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Brooks & Brooks, LLP

Estate Planning with Certainty

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It Happened! Federal Tax Law Changes Inherited Retirement Accounts

In our **August – September 2019** newsletter we reported on a pending bill in Congress, the ***"Setting Every Community Up For Retirement Enhancement Act"*** (*SECURE ACT*), that if passed, would make a **major change** in how retirement accounts are taxed to beneficiaries of the plan participant (the retiree account holder). Although the Act has benefits and enhancements to encourage small businesses and individuals to sock away money for the retirement years, it does come with a price. As with all federal legislation, the Act must be revenue neutral, meaning that what tax benefits Congress gives away, it must also provide for tax increases somewhere else to pay for those benefits.

So here's the scoop – The *SECURE ACT* tax increases ***do not affect the original plan participant*** (the employed person who paid into the plan, whether a 401(k), IRA or the like). The good news there is that the plan participant does not have to start withdrawing money from the account until age 72, up from the old rule of 70 1/2. This gives people who are not yet 70 ½ on January 1, 2020 an extra year and a half to keep their money in their retirement account before mandatory withdrawals are triggered.

The downside, and it's a BIG ONE!! - To pay for the expected loss in tax revenue the Act causes, our members of Congress have chosen to **end a 20+ year history** of allowing for tax-free growth of retirement money to **beneficiaries** of a plan participant's account. The Act requires beneficiaries of inherited retirement accounts to ***withdraw all of the money in the accounts by the end of the tenth year after the original plan participant's death***. This provision eliminates the old rule which allowed for a "*stretch out*" of taxable payments over younger beneficiaries' lives. NOTE—this provision does **not** apply to a spouse who inherits a deceased spouse's account. Additionally, there are a few other exceptions for underaged children and some other beneficiaries with disabilities. But for the most part, all those adult children of parents who pass away owning sizeable IRA's and 401k's will wind up paying a lot more income tax on retirement accounts

Free Workshops

February 11, 2020
Hampton Inn
Jamestown, NY
6:30 to 8:30 p.m.

February 25, 2020
Goodes Restaurant
Collins, NY
6:30 to 8:30 p.m.

March 10, 2020
Bartlett Country Club
Olean, NY
6:30 to 8:30 p.m.

than existed under the old law ~ Congress' **$15.7 billion expectation**.

Here's how it works **-** Joe has an IRA worth $500,000 when he dies in 2020. His wife Ellen inherits the account - no problem. Ellen continues to take out her minimum distribution based upon the IRS rules as normal. Two years later Ellen dies and her two children, Mike and Susie, inherit the account which because it was well-invested, is still worth $500,000.00. Mike and Susie are both in their early 50's, have good paying jobs and are married to spouses who also have good paying jobs. Pursuant to the *SECURE ACT*, by the time Joe and Susie are in their early 60's, each will have to empty their $250,000 (plus earnings) inherited IRA accounts... and pay income taxes on every single dollar...on top of their joint earnings with their spouses! Up, up the tax brackets they go!

Some okay news **~** Mike and Susie will have the option to take out whatever amount they want each year, or wait until the end of the tenth year and take one distribution of the whole account. So, they can still defer tax on the increase in the accounts until the end of the tenth year.

What Mike & Susie had to give up **~** As it used to be, for 20+ years, when Mike and Susie inherited their share of Ellen's IRA, each would only have to withdraw a minimum distribution each year ***based upon their own life expectancy!*** The IRS table for this purpose gives a 55 year old a life expectancy of 29.6 years. That extra 19.6 years would allow Joe and Susie to grow the account even more for their own retirement income, or possibly leave more money to their children when they pass away. That has all come to an end now.

Trusts Holding Retirement Accounts for Beneficiaries—A trust may be designated as a beneficiary, that's okay; but the *SECURE ACT* may have adverse income tax impacts on a client's plan for any beneficiary whose inheritance is to be held in a sub-trust for the future **and** which will be funded with retirement accounts. This will apply to any client's estate plan that provides for a continuing trust for a grandchild (to age 25 or 30 perhaps), or a spendthrift child. The new 10 year limit on keeping the retirement money in a tax deferred account will cause extra income tax being paid on the withdrawals from the account...or more money going to the trust beneficiary long before the client wanted.

Clients affected by this new change should re-examine their estate plans and make necessary adjustments as needed.

New Strategies **–** Now that the *SECURE ACT* has become law, planners will be busy coming up with alternative techniques to salvage as much tax benefit to family members as is possible. We at Brooks & Brooks, LLP will keep monitoring the situation and work with our colleagues to develop alternative planning techniques that will help mitigate the increased tax that middle class beneficiaries will now be faced with in the future.

ESTATE PLAN FINANCIAL REVIEW:

It's that time of year again when financial institutions will be issuing 1099s. This is a good time for clients to check and see if financial accounts are titled correctly.

Clients who have a **Revocable Living Trust** will want to be sure that non-retirement financial account are titled to the trust. However, retirement accounts (IRAs, Tax Qualified Annuities, and Deferred Compensation Plans) do not get titled to a trust—they must be owned by the individual personally).

Clients who have an **Irrevocable Family Trust** should check to be sure that any account intended to be owned by the trust is titled in the name of the irrevocable trust. If it is not, the trust does not own the account and it is **not** protected.