

DEALING WITH RETIREMENT ASSETS AFTER SECURE 2.0

The Tulsa Estate Planning Forum

Tulsa, Oklahoma – November 13, 2023

CHRISTOPHER R. HOYT

University of Missouri - Kansas City
School of Law

1

What Will Be Covered Today:

- Rules & planning for distributions from retirement accounts
 - Changes for the years 2023 & 2024 - SECURE 2.0
 - Inherited IRAs: Maximum years to liquidate
 - Tax advantages for a surviving spouse

2

REQUIRED MINIMUM DISTRIBUTIONS
***LIFETIME DISTRIBUTIONS – YEAR 2023**

<u>Age of Account Owner</u>	<u>Required Payout</u>
73	3.79%
75	4.07%
80	4.95%
85	6.25%
90	8.27%
95	11.24%
100	15.71%

3

25% Penalty
if Distribute Less Than RMD

Before 2023, the penalty had been a 50% penalty.

“SECURE 2.0” reduced the penalty to 25%.

And it is possible to have the penalty be as little as 10%.
 (e.g., the taxpayer voluntarily pays 10% before receiving an IRS notice)

4

2023 RETIREMENT PLAN LAW CHANGES

"SECURE ACT 2.0" – Dec. 29, 2022

- New RMD Age : 73 (75 in 2033) – up from 72 (and 70 ½)
(Despite new age 73, charitable QCD still at age 70 ½)
- High-payout annuity income can reduce RMD cash needed from other sources
 - Previously, payments from an IRA income annuity could not be used to satisfy the RMDs required from any of the owner's other IRAs.
 - Under SECURE 2.0, IRA income-annuity owners can now aggregate their income annuity with their other IRA accounts.
 - This permits IRA owners to satisfy their RMD solely with the annuity income, and permits them to invest their other IRAs in other investments (e.g., growth stocks that don't pay dividends)
 - Example: IRA Annuity \$500,000 and IRA growth-stock \$500,000
 - Annuity distributes \$42,000. Age 75 RMD: \$40,700 (4.07% x \$1 million)
 - No RMD required from the growth-stock IRA

5

2023 RETIREMENT PLAN LAW CHANGES

"SECURE ACT 2.0" – Dec. 29, 2022

- New RMD Age : 73 (75 in 2033) – up from 72 (and 70 ½)
(Despite new age 73, charitable QCD still at age 70 ½)
- High-payout annuity income can reduce RMD cash needed from other sources
- No RMDs from Roth 401(k) (to make same as Roth IRA rule) - effective 2024
- Employer **matching** contributions to Roth 401(k) can be after-tax,
(so distributions from the employer's Roth matching \$ can be tax-free after age 59 ½)
- Catch-up contributions: more \$ ages 60, 61, 62, & 63; after-tax if wealthy.
 - Whereas employees who have attained age 50 can add an extra \$7,500 to their 401(k) accounts, employees who are age 60, 61, 62, or 63 can add an extra \$10,000.
 - Beginning in 2026, workers who earn more than \$145,000 will have to put the catch-up money into a Roth 401(k) (i.e., they can't reduce taxable income by the catch-up).
- Money leftover in 529 accounts can be moved to a Roth IRA
(lifetime limit of \$35,000 per *beneficiary*; other restrictions on high-income T/P)

6

Money leftover in 529 accounts can be moved to a Roth IRA

A maximum of \$35,000 can be rolled over from a 529 plan to a **beneficiary's** Roth IRA (not to the Roth IRA of the 529 owner, if different from the beneficiary)

- Each year's maximum is that year's Roth IRA contribution cap (\$6,500 in 2023)
- Rollovers are not allowed until a 529 account has existed for at least 15 years
- Funds converted from a 529 plan to a Roth IRA must have been in the account for at least five years
- This law becomes effective in the year 2024

7

Stretch IRA

- "Stretch IRA" means an inherited retirement account (e.g., IRA), where payments are gradually made over the beneficiary's life expectancy
- Until the enactment of the SECURE Act, it was fairly easy for any beneficiary who inherited a retirement account to receive distributions until (at least) the age of 83 (older for beneficiaries who inherited at an older age)
- Beginning 2020: General rule is a ten-year liquidation

8

Distributions After Death

“life expectancy”

Oversimplified: Half of population will die before that age, and half will die after

9

Stretch IRA

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>	
30	83	53.3 more years
40	83	43.6
50	84	34.2
60	85	25.2
70	89	18.7
80	91	11.2
90	96	5.7

10

Why do people want a long stretch?

When administering a decedent's estate, isn't the usual objective to close the estate within a year of death and have everything distributed to the heirs and the beneficiaries?

11

Distributions from Inherited Retirement Accounts Are Taxable Income *Income In Respect of A Decedent "IRD" – §691*

- No stepped up basis for retirement assets
- Distributions from inherited retirement accounts are usually taxable income to the beneficiaries.

12

USUAL OBJECTIVE:
 Defer paying income taxes
 in order to get greater cash flow

	<u>Principal</u>	<u>10% Yield</u>
• Pre-Tax Amount	\$ 100,000	\$ 10,000
• Income Tax on Distribution (40%)	<u>40,000</u>	
• Amount Left to Invest	\$ 60,000	\$ 6,000

13

RETIREMENT PLANS SUBJECT TO THE LAW

- Section 401(a) - Employer pension, profit sharing and stock bonus plans [*incl. 401(k)*]
- Section 408 – IRAs
- Section 403(b) - School and charity employers
- Section 457(b) plans - Government and tax-exempt employers

14

REQUIRED MINIMUM DISTRIBUTIONS * DEFINITIONS *

- **Required Beginning Date (“RBD”)**
April 1 in year after attain age 73

15

Distributions After Death (for decedents who die in 2020 and later)

Maximum time period to empty account:

- **Ten years**

2022 Proposed Regulations – effective date: January 1, 2022

- Death **before** “required beginning date”? (e.g., before age 74)
 - No required distributions in the first nine years. The account needs to be empty by December 31 of the tenth year after the year of the decedent’s death, or else there is a 25% penalty on the balance.
- Death **after** “required beginning date”? (e.g., after age 73)
 - The proposed regs will require the beneficiary to receive minimum distributions every year in years 1 through 9, and the account must be empty at the end of the tenth year.
- **Failure to receive that year’s RMD triggers a 25% excise tax on the shortfall**

16

Distributions After Death (for decedents who die in 2020 and later)

These are only proposed regs. Some argue that the final regs should not require any RMDs until the tenth year. Legislative intent.

July 2023: IRS announced it will NOT apply the 50%/25% penalties to RMDs in years 2021, 2022 or 2023 for accounts of individuals who died after 2019. IRS Notice 2023-54 (July 14, 2023).

-- Exemption only applies to non-eligible designated beneficiaries (this term will be defined in a few minutes)

-- Eligible designated beneficiaries ("EDBs") **are** required to receive RMDs in 2021, 2022 & 2023.

- Death **before** "required beginning date"? (e.g., before age 74)
 - No required distributions in the first nine years. The account needs to be empty by December 31 of the tenth year after the year of the decedent's death, or else there is a 25% penalty on the balance.
- Death **after** "required beginning date"? (e.g., after age 73)
 - The proposed regs will require the beneficiary to receive minimum distributions every year in years 1 through 9, and the account must be empty at the end of the tenth year.
- **Failure to receive that year's RMD triggers a 25% excise tax on the shortfall**

17

Distributions After Death (for decedents who die in 2020 and later)

Maximum time period to empty account:

- **Ten years** (*No RMD until year #10), or*
- **Remaining life expectancy of an "eligible designated beneficiary"** (*RMD every year*)
 - *surviving spouse* -- *minor child of the decedent*
 - *disabled individual* -- *chronically ill person*
 - *beneficiary within 10 years of age of decedent*

18

LIQUIDATE INHERITED IRAs IN TEN YEARS

EXCEPTION: “Eligible Designated Beneficiary”

- *surviving spouse* -- *minor child of the decedent*
- *disabled individual* -- *chronically ill person*
- *beneficiary within 10 years of age of decedent*

An ***eligible*** designated beneficiary may take distributions over her/his life expectancy *

- * When minor child attains majority, 10 year clock starts
- * When an EDB dies, 10 year clock starts for successor

19

MANDATORY DISTRIBUTIONS

[Assume sister inherits IRA at age 80 and dies at 94]

- ☐ D. John Mustard died this year at age 85.
- ☐ He named his sister, Honey (age 80 this year) as the beneficiary of 50% of the IRA.
- ☐ He named his two children as beneficiaries of the other 50% (25% apiece). The children are ages 50 and 52.

20

MANDATORY DISTRIBUTIONS

[Assume inherit IRA at age 80 and die at 94]

AGE

80

IRA Owner's RMD in the year of death*Prop. Reg. § 1.402(c)-2(j)(3)*

- **If the deceased owner had not withdrawn the entire RMD before the date of death, then the balance must be distributed to *the beneficiary of the IRA that year.***
- *[Proposed Regs have a grace period if full distribution wasn't taken in year of death: beneficiary can receive next year before beneficiary's tax return filing deadline and avoid 25% penalty. Prop Reg § 54.4974-1(g)(3)]*

21

Case study: IRA payable
50% to sister and 50% to children

- What are required distributions in years after death?
- Problem when some beneficiaries are EDBs and others are not EDBs:
 - the EDB may have to receive all assets in just ten years rather than over the longer time period of the EDB's remaining life expectancy.

22

MANDATORY DISTRIBUTIONS

[Assume inherit IRA at age 80 and die at 94]

<u>AGE</u>	<u>Sister</u>	
81	Are there any distributions required between age 81 and age 90? Proposed Regs:	As an EDB, the general rule is that the sister can receive distributions over her remaining life expectancy, rather than just over 10 years. Does that rule apply here? NO!
85	Yes. There is an RMD every year	
90	100.00%	
91	empty	
92	empty /	

23

Prop. Reg. §1.401(a)(9)-5(d)(1) (2022)

Required minimum distributions from defined contribution plans.

EXPLANATION FROM THE PREAMBLE TO THE REGS:

“For example, if an employee died ***after the required beginning date*** with a designated beneficiary who is not an eligible designated beneficiary, then the designated beneficiary would continue to have required minimum distributions calculated using the ***beneficiary's*** life expectancy as under the existing regulations **for up to nine calendar years after the employee's death**. In the tenth year following the calendar year of the employee's death, a full distribution of the employee's remaining interest would be required.”

But would this rule apply to Honey? Honey is less than 10 years younger than D. John. So, Honey is an “eligible designated

24

Prop. Reg. §1.401(a)(9)-5(d)(1) (2022)

Required minimum distributions from defined contribution plans.

EXPLANATION FROM THE PREAMBLE TO THE REGS:

“these proposed regulations provide a general rule under which, if an employee has more than one designated beneficiary, and at least one of them is not an eligible designated beneficiary, then for purposes of section 401(a)(9), the employee is treated as not having an *eligible* designated beneficiary. As a result, the employee's interest must be distributed no later than the end of the tenth calendar year following the calendar year of the employee's death.”

Sorry, Honey! D. John's adult children are also considered.
So these payout rules *will* apply to you.

25

OBSERVE: If the beneficiary had been a surviving spouse (instead of a sister), then the surviving spouse could do a rollover to that spouse's own IRA to avoid a 10-year liquidation.

26

MANDATORY DISTRIBUTIONS

[Assume inherit IRA at age 80 and die at 94]

What is the minimum amount that must be distributed each year?

<u>AGE</u>	<u>Sister</u>		<u>AGE</u>	<u>Life Expectancy</u>
81	-0- % ??	.	80	11.2 years
85	-0- % ??	.	81	10.5 years
90	100.00% << 10 years%		82	9.9 years
91	empty		83	9.2 years
92	empty	.		

27

<u>AGE</u>	<u>Sister</u>	<u>AGE</u>	<u>RMD %</u>
	Age 81: $1/10.5 = 9.5\%$	81	9.5%
	Age 82: $1/ 9.5 = 10.5\%$	82	10.5%
	Age 83: $1/ 8.5 = 11.8\%$	83	11.8%
81	9.5%	84	13.3%
	15.4%	85	15.4%
		86	18.2%
90	100.0%	87	22.2%
91	empty	88	28.6%
92	empty	89	40.0%
		90	100.0%

28

Distributions After Death

(for decedents who die in 2020 and later)

Maximum time period to empty account:

- **Ten years** *(No RMD until year #10), or*
- **Remaining life expectancy of an “eligible designated beneficiary”, or**
- **Five Years, or**
- **“Ghost life expectancy”**

29

REQUIRED MINIMUM DISTRIBUTIONS

Ghost Life Expectancy

<u>Age of Beneficiary</u>	<u>Life Expectancy</u>
74	15.6 more years
75	14.8
76	14.0
77	13.3
78	12.6
78	11.9
80	11.2

30

Distributions After Death

(for decedents who die in 2020 and later)

Maximum time period to empty account:

- Ten years, *or*
 - Remaining life expectancy of an ***“eligible designated beneficiary”***, *or*
 - Five Years, *or*
 - ***“Ghost life expectancy”***
- If on “determination date”,
EVERY beneficiary is a human being
(designated beneficiary)

←

↪

←

↪

31

REQUIRED MINIMUM DISTRIBUTIONS

* DEFINITIONS *

- **Required Beginning Date (“RBD”)**
 April 1 in year after attain age 73
- **Designated Beneficiary (“DB”)**
A human being. An **estate** or **charity** can be a beneficiary of an account, **but not a DB.**
- **Determination Date**
 September 30 in **year after death.**

32

ACTIONS THAT CAN BE TAKEN BEFORE THE DETERMINATION DATE

- Disclaimers
- Full distribution of share
- Divide into separate accounts

For example, separate accounts when:

- one beneficiary is an EDB and another is not
- one beneficiary is a charity & can't pay by 9/30

33

MARRIED COUPLES: RETIREMENT ASSETS

Surviving spouse has an option that no other beneficiary has:

a **rollover** of deceased spouse's retirement assets to her or his own new IRA

(creditor protection, too!)

Other beneficiaries cannot do a rollover.

Main option: liquidate over ten years

34

LEAVE \$ IN DECEASED SPOUSES' ACCOUNT?

- Generally, a rollover produces greater income tax deferral than leaving assets in the decedent's account
- One situation when it may be advisable to leave some assets in the decedent's account (at least for a while)
 - Surviving spouse is under age 59 ½

35

LEAVE \$ IN DECEDENT'S ACCOUNT?

Required Distributions if the
Surviving Spouse is the Sole Beneficiary

- Spouse is an EDB – more than ten-year payout
- Spouse can recalculate life expectancy
- IRAs only: Spouse can elect to treat IRA as her own
- Deceased spouse died before age 73 ?
 - No required distribution to the surviving spouse until year the deceased spouse would have been age 73
- NEW: Surviving spouse may elect to be treated as the deceased spouse for purposes of the RMD rules (2024)
 - Tax advantage if younger spouse dies:
 - -- smaller RMDs based on the younger spouse's age?

36