LINDA C. SLIDER
ATTORNEY AT LAW

P.O. BOX 5756
WALNUT CREEK, CALIFORNIA 94596

TEL: (925) 932-8450
FAX: (925) 938-4844
LINDA@SLIDERLAW.COM

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Dear Clients and Colleagues:

The Setting Every Community Up for Retirement Enhancement Act (SECURE Act), which was signed into law on December 20, 2019, is landmark legislation that may significantly affect your retirement and estate planning, as well as income tax planning for your dependents who are subject to the "Kiddie Tax" or who have 529 Education Plans. Most of the provisions impacting individuals went into effect on January 1, 2020.

Here is a look at some of the more important elements of the SECURE Act that may impact you. Some changes in the law might provide you and your family with tax-savings opportunities. However, the most significant changes are not favorable, and there may be steps you can or should take to minimize their impact. Please give me a call if you would like to discuss any of the changes under the SECURE Act or how these changes may impact your estate planning, retirement planning, or dependents.

First, the most significant, and least favorable, changes created by the SECURE Act:

- *Elimination Of Stretch IRAs For Many Beneficiaries.* The most significant, and potentially adverse, change of the SECURE Act is the elimination of the ability to "stretch" out the distribution of employee retirement accounts and IRAs (collectively "Retirement Accounts") over the lifetime of most non-spousal beneficiaries.

    - Under the pre-SECURE Act law, beneficiaries (both spousal and non-spousal) were generally allowed to "stretch out" the tax-deferral advantages of the Retirement Accounts by taking distributions over the beneficiary's life or life expectancy (in the IRA context, this is often referred to as a "stretch IRA"). This ability to "stretch" out the required minimum distributions ("RMDs") from inherited Retirement Accounts over the non-spousal beneficiary's lifetime (and defer the income taxes on the accumulated earnings of Retirement Accounts) could significantly increase the wealth passed to the next generation. Under the pre-SECURE Act law, a taxpayer's estate planning could also include a carefully-structured trust to hold the Retirement Accounts for the benefit of an individual beneficial and still "stretch" out the RMD distributions over the life expectancy of the trust beneficiary (or oldest possible trust beneficiary, depending on the type of trust used). These "designated beneficiary

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trust" rules enabled a taxpayer to adopt an estate plan to maximize the income tax benefits of deferred Retirement Account distributions while designating a trustee to provide responsible management of the Retirement Accounts.

- However, the SECURE Act provides that, for the Retirement Accounts owned by plan participants or IRA owners who die on or after January 1, 2020, most non-spouse beneficiaries must distribute the remaining balance of the Retirement Accounts no later than ten years following the close of the calendar year of the plan participant's or IRA owner's death (the "ten-year rule"). For most non-spouse beneficiaries, inherited retirement benefits cannot be "stretched" beyond this ten-year period.

- Exceptions to the ten-year rule are still allowed for Retirement Accounts passing to certain "eligible beneficiaries" (and carefully-structured trusts for these "eligible beneficiaries", referred to as "eligible beneficiary trusts"), who can still "stretch" the Retirement Accounts over their life expectancy (or at least until the beneficiary no longer qualifies as "eligible beneficiary"). These "eligible beneficiaries" (and the general rules that impact their distributions) are:

  - The surviving spouse of the plan participant or IRA owner. A surviving spouse may still retitle Retirement Accounts in the surviving spouse's own name (a "rollover IRA") or treat the Retirement Accounts as an "inherited" IRA. With a rollover IRA, the surviving spouse is not forced to take RMDs until age 72. For both rollover IRAs and inherited IRAs, the surviving spouse may take RMDs based on the surviving spouse's life expectancy. However, upon the surviving spouse's death, only rollover IRAs are eligible to extend the IRA distribution period for other "eligible beneficiaries" following the surviving spouse's death. Inherited IRAs "flip" to the ten-year rule for distributions to the beneficiaries following the death of the surviving spouse, regardless of whether the beneficiaries might otherwise have qualified as "eligible beneficiaries".

  - A child of the plan participant or IRA owner who has not reached majority (but not grandchildren or other young beneficiaries who are not the child of the plan participant or IRA owner) may take RMDs from an inherited Retirement Account based on the child's life expectancy until the child reaches majority. Once the child reaches majority, the distribution rule "flips" to the ten-year rule and require the payout of the remaining balance of the inherited Retirement Account over the ten-year period. Traditionally, most states define "majority" as age 18 or 21. However, some practitioners argue (based on existing ERISA regulations) that a child may not reach majority until the earlier of (i) the date the child reaches age 26, or (ii) the date the child ceases to be engaged in a "course of education" (i.e., college or graduate school). It may take some time to obtain IRS guidance on the definition of "majority" for purposes of the SECURE Act. Again, this exception does not apply to grandchildren or other young beneficiaries, other than the plan participant or IRS owner's children.

- <u>A disabled or chronically ill individual</u> may take RMDs from an inherited Retirement Account based on the beneficiary's life expectancy, but the distribution rules "flip" to the ten-year rule to require the payout of the remaining balance of the inherited Retirement Account over the ten-year period if the beneficiary ceases to be disabled or chronically ill. The term "disabled" generally means that the beneficiary is unable to engage in any substantial gainful employment because of an impairment of long-lasting and indefinite duration or likely to continue until death, and the term "chronically ill" means that the beneficiary suffers from a significant debilitating illness which is certified to exist and expected to last for a lengthy but indefinite period.

- <u>Any other individual who is not more than ten years younger than the plan participant or IRA owner</u> may take RMDs from the Retirement Accounts based on the pre-SECURE Act rules.

- Many taxpayers have created estate plans which call for retirement accounts to be held in trust for their beneficiaries. <u>For taxpayers dying after December 31, 2019, the SECURE Act has also changed the planning picture for trusts which receive retirement distributions</u>. Briefly:

  - A trust for a child who has not reached majority will qualify to hold an inherited Retirement Account and take RMD distributions based on the child's life expectancy <u>only if</u> the trust qualifies as a "conduit" trust which <u>requires</u> the trustee to distribute RMD to or for the benefit of the child each year. The "conduit" trust <u>cannot</u> accumulate distributions from the inherited Retirement Account within the trust for future management by the trustee. This forced distribution rule applies even after the child reaches majority and the distribution of the retirement account "flips" to the ten-year rule. Taxpayers need to carefully consider whether the ability to extend the "stretch" distribution period is worth the potentially-adverse asset management consequences of the forced distribution of retirement distributions to or for the benefit of a young beneficiary each year.

  - Like a child's trust, Retirement Accounts held in a trust for the benefit of a surviving spouse will only qualify for "stretch" treatment (using the surviving spouse's life expectancy) <u>only if</u> the trust is a "conduit" trust which automatically pays out the distributed retirement benefits to the surviving spouse each year. This may be especially problematic for taxpayers in second marriages who want to plan for their surviving spouse but preserve the remaining balance of the Retirement Accounts for distribution to their own beneficiaries upon the surviving spouse's death.

  - Unlike a surviving spouse's trust or a child's trust, taxpayers can establish an "accumulation" trust for the benefit of a disabled or chronically ill taxpayer, which permits the trustee to retain distributed retirement benefits in the trust for on-going management. Given the high income tax rates which are applicable to

irrevocable trusts, taxpayers should carefully review the trust terms contained in their estate plans to ensure that the trustee has maximum flexibility to accumulate, manage and distribute the retirement benefits for the disabled or chronically ill taxpayer in a manner which minimizes income taxes.

- Finally, a trust which does not qualify as an "eligible beneficiary trust" (entitled to distribute Retirement Accounts based on the life expectancy of the "eligible beneficiary") must still be carefully structured to qualify for the ten-year rule. If the trust fails to qualify for the ten-year rule, an even more draconian five-year payout rule will apply. Again, given the high income tax rates which are applicable to trusts, taxpayers should carefully review the trust terms contained in their estate plans to ensure that the trust at least qualifies for the ten-year rule and that trustee has maximum flexibility to manage and distribute the retirement benefits in a manner which minimizes income taxes.

Notwithstanding the bad news about the loss of the ability to "stretch" out Retirement Account distributions for most beneficiaries, there are still planning opportunities for clients who wish to minimize overall income taxes from the distribution of Retirement Accounts. For example, clients may want to consider making strategic lifetime Retirement Account distributions or Roth IRA conversions to spread out the taxable distributions over a longer period, to avoid the "bunching" of taxable distributions into years where the recipient may be subject to higher income tax rates. In addition, there may be planning opportunities to use charitable remainder trusts (which provide an annual income payout to the beneficiaries) as a way to provide for a longer "stretch" of income distributions to beneficiaries (and a potential charitable estate tax deduction as well).

All taxpayers with Retirement Accounts should carefully review the terms of their beneficiary designations and the terms of any trusts created to hold Retirement Accounts for their beneficiaries to ensure that their estate plan still qualifies for the maximum "stretch" possible or desirable (given the risks of inadvertently distributing assets to too-young beneficiaries), while minimizing potentially adverse income tax consequences.

Second, the remaining, and possibly favorable, changes created by the SECURE Act:

- *Repeal Of The Maximum Age For Traditional IRA Contributions*. Before 2020, traditional IRA contributions were not allowed once the individual attained age 70½. Starting January 1, 2020, the new rules allow an individual of any age to make contributions to a traditional IRA, as long as the individual has earned income from wages or self-employment during the tax year.

- *Required Minimum Distribution Age Raised From 70½ To 72*. Before 2020, Retirement Account owners were generally required to begin taking required minimum distributions (RMDs) from their Retirement Account by April 1 of the year following the year they reached age 70½. For individuals who attain age 70½ after December 31, 2019, the age at which individuals must begin taking RMD distributions from their Retirement Account

is increased from 70½ to 72. Individuals who attained age 70 ½ on or before December 31, 2019 are still subject to the old rules and must start their RMDs by April 15 of the following tax year. NOTE: A taxpayer may still make qualified charitable donations from their IRA once they reach age 70½.

- *Employer Provisions To Encourage Broader Enrollment And Additional Investment Options In Employer-Sponsored Plans*. The SECURE Act includes provisions to encourage small employers to establish 401(k) plans and to adopt auto-enrollment features. In addition, the SECURE Act include a fiduciary safe harbor, which protects employers and plan advisors on the types of investment products which are offered in employer-sponsored plans, including new provisions to encourage annuities to be offered as an investment option and portability options for employees to move those annuities out of the Retirement Account under certain conditions.

- *Kiddie Tax Changes*. In 2017, Congress passed the Tax Cuts and Jobs Act (the "2017 Tax Act"), which made changes to the so-called "kiddie tax," which is a tax on the unearned income of certain children. Before enactment of the TCJA, the net unearned income of a child was taxed at the parents' tax rates if the parents' tax rates were higher than the tax rates of the child. Under the 2017 Tax Act, for tax years beginning after Dec. 31, 2017, the taxable income of a child attributable to net unearned income was taxed according to the brackets applicable to trusts and estates. Children to whom the kiddie tax rules apply and who have net unearned income also have a reduced exemption amount under the alternative minimum tax (AMT) rules. There were concerns that the 2017 Tax Act changes unfairly increased the tax on certain children, including those who were receiving government payments (i.e., unearned income) because they were survivors of deceased military personnel ("gold star children"), first responders, and emergency medical workers. The SECURE Act repeals the kiddie tax measures that were added by the 2017 Tax Act. Starting in 2020 (with the option to elect the same tax treatment retroactively for 2018 and/or 2019), the unearned income of children is taxed under the pre-TCJA rules and not at trust/estate rates. In addition, starting retroactively in 2018, the new rules also eliminate the reduced AMT exemption amount for children to whom the kiddie tax rules apply and who have net unearned income.

- *Expansion Of Section 529 Education Savings Plans To Cover Registered Apprenticeships And Distributions To Repay Certain Student Loans*. A Section 529 education savings plan (a 529 plan, also known as a qualified tuition program) is a tax-exempt program established and maintained by a state, or one or more eligible educational institutions (public or private). Any person can make nondeductible cash contributions to a 529 plan on behalf of a designated beneficiary. The earnings on the contributions accumulate tax-free. Distributions from a 529 plan are excludable up to the amount of the designated beneficiary's qualified higher education expenses. Before 2019, qualified higher education expenses didn't include the expenses of registered apprenticeships or student loan repayments. But for distributions made after December 31, 2018 (the effective date is retroactive), tax-free distributions from 529 plans can be used to pay for fees, books,

supplies, and equipment required for the designated beneficiary's participation in an apprenticeship program. In addition, tax-free distributions (up to $10,000) are allowed to pay the principal or interest on a qualified education loan of the designated beneficiary, or a sibling of the designated beneficiary.

- *Penalty-Free Retirement Plan Withdrawals For Expenses Related To The Birth Or Adoption Of A Child*. Generally, a distribution from a Retirement Account must be included in income, and a distribution before the age of 59½ is subject to a 10% early withdrawal penalty on the amount includible in income (unless an exemption applies, such as distributions from an "inherited IRA" or in case of financial hardship). Starting in 2020, plan distributions (up to $5,000) that are used to pay for expenses related to the birth or adoption of a child are penalty-free (but are still subject to income tax). That $5,000 amount applies on an individual basis, so for a married couple, each spouse may receive a penalty-free distribution up to $5,000 from each spouse's own Retirement Account for a qualified birth or adoption. However, spouses cannot aggregate their exclusions and withdraw $10,000 from a single spouse's Retirement Account.

- *Taxable Non-Tuition Fellowship And Stipend Payments Are Treated As Compensation For IRA Purposes*. Before 2020, stipends and non-tuition fellowship payments received by graduate and postdoctoral students were not treated as compensation for IRA contribution purposes, and so could not be used as the basis for making IRA contributions. Starting in 2020, the new rules permit taxable non-tuition fellowship and stipend payments to be treated as compensation for IRA contribution purposes. This change will enable students receiving those payments to begin saving for retirement without delay.

- *Tax-Exempt Difficulty-Of-Care Payments Are Treated As Compensation For Determining Retirement Contribution Limits*. Many home healthcare workers do not have taxable income because their only compensation comes from "difficulty-of-care" payments that are exempt from taxation. Because those workers did not have taxable income, they were not able to save for retirement in a qualified retirement plan or IRA. For contributions made to IRAs after Dec. 20, 2019 (and retroactively starting in 2016 for contributions made to certain qualified retirement plans), the new rules allow home healthcare workers to contribute to a retirement plan or IRA by providing that tax-exempt difficulty-of-care payments are treated as compensation for purposes of calculating the contribution limits to certain qualified plans and IRAs.

If you or your accountant would like more details about any aspect of the SECURE ACT, please let me know.

Very truly yours,

Linda C. Slider