Estate Planning for Retirement Accounts

Rules and Strategies for traditional IRAs, 401(k)s, 403(b)s, Roth IRAs, etc.

Fiduciary Positions in an Estate Plan

Document	Fiduciary Position	Who?
Durable Power of Attorney	Agent or Attorney in Fact	??? (2 to 3 people)
Advance Health Care Directive	Agent	??? (2 to 4 people)
Will	Executor / Executrix / Administator	??? (2 to 3 people)
Living Trust	Successor Trustee	??? (3 people or trust co)
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Conservatorship	Conservator	??? (nominate 1 in AHCD)

What will you learn?

- The latest rules that affect retirement accounts – SECURE Act December 20, 2019, CARES Act March 27, 2020, SECURE ACT 2.0 of 2022
- How to calculate your required minimum distributions
- Options for choosing beneficiaries for your retirement accounts
- Is the "stretch" dead?
- Information about Roth IRAs

What Are We Talking About?

- Retirement accounts include:
- IRAs (SEP, SAR SEP, Simple, etc.)
- 401(k)s
- 403(b)s
- 457s
- Keoghs
- Pension Plans – Defined Benefit Plans, Profit Sharing Pension Plans, ESOP, etc.
- ROTH IRAs (Different rules)

Benefits of Qualified Retirement Accounts

- Contributions reduce taxable income
- NEW RULE : SECURE Act – age limitation on contributing to an IRA eliminated. Must have earned income.
- Contributions grow tax deferred while inside account – No income tax or capital gains tax
- Significant Compounding Effect
- As of October 2022 there is $32,000,000,000,000 in these accounts – this is income that has not been taxed yet.

Income Tax Consequences

- All money in these accounts are “pre tax dollars”
- The contributions as well as the growth of these accounts have not been taxed
- What happens when the account holder dies? Does the government still collect the tax?
- Not tax free . . . Only tax deferred.

Important Part of Estate Planning

- Retirement accounts can actually be the largest asset of a person's estate
- Often missed or overlooked in estate planning
- Your Estate Plan needs to address retirement accounts

Rules During Life

Rules During Life

- Unless an exception applies, withdrawals before age 59 ½ are subject to a 12.5% (10% Fed & 2.5% CA) early withdrawal penalty <u>in addition to</u> income tax
  - No income tax has been paid on these assets
    - CARES Act – 2020 Coronavirus related withdrawals of up to $100,000
    - Consolidated Appropriations Act – 2021 Qualified Disaster Distribution

Rules During Life

- After age 59 ½ but before age 72, you may, but are not required to, make withdrawals
- No penalty but withdrawals are still subject to income tax
- Get a 1099-R for withdrawals

Lifetime Required Minimum Distributions

- Starting at age 73, the IRS requires you to withdraw or distribute part of the retirement account each year
- NEW RULE: SECURE ACT – year you turn 73 Referred to RMD –Required Minimum Distribution
- No penalty but withdrawals. distributions are still subject to income tax
- IRS says you have deferred long enough

Required Beginning Date

- With limited exceptions, RMD must start in the year you turn 73
- CARES Act – RMD was not required for year 2020 – must take for year 2021 – Notice 2022-53 amended that to year 2023
- RMD required by 12/31 of each year
- First Year Rule: Can delay distribution until April 1 of year following the year you turn 73
  - Tax trap – watch out for two distributions in same year – bunching income
  - May push account holder into higher income bracket or increase taxation of social security benefits and can affect Medicare Premiums

Required Minimum Distribution

- Can ALWAYS take more
- Does not give you "credit" for future years
- 50% penalty if you do not take your RMD

How to Calculate RMD

- Most banks and brokerage firms do the calculation for you and send you a letter
- You can do the calculation yourself using an IRS table
- Must recalculate each year

Required Minimum Distribution (RMD)

Prior Year 12/31 Account Balance ÷ Life Expectancy Divisor from Table = RMD

Uniform Table

AGE	Divisor
70	29.1
71	28.2
72	27.4
73	26.5
74	25.5
75	24.6
76	23.7
77	22.9
78	22.0

AGE	Divisor
79	21.1
80	20.2
81	19.4
82	18.5
83	17.7
84	16.8
85	16.0
86	15.2
87	14.4

Required Minimum Distribution (RMD)

- Age 72

$$\boxed{\$100{,}000} \div \boxed{27.4} = \boxed{\$3{,}649.64}$$

AGE	Divisor	Withdrawal Rate %	AGE	Divisor	Withdrawal Rate %
70	29.1	3.44%	85	16.0	6.25%
71	28.2	3.55%	86	15.2	6.58%
72	27.4	3.65%	87	14.4	6.95%
73	26.5	3.78%	88	13.7	7.30%
74	25.5	3.93%	89	12.9	7.76%
75	24.7	4.07%	90	12.2	8.20%
76	23.7	4.22%	91	11.5	8.70%
77	22.9	4.37%	92	10.8	9.26%
78	22.0	4.55%	93	10.1	9.91%
79	21.1	4.74%	94	9.5	10.53%
80	20.2	4.96%	95	8.9	11.24%
81	19.4	5.16%	96	8.4	11.91%
82	18.5	5.41%	97	7.8	12.83%
83	17.7	5.65%	98	7.3	13.70%
84	16.8	5.96%	99	6.8	14.71%

Lifetime Required Minimum Distributions

- Life Expectancy Divisor
- Uniform Table – (unless spouse is 10 years younger)
- IRS proposed new tables effective Jan 1, 2022
- IRS Publication 590-B (updated March 2021)

More than One IRA?

- If one has more than one IRA . . . .
  - RMD must be calculated separately for each IRA account but cumulative RMD can be taken out of one account

Qualified Charitable Distribution

- The Qualified Charitable Distribution (QCD) rules allow a taxpayer to distribute money from their IRA and gift it directly to a qualified 501c3 without including the IRA distribution in their income
- The Qualified Charitable Distribution is now permanent!

Qualified Charitable Distributions

- Without the Qualified Charitable Distribution rules, a taxpayer who wanted to withdraw money from an IRA and give it to a 501c3 would first need to add the distribution to their income (AGI) and hopefully offset that income with deduction for the gift to the 501c3
- Issues:
  - No deduction for taxpayers who do not itemize
  - This may be most of us under current tax law
  - Including the income in our AGI can affect the taxability of Social Security benefits and increased Medicare premiums
  - Including the income can affect several other tax breaks related to AGI such as deductions, passive losses, etc.

Qualified Charitable Distributions

- Benefits of the Qualified Charitable Distribution
  - The distribution is EXCLUDED from your income
  - The distributions will count towards your required minimum distribution
  - RULES
    - Limited to $100,000
    - Must be 70 ½ or older
    - Distribution must made directly to the 501c3 organization

Choosing Beneficiaries and Rules After Death

Concepts

- Concept 1: During life, you get to pick the beneficiary for your retirement accounts by completing a beneficiary designation form with the institution that holds your retirement account – Contact to pay death – NO PROBATE – Change at any time – the beneficiary designation controls how the assets is disposed.
- Concept 2: After death, a designated beneficiary can continue to defer income tax until money is distributed/withdrawn
- Concept 3: IRS still wants their share and requires your named beneficiary to withdraw money from the account so the IRS can collect the income tax

Concepts

- Concept 4: From a tax planning standpoint, it is likely preferred that your beneficiary avoid taking a lump sum distribution – lose deferred growth and pay higher taxes as beneficiary now has a higher marginal tax bracket
- Concept 5: Generally, the strategy is to try to make the beneficiary's withdrawal period as long as possible
  - Before SECURE Act, the beneficiary could often "stretch" the retirement account and create decades of tax deferred growth

SECURE Act

- Eliminates the "stretch" for retirement accounts inherited <u>after</u> December 31, 2019
- Basically, the SECURE Act requires retirement accounts, including Roth IRAs, to be distributed within 10 years of death of account owner
- Exceptions (EDBs) – Eligible Designated Beneficiaries
    - Surviving Spouse
    - A child of the taxpayer who has not reached the age of majority
    - A disabled or chronically ill individual
    - An individual who is not more than 10 years younger

Choosing Beneficiaries

- The rules/options for distribution of the retirement account will depend on who you designated as your beneficiary
- With this in mind, the selection of beneficiaries is **very important!**

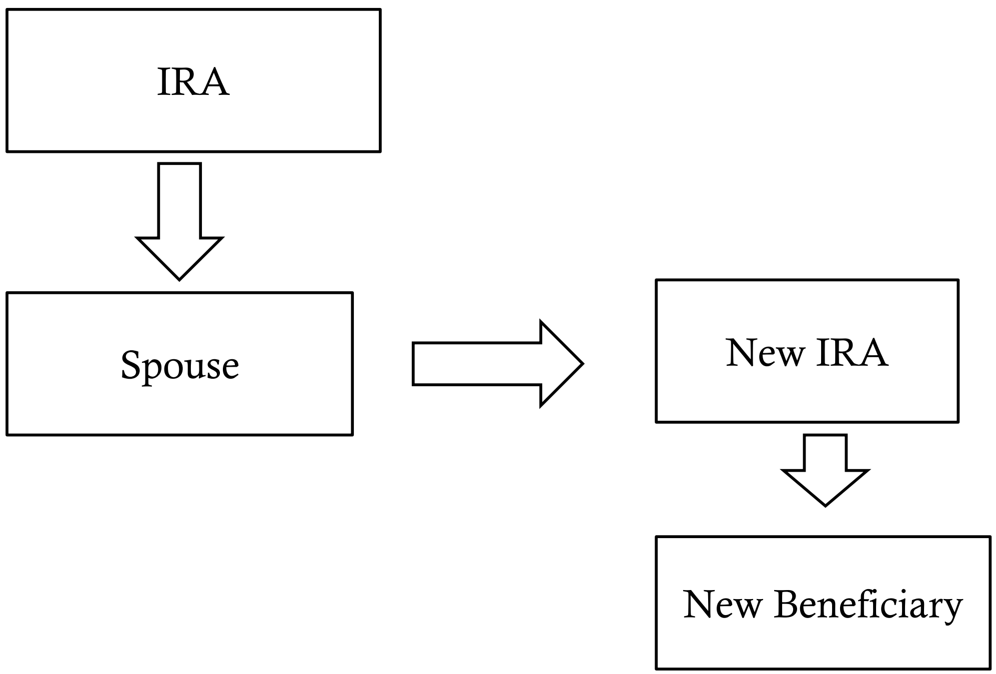
Five Beneficiary Options

- Spouse
- Children, Grandchildren, Friends
- Trust
- 501c3 nonprofit organization
- Some or all of the above

Option 1 – Spouse as Beneficiary

- Benefits:
  - Money available to spouse
  - No 10-year limitation under the SECURE Act
  - Special Rule: Spousal Rollover Option

Option 1: Spouse as Beneficiary IRA Spousal Rollover Example



Option 1 – Spouse as Beneficiary

- Disadvantages
  - Spouse has control of money
  - Possible issue with a blended family

Option 2: Children, Grandchildren, Friends

- Benefits
  - Minor Children exempted from 10 year limit until they reach the age of majority, then 10 years
  - Don’t want to name a minor children outright
  - Adult Children may have up to 10 years to distribute the account
  - Potentially years of tax-deferred growth
  - Execute effective tax planning strategies

Option 2: Children, Grandchildren, Friends

- Disadvantages
  - If child is named as outright beneficiary
    - Problematic to name a minor child
    - May do a lump sum distribution
    - Irresponsible Spending
    - Creditors

Trust as Beneficiary

- Can name a trust as a beneficiary
- Trust must meet certain IRS requirements and include special provision regarding retirement accounts

Trust as Beneficiary

- Benefits
  - Provides control
  - Can protect assets from courts, creditors, and irresponsible spending
  - If done properly, can still take advantage of the SECURE Act exceptions:
    - Surviving Spouse
    - A child of a taxpayer who has not reached the age of majority
    - A disabled or chronically ill individual
    - An individual who is not more than 10 years younger

Trust as Beneficiary

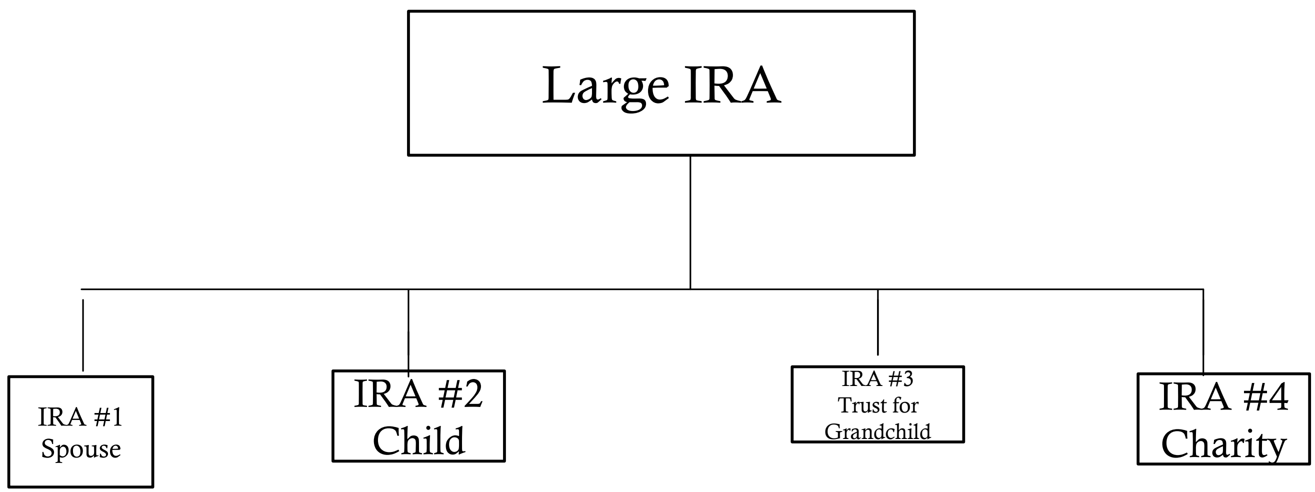
- Disadvantages
  - No spousal rollover available
  - Trust must be drafted with proper provisions to qualify for SECURE Act exceptions – provisions in trusts need to be reviewed after SECURE Act was enacted
  - Higher income tax marginal tax brackets if distributions stay in trust
  - Administratively complex
  - Expense

Charity as Beneficiary

- Benefits
  - NO Income tax
  - Reduces estate taxes

Disadvantages - None

Option 5: Some or All as Beneficiary



Responding to the SECURE Act

- Accept the taxes – manage income tac brackets and effectively tax plan
- Charitable Remainder Trust
- Insurance
- Roth Conversions
- Charity
- Spend it

Mistakes

- Not naming a beneficiary
- Naming "my estate"
- Naming a minor outright
- Not naming both primary and contingent beneficiaries
- Not keeping beneficiary designation forms up to date
- Not keeping records of beneficiary designations
- Not considering and/or planning for the income tax issues when selecting beneficiaries
- Case by case

Roth IRAs

Benefits of Roth IRA

- No required distributions during your lifetime
- Can make contributions (if earned income)
- Tax-free growth
- Tax-free distributions to you and your beneficiaries
- 10 year “stretch” and spousal rollover okay

Roth IRA Conversion

- Convert traditional IRA and other retirement accounts to a Roth IRA
- Everyone is eligible – no more limitations
- Must pay income taxes on conversion
- Need to do careful analysis to see if it makes sense

Roth IRA Conversion Factors

- You expect your tax rate to be higher in retirement
- You do not think you will need the money for living expenses – want the money to stay in the Roth IRA
- Your investment horizon is long enough to benefit from the tax-free growth of a Roth IRA
- You can afford to pay taxes on the conversion using separate funds
- Estate planning objectives