SECURE Act Planning Considerations and Opportunities

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As a result of the Tax Cuts and Jobs Act of 2017 (TCJA) the estate, gift and generation skipping transfer (GST) tax exemption amounts increased to approximately $11.18 million per person (approximately $22.36 million for a married couple). For assets transfers in excess of the applicable exemption amount and otherwise subject to such taxes, the highest applicable federal tax rate remains at 40 percent. While the exemption amounts are indexed for inflation, current law provides for an automatic sunset of these increased exemption amounts after 2025. As a result, the exemption amounts available in 2026 and beyond could be reduced to a level provided under prior law ($5.49 million/single and $10.98 million/couple in 2017, indexed for inflation) absent further action by Congress. In addition, under different rates, rules and exemption amounts (if any), there may be state and local estate, inheritance or gift taxes that apply in your circumstances.

Before rolling over the proceeds of your retirement plan to an Individual Retirement Account (IRA) or annuity, consider whether you would benefit from other possible options such as leaving the funds in your existing plan or transferring them into a new employer's plan. You should consider the specific terms and rules that relate to each option including: the available investment options, applicable fees and expenses, the services offered, the withdrawal options, the potential flexibility around taking IRS required minimum distributions from the option, tax consequences of withdrawals and of removing shares of employer stock from your plan, possible protection from creditors and legal judgments and your unique situation.

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SECURE Act – Where Things (Currently) Stand

- **SECURE (Setting Every Community Up for Retirement) Act—House Version**
  - Passed House 417-3 on May 23, 2019
- **RESA (Retirement Enhancement and Savings Act)—Senate Version**
  - Hope that bill would pass via unanimous consent before August recess
  - Possibly will be attached to spending bill

Effective Date

- **Effective Date (currently) is December 31, 2019**
  - Applies to beneficiaries of plans for participants who die after this date
    - No indication of whether a retroactive effective date would apply to legislation passed next year, but be aware of issue
  - Plans under collective bargaining agreements and governmental plans have effective date of December 31, 2021

SECURE Act

- **Primary Purpose of Legislation**
  - Notable reforms in the retirement planning space, including recognition that retirement plans are not intended to be wealth transfer vehicles
- **Prospects for Passage**
  - Senate Finance voted 26-0 on RESA
  - Conflicting provisions should offer minimal pushback (mostly procedural)
  - Revenue neutral

Stretch IRAs

- **Under current law, IRA assets can be distributed from tax-deferred account based on the life expectancy of the beneficiary**
  - Single Life Table (IRS Pub. 590-B)
- **Of course, beneficiary can choose to take excess distributions**
  - All distributions are taxable
  - No 10% penalty

End of Stretch IRAs

- **Limit 'Stretch' IRA planning for beneficiaries of IRAs and Qualified Plans**
  - SECURE version – 10 years
  - RESA version – 5 years
    - Exclusion from limit of $450K (now $400K)
      - Per IRA owner, or per beneficiary?
  - House version (SECURE) may prevail in light of limited legislative activity

End of Stretch IRAs

- **Exceptions to Withdrawal Period Rules**
  - Spousal beneficiaries;
  - Disabled and chronically ill beneficiaries
  - Minor children of the employee (while they are minors – so rule becomes 'up to' 28 years)
  - Beneficiaries who are not more than 10 years younger than participant
- **Once such exception beneficiary passes, ten year rule applies in all events**

End of Stretch IRAs

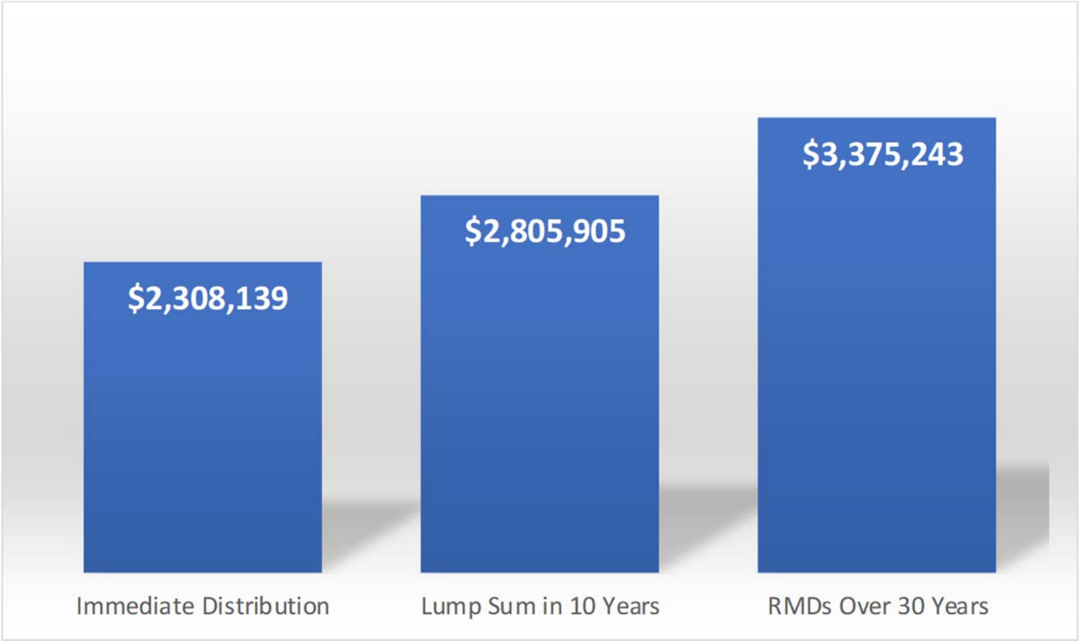
- **Exceptions to Withdrawal Period Rules**
  - Once such exception beneficiary passes, ten year rule applies in all events
  - Do RMDs continue to apply during such ten year period?
    - Would appear not, but unclear
  - Time for determining status of eligibility is as of employee's death
  - Also, qualified annuities remain subject to contractual terms if irrevocable election has been made prior to effective date

How Significant is This Change?

- **Depends on who you ask**
  - How large are the plans?
  - How valuable is the income tax deferral?
  - Would beneficiaries otherwise take maximum advantage of deferral?
  - How many IRA owners currently or will consider using trusts to maximize deferral?

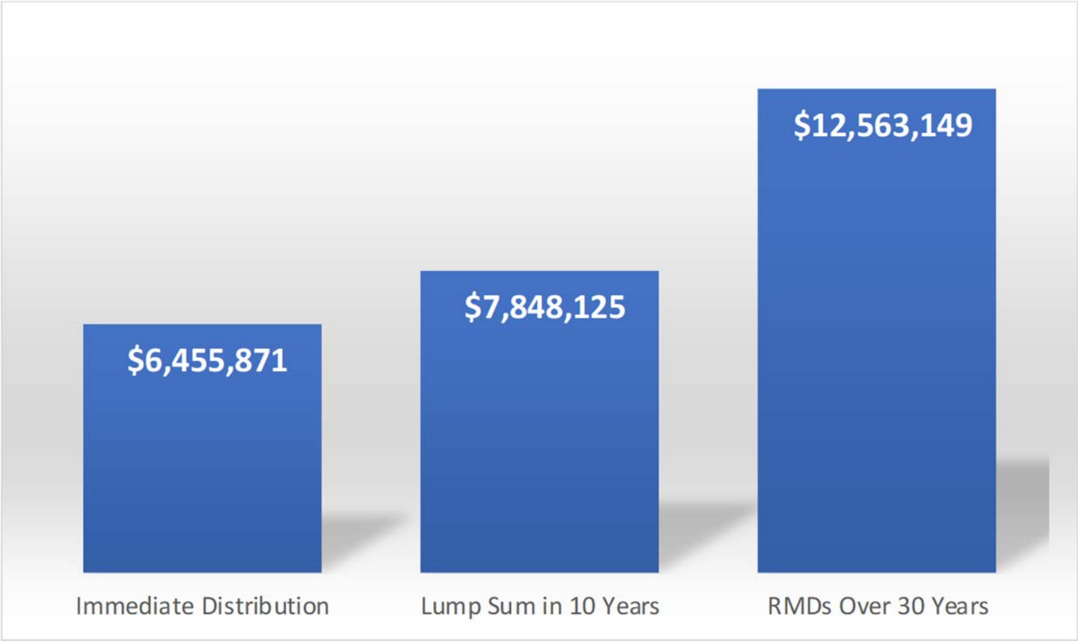
Impact of Tax Deferral Can be Significant

- **Assumptions: $1M IRA, 6% pre-tax growth, 30% tax rate**
  - Net After-Tax to Beneficiary (Age 40) in 30 Years



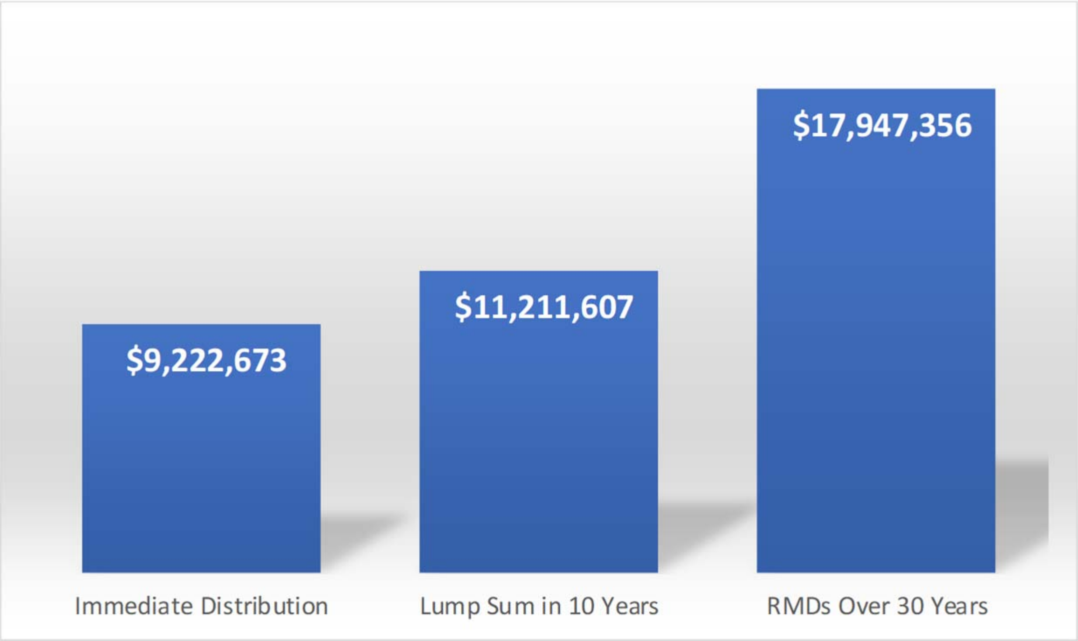
Impact of Tax Deferral Can be Significant

- **Assumptions: $1M IRA, 6% pre-tax growth, 30% tax rate**
  - Net After-Tax to Beneficiary (Age 10) in 55 Years



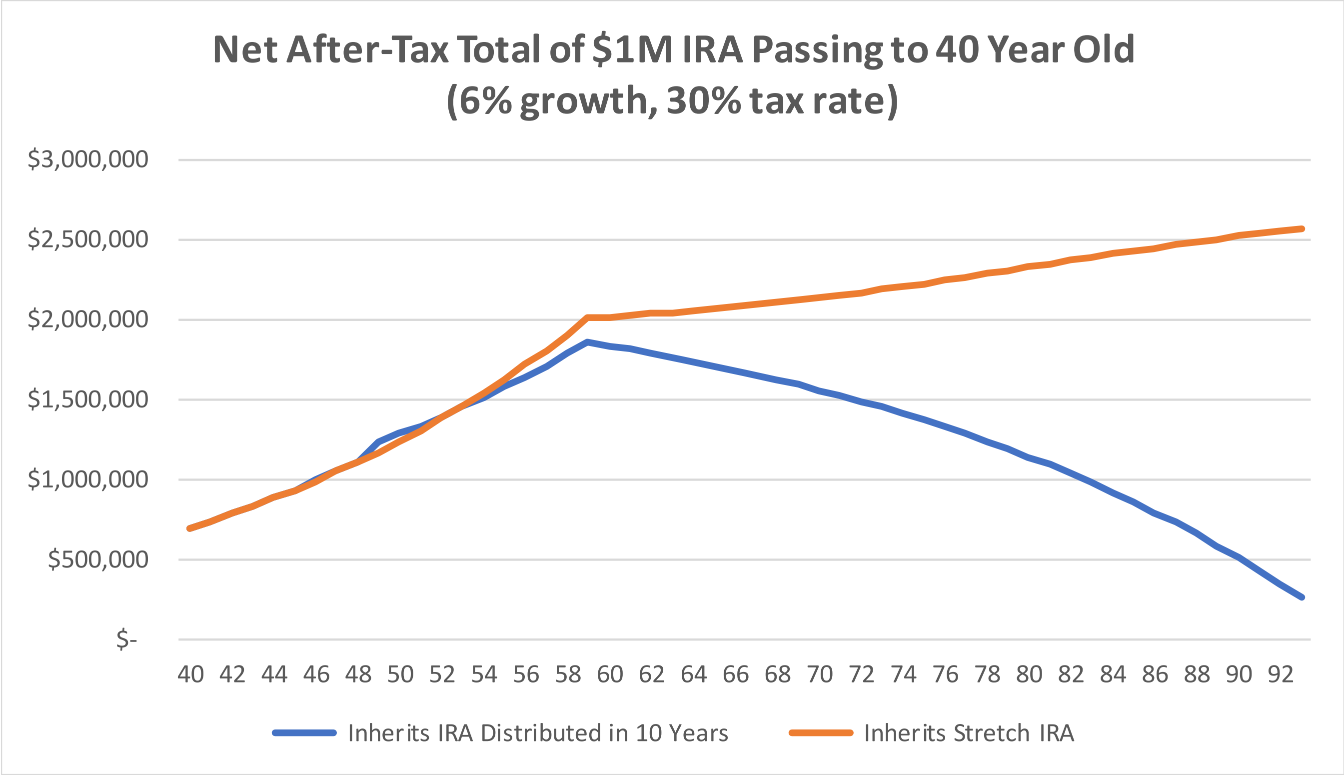
Impacts Qualified Plans and Roth IRAs as Well

- **Assumptions: $1M Roth IRA, 6% pre-tax growth, 30% tax rate**
  - Net After-Tax to Beneficiary (Age 10) in 55 Years



Impact of Consumption in Retirement

- **Assumes $100K annual spending after tax starting age 60**



Planning Considerations—Marginal Tax Rate on Distributions

- **Impact of Distributions on Beneficiary's Marginal Income Tax Rate**
  - Would it make sense to take distributions up to the marginal bracket versus deferring and subjecting larger later distributions to a higher marginal rate?
  - I.e., compare gradual distributions over 10 years to lump sum in year 10

Marginal Income Tax Rate Impact

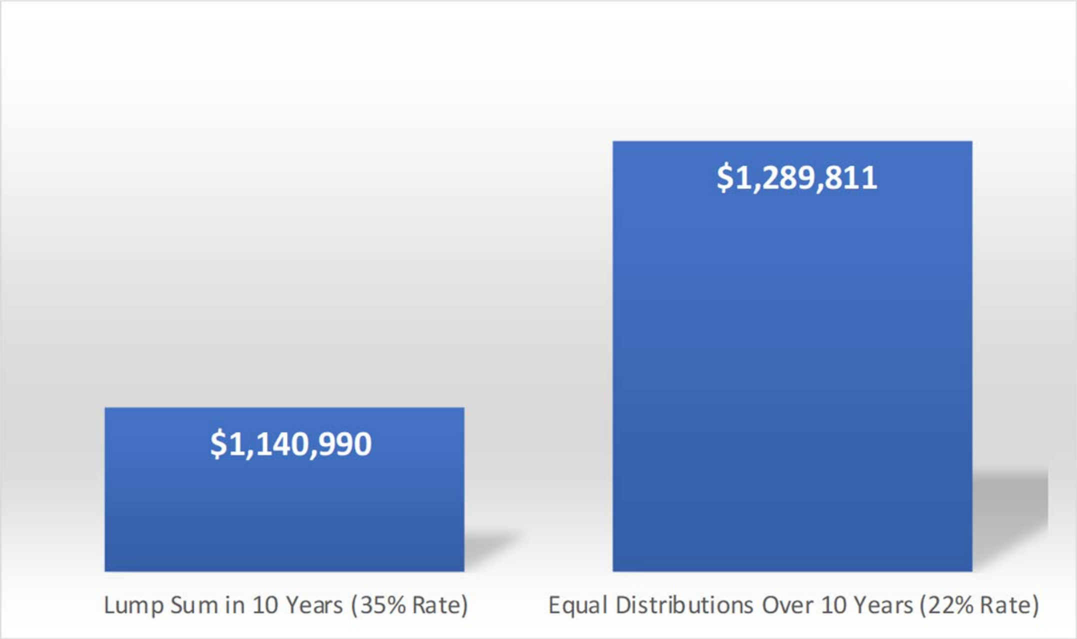
- **Federal Brackets (2019)**

SINGLE TAXPAYER RATES				
Taxable Income		Tax before Credits		
Over	But not over	Flat amount	+%	Of excess over
$ 0	$ 9,700	$ 0	10%	$ 0
9,700	39,475	970.00	12%	9,700
39,475	84,200	4,543.00	22%	39,475
84,200	160,725	14,382.50	24%	84,200
160,725	204,100	32,748.50	32%	160,725
204,100	510,300	46,628.50	35%	204,100
510,300	——	153,798.50	37%	510,300

MARRIED FILING JOINTLY RATES				
Taxable Income		Tax before Credits		
Over	But not over	Flat amount	+%	Of excess over
$ 0	$ 19,400	$ 0	10%	$ 0
19,400	78,950	1,940.00	12%	19,400
78,950	168,400	9,086.00	22%	78,950
168,400	321,450	28,765.00	24%	168,400
321,450	408,200	65,497.00	32%	321,450
408,200	612,350	93,257.00	35%	408,200
612,350	——	164,709.50	37%	612,350

Marginal Income Tax Rate Impact

- **Assumptions: $1M IRA, 6% pre-tax growth,**
  - Net After-Tax in Year 10 (Lump Sum/35% Rate) vs. Equal Distributions (Over 10 years/22% Rate)



Marginal Income Tax Rate Impact

- **What About State Rates?**
  - At least in Oklahoma, not likely a big factor, but perhaps in other states with a progressive structure
- **Impact of Higher AGI on Beneficiary**
  - Exceeding certain thresholds can impact:
    - Eligibility and amount of 199A QBI deduction
    - Net Investment Income Tax (3.8%) on investment income

Marginal Income Tax Rate Impact

- **Also, Don't Forget About Potential Sunset of 2017 Tax Act in 2026**
  - Top federal rate reverts to 39.6%
  - All brackets and rates increase
- **Outcome of Elections**
  - Some candidates are proposing significant increases to income tax rates, especially at the highest brackets and income levels

Planning Considerations—Spousal Beneficiary

- **Two Options Currently Available to Spousal Beneficiary are NOT Impacted:**
  - Rollover
    - Spouse becomes IRA participant
    - Delays RMDs until spouse's RBD
  - Inherited IRA
    - Spouse's age used to determine RMD
    - RMDs continue to be based on such schedule when passing at spouse's death

Planning Considerations—Creditor Protection

- **IRA Owner can claim protection under state exemptions**
  - Spousal rollover makes spouse IRA owner
  - Non-spouse beneficiaries generally will not enjoy creditor protection under recent jurisprudence

Planning Considerations—Trusts as Beneficiary of Plan/Account

- **In order to assure stretch planning is utilized, many clients may name a testamentary trust as beneficiary of the IRA**
  - To use beneficiary's age for RMDs, Trust must qualify as a "Designated Beneficiary":
    - Trust must be valid under state law
    - Beneficiary must identifiable for purposes of ascertaining age for RMDs (includes all potential remainder beneficiaries
  - Absent qualification as Designated Beneficiary, plan must be distributed over 5 years

Planning Considerations—Trusts as Beneficiary of Plan/Account

- **Conduit versus Accumulation Trusts**
  - Conduit Trust
    - Distributes all RMDs to beneficiary of trust directly
  - Accumulation Trust
    - Permits accumulation of RMDs in Trust
  - Conduit Trusts seem to be more common:
    - Assures income taxation of RMDs at beneficiary's tax rate (may be considerably lower)
    - Avoids failure of trust as designated beneficiary due impermissible remainder beneficiaries

Planning Considerations—Trusts as Beneficiary of Plan/Account

- **Trusts That Can Be Amended**
  - Consider modification of conduit verbiage that forces out all plan distributions to beneficiary **(though be aware of steeply graduated tax rates to trusts)**
    - Contrast potential distributions (Age 40 bene):

Year	IRA Value	Distributions
1	$ 1,000,000	$ 23,419.20
2	$ 1,035,176	$ 24,824.36
3	$ 1,070,972	$ 26,313.82
4	$ 1,107,338	$ 27,822.56
5	$ 1,144,286	$ 29,491.92
6	$ 1,181,682	$ 31,178.95
7	$ 1,219,533	$ 32,960.36
8	$ 1,257,767	$ 34,937.98
9	$ 1,296,199	$ 36,928.75
10	**$ 1,334,827**	$ 39,030.02

Planning Considerations—Trusts as Beneficiary of Plan/Account

- **Trusts That Can't Be Amended**
  - Decant where possible
  - Consider state law reformation

Trusts as Beneficiary and Exception to 10 Year Rule—Spouse

- **Trust FBO Spouse**
  - Common for 2nd marriages or for asset management purposes
  - QTIP might be able to use spouse's age for RMDs (continuing to remainder beneficiaries
  - Conduit trust with multiple beneficiaries (i.e., spouse and children) will require 10 year payout

Trusts as Beneficiary and Exception to 10 Year Rule—Minors

- **Trusts FBO Minor Children**
  - Review to ensure that maximum stretch can be employed—minor children can continue to rely on traditional RMD schedule until reaching age 18, at which point 10 year rule applies
    - Common pot trusts for minors are common, but oldest beneficiary will become measuring life for purposes of RMDs
    - Consider separate share trusts for each beneficiary, and specific beneficiary designation of each separate trust

Trusts as Beneficiary and Exception to 10 Year Rule—Disabled

- **Trusts FBO Disabled**
  - Disabled generally provided assets via Special Needs Trust (SNT)
    - Such trusts are by definition accumulation trusts
    - Remainder beneficiaries therefore considered for RMD purposes,
    - Consider separate share trusts for each beneficiary, and specific beneficiary designation of each separate trust

Planning Considerations—Roth Conversions

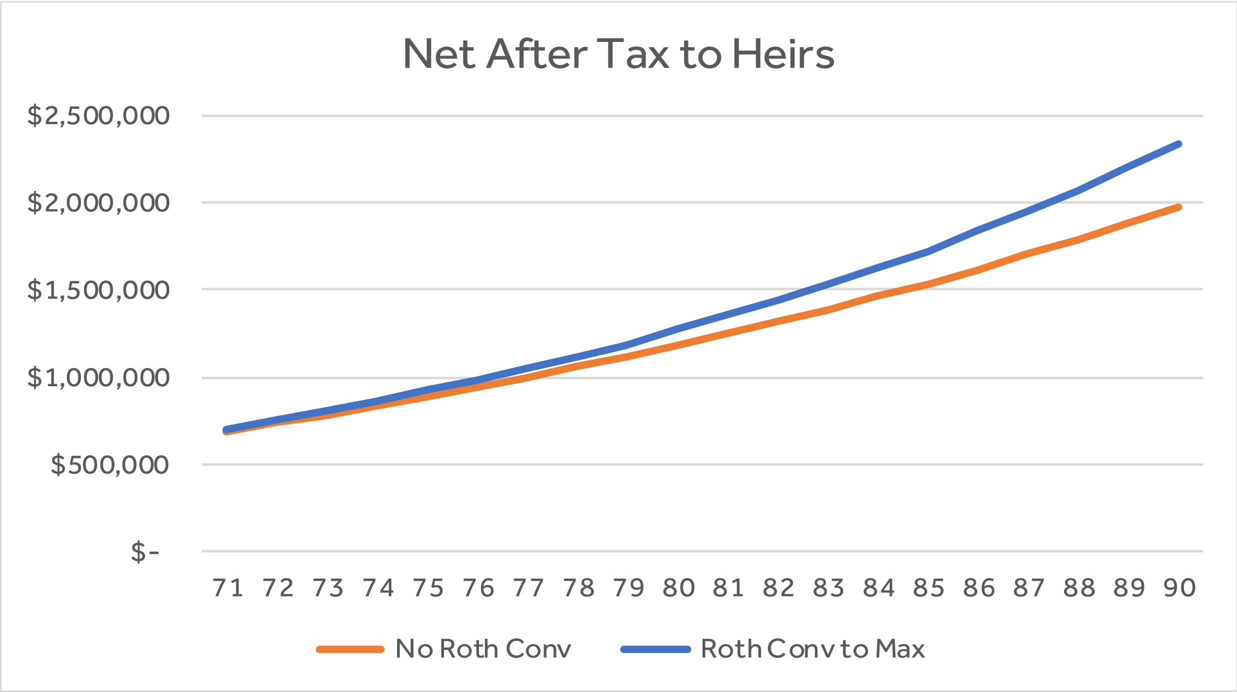
- **Roth Conversions May Take on Greater Importance for IRAs Intended as Wealth Transfer Vehicle**
  - Especially true if effective marginal bracket can be properly managed during conversion
    - Remember: pay taxes on conversion with assets currently outside of plan (i.e., non-qualified funds) in order to maximize balance in Roth that accumulates income tax-free
  - Roth conversions offer ability to get bigger bang for buck on tax deferral

Planning Considerations—Roth Conversions

- **Roth Conversions May Take on Greater Importance for IRAs Intended as Wealth Transfer Vehicle**
  - Conversion by spousal beneficiary (perhaps through life insurance to pay income taxes on conversion) may also make sense
  - Ability to avoid income taxation in the future also acts as guard against future changes in the law resulting in higher tax rates

Planning Considerations—Roth Conversions

- **Roth Conversion Example:**
  - IRA Owner Age 71, $1M IRA, 6% pre-tax growth, $100K AGI (assumes sunset)



Planning Considerations—Charitable Planning

- **Qualified Charitable Distributions**
  - Offers dollar for dollar deduction benefit, counts towards RMD (of participant), prevents distribution from increasing AGI
  - Can a beneficiary use a QCD too?
    - Yes! – Per IRS Notice 2007-7, Q&A-37, they can so long as they are over age 70 ½
- **Charitable Beneficiary at Death**
  - Avoid all taxation on balance
  - Replace with life insurance

Planning Considerations—Charitable Planning

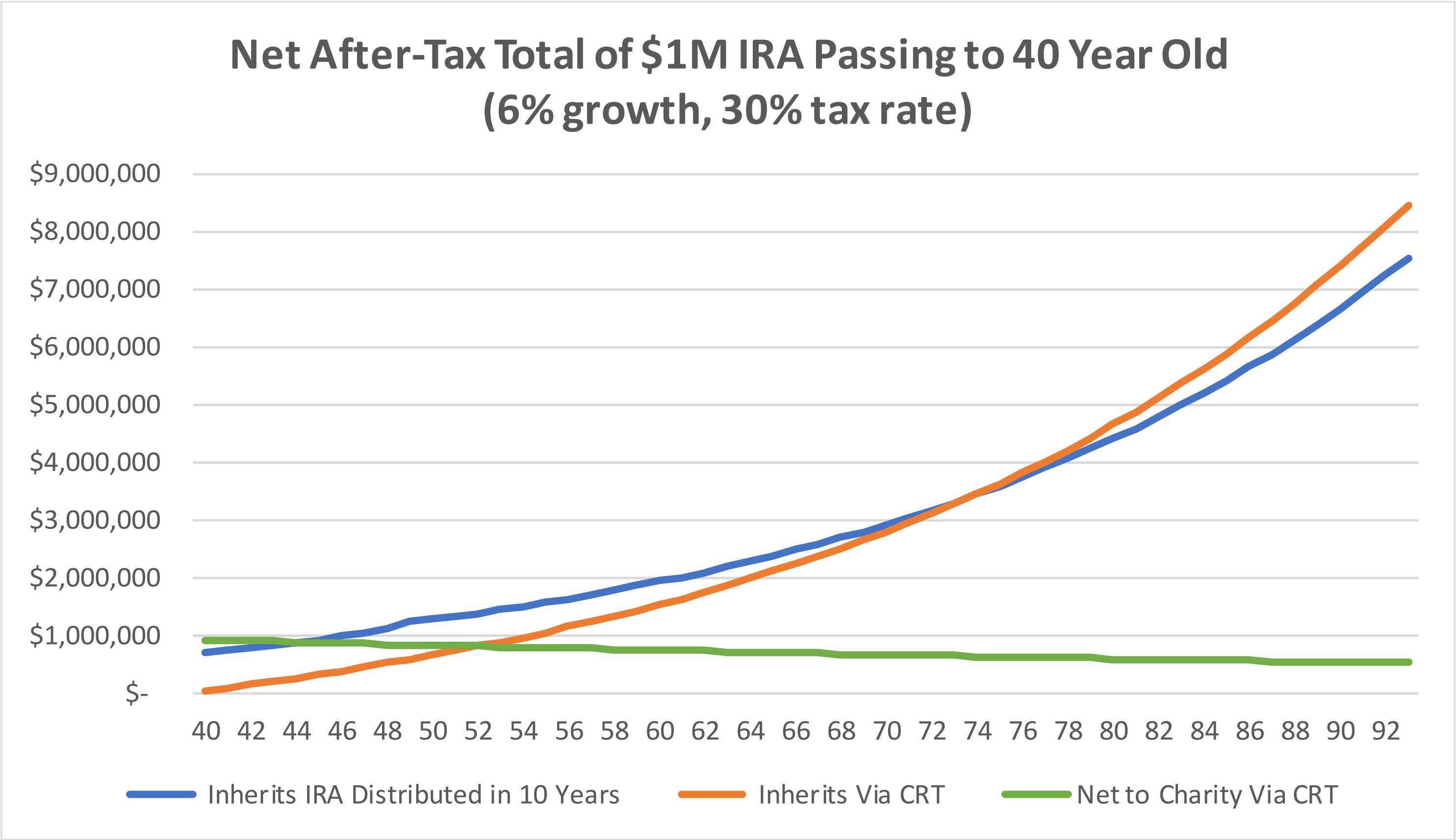
- **Name Charitable Remainder Trust (CRT) as Beneficiary**
  - Offers ability to maintain synthetic tax-deferral of account and limit taxable distributions
  - Charitable intent is key, as remainder passes to charitable entity at death

CRT as Beneficiary

- **Typically utilize a Charitable Remainder Unitrust in order to use life only CRUT**
  - Especially in current interest rate environment
  - Examples:
    - $1M IRA to 40 year old (distribution in 10 years) vs to life-only CRUT
    - 6% growth, 30% tax rate
    - CRUT payout = 7.702% based on 2.20% 7520 rate (September)

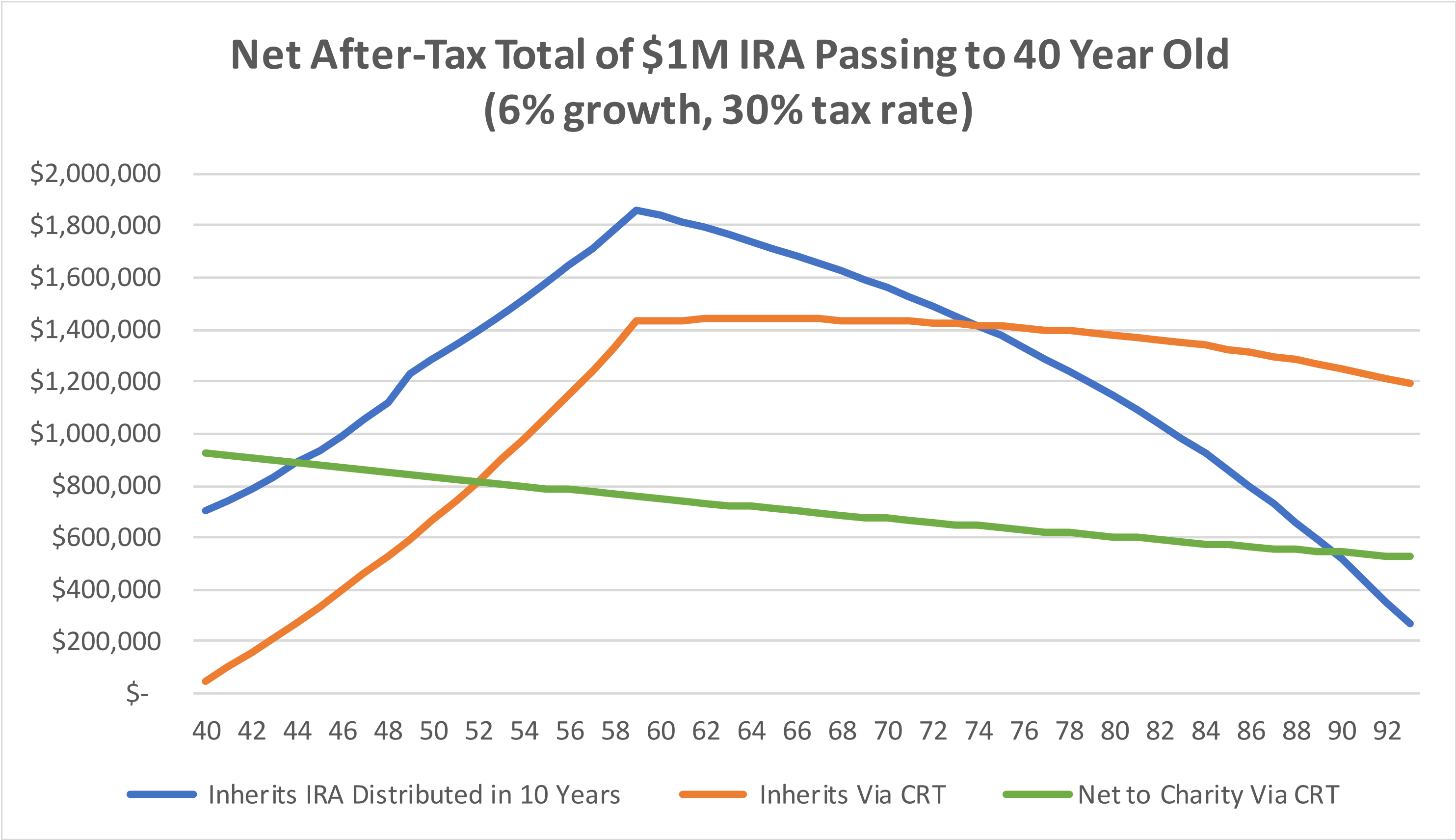
CRT as Beneficiary

- **Accumulate After Tax Proceeds**



CRT as Beneficiary

- **Include Annual $100K spending at age 60**



Planning Considerations—Life Insurance

- **Roth Conversions**
  - In Anticipation of Death
  - FBO Spouse for Conversion post Rollover
- **Income Taxes**
  - Cover Potential Liability FBO Beneficiary
  - Reallocation of IRA funds up to marginal bracket
- **Charitable Planning**
  - Income Tax-Free Wealth Replacement for Bequest

SECURE Act—Other Provisions

- **Change to RBD for RMDs for Account Owners**
  - Changed from Age 70½ to Age 72
- **Expand Eligibility of 529 Plans for Certain Expenditures**
  - Student loans and apprenticeship programs
  - House amendment eliminated initially broad categories of expenditures

SECURE Act—Other Provisions

- **Expanded Access to Multi-Employer Plans**
  - Make available to businesses in unrelated industries
  - Improved protection for employers where another party breaches a fiduciary duty
- **Tax Credits**
  - $5,000 for start up costs to employer sponsors
- **Plan Participation Rules**
  - Employees working more than 500 hours cannot be excluded (increasing from 1000 hours)

SECURE Act—Other Provisions

- **Safe-Harbor Provisions for Annuity Purchases**
  - Annuities may not be widely available due to fiduciary concerns over selection of provider
  - Safe harbor rules to encourage increased use of such products
- **IRA Contributions Beyond Age 70 ½**
  - Contributions can be made at any age
  - RMDs continue to apply