Workers and Retirees Take Note: The SECURE Act's Revised Rules on Retirement Plans Impact Popular IRAs

The Setting Every Community Up for Retirement Enhancement (SECURE) Act, which became law Jan. 1, 2020, was a bipartisan effort to make retirement savings more accessible to the less advantaged. While the Act touched on many areas, it made significant changes to the way individual retirement accounts (IRAs) are treated. Here are some of the most notable provisions workers and retirees should consider:

Required Beginning Date

Then: Before passage of the SECURE Act, the owner of an IRA was required to begin taking minimum required distributions at the age of 70½. Distributions were required regardless of need, and there was a stiff 50 percent penalty for failing to take the required distributions.

Now: The SECURE Act raised the required age to begin taking minimum distributions to 72. This allows the account to continue to be invested and grow, and taxes can be deferred a bit longer. The 50 percent penalty for not taking the required distribution remains. There have been discussions to raise the age to 75, but that proposal is still under review.

Required Minimum Distributions

Then: Prior to the SECURE Act, the beneficiary of an IRA was allowed to take distributions over the beneficiary's life expectancy. This was referred to as a "stretch IRA," and it allowed money to stay invested in the IRA over a long period of time, depending on the age of the beneficiary. For example, a 25-year-old who inherited a $1 million IRA could stretch out withdrawals over 58 years, thereby allowing the investments to continue to grow.

Now: The SECURE Act did not change a spouse's ability to roll an IRA over into an individual account and then take distributions over a lifetime. However, the rules changed significantly for non-spouse beneficiaries: the entire account balance must now be withdrawn within 10 years of the account owner's death.

Practitioners interpret this to mean a nonspouse beneficiary could wait until the 10th year and then take the entire account balance at that time. However the IRS has a different interpretation, and has proposed regulations that state distributions will have to be taken each year based on the nonspouse beneficiary's life expectancy, with the entire remaining balance taken in the 10th year. These regulations have yet to be finalized, so be alert to any changes that may occur.

Exceptions to the 10-year Rule

As noted above, the 10-year rule does not apply to a surviving spouse. The rule also does not apply to a beneficiary who is a minor, which according to the proposed regulations, is anyone under the age of 21. A minor is required to take minimum required distributions based on life expectancy while the beneficiary is a minor, and then the 10-year rule would apply. So, a minor will have until age 31 to take the full account. In addition, the 10-year rule does not apply to disabled or chronically ill beneficiaries (as defined by the Tax Code). Under those circumstances, distribution may be taken over the life expectancy of the beneficiary.

Consider a Roth Conversion

Since distributions must be taken within 10 years of an account owner's death, some beneficiaries will be required to take distributions and pay the tax when they are in their prime earning years. Therefore, if an account owner is in a lower tax bracket than the beneficiaries, it may make tax sense for the account owner to consider a Roth conversion.

A Roth IRA is an after-tax account, so no taxes are due when distributions are made. In a Roth conversion, the account owner pays the income taxes now so that no taxes will be due when the beneficiaries take distributions. A traditional IRA can be converted to a Roth IRA over several years so that the taxes will be more manageable. The best tax result is achieved if the account owner is able to pay the taxes due with assets outside of the IRA.

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