5 Planning Opportunities Brought About by the SECURE Act

By Carol Schmidlin, President, Franklin Planning

This document accompanies my article with more details on the SECURE Act, 6 Key Retirement Changes of the Secure Act

1. Re-Evaluate Beneficiaries

It is always important to review your beneficiary documents every now and then to make sure they are up to date. Now with the passage of the SECURE Act, it is especially important. A few things to consider:

- **Surviving spouses are exempt from the 10-year payout**.

  Instead of spending your taxable assets first and deferring tax-deferred assets, such as an IRA until age 72 (the new Required Minimum Distribution (RMD) age), it may be more prudent to use tax-deferred assets first. These are the ones that can no longer stretch to a non-survivor beneficiary. Then, pass taxable assets that have a step-up in basis to your non-spouse beneficiary.

- **Trusts for the most part have become a poor IRA beneficiary**.

  There are two types of IRA Trusts:

  - **Conduit Trusts** – pays out only RMDs to trust beneficiaries over their lifetime at the individual beneficiaries' personal tax rate. Under the new law, there is not an RMD until the end of the 10th year, which would be 100%.

    All inherited funds would be released to the beneficiaries, nullifying any further trust protection – **exactly the opposite** of what those with large IRAs wanted.

  - **Discretionary Trusts** – the trustee has the power (discretion) to pay out funds to the trust beneficiaries or hold and protect the funds in the trust. The RMD would have to be paid but can stay in the trust. Although this is now a better solution than the Conduit Trusts for

most individuals that want to control how the funds are disbursed, the funds are taxed at the high tax rates.

2020 Trust Rates

- 10% $0 - $2,600
- 24% $2,602 - $9,450
- 35% $9,451 - $12,950
- 37% Over $12,950

Critical Action Required Immediately – Anyone who has named a trust as their IRA beneficiary will need to immediately review and probably revise the trust. It may not make sense to have the trust as the beneficiary for many people.

Roth IRAs would work better because there would be o trust tax when the funds go to the trust or the trust beneficiaries.

2. Tax Bracket Management

- **Maximize Low Tax Brackets**
    - Use traditional funds (IRAs, 401k, TSP, 403b,) to pay heavy medical expenses (nursing homes, medical home improvements, etc.) partially offsetting the tax on the IRA withdrawals.
    - Draw down IRA funds to soak up business losses
    - Use up lower tax brackets each year

    Reference this article featuring Ed Slott for more details

- **Qualified Charitable Distributions (QCD)**

  For those who qualify (IRA owners or beneficiaries who are age 70 ½ or older). **If you are charitably inclined, IRAs are the best funds to give to charity.**

    - Income from a QCDs bypass a taxpayer's 1040, thereby reducing your taxable income.
    - You can contribute up to $100,000 per year per IRA owner
    - A QCD can satisfy your RMD once you turn 72 or 70 ½ if you turned age 70 ½ in 2019 or prior

To request the white paper: "Ten QCD Rules You Need to Know", click here.

- **IRA Beneficiaries That Inherit IRAs in 2020 and Beyond**

  Each beneficiary should maximize their lower tax brackets each year within the 10 years.

3. Roth Conversions

A huge advantage of Roth Conversion is to take advantage of the current tax rates, compared to the tax rates that will be paid in retirement or by the beneficiaries. The current tax brackets are scheduled to revert back to pre-2018 levels after 2025, unless Congress takes action before then. We believe that tax rates are on sale, and that there's a good chance taxes will be higher down the road.

Roth Conversion Benefits

- No lifetime RMDs
- Can reduce Medicare premiums in retirement
- Spousal rollovers can add to tax-free accumulation, and continue to be exempt from lifetime RMDs (surviving spouses are exempt from the 10-year limit)
- Tax-free retirement income for spouse
- Eliminates trust tax problem
- Works well with Discretionary Trusts under the 10-year rule
- The inherited funds can remain protected in trust even after the 10 years, even though the inherited Roth funds still must be paid out to the trust after the 10 years.
- Eliminates accelerated income tax to beneficiaries after the 10 years
- For larger estates (those that might be subject to federal or estate tax) the tax paid on conversion reduces the estate and the eventual income tax paid by the beneficiary

Evaluate with an advisor that understands the tax rules:

- Is paying the tax worth it?

- If you are not concerned about passing IRA assets to beneficiaries, are you going to benefit by it during your retirement
- Have your advisor done a thorough Roth Conversion analysis BEFORE doing Roth Conversions

4. Life Insurance

- **Upgrade –** Life insurance moves to the top of the list as an estate and tax planning vehicle for large IRAs. *On the flip side: IRA trusts move to the bottom of the list under the tax rules.*
- Life Insurance can replace all of the benefits of the stretch IRA and IRA trusts
- More post-death controls
- Less tax for beneficiaries – Life insurance will be income tax-free to beneficiaries (except for annual investment income)
- Life insurance is a better, more flexible, and customizable asset to leave to a trust
- Life Insurance Benefits
    - No RMDs
    - No complex tax rules
    - No rigid stretch provisions
    - No IRA custodian issues
    - No trust tax on proceeds paid to the trust
    - Life insurance can be customized to stimulate the stretch IRA over any payout period desired
    - Trustee can have the power to keep the funds protected in trust without having to incur a trust tax (other than on the earnings)
- **Long Term Care**

  Certain life insurance includes Long-Term Care riders to protect assets
- **Leverage**

  Life insurance provides leveraged wealth transfer. More funds will go to the eventual beneficiaries, and with less tax than if the IRA was left directly to the beneficiaries or to an IRA trust.

- **Life Insurance / IRA Strategy:**
    - Pay down IRA during lifetime – pay tax at current low rates, over a number of years
    - Invest the after-tax funds in life insurance
    - If a trust is needed, the life insurance can be paid to an insurance trust
    - Reduces current income tax by eliminating RMDs on IRA funds withdrawn
- **Downside**

  Only for funds specifically earmarked for beneficiaries. This is a long-term strategy that must be committed to.

5. Charitable Trusts (CRTs) and direct charitable beneficiaries

Benefits:

- Best for the largest IRAs
- If you are charitably inclined, CRTs can stimulate the stretch IRA, with yearly payouts to beneficiaries for a term of life
- Tax-free to CRT – no income tax on the transfer of the CRT
- Estate tax deduction based on the time period

Downsides:

- The funds go to the charity after the beneficiary dies
- If the beneficiary is in poor health, the funds may go to the charity earlier than planned. There is no payout to a successor beneficiary
- No lifetime access for lump-sum payouts, even for emergencies (only annual distributions). Some people may want that type of protection.
- CRT distributions will be taxable to the beneficiaries beginning as ordinary income
- Additional charity option: Leave IRAs directly to the charity
- No income or estate tax
- Can leave more non-IRA assets to beneficiaries

Action Items:

- Contact your advisor to review all IRA and Plan beneficiary forms including contingent beneficiaries
- Contact you advisor and attorney if you have named a trust as an IRA beneficiary. This should be reviewed and probably revised immediately!
- **Evaluate planning options:**
  - QCDs, other IRA distributions to use up lower tax brackets and offset IRA income
  - Roth Conversions
  - Life Insurance replacement plan
  - Leaving IRAs to a charity; CRTs or direct beneficiary

Remember, you can always contact the Franklin Planning team with any questions:

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