SECURE Act: Major Tax & Estate Planning Implications

Introduction

On December 20, 2019, President Trump signed the Setting Every Community Up for Retirement Enhancement Act (SECURE Act) as part of the 2019 omnibus spending bill. The SECURE Act, which is effective January 1, 2020, makes the most dramatic changes to retirement account laws seen in the past decade. While most popular media have focused on the impact of the SECURE Act during the original retirement plan owner's lifetime, you should be aware the Act also makes potentially catastrophic changes to the tax treatment of retirement plans for beneficiaries upon the account owner's death.

Part I of this Article (beginning on Page 2) outlines the implications of the SECURE Act during the lifetime of the original Retirement Plan Owner.

Part II of this Article (beginning on Page 5) outlines the implications of the SECURE Act upon the death of the original Retirement Plan Owner and the potential planning strategies relating to such.

Planning Tip: If you are more of a "skip to the bottom line" person, then jump ahead to "Bottom Line: Who Will Be Affected By The New 10-Year Rule?" on Page 17.

Terminology

For clarity, the following terminology will be used in this article:

- **Act** or **SECURE Act** refers to the Setting Every Community Up for Retirement Enhancement Act, effective on January 1, 2020.
- **Beneficiary** or **Beneficiaries** refers to the intended recipients of the Retirement Plan upon the Owner's death.
- **Employer Retirement Plan** refers to 401(k) and other similar work-based defined contribution retirement plans.
- **Inherited Retirement Plan** refers to a Retirement Plan inherited by a Beneficiary after the death of the original Owner that is still being held as a pre-tax account.

- **Owner** refers to the original account owner as in the person who made the original contributions to the account.
- **Required Beginning Date** refers to the date Required Minimum Distributions must begin.
- **Required Minimum Distribution** refers to the mandatory minimum Retirement Plan withdrawals required under the tax code. For pre-tax Retirement plans, these distributions are subject to income tax.
- **Spousal Rollover** refers to special rules under which a surviving spouse that is named as a beneficiary of the Owner's Retirement Plan, has the option to "roll over" the Retirement Plan into the surviving spouse's name and the tax rules then treat the surviving spouse as the account "Owner" for purposes the Retirement Plan tax rules such as Required Beginning Date and Required Minimum Distributions.
- **Retirement Plan** is used generally to refer to pre-tax retirement plans such as Individual Retirement Accounts (IRAs), 401(k)s, 403(b)s, SEP, SIMPLE IRAs, Keoghs, and similar.
- **Stretch** or **Stretchout** refers to the historical practice of Beneficiaries of Inherited Retirement Plans only withdrawing Required Minimum Distributions while letting the remainder of the Inherited Retirement Plan grow tax-deferred. (This is discussed in more depth on page 5.)

PART I

Implications of the SECURE Act During Account Owner's Lifetime

For the Retirement Plan Owner, the SECURE Act makes the following changes:

- **Delayed Required Beginning Date:** Required Minimum Distributions will now begin at age 72 (rather than age 70 ½).

- **No Change to Qualified Charitable Distributions:** Owners may still make Qualified Charitable Distributions beginning at age 70 ½.

- **New Penalty Exemption for Childbirth and Adoption:** New Exception to the 10% Early Distribution Penalty added for Childbirth and Adoption allowing the Owner to withdraw up to $5,000 penalty-free (not tax-free) from an IRA during the one-year period beginning on the date of birth of the child or the date on which the adoption of an individual under the age of 18 is finalized. This new exception appears to be available on a "per child" basis, meaning that it can be used upon the birth or adoption of each child rather than a one-time use only.

- **Removal of Contribution Age Limit:** Removal of age limitations for contributions to a Traditional IRA. In the past, contributions to a Traditional IRA were not permitted past age 70 ½. This limitation has been removed meaning that individuals who are 70 ½ or older and still working (or who have a spouse who is still working and are contributing under the Spousal IRA rules), will be able to continue making contributions to a Traditional IRA.

- **More Flexible Annuity Rules for Employer Retirement Plans:** Annuity-related changes for 401(k) and other Employer Retirement Plans will allow for greater flexibility for ownership of annuities within an Employer Retirement Plan.

- **Small Business Tax Credits to Incentivize Employer Retirement Plans:** Increased tax credits to encourage small business to adopt Employer Retirement Plans, including an additional tax credit for small businesses that adopt auto-enrollment in an Employer Retirement Plan.

- **Greater Access to Employer Retirement Plans for Long-Term Part-Time Employees:** Updated rules aimed at increasing Employer Retirement Plan participation, particularly for long-time part-time employees who may not have been eligible for the Employer Retirement Plan under past rules.

- **Graduate or Postdoctoral Stipends:** Individuals receiving taxable non-tuition fellowship and stipend payments, such as for graduate or postdoctoral studies, may use that compensation for Traditional IRA or Roth IRA contribution purposes.

- **Non-Deductible IRA Contributions for Certain Foster Care Payments: Individuals** receive "Difficulty of Care" Qualified Foster Care Payments can use such amounts to make a non-deductible IRA contribution (provided such amounts don't exceed the IRA contribution limits when added to other contributions).

- **Elimination of 401(k) Credit Cards:** Loans from 401(k)s may no longer be paid via credit cards or similar arrangements.

- **More Retirement Plans Can Be Established After Year-End:** Under past laws, most Employer Retirement Plans had to be established before year end. The new rules allow for certain plans that are entirely employer-funded, such as stock bonus plans, profit sharing plans, pension plans, and qualified annuity plans to be established up to the due date of the employer's tax return (including extensions).

- **Increased Penalties for Failing to File Returns:** The penalties for failing to file income tax returns and IRS Form 5500, for reporting employee benefit plans, have been significantly increased.

- **Apprenticeships Added as Qualified Education Expenses for 529 Plans:** The list of Qualified Education Expenses for 529 Plans has been expanded to note that Qualified Higher Education Expenses includes expenses for Apprenticeship Programs that include fees, books, supplies, required equipment, so long as the Apprenticeship Program is registered and certified with the Department of Labor. *This change is retroactive to 2019.*

- **Student Loans Added as Qualified Education Expenses for 529 Plans:** The Act also adds "Qualified Education Loan Repayments" to the list of "Qualified Higher Education Expenses." Such distributions may be used to pay the principal and/or interest of a qualified education loan (as defined under IRC Section 221(d)), and are limited to a

lifetime amount of $10,000 (not adjusted for inflation). If 529 plan funds are used to pay the interest on qualified student debt, then the interest paid will be ineligible for the above-the-line student loan interest deduction under IRC Section 221. The $10,000 lifetime limit is a per-person limit, and in addition to being used to pay the 529 plan beneficiary's debt, an additional $10,000 may be distributed for qualified education loan repayment for the student loan debt for each of the 529 plan beneficiary's siblings. *This change is retroactive to 2019.*

- **Kiddie-Tax Rules Revert to Pre-Tax Cuts and Jobs Act Rules:** In 2017, The Tax Cuts and Jobs Act made changes to the so-called "Kiddie Tax." Prior to the Tax Cut and Jobs Act, any income subject to the Kiddie Tax was taxable at the child's parents' marginal income tax rate. The Tax Cut and Jobs Act changed the rules such that the Kiddie Tax was taxable at the trust income tax rates. For those with children with modest unearned income, this resulted in a modest amount of tax savings. But for children with higher unearned income, the rules resulted in a higher tax bill. Under the SECURE Act, the Tax Cut and Jobs Act changes to the Kiddie Tax have been reversed and any income that is subject to the Kiddie Tax will once again be taxed at the child's parents' marginal income tax rate. *For the 2018 and 2019 tax years, taxpayers can elect whether to use the "Original"/SECURE Act rules or the Tax Cut and Jobs Act rules, including the ability to amend 2018 filings which may be beneficial for children that had substantial unearned income in 2018 and/or 2019.*

- **Tax Extenders Bill:** Also included in the omnibus spending bill was the "Taxpayer Certainty and Disaster Relief Act of 2019" but don't be fooled by the use of "certainty" in the name. This act merely extends certain tax benefits through 2020 (and retroactively for 2018), including:

    - Excluding from gross income the discharge of certain qualified principal residence indebtedness;
    - The mortgage insurance premium deduction;
    - The deduction for qualified tuition and related expenses;
    - The Adjusted Gross Income "hurdle" that one must exceed for purposes of deducting qualified medical expenses remains at 7.5% (lowered from previous hurdle of 10% in 2017);
    - Created special Qualified Disaster Distribution rules for individuals with principal residences in Federally declared disaster areas who suffered economic loss as a result of such disaster to take loans from retirement plans subject to specific rules and qualifications.
    - The bill also included miscellaneous incentives for economic growth such as energy production and green initiatives.

PART II

Implications of the SECURE Act After Account Owner's Death

Background

The SECURE Act makes drastic changes to the rules for Beneficiaries of Retirement Plans, but to understand the impact of these rules first requires a general understanding of the previous rules.

Under the previous rules, the distribution rules varied dramatically depending on who was named as beneficiary on the account and whether the Owner died before or after the Required Beginning Date (e.g., age 70 ½). The rules are quite technical, but here is a general summary:

- **Surviving Spouse as Beneficiary:** The Surviving Spouse had the option of either:
  - A Spousal Rollover, whereby the Surviving Spouse becomes the "Owner" of the account for purposes of the tax rules; or
  - Inherited IRA (discussed further below).
- **"Estate" or Charity as Beneficiary:** If the Owner died before the Required Beginning date (i.e., before beginning Required Minimum Distributions), then the Retirement Plan must be fully distributed within 5 years. If the Owner died after the Required Beginning Date, then the Retirement Plan would be distributed according to the Owner's remaining life expectancy as if the Owner hadn't died as set forth under life expectancy tables.
- **"Designated Beneficiaries" e.g., Children, Grandchildren, or Individuals as Beneficiary:** The individual has the choice of three distribution options:
  - Immediate full distribution of the account, resulting in 100% of the account being immediately subject to income tax;
  - 5-year distribution of the account, resulting in 100% of the account being taxed within the 5-years from the Owner's death; or
  - Inherited IRA with Required Minimum Distributions based on the age of the beneficiary (often referred to as a "Stretch" or "Stretchout"—more on this below).
- **Trust as Beneficiary:** If the trust qualifies as a "Designed Beneficiary" then the Retirement Plan may be distributed according to the rules set forth above for Children, Grandchildren, or Individuals. If the trust does not qualify as a "Designed Beneficiary" then it must be distributed according to the rules set forth above for Estate and Charities.

Popularity of Stretchout Planning

A popular tax and estate planning strategy has historically been to use Inherited IRAs to maximize "Stretchout" Planning.

If a Beneficiary were to distribute the entire Inherited IRA at once, the entire distribution would be treated as ordinary income on their income tax return. Depending on the value of the account, this would make it likely that the additional income attributed to the Beneficiary would push the Beneficiary into a higher tax bracket (depending on the size of the account, potentially up to the

highest tax bracket). This would result in a double-whammy of paying taxes sooner rather than later *and* paying the taxes at a higher tax bracket resulting in a higher tax bill.

Instead, under the previous rules, the Beneficiary had the option to retain the Inherited IRA as a tax-deferred account that would continue to grow on a tax-deferred basis and the Beneficiary was only required to withdraw Required Minimum Distributions based on the Beneficiary's age. Unlike the Owner, who did not have to take Required Minimum Distributions until age 70 ½, a Beneficiary of an Inherited IRA had to immediately start taking Required Minimum Distributions. This option allowed the Beneficiary to continue to reap the benefits of tax-deferred growth of the Beneficiary's lifetime.

New SECURE Act Rules for Beneficiaries

The SECURE Act totally overhauls the rules for Designated Beneficiaries of Retirement Plans. Under the new rules, effective January 1, 2020, there are no longer Required Minimum Distributions for Inherited IRAs and Inherited Qualified Plans. Instead, the Inherited Retirement Plan must be 100% distributed within 10-years of the Owner.

There are a few exceptions for certain beneficiaries:

- Surviving Spouse;
- Owner's *children* under the age of 18 (not grandchildren or any other children such as stepchildren, nieces or nephews);
- Disabled beneficiaries;
- Chronically ill beneficiaries;
- Beneficiary not more than 10 years younger than the Owner.

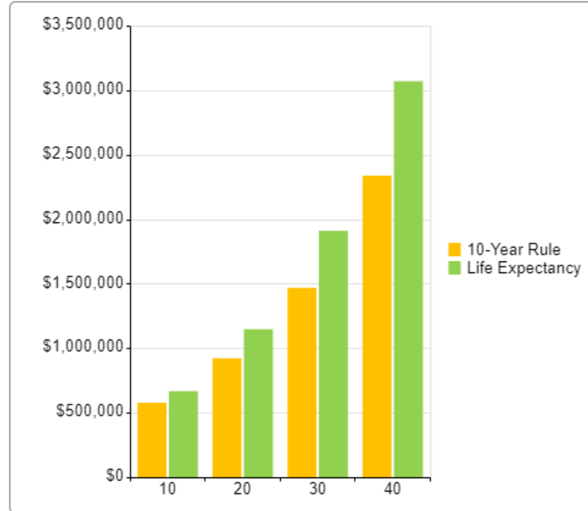
Example 1A: Life Expectancy Under Old "Stretchout" Rule Vs. Lump Sum Under New "10-Year" Rule

Let's assume upon the Owner's death, the Beneficiary is 50 years old and the balance of the Inherited IRA is $500,000. Investments inside the Inherited IRA grows tax-deferred at 6% per year. We'll assume that after paying tax on distributions from the Inherited IRA, the distributions are re-invested in a brokerage account. The growth on the brokerage account will be subject to income and capital gains tax for an effective post-tax growth rate of 4.75% (e.g., the same 6% growth per year, but netting 4.75% growth after taxes because the investments are now subject to taxes).

Under the new 10-Year Rule, we assume no distributions are made from the Inherited IRA until the final year, when the entire account is distributed. Thus, we'll assume that the Beneficiary had an average income tax rate of 24% under the Old "Stretchout" rules but that due to the larger distributions under the New "10-Year" rule, the Beneficiary is pushed into the highest tax bracket resulting in a 35% average income tax rate under the new rules. Here's what the account values look like over time:

Ten-Year vs. Life Expectancy

Age of (Oldest Trust) Beneficiary ⓘ	50
IRA Balance	500,000
Pre-Tax Growth Rate ⓘ	6.00%
After-Tax Growth Rate ⓘ	4.75%
Average Income Tax Rate-Life Expectancy Rule ⓘ	24.00%
Average Income Tax Rate-Ten Year Rule ⓘ	35.00%
Distributions Occur at Beginning or End of Period? ⓘ	End
Lump-Sum Distribution or Amortize Payments? ⓘ	Lump-Sum



Years after Death	Ten Year Rule	Life Expectancy
10	$582,026	$671,333
20	$925,726	$1,151,390
30	$1,472,389	$1,914,297
40	$2,341,871	$3,073,828

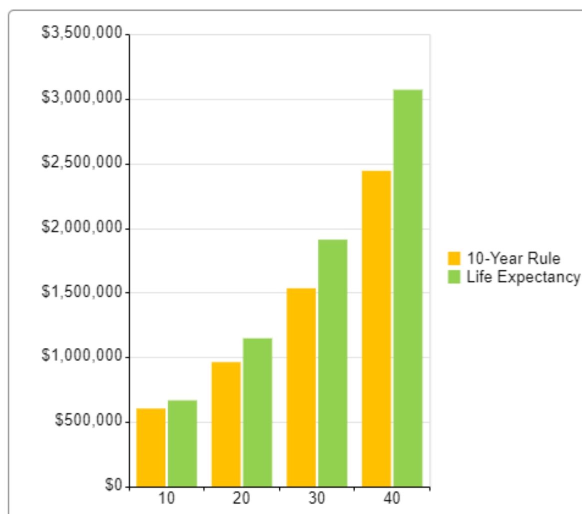
Example 1B: Life Expectancy Under Old "Stretchout" Rule Vs. Even Annual Distributions New "10-Year" Rule

Under the New 10-Year Rule, the Beneficiary does not have to wait until the 10th year to take a distribution from the account. Thus, in some instances, it may make sense to spread the distributions out, taking 1/10th per year from the account to reduce the effective tax rate on the distributions.

For example, let's assume all the same facts as Example 1A except we'll assume that the Beneficiary instead opts to distribute 1/10th of the account per year for 10-Years. As a result, the average income tax rate of the distributions is 28% (rather than 35% when it was distributed as a single lump sum). Here's what that looks like over time:

Ten-Year vs. Life Expectancy

Age of (Oldest Trust) Beneficiary ⓘ	50
IRA Balance	500,000
Pre-Tax Growth Rate ⓘ	6.00%
After-Tax Growth Rate ⓘ	4.75%
Average Income Tax Rate-Life Expectancy Rule ⓘ	24.00%
Average Income Tax Rate-Ten Year Rule ⓘ	28.00%
Distributions Occur at Beginning or End of Period? ⓘ	End
Lump-Sum Distribution or Amortize Payments? ⓘ	Amortize



Years after Death	Ten Year Rule	Life Expectancy
10	$608,084	$671,333
20	$967,173	$1,151,390
30	$1,538,312	$1,914,297
40	$2,446,722	$3,073,828

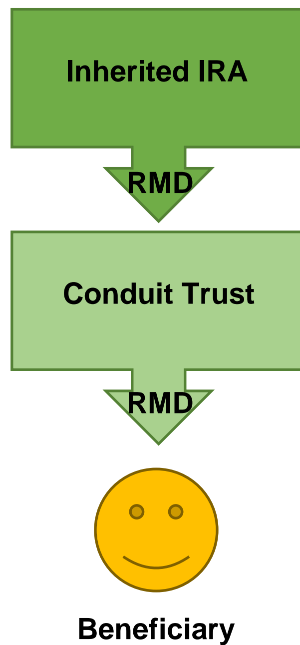
Conduit Trust Disaster

Many Owners include Stretchout Planning in their estate planning, often via Trusts that are designed to also protect the Beneficiary's inheritance from other threats such as lawsuits, creditors, and divorce. These Trusts may include Testamentary Trusts under a Will, Testamentary Trusts under a Revocable Living Trust, "Stretchout Protection" Trusts, Retirement Plan Trusts, IRA Trusts, and similar.

Due to the special Retirement Plan tax rules for Trusts (see above on Page XX), these Trusts were often designed as what are referred to as "Conduit" Trusts. Under a Conduit Trust, all required distributions from a Retirement Plan flow directly through the trust and are immediately distributed directly to the Beneficiary.

This is done to prevent the trust from having income and paying taxes as the compressed tax brackets. For example, a single individual does not reach the top tax bracket until they have total Adjusted Gross Income of $518,400 or higher and a Married Couple Filing Jointly does not reach the top tax bracket until they have a total Adjusted Gross Income of $622,050 or higher. However, a trust hits the top tax bracket at only $12,950 of Adjusted Gross Income.[1]

[1] And if your scratching your end wondering why the trust tax brackets are so compressed: In brief, during World War II, the top income tax rate was a whopping 94%. As a result, trusts were being aggressively used by high income individuals as a means of reducing income taxes by spreading assets out through a series of trusts with



This resulted in the distributions from the Inherited IRA being reported on the Beneficiary's income tax return and taxable at the Beneficiary's income tax rate. Unless there were strong concerns for having the distributions pass directly to the Beneficiary (e.g., financial irresponsibility, substance abuse concerns, existing creditors), this was generally deemed most beneficial as under most circumstances the Beneficiary's effective income tax rate on the distributions would be less than if the trust paid the income taxes.

Conduit Trusts were also a great "safe-haven" for ensuring that the trust would qualify as a Designed Beneficiary to ensure Stretchout planning, thus making it one of the most popular design strategies used by most estate planning attorneys in order to protect the tax benefits of Stretchout planning.

Under the new 10-Year Rule, using Conduit Trusts can be disastrous. It may result in higher taxes by forcing the Inherited IRA to be distributed in a single lump sum in the 10th Year (See Example 1A vs. Example 1B, above). Worst still, the inheritance will no longer be protected from the Beneficiary's future lawsuits, creditors, or divorce.

Going forward, Owners will have to give greater consideration as to whether to name a trust as a beneficiary. If so, "Accumulation" Trusts will be more beneficial for Owners wanting to protect inherited assets from the Beneficiary's financial irresponsibility or the Beneficiary's potential future lawsuits, creditors, or divorce.

multiple beneficiaries so that the income would be taxed at the beneficiaries lower income tax rates rather than at the parent or grandparents high income tax rate. These were commonly referred to as "Orphan Annie Trusts" in a nod to Orphan Annie and Daddy Warbucks.

With an Accumulation Trust, distributions are taken from the Inherited IRA, but held within the trust and reinvested. The Accumulation Trust can include instructions to take the distributions spread out over the 10 years, rather than taking a single distribution in the 10th year. Holding the distributions within the Accumulation Trust keeps the inheritance protected from the Beneficiary's financial irresponsibility or the Beneficiary's potential future lawsuits, creditors, or divorce. However, this also means that taxes paid on the distributions from the Inherited IRA may be higher (the income tax brackets for trusts are significantly compressed compared to the income tax brackets for individuals, resulting in a higher marginal income tax rate).

For those who opt for Roth Conversion planning, Accumulation Trusts will become a valuable tool for keeping the Inherited Roth IRA protected from the Beneficiary's irresponsibility or immaturity and the Beneficiary's potential lawsuits, creditors, or divorce.

Some Owners may prefer to use a "wait and see" approach by using a "Discretionary Trust". Let's say the Owner has a current concern about a Beneficiary's irresponsibility or immaturity, but the Owner is optimistic that this may improve in the future. A "Discretionary Trust" can be drafted such that the Trustee determines at the time of distribution from the Inherited IRA, whether the trust will operate as a Conduit Trust or an Accumulation Trust. If the Beneficiary still hasn't "seen the light", the Trustee may opt for the Accumulation Trust in order to keep the distributions protected from the Beneficiary's irresponsibility or immaturity. However, if the Beneficiary has "seen the light," then the Trustee may opt for Conduit Trust treatment in an effort to reduce taxes paid on the distributions.

Planning Tip: We strongly recommend a review of your existing planning to determine whether it includes the use of a Conduit Trust for your beneficiaries and if so, whether that is still the appropriate planning tool under the specific circumstances for you and your beneficiaries.

Tax & Estate Planning Strategies Under the New 10-Year Rule

Under the prior rules, the "best" planning strategies were pretty straightforward. Unfortunately, the new 10-Year Rule adds a new layer of complexity to this planning as the "best" solutions will vary dramatically from one Owner to the next. Considerations include:

- Age of the Owner;
- Whether the Owner is married and if so, age of the Owner's spouse;
- Number of beneficiaries;
- Ages of beneficiaries;
- Marginal income tax bracket of the Owner;
- Marginal income tax brackets of the beneficiaries;
- Whether the Owner is charitably inclined;
- Whether the Owner is insurable for purposes of obtaining life insurance;

- Owner’s state of residence and applicable state income taxes;

Planning Tip: We highly recommend working closely with your attorney, accountant, and financial advisor to develop the best strategy for your specific goals and circumstances. The benefit of the planning strategies outlined below vary dramatically based upon the factors listed above.

Roth Conversions

Most Owners have historically preferred the use of traditional pre-tax Retirement Plans to defer paying taxes for as long as possible and continue to enjoy tax-deferred growth. However, we expect Roth Conversions to become more popular, in light of the new “10-Year Rule” and the fact that we are currently enjoying some of the lowest income tax rates in history which may change in the future (particular with 2020 being an election year).

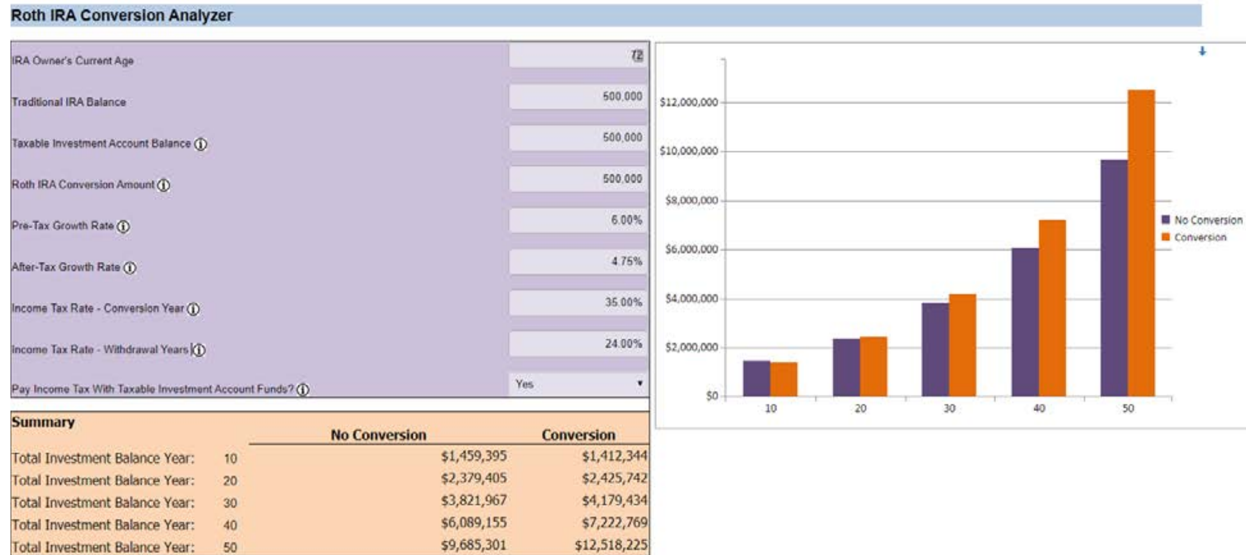
For some Owners, it may be a good strategy to convert some or all of their Retirement Plans to Roth IRAs and pay the applicable income taxes now. This may be an effective strategy if the Owner is retired with limited income from other sources and the Owner’s Beneficiaries are likely to be in higher income tax brackets.

The passage of the SECURE Act, which overhauled a major financial and legal instrument enjoyed by millions of families has made us ponder: If Congress is willing to make such sweeping changes to Retirement Plans with the SECURE Act, what’s to stop them from making similar changes to Roth IRAs in the future? For example, what if you opt to pay the applicable taxes to convert your Traditional IRA to a Roth IRA with the expectation that the account will continue to grow tax-free for your beneficiaries, only for Congress to change the rules and decide that tax-free growth stops upon your death? To be clear: *this has <u>not</u> been proposed*, but any strategy dependent on existing tax rules is still subject to future changes at the whim of elected officials.

Example 2: Roth Conversion

Assume that Owner is 72 years old and has $500,000 in a Traditional IRA and $500,000 in a brokerage account. Investments within the Traditional IRA grow tax-free at 6% per year. Investments within the brokerage account yield an after-tax growth rate of 4.75% per year. The Owner’s typical income tax rate is 24%. However, if the Owner opts to convert his $500,000 Traditional IRA to a Roth IRA, his income tax rate during the year of conversion will be 35%. Based on these factors, it will take about 20 years for the total investments under the Roth Conversion approach to exceed the total investments if the Owner had not converted the account. Assuming that upon the Owner’s death, the accounts pass to the Owner’s children who are able

to enjoy the tax-free growth of the Roth IRA for decades to come, this strategy can be hugely beneficial in the long run:



Roth IRA Conversion Analyzer

IRA Owner's Current Age	72
Traditional IRA Balance	500,000
Taxable Investment Account Balance	500,000
Roth IRA Conversion Amount	500,000
Pre-Tax Growth Rate	6.00%
After-Tax Growth Rate	4.75%
Income Tax Rate - Conversion Year	35.00%
Income Tax Rate - Withdrawal Years	24.00%
Pay Income Tax With Taxable Investment Account Funds?	Yes

Summary		No Conversion	Conversion
Total Investment Balance Year:	10	$1,459,395	$1,412,344
Total Investment Balance Year:	20	$2,379,405	$2,425,742
Total Investment Balance Year:	30	$3,821,967	$4,179,434
Total Investment Balance Year:	40	$6,089,155	$7,222,769
Total Investment Balance Year:	50	$9,685,301	$12,518,225

Additional Considerations for Roth Conversions:

There are several factors that affect the advantages or disadvantages of a Roth Conversion, including:

- How the Roth Conversion may impact the Owner's estate tax planning;
- Federal income tax brackets are more favorable for married couples filing jointly than for single individuals;
- Post-death distributions from the Roth IRA go to the Beneficiaries tax-free;
- Income tax rates are likely to increase in the future;
- IRA withdrawals can impact the 3.8% Medicare surtax;
- IRA withdrawals may impact the taxation of Social Security benefits;
- IRA withdrawals may impact Medicare premiums;
- Tax bracket management for IRAs that are payable to a trust;
- Tax bracket management for the surviving spouse who will be filing taxes as a single individual.

Spousal Rollovers May No Longer Be the Best Option

Under the old rules, spousal rollovers were often the preferred option for a surviving spouse. Under the spousal rollover rules, the surviving spouse got to "roll over" the account into his or her own name and the surviving spouse was treated as the "Owner" of the account for tax purposes. Thus, Required Minimum Distributions were based on the age of the surviving spouse.

In addition, upon the surviving spouse's death, the account still qualified for "Stretchout" planning when it passed down to the children and other beneficiaries.

Example 3A: Spousal Rollover

Let's assume the Owner has a $1M IRA. Upon the Owner's death, the entire account passes to the Owner's surviving spouse via spousal rollover. The surviving spouse lives another 8 years. Upon the surviving spouse's death, the account passes to their only Child and is subject to the 10-Year Rule. In order to keep the example simple, we'll assume the growth on the account balances out the Required Minimum Distributions, such that the value of IRA is still $1,000,000 upon the surviving spouse's death.

Year	Total Income from Distributions for Child
1	$100,000
2	$100,000
3	$100,000
4	$100,000
5	$100,000
6	$100,000
7	$100,000
8	$100,000
9	$100,000
10	$100,000

Example 3B: Blended Spousal Rollover and Inherited IRA

Under the new rules, the spousal rollover may not always be the best approach as it may be better to begin distributing the Retirement Plan earlier in order to minimize exposure to higher tax brackets.

For example, let's assume that the same Owner with the $1M IRA leaves half of the account to the surviving spouse for a spousal rollover (Part A) and leaves the other half directly to their only Child (Part B).

Part B will be subject to the 10-Year Rule and the Child can opt to withdraw $1/10^{th}$ per year $50,000 for 10 years to minimize effective income tax rates.

Part A is rolled over to the surviving spouse who lives for another 8 years. Again, to keep the math simple, we'll assume that during the surviving spouse's lifetime, the growth on the account matches the Required Minimum Distributions, such that the value of Part A is $500,000 upon the surviving spouse's death. When the surviving spouse dies, the remainder of Part A will be subject to the 10-year rule when it passes to the Children.

Here's what this might look like:

Year	Distributions from Part A to Child	Distributions from Part B to Child	Total Income from Distributions for Child
1	$0	$50,000	$50,000
2	$0	$50,000	$50,000
3	$0	$50,000	$50,000
4	$0	$50,000	$50,000
5	$0	$50,000	$50,000
6	$0	$50,000	$50,000
7	$0	$50,000	$50,000
8	$0	$50,000	$50,000
9	$50,000	$50,000	$100,000
10	$50,000	$50,000	$100,000
11	$50,000	$0	$50,000
12	$50,000	$0	$50,000
13	$50,000	$0	$50,000
14	$50,000	$0	$50,000
15	$50,000	$0	$50,000
16	$50,000	$0	$50,000
17	$50,000	$0	$50,000
18	$50,000	$0	$50,000

Depending on the Child's income tax rate, the second approach may reduce the cumulative income taxes paid and maximize the net amount actually received by the Child.

Multi-Generational Planning & "Spray" Trusts

While historically many clients have preferred to leave Retirement Plans to their adult children rather than minor grandchildren, the new Act may make multi-generational planning a more relevant consideration. Under the new 10-Year Rule, it may be beneficial to spread the income distributions among a larger number of beneficiaries/taxpayers in order to lower the effective tax rate across the collective beneficiaries.

Whether or not this approach makes sense depends on a number of factors, including:

- The Owner's overall planning goals and whether the Owner desires to include other beneficiaries;
- The applicable income tax rates of the beneficiaries, including applicability of the "Kiddie Tax."

Life Insurance Solutions

For some, life insurance strategies may be beneficial. The 10-Year Rule creates a risk of significantly higher income taxes if the Owner dies prematurely. For example, if the Owner dies shortly after retirement and before beginning Required Minimum Distributions, then the Owner may have died when their account value and total estate was at its peak, and the beneficiaries will be subject to the 10-Year Rule. Whereas, an Owner living well into their 80s, 90s, or older, is likely to deplete the account gradually over many years (i.e., at lower marginal income tax rates) and then the smaller account balance will pass to the beneficiaries subject to the 10-Year Rule (again, at lower marginal income tax rates due to the account being smaller).

As such, some Owners might opt to purchase additional life insurance to hedge against this risk and maximize the family wealth.

Further, life insurance enjoys numerous benefits:

- It can be held by a trust to protect the proceeds from the beneficiaries' potential lawsuits, creditors, or divorce.
- Life insurance death benefits are paid out income-tax free upon the death of the insured.
- If structured properly, life insurance death benefits can also pass estate tax free at the death of the insured.
- If structured properly, life insurance can function much like a Roth IRA for the Owner where the Owner can withdraw money from the life insurance policy income-tax free.
- Some life insurance policies come with the additional benefit of a long-term care or chronic care rider that can help pay for health and long-term care costs during the owner's lifetime.
- Life insurances are significantly "easier" and more flexible from an estate planning perspective as they are not subject to the cumbersome Retirement Plan income tax rules.

Such strategies may be particularly beneficial for:

- Those with excessive Required Minimum Distributions and high income tax rates (particularly where Roth Conversions may not be desirable due to already high income tax rates);
- Those who may be subject to estate tax upon death (discussed further on Page XX);
- Those also wanting to long-term care protection as many life insurance policies can also include long-term care riders or similar benefits;
- Other situations on a case-by-case basis.

Charitable Planning with IRAs & Charitable Remainder Trusts

For Owners who are charitably inclined, incorporating charitable planning into their Retirement Plan strategy may be appropriate.

Qualified Charitable Distributions (QCDs)

A QCD is a direct transfer from an IRA to a qualified charity. A QCD counts towards the Owner's Required Minimum Distribution and is excluded from taxable income so long as certain rules are met, such as:

- The Owner must be 70 ½ years of age or older;
- The QCD is limited to the amount that otherwise would have been taxed as ordinary income;
- The maximum annual amount that can qualify for a QCD is $100,000 total (however, if you file taxes jointly with your spouse, you each can make a QCD of up to $100,000 total);
- The funds must have come out of the IRA by the Owner's Required Minimum Distribution deadline (generally December 31st).
- The charity must be a 501(c)(3) organization and some charities do not qualify (private foundations, supporting organizations, donor-advised funds).

Naming a Charity as Beneficiary

One approach is to leave all or a portion of the Retirement Plan to charity. While this is a "tax efficient" approach in that there is an off-setting Charitable Deduction for income tax purposes, the end result is that the funds go to Charity rather than to family. Thus, this approach is only beneficial for Owners who were already intending to make a bequest to charity upon their death.

Charitable Remainder Trusts

An alternative is to name a Charitable Remainder Trust as the beneficiary of the Retirement Plan.

Under a Charitable Remainder Annuity Trust (CRAT):

- The beneficiaries (e.g., the Owner's family members) receive a fixed percentage of the initial trust value per either annually, quarterly, or monthly.
- The amount received by the beneficiaries is a fixed percentage that cannot and the annual payment must be between 5-50% of the fair market value of the account at the time of contribution.
- The term of the annuity can be:
  - A specific term of up to 20 years;
  - Over the life of the annuitant(s) (e.g., the beneficiaries);
  - Over the shorter of the first two options; or
  - Over the longer of the first two options.
- At the end of the term, the remaining assets in the trust are distributed to one or more charities selected by the Owner.

Under a Charitable Remainder Unitrust (CRUT):

- The beneficiaries receive a stated percentage of the trust's assets which are revalued each year (i.e., the distribution amount will vary from year to year based upon investment performance and previous withdrawals).

In most cases, a Charitable Remainder Trust will not necessarily result in a greater inheritance for the Owner's family members, but it can result in funds that otherwise would have gone to taxes instead going to charity.

Bottom-Line: Who Will Be Affected By The New 10-Year Rule?

While everyone's specific planning goals will vary, if we were to try and simplify who should be concerned about the new rules, here's how we would break it down:

- **If You Have a Trust Named as a Beneficiary:**
  - If you have *any type of trust* designated as a beneficiary on your Retirement Plan beneficiary designation forms, you should have your current estate planning reviewed to determine whether (1) the trust should be modified; and/or (2) the beneficiary designation should be modified.
- **If You Have Your "Estate" Name as a Beneficiary:**
  - If you have designated your "Estate" as a beneficiary on your Retirement Plan beneficiary designation forms, you should have your current estate planning reviewed to determine whether (1) the trust should be modified; and/or (2) the beneficiary designation should be modified.
- **If Your Retirement Plans Combined Total Is Less Than $500,000:**
  Less Impact
  - If you are retired or nearing retirement and your Retirement Plans will be a significant source of your retirement income, then it is likely that your accounts will be consumed during your lifetime and additional planning may be less urgent.
  - If you are high income and you expect your accounts to keep growing (either because you are continuing to contribute to them, or you are retired but only withdrawing Required Minimum Distributions), then a Retirement Plan Analysis may be beneficial for examining the potential benefits of available planning strategies.
- **If Your Combined Retirement Plans Total $500,000 to $1,000,000:**
  Moderate Impact
  - If you are retired or nearing retirement, a good portion of your Retirement Plan may be consumed during lifetime and the difference between the remaining funds being distributed over 10 years verses as a lump sum may not have as significant of an impact.

    - If you are high income and you expect your accounts to keep growing, then additional planning may be beneficial.
    - A review of your current estate planning may be beneficial, including review for whether planning makes use of trusts which may need to be updated in light of the new rules.
    - A Retirement Plan Analysis may be beneficial for examining the potential benefits of available planning strategies.
- **If Your Combined Retirement Plans Total More Than $1,000,000: Major Impact**
    - There is a high likelihood that a significant chunk of these accounts will be left to beneficiaries, often in trust.
    - A review of your current estate planning is urgently recommended as your trusts likely need to be updated.
    - A Retirement Plan Analysis for examining the potential benefits of various planning strategies is urgently recommended.

Next Steps

The SECURE Act brings HUGE change that impacts many of our clients that we've worked with over the years. As such, we're hard at work in helping our clients review their existing plans and figure out their best steps going forward.

If you are current or past CFEP client: If our office helped you set up your estate plan and you would like assistance figuring out how the SECURE Act impacts you and your planning, please visit https://secureactsurvey.carolinafep.com and complete the survey. Surveys will generally be reviewed on a first-come, first-served basis, although priority will be given to members of our paid VIP Inner Circle maintenance program. Based on your survey responses, we will follow up with the best next steps for reviewing or updating your planning and legal fees associated with such. Given the enormity of these changes and the number of clients impacted, we thank you in advance for your patience as it may take several weeks or months to assist everyone with their updates.

If you are not currently a CFEP Client: If you need help setting up your estate plan or reviewing your planning options under the SECURE Act, please give us a call at 919-443-3035 to discuss scheduling a Vision Meeting.