020. However, if you have a large amount of funds in tax-deferred accounts, then you should speak with your investment advisor about strategies to help avoid large tax-bills for your non-spouse beneficiaries of these accounts.

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