

LOOKING FORWARD THINKING ABOUT TAX SEASON

Warren Wealth Weekly Wisdom
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We've barely a month until taxes are due - have you contacted your accountant? Accountants are quite busy this time of year, so if you haven't already scheduled a time to meet with them, please do so ASAP (provided you have one). Before you head to their office, be sure you've gathered all your necessary tax preparation information - this will save everyone time and make for a more productive meeting. Lastly, have you max-funded your IRA or Roth IRA for tax calendar year 2019? If not, and if you're eligible to do so, you have until the tax-filing deadline to make prior year contributions. The ability to make prior tax calendar year contributions also applies to self-employed individuals maintaining Health Savings Accounts (HSAs).

#HelpfulTip: Does your accountant send you an organizer? If so, use it as a guideline for the documents you provided during tax seasons in the prior year.

Thinking Ahead: Take the time to review the recently passed SECURE Act and determine whether any of the legislation applies to you personally. Take a look at the subsequent pages of this week's Weekly Wisdom for a summarization of the SECURE Act. As always, we are here to answer any questions that may arise!



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The Setting Every Community Up for Retirement Enhancement (SECURE) Act

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On December 20, 2019, the SECURE Act was signed into law. The SECURE Act contains 29 provisions, encompassing many aspects of financial planning and retirement saving. Once treasury regulations are released, nuances in interpreting this new law will become clearer. Until then, individuals are left to interpret the law's effects based on the language of the law itself. This article will address what the SECURE Act entails and who it affects, as well as provide suggestions on how to plan for the changes that have been instituted.

Key Provisions of the SECURE Act

- Repeal the prohibition of retirement contributions after the account owner reaches age 70½.
- Delay the age for required minimum distributions (RMDs) from 70½ to 72.
- Eliminate the lifetime “stretch” IRA option, requiring nonspouse beneficiaries of IRAs to deplete the inherited balance within 10 years of the decedent’s death (with exceptions; see below for more details).
- Permit penalty-free withdrawals of up to \$5,000 from retirement accounts to help pay for childbirth or adoption expenses.
- Expand permitted expenses for 529 college savings plans to include apprenticeships, as well as up to \$10,000 of qualified student loan repayments for the beneficiary and \$10,000 for each of the beneficiary’s siblings (an aggregate lifetime limit, not an annual limit).
- Reinstate the “kiddie tax” to pre-Tax Cuts and Jobs Act rates. (Excess income will be taxed at the parents’ rate rather than the trust and estate rates.)
- Allow graduate students to count stipends and nontuition fellowship payments as compensation for IRA contribution purposes.

Many of the provisions adopted into the Internal Revenue Code as part of the SECURE Act allow individuals more time for tax-deferred savings and growth before distributions are required. The provisions deemed advantageous to individuals and businesses may result in less tax revenue to the government, however. So, the SECURE Act also includes requirements designed to account for this loss of revenue by accelerating the withdrawal and taxation of inherited retirement accounts.

Planning for the Loss of the “Stretch” IRA Option

Although there are many ways in which the SECURE Act will change how individuals save for retirement, the provision with the greatest effect is the elimination of the lifetime “stretch” option for IRAs. Prior to the SECURE Act, individual beneficiaries were entitled to stretch out the withdrawal of their inherited retirement account in accordance with their life expectancy. Now, beneficiaries are required to withdraw their entire inherited retirement account within 10 years of the original owner’s death.

There are some exceptions to this rule, however. The individuals who remain entitled to the lifetime “stretch” option include:

- The surviving spouse of the employee
- A child of the employee who has not reached the age of majority (account would need to be distributed within 10 years of reaching the age of majority)
- Disabled individuals
- A chronically ill individual
- An individual who is not more than 10 years younger than the employee

In most instances, withdrawal of a beneficiary’s retirement account over a 10-year period (rather than over the course of his or her lifetime) will result in substantially less tax-deferred growth, as well as more taxes due on withdrawal from the account. To help mitigate the potential negative ramifications of these changes, below are a few strategies to consider when planning for the loss of the beneficiary “stretch” IRA option.

Roth conversions. With tax rates at historic lows and uncertainty surrounding their future, it could be a good year to coordinate with a CPA to potentially accelerate Roth conversions, so that beneficiaries may avoid being taxed rapidly on distributions. This is an especially applicable strategy if the beneficiaries are in a higher tax bracket than the account owner.

Alternatively, individuals with legacy priorities may not be motivated to accelerate Roth conversions under the SECURE Act because a grandchild (for example) will not receive the long period of tax-free growth from the inherited Roth.

Going forward, account owners should be sure to ask these key questions before making a Roth conversion:

- Will the individual need the money within five years of conversion?
- Will the individual be in a higher or lower tax bracket in the future? Are the beneficiaries expected to be in a higher tax bracket?
- Where will the individual get the money from to pay the taxes owed because of the conversion?

Charitable remainder trusts (CRTs). An account owner could consider naming a CRT as the beneficiary of an IRA. These trusts are structured so that a beneficiary would collect a stream of income from the assets of the CRT for a specified time. At the end of that period, the charity would collect whatever is left. The CRT isn’t taxed on the distribution from the IRA or the income it earns; however, the beneficiary will be responsible for any taxes owed on distributions from the CRT.

Life insurance. Individuals may want to explore whether taking a withdrawal from the retirement account to pay premiums on a life insurance policy is more advantageous than leaving the retirement account to the beneficiaries. Beneficiaries typically receive life insurance money tax free. Depending on the insurability of the individual, the total death benefit payable to the beneficiaries may exceed what they receive as beneficiary of an IRA. This analysis should be performed by a qualified financial professional.

Qualified charitable distribution (QCD). If an individual is older than 70½, he or she is entitled to make tax-free gifts of up to \$100,000 per year from their IRA payable directly to charity. QCDs may become more advantageous after the SECURE Act because IRAs will become a less attractive inherited asset. Therefore, tax-free depletion of the IRA may be more beneficial than the dissipation of other nonqualified appreciated assets, which could pass to beneficiaries at a stepped-up basis.

Account owners will need to coordinate with their CPA if they are planning to contribute to their IRA after age 70½, as such contributions may affect the QCD treatment.

Trusts. The SECURE Act decreases the amount of complexity and risk involved in naming a trust as a beneficiary. The cost-benefit analysis of tax deferral versus control of distributions will shift, as the stretch would be no more than 10 years.

It is imperative that individuals who named a trust as the beneficiary of an IRA prior to the implementation of the SECURE Act review their current estate plan with an attorney to determine how the SECURE Act may affect the distributions from the IRA to the trust. In some instances, trusts drafted prior to the SECURE Act may be obsolete, resulting in a distribution pattern that works against the original intent of the trust.

Estate planning. It may make sense for account owners to revise their estate plan to take a more comprehensive “asset-by-asset” approach, rather than to continue splitting assets by percentage. For example, the account owner might earmark IRA assets to be distributed to minors or individuals in lower tax brackets and designate a larger proportion of non-retirement assets to those with higher incomes.

Who Is *Not* Affected by the SECURE Act?

This new legislation will not affect the following individuals:

- Those who turned 70½ prior to December 31, 2019 (Individuals who were 70½ or older as of December 31, 2019, will continue with RMDs under the pre-SECURE Act rules.)
- Surviving spouses of IRA owners
- Beneficiaries of IRA owners who died before December 31, 2019
- Beneficiaries of some owners of existing qualified annuities

Secure Your Future

As more information becomes available regarding the interpretation of the SECURE Act, it's important to continue to review all aspects of your financial plan and beneficiary elections to ensure that you understand how you and your family have been affected. Be sure to reach out to your tax professional or contact our office for help navigating your situation.

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