The SECURE Act - Retirement Plan Impacts for Individuals and Businesses

The Setting Every Community Up for Retirement Enhancement Act, known as the SECURE Act was signed into law on December 20, 2019. The legislation instituted important changes to the treatment of deferred income tax retirement accounts for individuals and the requirements for employers and sponsors of retirement plans.

Some of the key areas impacting retirement accounts for individual taxpayers are outlined below.

Change in ages for required minimum distributions and retirement contributions

For tax years beginning after December 31, 2019, qualified retirement plan participants and IRA owners will have the age for required minimum distributions increased from 70.5 to 72. The provision is effective for taxpayers who reach age 70 ½ after December 31, 2019.

Additionally, a prohibition that was in place pre-Secure Act, which prevented retirement plan contributions after 70 ½ years of age, has now been repealed.

Retirement plan beneficiary distributions

Under the SECURE Act when an IRA owner passes away the account must be distributed to the beneficiaries within 10 years, with exceptions for surviving spouse, a minor child, chronically ill individuals, and other individuals less than 10 years younger than the original account holder. Prior legislation allowed the account distributions to occur over the life of the beneficiary. This is applicable to both Traditional and Roth IRA's.

Increased definition for qualified distributions from retirement accounts

Qualified retirement plans have added birth and adoption costs to the definition of qualified early distributions not subject to the 10% additional tax. The tax is often termed an early withdrawal penalty. This is effective for distributions after December 31, 2019 and is applied on an individual basis with a maximum covered amount of $5,000 per taxpayer.

Changes affecting employers and plan sponsors include:

Retirement plan adoption period

Pre SECURE Act new retirement plans were required to be adopted by year-end in the year of adoption but did not have to be funded until the tax return filing deadline the following year.

Under the SECURE Act plans adopted after December 31, 2019 do not need to be adopted until the tax return due date. This allows additional time for the implementation of a plan.

Small employer retirement plan tax credit

Effective for years beginning after December 31, 2019 certain small employers are eligible for a 50% credit of qualified costs incurred in setting up a retirement plan up to $5,000. Previously, the credit limitation was $500.

Part-time employee retirement plan participation

Under pre-SECURE Act law employers were able to exclude part-time employees from retirement plan participation. For plan years beginning after December 31, 2020, long-term part-time employees will have the option to participate in the employer plan. A long-term part-time employee is an individual over the age of 21 at the end of the three year period, who has worked at least 500 hours annually each of the last 3 years for the employer.

Non-discrimination testing for closed plans

The SECURE Act modified non-discrimination rules for closed defined benefit pension plans as of December 20, 2019. Under the old law, the plan could not favor highly compensated employees. Since a closed plan may have older, and therefore higher compensated employees participating in the plan, it was more likely to fail testing.

Now a plan that has been closed to new participants will pass testing if the plan would have passed on the date the plan closed.

Additionally, the legislation changed items that affect individual taxpayers beyond deferred income tax retirement accounts.

Increased definition for qualified distributions education saving plans

College savings plans, termed 529 plans are set-up to cover higher education expenses. These expenses now include student loan repayments up to $10,000 and registered apprenticeship costs. Previously, tax-free distributions could only be made for tuition, fees, books, supplies and equipment at an eligible educational institution, or special needs services.

Kiddie Tax reverts to pre-Tax Cuts and Jobs Act treatment

Unearned income of children under the age of 19 or full-time students under the age of 24 has historically been taxed at special rates, with this treatment termed the “Kiddie Tax”. Before the Tax Cuts and Jobs Act was passed at the end of 2017, a dependent child was required to pay tax on their unearned income using their parents’ tax rate. Beginning in 2018, the Kiddie Tax rates were changed to those used by Trusts, creating an effective increase in tax for most taxpayers subject to the Kiddie Tax. The SECURE Act returns the regime to pre-Tax Cuts and Jobs Act rules for years beginning after December 31, 2019. Additionally, the SECURE Act has provided the option to apply these rules to tax years beginning in 2018 and 2019 as well, which creates the opportunity to revisit returns filed in 2018 to determine if there is a benefit to amending the filings to potentially utilize lower tax rates.

Account holders and employers should review these changes with their tax and retirement advisors to determine the impact of this legislation on their tax planning and plan offerings.

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