ESTATE PLANNING ADVISOR

The SECURE Act Changes

Retirement Rules

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On December 20, 2019, Congress passed, and the President signed an appropriations bill (Public Law No. 116-94) that contained the SECURE Act. The word SECURE is an acronym for “Setting Every Community Up for Retirement Enhancement.” The Act fundamentally changes estate planning related to retirement accounts.
Contributing to a Traditional IRA, 401(k), 403(b) or 457 retirement plan allows you to save money for retirement without paying income taxes on the funds contributed or on the income generated by the account. You only pay income tax when you take distributions. Contributing to a Roth IRA or Roth 401(k) does not shield the contribution from income tax but allows the account to grow tax-free, and you do not pay any income tax upon receiving distributions. Federal law requires you to begin taking minimum distributions annually starting at retirement age for all retirement plans except Roth IRAs.
Prior to 2020, the law required minimum distributions to start at age 70½. You could not contribute to a retirement plan after reaching this retirement age. You had to work at least 1000 hours in a year to contribute to an employer’s retirement plan. You could not take distributions from a retirement plan for the birth or adoption of a child without paying a 10% penalty and the income tax due. A business had to set up a retirement plan by December 31st for employees to make contributions during that year. If you died before retirement age and you named a person to receive your retirement plan, the designated beneficiary could take distributions over his or her life expectancy. The life expectancy period came from the IRS Uniform Lifetime Table for the employee (“the participant”) and the participant’s spouse or from the Single Lifetime Table for the participant’s non-spouse beneficiaries. If you died after the required beginning date, your designated beneficiary could take distributions over your remaining “ghost” life expectancy under the Uniform Lifetime Table. These rules remained unchanged from 2001 to 2019.
Now, with the enactment of the SECURE Act, required minimum distributions don’t have to start until age 72. For example, if you turn 70 in 2020, you do not have to take a required minimum distribution yet. You can now contribute to a retirement plan at any age. Congress recognized that people live much longer so making retirement contributions in your 70’s could help you in your 90’s.
Under the SECURE Act, you can now contribute to an employer’s retirement plan as a part-time employee. If you only work 500 hours or more for 3 consecutive years, you can participate in an employer retirement plan. Employers also have more time to set up a retirement plan. An employer can now set up a retirement plan before its income tax return is due (including extensions).
If you need additional funds at the time of the birth or adoption of a child, you can now tap up to $5,000 of your retirement plan without incurring a penalty. You still must pay the income tax due on the distribution. You must tap the retirement plan within 1 year of the birth or adoption.
The end of the stretch IRA for non-spouse beneficiaries constitutes the greatest change for estate planning purposes. Except for eligible designated beneficiaries, the retirement plan custodian must distribute the entire retirement plan to a non-spouse beneficiary within 10 years of the participant’s death. This may have a big impact on children who are in their prime earning years and don’t yet need the additional income from an inherited retirement plan. A child may now have to take all the distributions during the child’s prime working years, rather than stretching the payments out over the child’s retirement years when the child is likely in a lower tax bracket. For instance, if a decedent had a $500,000 IRA at her death and she leaves it to her only child, the child must take the entire $500,000 within 10 years. The child will pay tax on the distribution(s) at the child’s income tax rate. Thus, if a child is in the 24%
529 Education Plans Get A Boost
The SECURE Act also expanded Section 529 Plans. Grandparents and parents often use 529 Plans to fund a child’s college or graduate school education. Funds contributed incur no gift tax and grow tax-free. Students incur no income tax if they use distributions for qualified education expenses, including up to $10,000 of tuition for private, pre-college education. The Act expanded 529 Plans by allowing distributions to repay education loans up to $10,000 for the designated beneficiary or his or her sibling. It also expanded the education programs to include homeschooling and apprenticeship programs.
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income tax bracket, the child will pay $125,000 in income taxes.
Eligible designated beneficiaries include spouses, beneficiaries who are less than 10 years younger, children of the participant who have not reached age 18 and disabled or chronically ill beneficiaries. If you leave your retirement plan to your spouse, your spouse can still roll over an IRA to his or her own IRA and wait until he or she reaches age 72 to take distributions over his or her life expectancy. If you leave a retirement plan to your spouse in a trust that requires payment of the required minimum distribution, the trust does not have to begin making required minimum distributions until your spouse reaches age 72 and the distributions, thereafter, will be
based on his or her life expectancy. When the spouse dies, however, the distributions to children must be paid over 10 years.
Beneficiaries who are less than 10 years younger than the participant continue to be able to take required minimum distribution over their life expectancy. For unmarried couples, it allows the survivor to use the retirement funds for the rest of his or her life.
Leaving a retirement plan to children under age 18 will not require distribution within 10 years if they are your children. Instead, the 10-year period will not start running until they reach age 18. If you leave a retirement plan to your grandchildren, however, your grandchild will receive the entire retirement account balance within 10 years. Let’s say you have a grandson who is age 3. If you leave $50,000 of your IRA to your grandson, the probate court will have to appoint a guardian for your grandson and all the funds must come out by December 31st of the year he reaches age 13. Giving the retirement plan distribution in trust to your grandson will avoid the appointment of a guardian by a court, but it will not delay distribution of the entire amount to the Trustee by the time your grandson reaches age 13.
Leaving a retirement account to a disabled individual or a chronically ill individual will not require distribution of the account within 10 years. A beneficiary is disabled if the beneficiary cannot engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment which can be expected to end in death or be of indefinite duration. An individual is chronically ill if a licensed health care practitioner certifies that the individual (i) is unable to perform (without substantial assistance from another individual) at least 2 activities of daily living for a period of at least 90 days, or (ii) requires substantial supervision to protect such individual from threats to health and safety due to severe cognitive impairment. The disabled or chronically ill beneficiary can receive required minimum distributions based on his or her life expectancy.
What about trusts for disabled or chronically ill individuals? If the disabled individual has a right to the participant’s interest in the retirement plan, then the life expectancy method applies to the distributions to the disabled or chronically ill individual.
Given these new 10-year distribution rules for non-spouse beneficiaries who do not fit into one of the exceptions, you may have to consider some new strategies for estate planning with your retirement plans. Those strategies might include:
(1) Converting your Traditional IRA or 401(k) to Roth IRA or Roth 401(k). You will have to pay the income tax, but it may be doable if your income bracket drops in retirement or you convert only a portion of the account to a Roth account each year.
(2) Buying life insurance to pay the income tax that your child will bear. Of course, you must be insurable, and the cost of the life insurance may be too great if you are over 70.
(3) Leaving Your Retirement Plan to a Charitable Remainder Trust. Your child could be the life beneficiary of the trust and anything left over goes to a charity you identify.
(4) Leave more non-retirement assets to individuals and more of your retirement assets to charity. Charities are not subject to income taxes. Thus, if you planned to leave some of your estate to charity, do it through your retirement plan. Your individual beneficiaries will not pay income taxes on the non-retirement assets they receive. Non-retirement assets receive a step-up in basis at death.
(5) Communicate with your children about these new distribution rules for retirement plans. Tell them to spread out the income taxes over 10 years by taking 10% distributions each year. Your children may also want to time distributions to coincide with years that they will have less income.
Estate planning with retirement plans can raise a lot of issues. The estate planning attorneys at Cipparone & Zaccaro, P.C. can help you understand how to navigate these new rules.

Joe Cipparone wrote the articles in this edition. No taxpayer can avoid tax penalties based on the advice given in this newsletter. This information is for general purposes only and does not constitute legal advice. For specific questions related to your situation, you should consult a qualified estate planning attorney.
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