SECURE ACT TAX REFORMS

CHANGES YOU SHOULD CONSIDER TO HELP PRESERVE YOUR LEGACY

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GET TO KNOW THE SECURE ACT

On December 20, 2019, President Trump signed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act). The Act is considered the most impactful legislation affecting individual retirement accounts (IRAs) in decades. The Act has many notable changes impacting IRA holders and IRA beneficiaries. While some giving occurs, the IRS also taketh away.

For IRA owners, the Act adjusts the law to account for the increased periods of employment and life expectancy we experience in the USA. However, the Act negatively impacts the distribution of an IRA upon the death of the account holder and makes it a less attractive tool for inheritance.

The Issue

Revised Tax Rules for Non-Spousal Beneficiaries of Qualified Assets (IRAs)

The Act increases the required beginning date for required minimum distributions (RMDs) from age 70.5 to age 72. Correspondingly, the Act eliminates the age restriction for contributions to qualified retirement accounts. This change allows account holders to contribute to their IRAs even after they turn 70.5, which was the cutoff date under the old law, as long as the contributed funds come from earned income and not investments or savings.

Significantly, the Act requires most designated beneficiaries of IRAs to withdraw the entire balance of an inherited IRA within 10 years of the account owner's death, and within 5 years for estates and charities. There are a few exceptions to the new withdrawal period: spouses, beneficiaries who are not more than 10 years younger than the account owner, the account owner's minor children, disabled individuals, and chronically ill individuals. In changing the distribution time-period for beneficiaries, the Act largely serves to provide an estimated $15.7 billion in tax revenue over the next 10 years, according to the Congressional Research Service.

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THE IMPACT

Significantly Increased Distributions in a Decreased Timeframe, Resulting in Greater Tax Liabilities

For many, a retirement account is the largest asset they will own when they pass away. Previously, if an account owner passed with assets remaining in the IRA, the beneficiary of the IRA could "stretch" the distribution over the course of the beneficiary's lifetime. This "Stretch Provision" helped reduce the tax implication for the IRA distribution and allowed beneficiaries to grow their own IRA by rolling over the inherited IRA into their own personal IRA.

However, the new mandatory 10-year withdrawal period removes the ability for beneficiaries to stretch the IRA. The shorter withdrawal period will result in the acceleration of income tax due, possibly at times when a beneficiary's taxable income and marginal tax rate is higher, thus receiving less of the funds contained in the IRA than may have originally been anticipated. The shorter withdrawal period also means that the assets are exposed to creditors, or are available in the event of bankruptcy or divorce proceedings.

Let's look at an example:

Under the "Stretch Provision", a 40-year-old who received a $500k IRA as inheritance, and was required to initially distribute ~$10,900 and pay taxes on that income. At a 6% rate of return, that Inherited IRA could grow to ~$900k over a 20-year period, inclusive of the required distributions each year.

With the provisions eliminated in 2019, that same $500k being fully distributed over 10-years, with a 6% growth rate, and presuming level distributions for the 10-years, – that initial distribution jumps from ~$10,900 to $64,000! That's a $53,100 income increase, which is likely to vault the individual into a higher tax bracket causing higher taxes on all their income.

At the end of the decade when the IRA is fully exhausted, the inheritor will have paid as much as $72k to $196k MORE in taxes due to elevated distributions and tax brackets. Perhaps the IRS knew exactly what they were doing!

Material discussed herewith is meant for general illustration and/or informational purposes only. Please note that individual situations may vary. The information should be relied upon when coordinated with individual professional advice.

STRATEGIES

Through a TRUST

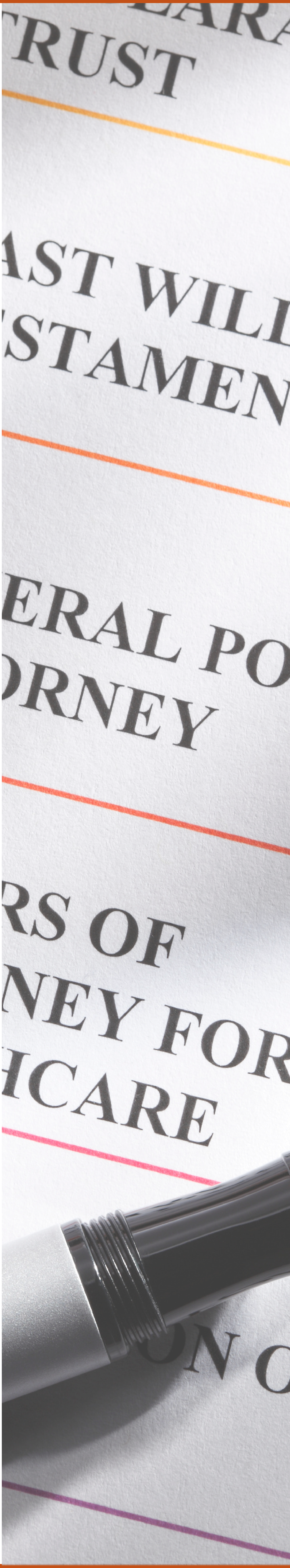
Before the SECURE Act was passed, you may have included "conduit" provisions in your trust so that the trust would qualify as a designated beneficiary of a retirement account, allowing the RMDs to pass through to the trust's primary beneficiary for their individual life expectancy. Now, conduit trusts are ineffective after ten years, at which point the retirement account balances must be paid directly to the trust's beneficiaries, which may substantially increase the income taxes they owe and make the entire amount available to claims by their creditors or divorcing spouses. Needless to say, if your estate plan includes this type of trust, it may be time to discuss new options with a legal professional.

Some alternatives include the following:

1. **Give Outright:** Modify your plan to allow for the outright gift of any IRA assets upon death and distribute other assets pursuant to a Trust.

2. **Trust Protector**: Include a Trust Protector in your trust. The role and responsibility of the Trust Protector should be discussed further with an estate planner, but this addition can help to account for changes in the law and tax structure since the plans original finalization.

3. **Accumulation Trust**: If you prefer using a trust with robust asset protection features, then you should consider naming an accumulation trust as beneficiary of an IRA. An accumulation trust is subject to the usual 10-year liquidation rule, but the assets distributed to the trust may be held (accumulated) within the trust. This option can provide flexibility to a trustee as to the timing of distributions from the account to the trust (during the 10-year liquidation period) and distributions from the trust to your beneficiary (at any time pursuant to the provisions of the trust document). The accumulated trust assets remain safely in the trust until the trustee chooses to make a distribution. Unless the account is Roth-qualified, all withdrawals will be taxable either (A) to the trust at the trust's income tax rate, if accumulated in the trust, or (B) to your beneficiary at his or her income tax rate, if distributed to your beneficiary. This is most effectively handled through the creation of a standalone IRA beneficiary trust solely for the purpose of serving as beneficiary of your retirement account.



4. **Charitable Remainder Trust**: This approach uses trust laws to shield inherited assets from future threats, while using the tax-favored charitable trust provisions to achieve income tax optimization. A charitable remainder trust will establish a predictable plan for the timing and amount of distributions to your beneficiary by using an annuitized income stream or "unitrust" percentage. Upon your death your trustee (who may be your beneficiary, if desired) must liquidate your retirement account immediately, but the entire amount will pass income-tax free to the trust. Each subsequent year the trustee is required to distribute an established amount ("annuity") or percentage of trust assets ("unitrust") to your beneficiaries (e.g., your children) for a term of years or until the death of the last remaining beneficiary, all of which are subject to income tax. Meanwhile, the balance of trust assets may continue to be invested in a tax-deferred environment. When the distribution period ends, any remaining trust assets are distributed to the charity you named in the trust originally, although you may include a provision giving beneficiaries the right to name a different charity as remainder beneficiary.

Through INSURANCE

To help protect against the greater tax bite, consider three strategies utilizing life insurance:

1. Project the IRA account's value to a specific age or life expectancy (and don't forget to include the Required Distributions along the way). Attempt to calculate the tax bill associated to the distribution of the IRA. Thereafter, you can purchase a life insurance policy designed to last the life of the original IRA owner and provide the death benefit on an income tax-free basis.

2. Project the value of the IRA at a specific age, and purchase a life insurance policy in the same amount. Designate a charity as the Primary Beneficiary of your IRA. Upon your passing your heirs will receive the IRA amount on an income tax-free basis, and the charity can receive the donation on a tax-exempt basis.

3. Calculate the value of your IRA in the future, and the likely tax liability. Designate your spouse as beneficiary and purchase an insurance policy in the amount of the tax liability. At your passing, your spouse can convert the IRA to a Roth IRA, and utilize

insurance proceeds to offset the tax liability. At the time your spouse passes the Roth IRA assets will pass along to your heirs on a tax-free basis.

CONCLUSION

We experienced a litany of emergency measures enacted by the Government this year to combat the Covid-19 pandemic. It not only changed the way we conduct our day to day lives, but also the way we must plan to prepare for our futures. The IRS's new rules regarding Non-Spousal beneficiaries will take some time to get used to, but with planning and foresight there are manners in which they can be mitigated!

All Guarantees protections are subject to claims-paying ability of the issuing insurance company. They do not apply to the investment performance or safety of the underlying investment options.

Depending on the value of the IRA and intended distribution and beneficiaries, IRA owners may need to revisit their IRA beneficiary designations and estate plans. If you don't have an estate plan, there's never a bad time to create one. In death, your money can only do three things – go to beneficiaries, charity, or the IRS. Estate plans are about more than how much money you have — they help ensure that your wishes are carried out. Don't leave your heirs with the burden of undetermined financial affairs during a time of grief. If you are concerned about the recent tax changes and financial impact, or you need to start putting an estate plan together - you should explore different strategies with your financial, tax, and estate planning advisors. **Don't delay in protecting your legacy!**

Call us for a consultation

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