An Addendum to the
2020 Ministers' Tax Guide for 2019 Returns

Six Provisions from the SECURE Act Offer Greater Incentives to Save for Retirement

A Detailed Review of How These Changes Will Benefit Churches and Staff

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In the waning hours of 2019, Congress enacted the Setting Every Community Up for Retirement Enhancement Act of 2019 (the SECURE Act). The SECURE Act includes several previous legislative initiatives that had not been enacted and generally incentivizes taxpayers to save for retirement.

Here are six provisions from the SECURE Act most relevant to churches and church staff:

1. **Required Minimum Distribution (RMD) Changes**
   Increases the RMD age from 70½ to 72, after which RMDs from certain retirement accounts must begin.
2. **Individual Retirement Account (IRA) Contribution Changes**
   Repeals the prohibition on contributions to a Traditional IRA by an individual who has reached age 70½.
3. **Penalty-free Distribution Allowance**
   Allows penalty-free distributions from qualified retirement plans and IRAs for births and adoptions.
4. **Clear Eligibility for Individuals Under Church-controlled Organization Pension Plan Coverage**
   Specifies those individuals who may be covered by pension plans maintained by church-controlled organizations.
5. **New Cost Inclusions for Section 529 Accounts**
   Expands section 529 education savings accounts to cover costs associated with registered apprenticeships and student loan repayments and certain costs associated with elementary and secondary education and homeschooling.
6. **Failure-to-file Penalty Increase**
   Increases the penalty for failure to file to the lesser of $435 or 100% of the amount of the tax due.

(1) Required Minimum Distribution (RMD) Changes

Under Prior Law

Because you cannot keep retirement funds in your account indefinitely, you generally had to start taking withdrawals, called RMDs, annually from all employer-sponsored retirement plans (including 403(b) plans) starting with the year that you reached age 70½ or, if later, the year in which you retired (if allowed by the terms of your plan documents).

The beginning date for your first RMD was December 31 of the year you turned age 70½, although you were allowed to delay your first RMD until April 1 of the following year. If you chose to delay, then you had two RMDs due for that year, one on April 1 and one on December 31.

What Will Continue

The RMD rules apply to all employer-sponsored retirement plans, including 403(b) plans and Traditional IRAs and IRA-based plans such as SEPs, SARSEPs, and SIMPLE IRAs. Retirement plan participants and IRA owners are responsible for taking the correct amount of RMDs on time every year from their accounts. They face stiff penalties for failure to do so.

☞ **Key Point:** If you do not take any distributions, or if the distributions are not large enough, you may have to pay a 50% excise tax on the amount not distributed as required.

Generally, an RMD is calculated for each account by dividing the prior December 31 balance of that IRA or retirement plan account by a life expectancy factor that the IRS publishes in tables in *Publication 590-B*, *Distributions from Individual Retirement Arrangements (IRAs)*. Choose the life expectancy table to use based on your situation.

☞ **Key Point:** When mandatory distributions from qualified retirement plans based on age were added to the tax code in 1962, the life expectancy of Americans was shorter. In addition, increasing numbers of Americans are continuing to work past traditional retirement ages. Based on these circumstances, Congress concluded that it is appropriate to increase the age by which RMDs must be made to more accurately reflect present-day conditions.

Moving Forward with the SECURE Act

The SECURE Act changes the age on which the beginning date for RMDs is based — from the calendar year in which the employee or IRA owner attains 70½ years to the calendar year in which the employee or IRA owner attains 72 years. However, prior law continues to apply to employees and IRA owners who attain age 70½ prior to January 1, 2020.

This provision is effective for distributions required to be made after December 31, 2019, for employees and IRA owners who attain age 70½ after December 31, 2019. In all other respects, prior law treatment of RMDs is not affected.

▲ **Caution:** The terms of your employer-sponsored retirement plan may allow employees to wait until the year they actually retire to take their first RMD. Alternatively, a plan may require employees to begin receiving distributions by April 1 of the year after they reach age 72 even if they have not retired. In some cases, employers will need to amend their plan to enable employees to benefit from the new rule.

☞ **Key Point:** What has not changed is the requirement to actuarially adjust accrued benefits for an employee who retires in a calendar year after the year the employee attains age 70½ to take into account the period after age 70½ in which the employee was not receiving any benefits under the plan.

After the first RMD, you must take subsequent RMDs by December 31 of each year beginning with the calendar year containing your required beginning date. The first year following the year you reach age 72, you will generally have two required distribution dates: an April 1 withdrawal (for the year you turn 72) and an additional withdrawal by December 31 (for the year following the year you turn 72). To avoid having both of these amounts included in your income for the same year, you can make your first withdrawal by December 31 of the year you turn 72 instead of waiting until April 1 of the following year.

✍ **Example:** Pastor John reaches age 72 on August 20, 2022. He must receive his first RMD by April 1, 2023, based on his 2021 year-end balance. He must receive his second RMD by December 31, 2023, based on his 2022 year-end balance. If Pastor John receives his initial RMD for 2022 on April 1, 2023, then both his 2022 and 2023 distributions will be included in income on his 2023 income tax return. To avoid this problem, Pastor John should receive his first RMD by December 31, 2022.

Note the following additional developments regarding RMDs:

- One effect of increasing the age for an initial RMD is that the RMD calculation will be based on fewer years and more retirement assets, meaning that RMDs will be slightly larger.
- Increasing the initial RMD from April 1 of the year following the year in which you turn 70½ to the year following the year in which you turn 72 comports more with how we naturally reckon time.
- Many retired workers depend on income from their employer-sponsored retirement plan (including 403(b) plans) for living expenses, and many will be exceeding their applicable RMD without legal compulsion.
- The cable news network CNBC has estimated that under the new rules, "a theoretical $500,000 portfolio, earning 5% annually, would have $33,500 more at age 89 if the RMDs started at age 72."
- An earlier version of the SECURE Act would have raised the initial RMD age to 75. This provision had substantial bipartisan support, but in the end was dropped.
- Although the IRA custodian or retirement plan administrator may calculate the RMD, the IRA or retirement plan account owner is ultimately responsible for calculating the amount of the RMD.
- The 50% penalty on undistributed amounts may be waived if the account owner establishes that the shortfall in distributions was due to reasonable error and that reasonable steps are being taken to remedy the shortfall. In order to qualify for this relief, you must file IRS *Form 5329* and attach a letter of explanation.
- In the past, a modified RMD applied to IRA beneficiaries following the death of the IRA account holder. A 5-year rule required most IRA beneficiaries to withdraw 100% of the IRA by December 31 of the year containing the fifth anniversary of the owner's death. For example, if the owner died in 2018, the beneficiary would have had to fully distribute the plan by December 31, 2023. The beneficiary was allowed, but not required, to take distributions prior to that date. The 5-year rule never applied if the owner died on or after his or her required beginning date. The SECURE Act extends this to a 10-year rule.

(2) Individual Retirement Account (IRA) Contribution Changes

Under prior law, an individual who had attained age 70½ by the close of a year was not permitted to make contributions to a Traditional IRA. This restriction did not apply to contributions to a Roth IRA. In addition, employees over age 70½ were not precluded from contributing to employer-sponsored plans.

The SECURE Act repeals the prohibition on contributions to a Traditional IRA by an individual who has attained age 70½. This change was based on the reality that as Americans live longer, increasing numbers are continuing to work past traditional retirement ages. This provides such working individuals with current income, as well as the potential for additional retirement savings. **An individual working past age 70½ may contribute to an employer-sponsored retirement plan, if available, or to a Roth IRA or to a Traditional IRA.**

This provision applies to contributions made for taxable years beginning after December 31, 2019.

(3) Penalty-free Distribution Allowance

Under prior law, a distribution from a qualified retirement plan, a tax-sheltered annuity plan (a section 403(b) plan), or an IRA generally is included in taxable income for the year distributed. These plans are referred to collectively as eligible retirement plans. In addition, unless an exception applies, a distribution from a qualified retirement plan, a section 403(b) plan, or an IRA received before age 59½ is subject to a 10% additional tax (referred to as the early withdrawal penalty tax) on the amount includible in income.

The SECURE Act creates an exception to the 10% early withdrawal penalty tax in the case of qualified birth or adoption distributions from an applicable eligible retirement plan. This provision was based on the following excerpt from the House Ways and Means Committee report:

> Births and adoptions are important life events that can come with significant financial costs for a family. The Committee believes that, in these situations, individuals should have access to portions of their retirement savings to help pay for these costs. The ability to access retirement savings on a penalty-free basis at the time of the birth of a child or adoption will provide such flexibility. As a result, the Committee believes this will encourage younger workers to save earlier for their retirement, whether through participation in an employer-sponsored plan or an IRA.

In addition to an exception to the 10% early withdrawal penalty tax, qualified birth or adoption distributions may be recontributed to an individual's applicable eligible retirement plans, subject to certain requirements. The report of the House Ways and Means Committee provides this clarification:

> **A qualified birth or adoption distribution** is a permissible distribution from an **applicable eligible retirement plan** which, for this purpose, encompasses eligible retirement plans other than defined benefit plans, including qualified retirement plans, section 403(b) plans, and IRAs.
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> **A qualified birth or adoption distribution** is a distribution from an applicable eligible retirement plan (including qualified retirement plans, section 403(b) plans, and IRAs) to an individual if made during the one-year period beginning on the date on which [including qualified retirement plans, section 403(b) plans, and IRAs] a child of the individual is born or on which the legal adoption by the individual of an eligible adoptee is finalized. An eligible adoptee means any individual (other than a child of the taxpayer's spouse) who has not attained age 18 or is physically or mentally incapable of self-support. The provision requires the name, age, and taxpayer identification number of the child or eligible adoptee to which any qualified birth or adoption distribution relates to be provided on the tax return of the individual taxpayer for the taxable year.
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> The maximum aggregate amount which may be treated as qualified birth or adoption distributions by any individual with respect to a birth or adoption is $5,000. The maximum aggregate amount applies on an individual basis. Therefore, each spouse separately may receive a maximum aggregate amount of $5,000 of qualified birth or adoption distributions (with respect to a birth or adoption) from applicable eligible retirement plans in which each spouse participates or holds accounts.
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> An employer plan is not treated as violating any tax code requirement merely because it treats a distribution (that would otherwise be a qualified birth or adoption distribution) to an individual as a qualified birth or adoption distribution, provided that the aggregate amount of such distributions to that individual from plans maintained by the employer and members of the employer's controlled group does not exceed $5,000. Thus, under such circumstances an employer plan is not treated as violating any tax code requirement merely because an individual might receive total distributions in excess of $5,000 as a result of distributions from plans of other employers or IRAs.
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> ☞ **Key Point:** Generally, any portion of a qualified birth or adoption distribution may, at any time after the date on which the distribution was received, be recontributed to an applicable eligible retirement plan to which a rollover can be made. Such a recontribution is treated as a rollover and thus is not includible in income.
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> If an employer adds the ability for plan participants to receive qualified birth or adoption distributions from a plan, the plan must permit an employee who has received qualified birth or adoption distributions from that plan to recontribute only up to the amount that was distributed from that plan to that employee, provided the employee otherwise is eligible to make contributions (other than recontributions of qualified birth or adoption distributions) to that plan.
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> Any portion of a qualified birth or adoption distribution from an individual's applicable eligible retirement plans (whether employer plans or IRAs) may be recontributed to an IRA held by such an individual that is an applicable eligible retirement plan to which a rollover can be made.

This provision applies to distributions made after December 31, 2019.

(4) Clear Eligibility for Individuals Under Church-controlled Organization Pension Plan Coverage

Assets of a tax-sheltered annuity plan (a section 403(b) plan) generally must be invested in annuity contracts or mutual funds. However, the restrictions on investments do not apply to a retirement income account, which is a defined contribution program established or maintained by a church, a convention, or association of churches, to provide benefits under the plan to employees of a religious, charitable, or similar tax-exempt organization.

Certain rules prohibiting discrimination in favor of highly compensated employees, which apply to section 403(b) plans generally, do not apply to a plan maintained by a church or qualified church-controlled organization (QCCO). For this purpose, "church" means a church, a convention, or association of churches or an elementary or secondary school that is controlled, operated, or principally supported by a church or by a convention or association of churches and includes a QCCO.

A QCCO is any church-controlled tax-exempt organization other than an organization that:

1. Offers goods, services, or facilities for sale, other than on an incidental basis, to the general public, other than goods, services, or facilities that are sold at a nominal charge substantially less than the cost of providing the goods, services, or facilities and
2. Normally receives more than 25% of its support from either governmental sources or receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities in activities that are not unrelated trades or businesses, or from both. Church-controlled organizations that are not QCCOs are generally referred to as non-qualified church-controlled organizations (NQCCOs).

In recent years, a question has arisen as to whether employees of NQCCOs may be covered under a section 403(b) plan that consists of a retirement income account. **The SECURE Act clarifies that a retirement income account may cover:**

1. **A duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of compensation;**
2. **An employee of an organization, whether a civil law corporation or otherwise, that is exempt from tax under section 501 and is controlled by or associated with a church, a convention, or association of churches; and**
3. **An employee who is included in a church plan under certain circumstances after separation from the service of a church, a convention, or association of churches, or an organization described above.**

This provision applies to years beginning before, on, or after the date of enactment.

(5) New Cost Inclusions for Section 529 Accounts

A section 529 plan (also known as a qualified tuition plan) is a plan operated by a state or educational institution with tax advantages and potentially other incentives to make it easier to save for college and other post-secondary training for a designated beneficiary, such as a child or grandchild.

The main tax advantage of a 529 plan is that earnings are not subject to federal tax and generally are not subject to state tax when used for the qualified education expenses of the designated beneficiary, such as tuition, fees, books, as well as room and board. Contributions to a 529 plan, however, are not deductible.

Contributions to a 529 plan cannot exceed the amount necessary to provide for the qualified education expenses of the beneficiary. If you contribute to a 529 plan, however, be aware that there may be gift tax consequences if your contributions, plus any other gifts, to a particular beneficiary exceed $15,000 during the year.

The Tax Cuts and Jobs Act of 2017 modified section 529 plans to allow such plans to distribute **not more than $10,000** in expenses for tuition incurred during the taxable year in connection with the enrollment or attendance of the designated beneficiary at a public, **private, or religious elementary or secondary school.** This limitation applies on a per-student basis, rather than a per-account basis. Thus, although an individual may be the designated beneficiary of multiple accounts, that individual may receive a maximum of $10,000 in distributions free of tax, regardless of whether the funds are distributed from multiple accounts. Any excess distributions received by the individual would be treated as a distribution subject to tax under the general rules of section 529.

The final text of the Tax Cuts and Jobs Act deleted a provision modifying the definition of higher education expenses to include certain expenses incurred in connection with a **homeschool.**

The SECURE Act makes the following three changes to 529 plans:

First, the Act allows tax-free treatment to apply to distributions made for certain expenses in connection with a homeschool. Under the provision, distributions for certain homeschool expenses are treated in the same manner as distributions for qualified higher education expenses and, like distributions for elementary and secondary school tuition, are also subject to an annual limit of $10,000 in aggregate 529 distributions per beneficiary.

For these purposes, qualifying homeschool expenses are those expenses, with respect to a beneficiary, that are incurred in connection with a homeschool and are for:

- Curriculum and curricular materials
- Books or other instructional materials
- Online educational materials
- Tuition for tutoring or educational classes outside of the home if the tutor or instructor is unrelated to the student
- Dual enrollment in an institution of higher education
- Educational therapies for students with disabilities

Second, the Act allows tax-free treatment to apply to distributions of certain amounts used to make payments on principal or interest of a qualified education loan. No individual may receive more than $10,000 of such distributions, in aggregate, over the course of the individual's lifetime. To the extent that an individual receives in excess of $10,000 of such distributions, they are subject to the usual tax treatment of 529 distributions (i.e., the earnings are included in income and subject to a 10% penalty tax). The provision contains a special rule allowing such amounts to be distributed to a sibling of a designated beneficiary (e.g., a brother, sister, stepbrother, or stepsister). This rule allows a 529 account holder to make a student loan distribution to a sibling of the designated beneficiary without changing the designated beneficiary of the account. For purposes of the $10,000 lifetime limit on student loan distributions, a distribution to a sibling of a designated beneficiary is applied toward the sibling's lifetime limit and not the designated beneficiary's lifetime limit. The deduction available for interest paid by the taxpayer during the taxable year on any qualified education loan is disallowed to the extent such interest was paid from a tax-free distribution from a 529 plan.

Third, the Act allows tax-free treatment to apply to distributions made for certain additional qualifying expenses on behalf of designated beneficiaries attending elementary or secondary school. Under the provision, in addition to tuition, tax-free treatment would apply to a distribution made for expenses for fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with enrollment or attendance at such elementary or secondary school.

The provision applies to distributions made after December 31, 2018.

(6) Failure-to-file Penalty Increase

Regarding the failure-to-file penalty, the Taxpayer First Act of 2019 stated the following:

> The Federal tax system is one of ''self-assessment,'' i.e., taxpayers are required to declare their income, expenses, and ultimate tax due, while the IRS has the ability to propose subsequent changes. This voluntary system requires that taxpayers comply with deadlines and adhere to the filing requirements. While taxpayers may obtain extensions of time in which to file their returns, the Federal tax system consists of specific due dates of returns. In order to foster compliance in meeting these deadlines, Congress has enacted a penalty for the failure to timely file tax returns.
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> A taxpayer who fails to file a tax return on or before its due date is subject to a penalty equal to 5% of the net amount of tax due for each month that the return is not filed, up to a maximum of 25% of the net amount. If the failure to file a return is fraudulent, the taxpayer is subject to a penalty equal to 15% of the net amount of tax due for each month the return is not filed, up to a maximum of 75% of the net amount. The net amount of tax due is the amount of tax required to be shown on the return reduced by the amount of any part of the tax that is paid on or before the date prescribed for payment of the tax and by the amount of any credits against tax that may be claimed on the return. The penalty will not apply if it is shown that the failure to file was due to reasonable cause and not willful neglect.
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> If a return is filed more than 60 days after its due date, and unless it is shown that such failure is due to reasonable cause, then the failure to file penalty may not be less than the lesser of $205 or 100% of the amount required to be shown as tax on the return. If a penalty for failure to file and a penalty for failure to pay tax shown on a return both apply for the same month, the amount of the penalty for failure to file for such month is reduced by the amount of the penalty for failure to pay tax shown on a return. If a return is filed more than 60 days after its due date, then the penalty for failure to pay tax shown on a return may not reduce the penalty for failure to file below the lesser of $205 or 100% of the amount required to be shown on the return.
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> The failure to file penalty applies to all . . . income tax returns of an individual, fiduciary of an estate or trust, or corporation, self-employment tax returns, and estate and gift tax returns.

The SECURE Act increases the failure-to-file penalty to the lesser of $435 or 100% of the amount of tax due for returns due after December 31, 2019.

The House Ways and Means Committee noted that the penalties for failing to file tax returns have not been increased in several years, and it believes that increasing the penalties will encourage the filing of timely and accurate returns, which, in turn, will improve overall tax administration.

HELPFUL NUMBERS AND RESOURCES

1-800-TAX-FORM or 1-800-829-3676
To request IRS forms

IRS.gov
To visit the IRS home page

GuideStone.org/Tax Guide
To access GuideStone's helpful resources about ministerial tax issues and frequently asked questions about minister's housing allowance

ChurchLawandTax.com

To visit a *Christianity Today* website featuring Richard Hammar and a host of other professionals who provide information on church law, tax, finance, and risk management

ChurchLawandTaxStore.com
To visit *Christianity Today's* online store with church management resources to keep your church safe, legal, and financially sound

Church & Clergy Tax Guide
To purchase Richard Hammar's comprehensive tax guide published annually by Christianity Today International, visit *ChurchLawandTaxStore.com*.

Church Compensation: From Strategic Plan to Compliance
To purchase Elaine Sommerville's reference book that guides you through every aspect of employment compensation in easy-to-understand language, visit *ChurchLawandTaxStore.com*.

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