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Top Eight Changes in the SECURE Act You Need to Know

As has become usual practice, Congress passed some meaningful tax legislation as it recessed for the holidays.

In one of the new meaningful laws, passed by Congress on December 19 and signed into law by the President on December 20, you find the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act).

The SECURE Act made many changes to how you save money for your retirement, how you use your money in retirement, and how you can better use your Section 529 plans.

Whether you are age 35 or 75—these changes affect you.

We'll give you the most significant changes you need to know about when you read the article.

1. Small-Employer Automatic Contribution Tax Credit

If your business has a 401(k) plan or a SIMPLE plan that covers 100 or fewer employees, and it implements an automatic contribution arrangement for employees, either you or it qualifies for a $500 tax credit each year for three years, beginning with the first year of such automatic contribution.[1]

This change is effective for tax years beginning after December 31, 2019.[2]

Tax tip. This credit can apply to both newly created and existing retirement plans.

2. IRA Contributions for Graduate and Postdoctoral Students

Before the SECURE Act, certain taxable stipends and non-tuition fellowship payments received by graduate and postdoctoral students were included in taxable income but not treated as compensation for IRA purposes. Thus, they could not be used as a basis for IRA contributions.

The SECURE Act removed the “compensation” obstacle. The new law states: “The term ‘compensation’ shall include any amount which is included in the individual’s gross income and paid to the individual to aid the individual in the pursuit of graduate or postdoctoral study.”[3]

The change enables these students to begin saving for retirement and accumulating tax-favored retirement savings, if they have any funds available (remember, these are students).

This change applies to tax years beginning after December 31, 2019.[4]

Tax tip. If your child pays no income tax or pays tax at the 10 percent or 12 percent rate, consider contributing to a Roth IRA instead of a traditional IRA.

3. No Age Limit on Traditional IRA Contributions

Prior law stopped you from contributing funds to a traditional IRA if you were age 70 1/2 or older.[5]

Now you can make a traditional IRA contribution at any age, just as you could and still can with a Roth IRA.[6]

There is a cost. If you want to make a tax-free qualified charitable distribution (QCD) from your traditional IRA (we discuss this in Make the RMD from Your Traditional IRA Tax-Free), then you have to reduce your tax-free distribution (but not below $0) by[7]

- the total traditional IRA contribution deductions taken after age 70 1/2, less
- all prior reductions you made to your tax-free QCDs before the current tax year.

Example. Helen turns age 70 1/2 in 2020. She makes deductible IRA contributions after age 70 1/2, as follows:

- $5,000 in 2020
- $5,000 in 2021
- $5,000 in 2022

Helen then make direct charitable transfers that would normally be tax-free QCDs, as follows:

$10,000 in 2023

- $10,000 in 2024
-

In 2023, Helen has to reduce her tax-free QCD by $10,000, so she pays tax on the entire $10,000 distribution:

- $15,000 total deductible IRA contributions after age 70 1/2, less
- $0 prior reductions to tax-free QCDs.

In tax year 2024, Helen has to reduce her tax-free QCD by $5,000, so she pays tax on $5,000 of the distribution:

- $15,000 total deductible IRA contributions after age 70 1/2, less
- $10,000 prior reductions to tax-free QCDs.

This change applies to contributions made for tax years beginning after December 31, 2019.[8]

Tax tip. If you pay tax on some or all of your IRA distribution to a charity, then you can deduct that amount on Schedule A as a charitable contribution.

4. No 10 Percent Penalty for Birth/Adoption Withdrawals

You pay no 10 percent early withdrawal penalty on IRA or qualified retirement plan distributions if the distribution is a "qualified birth or adoption distribution."[9] The maximum penalty-free distribution is $5,000 per individual per birth or adoption.[10] For this purpose, a qualified plan does not include a defined benefit plan.[11]

Remember, this is only a penalty exception—you still pay income tax on the distribution.

A qualified birth or adoption distribution is any distribution from an IRA or a qualified retirement plan if made during the one-year period beginning on[12]

- the date of birth of a child, or
- the date a legal adoption of an eligible adoptee is final.

An “eligible adoptee” is any individual (other than a child of your spouse) who is[13]

- under age 18, or
- physically or mentally incapable of self-support.

You can repay a qualified birth or adoption distribution and treat it as a 60-day trustee-to-trustee rollover provided you are eligible to make rollover contributions to the account.[14] The repayment avoids paying income tax on the distribution. (Remember, the adoption/birth distribution is penalty-free but not tax-free.)

This change applies to distributions made after December 31, 2019.[15]

Tax tip. A birth or adoption in 2019 can signal the start of the one year, allowing qualified birth and adoption distributions as soon as January 1, 2020.

5. RMDs Start at Age 72

Before the SECURE Act, you generally had to start taking required minimum distributions (RMDs) from your traditional IRA or qualified retirement plan in the tax year you turned age 70 1/2.[16]

Now you can wait until the tax year you turn age 72.[17]

This change applies to RMDs after December 31, 2019, if you turn age 70 1/2 after December 31, 2019.[18]

Example. Jane turns age 70 1/2 on May 9, 2020; therefore, she will start her RMDs in 2021, because she turns 72 before December 31, 2021. Under the old rules, Jane would have started taking RMDs in 2020.

Tax reminder. The RMD requirement does not apply to the Roth IRA.[19]

6. Open Retirement Plan Later

Under the SECURE Act, if you adopt a stock bonus, pension, profit-sharing, or annuity plan after the close of a tax year but before your tax return due date plus extensions, you can elect to treat the plan as if you adopted it on the last day of the tax year.[20]

Under prior law, you had to establish the plan before the end of the tax year to make contributions for that tax year.

This change applies to plans adopted for tax years beginning after December 31, 2019.[21]

How it works. You can establish and fund, for example, an individual 401(k) for a Schedule C business as late as October 15, 2021, and have the 401(k) in place for 2020.

7. Expanded Tax-Free Section 529 Plan Distributions

Distributions from your child's Section 529 college savings plan are non-taxable if the amounts distributed are[22]

- investments into the plan (your basis), or
- used for qualified higher education expenses.

Qualified higher-education expenses now include

- fees, books, supplies, and equipment required for the designated beneficiary's participation in an apprenticeship program registered and certified with the Secretary of Labor under Section 1 of the National Apprenticeship Act,[23] and
- principal or interest payments on any qualified education loan of the designated beneficiary or his or her siblings.[24]

If you rely on the student loan provision to make tax-free Section 529 plan distributions,

- there is a $10,000 maximum per individual loan holder,[25] and
- the loan holder reduces his or her student loan interest deduction by the distributions, but not below $0.[26]

This change applies to distributions made after December 31, 2018 (not a typo—see below).[27]

Tax tip. Did you notice the 2018 above? Good news. You can use the new qualified expense categories to identify tax-free Section 529 distributions that are retroactive to 2019.

8. RMDs on Inherited Accounts

Under the old rules for inherited retirement accounts, you could "stretch" out the account and take RMDs each year to deplete the account over many years.

Now, if you inherit a defined contribution plan or an IRA, you must fully distribute the balances of these plans by the end of the 10th calendar year following the year of death. There is no longer a requirement to take out a certain amount each year.[28]

The current stretch rules, and not the new 10-year period, continue to apply to a designated beneficiary who is[29]

- a surviving spouse,
- a child who has not reached the age of majority,
- disabled as defined in Code Section 72(m)(7),
- a chronically ill individual as defined in Code Section 7702B(e)(2) with modification, or
- not more than 10 years younger than the deceased.

This change applies to distributions for plan owners who die after December 31, 2019.

Takeaways

The SECURE Act made a lot of changes to how you save for retirement and take money out in retirement.

But we read the law and gave you the eight most important changes that could impact you, the small-business owner:

1. New tax credit for automatic contribution retirement plans.
2. Graduate students and postdocs can contribute to an IRA based on their taxable support income.
3. No age limit on traditional IRA contributions.

4. No 10 percent penalty on qualified birth or adoption distributions.

5. RMDs now delayed to age 72.

6. Retirement plans opened by the due date of the tax return allow deductible contributions for that tax year.

7. More ways to take tax-free distributions from your Section 529 plan.

8. New rules for taking money out of inherited retirement accounts.

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1 IRC Sections 45T; 408(p)(2)(C)(i).
2 Pub. L. 116-94, Sec. 105(d).
3 IRC Section 219(f)(1) as amended.
4 Pub. L. 116-94, 106(b).
5 IRC Section 219(d)(1) [repealed].
6 IRC Section 219(d)(1) [repealed].
7 IRC Section 408(d)(8)(A) as amended.
8 Pub. L. 116-94, Sec. 107(d).
9 IRC Section 72(t)(2)(H)(i).
10 IRC Section 72(t)(2)(H)(ii).
11 IRC Section 72(t)(2)(H)(vi)(I).
12 IRC Section 72(t)(2)(H)(iii)(I).
13 IRC Section 72(t)(2)(H)(iii)(II).
14 IRC Section 72(t)(2)(H)(v).
15 H Rpt 116-65, Part 1, p. 71.
16 Pub. L. 116-94, Sec. 114.
17 Ibid.
18 Pub. L. 116-94, Sec. 114(d).
19 IRC Section 408A(c)(5).
20 IRC Section 401(b) as amended.
21 Pub. L. 116-94, Sec. 202(b).
22 IRC Section 529(c)(3).
23 IRC Section 529(c)(8).
24 IRC Section 529(c)(9).
25 IRC Section 529(c)(9)(B).
26 IRC Section 221(e)(1) as amended.
27 Pub. L. 116-94, Sec. 302(c).
28 IRC Section 401(a)(9)(H).
29 IRC Section 401(a)(9)(E)(ii).