FINANCIAL PLANNING
A PEAPACK PRIVATE WEALTH MANAGEMENT PUBLICATION

UPDATE: SECURE ACT LEGISLATION ENACTED

On December 20, 2019, President Trump signed catch-all spending legislation that contained provisions for the Setting Every Community Up for Retirement Enhancement ("SECURE") Act. Enactment of this legislation is viewed as the most significant retirement related policy in over a decade as a result of sweeping changes to existing retirement planning due to provisions such as:

- Altering the starting date of Required Minimum Distributions from age 70 ½ to 72
- Allows for deductible IRA contributions after age 70 ½ and beyond
- Provides additional circumstances for penalty free withdrawals prior to retirement age
- Allows part-time employees to participate in 401(k) plans
- Eliminates the "stretch" IRA concept for non-spouse beneficiaries

Required Minimum Distributions ("RMDs")

Prior to enactment of the SECURE Act, an IRA account owner was mandated to begin taking RMDs from the account upon reaching age 70 ½. The SECURE Act provides for this required distribution date to be delayed to age 72, allowing for longer tax-free accumulation within the IRA. The effective date of this change applies to distributions for individuals who attain the age of 70 ½ after December 31, 2019.

No Age Limit Contributions

In conjunction with an increase in the above referenced RMD beginning date, the SECURE Act removes the existing limit of age 70 ½ for contributing to a traditional IRA. Instead, the legislation places no age-based restriction on contributions thereby allowing individuals with earned income to continue contributing to their retirement for as long as they choose. These provisions are applicable for contributions made for tax years after December 31, 2019.

Penalty Free Withdrawals

Apart from a few limited situations such as unreimbursed medical bills and first-time homebuyers, distributions from an IRA prior to age 59 ½ were previously subjected to a 10% penalty on the amount withdrawn. The SECURE Act expands the current list of exceptions allowing for penalty free withdrawals of up to $5,000 within the one-year period following the birth or adoption of a child. This provision applies to distributions made after December 31, 2019.

Participation In 401(k) Plans For Part-Time Employees

Employees who have not worked more than 1,000 hours during any year were typically not eligible to participate in a company sponsored 401(k) retirement plan. Under the SECURE Act, employees 21 years or older who have worked more than 500 hours annually for a minimum of three consecutive years are eligible to participate in the company 401(k) plan. This applies to plan years beginning after Dec. 31, 2020; 12-month periods beginning before Jan. 1, 2021, shall not be considered.

"Stretch" IRAs

Under current rules, if a non-spouse beneficiary (i.e. child, grandchild) inherits an IRA due to an account owner's death he/she must take required minimum distributions from the Inherited IRA immediately. The rate of distribution, however, is based upon the beneficiary's remaining life expectancy providing the heir an ability to "stretch" the tax-deferral on Inherited IRA assets for multiple decades.

For example, in the case of a 30-year old beneficiary, the IRS tables state this individual has 53 years left to live and therefore would be required to withdraw only 1.89% (1/53) in Year 1. The following year would reduce the denominator by one (e.g. 1/52) slightly increasing the percentage required for withdrawal. This pattern would continue in each subsequent year during the beneficiary's lifetime or until the account assets have been depleted.

Per the terms of the SECURE Act, this same beneficiary is required to withdraw the IRA assets, and pay income tax on the assets distributed, within 10 years of the account owner's passing. There is no requirement for annual distributions during this time period. This new method of required distribution applies to distributions with respect to individuals who pass away after Dec. 31, 2019 (i.e. Inherited IRAs formed due to an account owner's death after 12/31/19).

Conclusions

While most provisions of the SECURE Act appear to have modest positive implications (e.g. delayed RMDs, no age limit on contributions), a potentially significant drawback of the legislation is the inability for a non-spouse beneficiary to "stretch" Inherited IRA distributions over his/her lifetime. With the enactment of the SECURE Act into law, it is imperative to review the legislation's provisions and their potential effects on individual retirement and financial plans. Of particular concern will be the review of trusts currently designated as the beneficiary of a retirement account and the applicability of terms and conditions set forth in the trust agreement. In addition, the potential financial and economic impacts of strategies such as Roth IRA conversions should be assessed in attempting to maximize opportunities within the law to meet individual goals and objectives.

PEAPACK PRIVATE

Wealth Management

500 HILLS DRIVE, SUITE 300, BEDMINSTER, NJ 07921
TEL (908) 234-0700 • WWW.PEAPACKPRIVATE.COM

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