Making the Most of Your Giving Under the SECURE Act

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Important Note

- The information provided in this presentation is a brief summary of recent legal developments, subject to change, that is intended for general guidance only and does not create an attorney-client relationship between the author and the reader or attendee.
- Readers are encouraged to seek individualized legal advice in regard to any particular factual situation.

Roadmap

- Welcome to the SECURE Act
- The New RMD Rules
  - Eligible Designated Beneficiaries
  - Trusts as Beneficiaries
- SECURE Act Impact on Estate Planning
- The 2020 Election – Changes Coming?

Terms & Abbreviations

- CRT – Charitable Remainder Trust
- DB – Designated Beneficiary
- **EDB – Eligible Designated Beneficiary**
- IRA – Individual Retirement Account or Annuity
- IRC – Internal Revenue Code
- LE – Life Expectancy
- Participant – IRA owner or owner of qualified plan account. (IRC refers to "employee.")

Terms & Abbreviations

- QCD – Qualified Charitable Distribution
- RBD – Required Beginning Date
- RMD – Required Minimum Distribution
- **SECURE Act: Setting Every Community Up for Retirement Enhancement Act.**

Welcome to the SECURE Act

Welcome to the SECURE Act

- Upends the required minimum distribution (RMD) rules that have been in place since 1986 (regulations finalized in 2002), for "defined contribution" (e.g., 401(k)/profit-sharing) retirement plans and IRAs.
- Contracts life expectancy payouts to a 10-year rule in many cases.
- Acceleration of income taxes estimated to transfer approximately $15.8 billion of family wealth to the government between now and 2029. (Joint Committee on Taxation)

Welcome to the SECURE Act

Kevin Brady (R-Tx 8th Dist.)

Quote:

- "IRAs are for retirement security. **They are not wealth succession management tools**, and I think we've now got the policy right."

The New RMD Rules

The New RMD Rules

- The new RMD rules apply to distributions from traditional IRAs and defined contribution plans, occurring for deaths on or after January 1, 2020.
  - However if participants have locked in annuity payouts prior to SECURE Act, those annuity distribution rules govern.
- Different rules apply to defined benefit plans.
- There is some delayed effect to benefits under governmental and some collective bargaining plans.

The New RMD Rules

Designated Beneficiary TWO TYPES

- Eligible Designated Beneficiary – Life Expectancy payout for their lifetime only.
  - Spouse gets spousal conversion/rollover right.
- Other Designated Beneficiaries: 10-Year Rule.
  - Distributions must be completed by the end of the calendar year containing the 10th anniversary of the participant's death.

No Designated Beneficiary SAME AS BEFORE

- If dies *before* Required Beginning Date, 5-Year Rule applies:
  - payments must be completed by December 31 of the year containing the fifth anniversary of the date of death.
- If dies *on or after* RBD:
  - payout over "ghost" life expectancy of deceased IRA account holder/plan participant.

The New RMD Rules

- At death of EDB or other cessation of EDB status, the 10-Year Rule kicks in, <u>even if EDB's successor beneficiary is an EDB at that time</u>.
  - So, you cannot "chain" EDB beneficiaries.
- At death of "Other" DB (Plain Old DB), distributions must be completed by end of original 10 year period.
- The 10-Year Rule operates like the 5-Year Rule. Even though the only "required" distribution is in the final year, the following options should exist:
  - 0% distributed in years 1-9, 100% distributed in year 10
  - 10% distributed for each of the 10 years

The New RMD Rules

- The SECURE Act rules will apply at the death of DBs of pre-2020 decedents, absent further guidance from Treasury.
  - Not clear what rule applies if there are multiple beneficiaries (e.g., accumulation trust) – does rule kick in at first beneficiary death? Oldest beneficiary death? After last beneficiary death?
  - There was a qualified disclaimer opportunity – surviving spouse of pre-2020 decedent disclaims to younger children. This opportunity expired on 9/30/2020.

The New RMD Rules

- Start date for RMDs moved from 70.5, to 72 for persons who attain 70.5 after December 31, 2019. Thus, first impacts those born on or after July 1, 1949.
- RMDs due in 2020 from defined contribution retirement plans and IRAs may be skipped per CARES Act, no need to double up in 2021
  - This includes people who turned 70.5 in 2019 and would normally have to take first RMD by April 1, 2020.

Eligible Designated Beneficiaries

Eligible Designated Beneficiaries

- EDBs, as outright designated beneficiaries, can use the Life Expectancy payout method.
- EDB status is determined as of the participant's date of death.
  - Note that this is different from the Beneficiary Finalization Date (September 30 of the year following the year of the participant's death.)

Eligible Designated Beneficiaries

- Spouse
- Minor child, until age of majority
  - Exception for full-time students up to age 26
- Beneficiary who is not more than 10 years younger than account holder
- Disabled/Chronically Ill Individual

Trusts as Beneficiaries Under the SECURE Act

Trusts as Beneficiaries

- SECURE Act does **not** change:
  - Definition of a see-through trust.
  - What a conduit trust is and how it works
    - "Automatic" see-through status; conduit beneficiary = sole beneficiary for IRA/plan RMD purposes.
  - What an accumulation trust is and how it works
    - Qualifies as see-through only if all beneficiaries (other than residuary beneficiaries ("mere potential successors")) are identifiable individuals as of beneficiary finalization date; all such beneficiaries are considered beneficiaries of the IRA.
    - Note – references to "accumulation trust" in this presentation assume multiple beneficiaries that include non-EDBs.

Trusts as Beneficiaries

- SECURE Act creates **different results** than were intended when the trusts were established:
  - Unless the beneficiary of a conduit trust is an EDB, the 10-Year Rule will apply at the account holder's death.
  - An accumulation trust loses the stretch, and the 10-Year Rule applies, unless it is set up to benefit disabled or chronically ill beneficiaries and meets other criteria.
    - Bigger tax hit because accumulated IRA distributions taxed at trust rates.
- In either event, if a trust is DB and 10-Year Rule applies, trust does not need to be terminated at the end of the 10-Year period, but distribution of IRA account must be complete.

Trusts as Beneficiaries

- Nevertheless, accumulation trusts will be favored in a post-SECURE Act world:
  - In the 10-year regime, keeping beneficiaries from the 10-Year accelerated income stream is desirable, as is
  - Being able to allocate funds to lower tax bracket beneficiaries, where possible.
- The ages of accumulation trust beneficiaries don't matter the way they did before.
  - However, for an accumulation trust to qualify as a DB all beneficiaries must be identifiable and non-individuals must be removed by the Beneficiary Finalization Date
    - If you miss DB status, you cannot use the 10-Year Rule

Trusts as Beneficiaries

- Don't forget path of least resistance – outright designation on IRA beneficiary form.
- Other options to preserve the stretch:
  - Conduit trust for surviving spouse
  - Conduit trust for minor child (age of majority/end of student status)
  - Conduit trust for less than 10 years younger DB
  - Conduit trust for a disabled/chronically ill EDB
- What won't work anymore to preserve the stretch
  - Accumulation trust for anyone other than a disabled/chronically ill EDB, where the trust meets Applicable Multi-Beneficiary Trust
  - criteria.
- Anything works if you are comfortable with the 10-Year Rule and tax consequences of same.

SECURE Act Changes Impacting Estate Planning

SECURE Act Impacts on Estate Planning

There are many, but key items are:

- IRAs that name Trusts as beneficiaries
  - Trust must qualify as a "see through" trust, but even then subject to the ten-year rule
  - Conduit Trust rules apply
  - With any non-eligible designated beneficiaries, ten-year rule applies to entire account, even if there are eligible designated beneficiaries
- Where surviving spouse may have disclaimed IRA assets to provide longer stretch out for younger beneficiaries
- Where there are charitable giving goals

Using Retirement Assets for Charitable Giving

Example of Prior Planning with Benefit of Stretch

- Settlor names children as beneficiaries of IRAs
- Children receive inherited IRA accounts; stretch provisions create RMDs based on life expectancy of child
- Continued tax-free growth for life of child
- Child can use inherited IRA as part of his or her own retirement planning (but no additional contributions)
- Settlor names charities in Trust to receive cash (% or $ amount) or certain assets upon death
- Pros and Cons to this plan?

New Planning Approach with Loss of Stretch

- Settlor names charities as beneficiaries of IRAs
- Charities remove all assets immediately with no tax consequence
- Child receives assets from Trust instead
- Pros and Cons to this plan?
  - No shortened stretch period
  - No income tax consequence
  - No long-term tax-free growth

Another Planning Approach – A CRT for your IRA

- Settlor creates CRT during lifetime; names CRT as beneficiary of IRAs
- Estate tax charitable deduction for projected value of charitable portion
- Children receive payout from CRT during trust term
- Children pay income tax on annual distributions
- Pros and Cons to this plan?
  - Payout percent is fixed by CRT, cannot be changed
  - 7520 Rate changes monthly; uncertain what gift amount will be
  - Can replicate "stretch" within CRT restrictions

Another Planning Approach – Charitable Distribution from IRA During Your Lifetime

- Also consider Qualified Charitable Distributions from an IRA. Not a stretch re-capture, but avoids income tax on RMDs up to $100,000.
- Beware, however – SECURE Act permits post-age 70.5 *contributions* to an IRA (from earned income), and the cumulative net deductions resulting from such contributions reduces the $100,000 annual limit on qualified charitable distributions (but not below zero).
  - Non-deductible IRA contributions do not reduce the QCD limit.
- Note: QCD age remains 70.5.

The 2020 Election – Changes Coming?

ELECTION 2020

The 2020 Election

Changes on the table if Biden wins

- Reduced gift and estate tax exemption
- Increased tax rates on amounts over exemption
- Elimination of the step-up in income tax basis

The 2020 Election

Reduced Gift and Estate Tax Exemption

Current

- $11.6 million per individual
- $23.2 million per married couple
- Unified credit – gifts may be made during lifetime

Proposed

- $3.5 million per individual
- $7 million per married couple
- Unified credit

The 2020 Election

Increased Tax Rates on Amount Over Exemption

Current

- Tax rate over this amount: 40%

Proposed

- Tax rate over this amount: 50-70%

The 2020 Election

Elimination of Step Up in Income Tax Basis

Current

- At death, all assets owned receive a full fair market basis
- Heirs may sell without any capital gains tax on decedent's pre-death appreciation
- Heir may hold and pay gains on future growth

Proposed

- No step up in basis at death
- Heir receives "carry over" basis
- Capital gains tax paid on sale
- Potential for tax to be paid on unrealized gains even without a sale

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