What Every Financial Advisor Needs to Know About the SECURE Act Of 2019

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Overview

On May 23, 2019 the House of Representatives voted to pass the Setting Every Community Up for Retirement Enhancement Act of 2019 (SECURE Act). A similar, almost identical bill called the Retirement Enhancement and Savings Act (RESA) was in the Senate. Both bills had broad bipartisan support and were aimed at two things.

- First, to encourage more businesses to offer a retirement plan to their employees. Nearly half of all working Americans don't have the ability to contribute to a retirement plan at work.
- Second, to encourage employees to save more for retirement.

The bills stalled in both houses until the end of 2019. At that point, Congress agreed to a bipartisan appropriations bill to help avert another government shutdown. In doing so, the provisions of these earlier bills were included in the appropriations bill and President Trump signed the bill into law. The SECURE ACT of 2019 went into effect on January 1, 2020, and it is the most significant qualified plan act since the Pension Protection Act of 2006.

What are the key changes and their planning implications?

The SECURE Act offers several provisions to encourage smaller employers to offer retirement plans to their employees.

Increased tax credits. Under the SECURE Act, small businesses can receive up to $5,000 in tax credit for retirement plan start-up costs. An additional tax credit of $500 a year for three years will also be available if the plan offers automatic enrollment. This plan feature, which was first introduced with the passage of the Pension Protection Act of 2006, will automatically enroll employees into the plan unless they affirmatively elect out of participation. Automatic enrollment has proved to increase both plan participation and savings rates among employees.

> **Action plan:** This opens up an excellent opportunity to talk with business owners about the benefit of tax credits and automatic enrollments. Many employers are hesitant about installing qualified plans due to the cost of the plan set up – the tax credit eases those concerns. Furthermore, life insurance, investments and annuities are oftentimes used to fund qualified benefits programs. Offering the qualified plan with an available tax credit opens the door for numerous life insurance related discussions.

Multiple employer plans. The SECURE Act permits unrelated small businesses to share the administrative and financial burden of establishing and maintaining a retirement plan. Currently, multiple employer plans (MEPs) are only available to employers in a common industry. Furthermore, there had been a concern that a breach in one employer's fiduciary duty could spoil the plan for other participating employers. The SECURE Act opens up MEPs to unrelated businesses and shields employers from the breach of another's administrative duties. This change can put small employers in the same pricing classes as large employers, as the MEP offers a pooling together of multiple lives, which creates a larger plan for volume discounts.

Action plan: For existing clients with qualified retirement plans such as a 401(k) this opens up a discussion of whether or not a MEP is right for them. Multiple employer plans contain risks which can include plan failure. Furthermore, MEPs are often times not customizable and may contain significant investment restrictions versus a customized plan.

Requires long-term, but part-time, employees to participate in retirement plan. Currently, employers can exclude part-time employees that work less than 1,000 hours per year. The SECURE Act expands employee coverage to those that have worked at least 500 hours per year for the past three consecutive years.

Action plan: This offers an excellent opportunity to talk to clients about what employees are included in the plan and provides a mechanism to get loyal (three years) part-time employees enrolled in the plan.

Annuities and lifetime income options. The SECURE Act includes several provisions that encourage employers to offer guaranteed lifetime income options in their retirement plans. Few retirement plans offer an annuity option to their participants largely due to plan sponsor concerns about their fiduciary responsibility in selecting an annuity provider. The legislation simplified some of the compliance and fiduciary rules by offering a safe harbor provision for annuities. It also requires the plan sponsor to provide plan participants an annual disclosure that estimates the monthly payment an employee will receive at retirement. Furthermore, employees will be permitted to roll the annuity from their plan to an IRA when they retire by way of an in-service withdrawal. Considering over 90% of IRA owners over age 70½ only take their RMD, these provisions may encourage retirees to spend more of their retirement savings on themselves while helping them maintain a financially secure lifestyle in and through retirement. Longevity annuities (QLACs) have been available in IRAs since 2014. They are limited to the lesser of 25% of the account value or $130,000.

Action plan: This option offers an opportunity to add additional annuity transactions within an employer's plan, while at the same time offering retired employees a monthly or periodic income stream that they might not have should they simply do a rollover into IRA or other plan.

Future Planning

Even with these changes there remains a "retirement savings crisis" in America. With losses in traditional pensions, longer life expectancies and the prospect of future higher tax rates, many clients are concerned about having enough funds in retirement. Congress has done little to directly address these issues or to shore up Social Security and the Pension Benefit Guaranty Fund. Financial Professionals know that they can't depend on Congress or the IRS for consistency. Even as these provisions were going through Congress, the IRS was proposing changes to the RMD tables.

With that in mind, Financial Professionals should encourage their clients to take stronger steps towards their own retirement security.

Annuities and permanent cash value life insurance offer certainty and options for clients, particularly those who fully fund their 401ks and IRA accounts each year. Annuities offer tax deferred growth and income certainty, an option few other assets offer. Life insurance, under IRC §7702, offers the ability to both grow cash values tax-free and take withdrawals and loans in a tax-advantaged manner. Policy loans and withdrawals will reduce the face amount and cash value of a life insurance policy. Clients may need to fund higher premiums in later years to keep the policy from lapsing. For clients who need other sources of retirement accumulation, have a life insurance need and have concern about future taxes, annuities and life insurance may fit the bill. AXA Equitable and MONY Life Insurance Company of America (MLOA) have a wide range of annuity and accumulation life insurance contracts that can help clients meet their retirement goals, diversify across retirement assets with a variety of tax treatments and help manage their tax brackets in retirement.

A range of changes, with significant planning implications around Individual Retirement Accounts (IRAs)

Repeal age limitations for IRA contributions. The legislation also recognizes that more Americans are both living longer and working past normal retirement age. As a result, the SECURE Act now permits those over age 70½ to continue to contribute to a traditional IRA. Extra contributions to a tax deferred vehicle such as an IRA can extend the amount of time before retirement income runs out.

> **Action plan:** Additional contributions to IRAs present a huge, untapped marketplace for financial advisors. Even though a person may be in the liquidation phase of their IRA account, the ability to make additional contributions for tax deferral can make dramatic differences in maintaining an individual's IRA account value.

Delaying required minimum distribution (RMD) dates. Currently, most qualified plan participants and IRA owners must begin taking distributions at age 70½. The SECURE Act delays RMDs until age 72. This provision recognizes that life expectancy has increased since the first RMD rules were created in 1986.

> **Action plan:** Clients will need to know that age 70½ is no longer a triggering date for RMDs, the age is now 72. In short, 72 is the new 70½. It is also important to note that since new RMD tables have been proposed, the longer life expectancy under the new RMD tables makes an RMD at 72 almost the same calculation as one at 70½ under the old tables. Of course, the new RMD tables, if approved will not be effective until 2021. So, for 2020 the older RMD tables are still the law.

Potential Opportunity

Both the general demographic trend in older age life expectancy and the proposed RMD Tables from the IRS (effective 2021) offer an interesting planning discussion with clients. They may be able to delay distributions, but they will be taking distributions at age 72 at roughly the same rate as if they began at age 70½ under the old table. The effect could possibly be greater tax deferred growth, but larger taxable distributions in later years. To see the effect, compare the old RMD tables and to the recently proposed RMD tables along with waiting until age 72 for a client to take their RMDs.

Age	Current RMD Factors	Proposed RMD Factors
70	27.4	29.1
71	26.5	28.2
72	25.6	27.3

Although it's a seemingly short delay from age 70½ to 72, clients will potentially have larger future RMD amounts. The effect of the delay until 72 percentage is 27.3% as compared to the old 27.4% at 70, the same factor but 1½ more years of compounding.

The interplay between the deferred growth and the RMD factors notwithstanding, the conventional wisdom is that these new factors mean that IRA owners will be taking less each year as RMDs. As such, it allows for more tax-deferred growth over the years. This may increase the amounts passed to beneficiaries and will be subject to the 10-year distribution limit on inherited non-spousal IRAs. These additional income tax ramifications could be critical with regards to coordinated Social Security benefits and other governmental programs that are income and means tested.

Life Expectancy may actually improve as the Budget Reconciliation Act also included an increase in the legal age to buy tobacco products from 18 to 21 years old.

Eliminate "Stretch" IRAs. To help pay for the legislation, the SECURE Act will require beneficiaries to completely withdraw inherited IRAs and retirement plans within 10 years and pay the resulting tax liability. The 10-year rule would not apply to some beneficiaries such as surviving spouses, disabled individuals, minors and those who are not more than 10 years younger than the account owner. Since retirement accounts make up the largest share of many Americans' net worth, proponents of the bill anticipate this will raise $15.7 billion in increased tax revenue. There appears to be no "grandfathering" of this provision. The elimination of the Stretch IRA is probably the most controversial provision in the legislation and will likely affect several common retirement planning strategies.

> Action plan: This provision opens a planning opportunity to sell additional life insurance. With the income taxation of an inherited IRA now required to be distributed within 10 years, a more immediate taxation burden will naturally occur. Under prior law, if a $1,000,000 IRA was passed to beneficiaries with a 20-year life-expectancy, the distribution would be $50,000 per year plus earnings. The new 10-year distribution doubles that amount to $100,000 per year plus earnings. Assuming a beneficiary who earns around $100,000 a year, an additional $50,000 would increase their tax burden from the 24% bracket to the 32% marginal bracket. That is an 8% increase in tax or an 8% decrease in the value of the inheritance. Life insurance can be used to replace this decrease.

What are some of the implications of the SECURE Act?

Roth conversions. The overall appeal of Roth IRAs and Roth 401(k) accounts will not be affected by this legislation. As a matter of fact, more clients may convert taxable retirement accounts to Roth, both to take advantage of the current lower tax rates due to the Tax Cuts and Jobs Act (TCJA) of 2017, and to hedge against the higher taxes in the future when TCJA sunsets after 2025. It would also allow them to tax-diversify their retirement savings. However, Roth IRAs as a wealth transfer option has been significantly diminished. See below relative to Stretch IRAs.

Stretch IRAs have reduced appeal. A 10-year deferred withdrawal for an account that can grow tax deferred is still valuable, but for many the attractiveness may be reduced. There are still some limited lifetime or extended stretch options, but they are limited to:

- Beneficiaries where the original owners died before 2020
- Surviving spouses
- Chronically ill or disabled beneficiaries
- Beneficiaries within 10 years of age of the original IRA owner
- Minor children up to their state's age of majority, then the 10-year payout begins

Reduced stretch IRAs particularly hits clients who have completed Roth IRA conversions (and have already paid taxes associated with the conversion) or planned to do Roth Conversion with an eye toward using those assets for wealth transfer. For clients unlikely to spend all their retirement assets while alive, a common strategy was to convert some of their retirement savings to a Roth IRA, thereby allowing their beneficiaries to inherit an account that will continue to grow tax-free as well as provide tax-free income over their lifetime. Moreover, the account would have grown tax-free during both of the client and the beneficiary's lifetimes. Requiring withdrawals within 10 years makes this estate planning strategy less appealing from a tax perspective. Why pay up-front taxes on the Roth conversion if the subsequent tax-free growth potential is severely limited? Also, the conversion strategy "lumps" the income into the year of the conversion.

Review IRA trusts. Many attorneys use trusts to facilitate the effective transfer of wealth, including retirement assets. Although the IRS generally requires the assets to be paid to the trust within five years after the death of the account owner, a trust drafted to be a "look through" trust permits the IRA to be "stretched" to the trust over the life expectancy of the oldest trust beneficiary. With the "stretch" being eliminated, a careful review should be conducted as to whether these IRA trusts still make sense—especially when considering IRA distributions could be taxed at a much higher tax rate. Without careful planning, should the trust receive and retain retirement assets for the future benefit of the trust beneficiaries, IRA distributions could be taxed at 37% as soon as the income exceeds $12,750. By comparison, individual taxpayers do not reach the 37% tax rate until their income exceeds $500,000. Married couples do not reach until their income hits over $600,000.[1]

Direct IRA Distributions to charities. This option, recently made permanent by Congress, remains a viable planning opportunity. By directing an IRA Custodian to directly pay IRA distributions to a qualifying charity, an IRA owner can avoid taking those funds into income. This option is magnified under the TCJA with its provisions that eliminated or reduced itemized deductions for many taxpayers.

Life insurance sales opportunities

The loss of "stretch" may encourage wealthier Americans to consider more comprehensive estate planning strategies with their retirement assets. Now that more beneficiaries are likely to inherit assets with a larger up-front income tax bill, life insurance can help alleviate some of those costs. The life insurance proceeds can be used to pay for some, or all the tax liability, caused by the accelerated inherited retirement account. Furthermore, it may now make more sense for the account owner to withdraw more of their retirement assets that they do not otherwise need for retirement purposes and leverage life insurance to provide a tax-free legacy to their heirs. In addition to repositioning taxable assets to a tax-free vehicle, life insurance is generally easier to use to fund an irrevocable trust than retirement assets. Furthermore, with the additional gift tax leverage that can be gained due to the applicable exclusion amount being $11,400,000 per person, 2019 as indexed for inflation, $11,580,000 (2020) as indexed for inflation, large amounts of wealth can be passed through ILITs and other such devices.

No less a commentator than IRA specialist and CPA, Ed Slott, commented that the new law may favor life insurance as a possibly better wealth transfer option, because of the IRA changes and the ability to receive life insurance benefits income and estate tax free.

Charitable remainder trusts (CRTs). Naming CRTs as beneficiaries of retirement assets may be an appealing alternative to the "stretch" IRA. The retirement assets will be distributed to the CRT and the trust will then make an annual distribution to the owner's children each year for the rest of their lives calculated on a fixed percentage of trust assets. Upon the death of the lifetime trust beneficiaries, the children, the remainder will go to charity. The retirement assets will be included in the owner's estate but will get a charitable contribution deduction in an amount determined based on interest rates and the ages of the children at that time. Furthermore, the CRT isn't taxed on either the distribution from the retirement account or the income it earns. While the children will likely owe taxes on the distributions from the CRT, the CRT assets will continue to grow tax deferred. This type of strategy is obviously more complex and a seasoned tax professional should be consulted to help determine if this makes sense for a given circumstance.

Adoption and birth expenses 10% penalty free withdrawals. If a client has a 401(k), IRA or other retirement account, the SECURE Act will let them withdraw up to $5,000 following the birth or adoption of a child without paying the usual pre-59½, 10% early-withdrawal penalty. These are not income tax free withdrawals; clients still owe income tax on the distribution. For people who are married, each spouse will be able to withdraw $5,000 from his or her own account, penalty-free for a total of $10,000 of adoption or child birth expenses.

Planning Scenarios

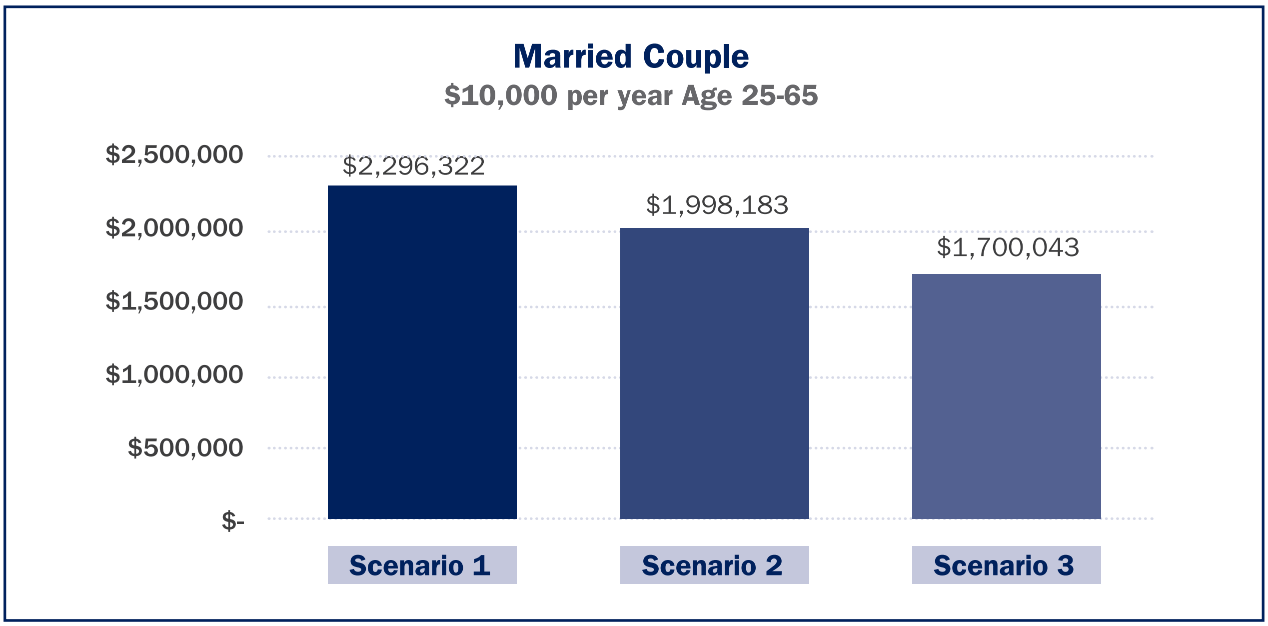
It is important to remember that withdrawals and not contributing to a qualified plan overtime can significantly diminish the total available for retirement income at age 65. If you compare three different planning scenarios for a married couple, the results can be dramatically different.

Scenario 1: They contribute $10,000 per year from age 25 to 65 and earn a 7% rate of return.

Scenario 2: If the same couple contributes the same $10,000 per year but withdraws $10,000 for child care expenses for child births at ages 28, 31 and 35.

Scenario 3: The difference becomes even more striking if the same couple would make no contributions to the plan in the years they had children, and they also withdrew the $10,000 child care birth expenses (again, ages 28, 31, 35).

Said another way, from Scenario 1 to Scenario 2 there is nearly $300,000 less retirement income at age 65, because they withdrew $30,000 total in the early years. Between Scenarios 1 and 3, there is over $600,000 less retirement income because of the combined lack of contributions and child birth expense costs of $60,000. In short, 10 times the amount taken out could be lost.



Action plan: Although using retirement funds for child birth or adoption expenses obviously reduces the amount of money available in retirement, some lawmakers believe this SECURE Act provisions will encourage younger workers to start funding 401(k)s and IRAs earlier as they'll know with certainty that these expenses can be paid for. Informing clients of this new exception to the 10% penalty tax opens the door for many other potential uses of qualified plan assets including purchasing insurance in the plan within plan limits. Also, there is no better gift a parent can make for a child than a life insurance contract. As we know, cash value builds tax free and death benefit can be received income tax free.

Conclusion

With the SECURE Act of 2019 Congress has made significant changes to retirement plans and retirement planning. Every financial advisor should consider how these changes are likely to impact their clients and what they can do to assist them in reaching their retirement planning goals.

For more information, please contact AXA Equitable Advanced Markets.

1 Laura Saunders, Inheriting IRAs Just Got Complicated, The Wall Street Journal, December 21, 2019, page B1.

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