IMPORTANT TAX INFORMATION FOR RETIREES

These new tax laws may affect you!

On December 20th of 2019, Congress made some significant tax changes taking effect in the 2020 tax year that may apply to you. Please read over this summary and ask questions about anything you do not understand. These are federal tax law changes. If you are a resident of a state with an income tax, please inquire with this office whether your state conforms to these new laws. Here is a rundown of the changes:

Maximum Age for Traditional IRA Contributions Repealed

The maximum age (previously 70½) for making traditional IRA contributions has been repealed, allowing you to make traditional IRA contributions if you also have income from employment. This change is effective starting with contributions for tax year 2020. The contribution is generally limited to the lesser of your income from working or $6,000 ($7,000 if age 50 or over). However, a traditional IRA may not be the best option, and you should contact this office before making a contribution. In addition, if you are also making qualified charitable distributions (QCDs), the IRA contribution can have a detrimental impact on the QCDs. A QCD is a direct transfer from an IRA to a qualified charity and is discussed further in this material.

Required Minimum Distribution (RMD) Age Increased

For years, retirees have been required to withdraw minimum distributions from their traditional IRAs and qualified retirement plans such as 401(k)s after reaching age 70½. That age has been increased to 72. In other words, taxpayers turning 70½ in 2019 must begin their RMDs in 2019 or by April 1, 2020 under a first-year-only delayed RMD provision. However, those turning 70½ in 2020 do not have a required beginning date until the year they turn age 72. Of course, individuals are allowed to take out as much as they like after age 59½ without penalty, but a distribution is always taxable (except a part may be nontaxable if nondeductible contributions had been made to the traditional IRA).

Qualified Charitable Distributions (QCDs)

The QCD option permits a retiree who is age 70½ or older to **transfer** any amount of his or her IRA funds, up to a maximum of $100,000 annually, tax free to a qualified charity.

At first glance, this may not appear to provide a tax benefit. But in addition to counting toward your RMD (if an RMD is required), by excluding the distribution from taxation, you lower your adjusted gross income (AGI), which helps with other tax breaks (or penalties) that are pegged at AGI levels, such as for medical expenses, passive losses, and taxable Social Security income. In addition, non-itemizers essentially receive the benefit of a charitable contribution to offset the IRA distribution.

However, because the age restriction for making traditional IRA contributions has been repealed, starting in 2020 you can make an IRA contribution and also make a QCD. For that reason, Congress included a provision requiring a taxpayer who qualifies to make a QCD to reduce the non-taxable QCD portion by any traditional IRA contribution that is deducted and made after reaching 70½, even if the QCD and IRA contribution are not in the same year.

Example #1 – Jack makes a traditional IRA contribution of $7,000 when he is age 71 and another $7,000 contribution at the age of 72. He claims an IRA deduction of $7,000 on his tax return for each year. Later, when he is 74, he makes a QCD in the amount $10,000 to his church's building fund. Since Jack made the IRA contributions after age 70½, his QCD must be reduced by the post-70½ contributions that were deducted (but not reduced below zero). As a result, the $10,000 is taxable. However, he can claim his $10,000 donation to the church building fund as a charitable contribution on Schedule A if he itemizes his deductions.

Example #2 – Bob makes a traditional IRA contribution of $7,000 when he is age 71 and another $7,000 contribution at the age of 72, and deducts the IRA contributions on his returns. When he is 74, he makes a QCD in the amount of $20,000 to his church's building fund. Since Bob made the deductible IRA contributions after age 70½, his QCD must be reduced by $14,000 for tax reporting. As a result, of the $20,000 QCD, $14,000 is a taxable distribution, $6,000 is nontaxable and Bob can claim a $14,000 charitable contribution if he itemizes his deductions.

RMDs for Designated Beneficiaries

Some members of Congress have, for some time, expressed their displeasure with the so-called "stretch" IRAs that have permitted some beneficiaries, such as young children or grandchildren, to extend the payout periods from the IRAs they inherited for decades.

When someone inherits an IRA or retirement plan, with the exception of a Roth IRA, the distributions from the retirement plan are generally taxable to the beneficiary. In the past, beneficiaries have often been able to use a lifetime distribution option to stretch the payments over a long period of time. That's how these IRAs came to be referred to as stretch IRAs.

Under the new law, many beneficiaries of IRAs or defined contribution retirement plans are required to distribute (and pay taxes on) the funds within a 10-year period after the year of death of the plan owner. This effectively eliminated the stretch IRA.

A surviving spouse still has the option of treating the decedent's IRA as his or her own or rolling it into their own IRA, thus permitting a lifetime distribution period. Other exceptions to the new, shortened distribution period apply to:

- *Disabled or chronically ill individuals, who also continue to have the lifetime distribution option.*
- *Individuals who are no more than 10 years younger than the decedent, who can choose a lifetime distribution period.*
- *A child of the decedent, who is generally not required to take distributions until they have reached the age of majority (as determined by state law). Once they have reached the age of majority, the plan funds must be distributed, in any amounts, within the next 10 years.*

If you have any questions about these tax law changes, please give this office a call.

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