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The new paradigm for retirement savings

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The coronavirus pandemic has brought home to many just how important estate planning can be, and how much events over which we have no control may upset the plans we have. The temporary doubling of the amount exempt from federal estate and gift tax in 2017 was significant but had a practical impact on a very tiny slice of American wealthholders. In contrast, the new tax rules governing tax-favored retirement savings will touch far more families. Estate planners will need to help their clients to navigate the new rules for:

- The CARES Act
- The SECURE Act

THE CARES ACT

The Coronavirus Aid, Relief, and Economic Security Act (or CARES Act) was enacted by Congress and signed into law by President Trump on March 27, 2020. The new law has many facets, but in this article we focus on the effects on retirement savings.

Employer plans

These changes are contingent upon adoption by the plan sponsor.

Plan loans. The normal rule for a plan loan from a 401(k) plan or qualified retirement plan is that one may borrow up to 50% of the vested balance, to a maximum of $50,000. These caps are doubled for certain loans made from March 27, 2020, to September 23, 2020, to a maximum of $100,000 or 100% of the vested balance. Repayment of the loan may be deferred until January 1, 2021, when a five-year amortization must begin.

The expanded loan rule is available to any taxpayer who tests positive for COVID-19 or whose spouse tests positive. The larger loan may also be permitted for:

- someone who was quarantined, furloughed, laid off, or had reduced hours because of the disease;
- someone who was unable to work because of lack of childcare;
- closing or reduced hours of a business owned by the taxpayer because of the disease; or
- other factors that may be identified by the Treasury Department.

Loans are not permitted from IRAs or Roth IRAs.

Coronavirus-Related Distributions. An alternative to the loan is a distribution, which is permitted for the same “qualified individuals” as the expanded loan provision. Up to $100,000 may be distributed. The distribution will be subject to income tax, but there will be no 10% penalty on premature distributions if the account owner is younger than 59½. The income tax may be paid in full for the 2020 tax year (it could be the best choice if the taxpayer has fallen into a low tax bracket). Alter-

natively the distribution may be treated and taxed as if it were received 1/3 in 2020, 1/3 in 2021, and 1/3 in 2022. Deferring the tax bill is tempting, but one may be in a higher tax bracket in two years. Also, the state income tax treatment of the distribution may not match the federal rules.

However, there is an alternative that involves no income taxation at all. The taxpayer may elect to repay the Coronavirus-Related Distribution over three years. Such repayments will be treated as if they were trustee-to-trustee transfers. What's more, the repayments will not affect the taxpayer's right to make future normal retirement plan contributions.

No 2020 RMDs

When the stock market collapsed during the 2008 great recession, Congress created a one-year suspension of the rule that requires minimum distributions (RMDs) from IRAs and qualified retirement plans. The purpose of the suspension was to avoid forcing withdrawals when values were low, which could dramatically deplete account balances. Because the drop in stock prices affects all taxpayers, there is no requirement to show specific harm from the pandemic for the rule to apply.

Here is the applicable portion of CARES Section 2203 as it is written:

"SEC. 2203. TEMPORARY WAIVER OF REQUIRED MINIMUM DISTRIBUTION RULES FOR CERTAIN RETIREMENT PLANS AND ACCOUNTS.

"(a) IN GENERAL.—Section 401(a)(9) of the Internal Revenue Code of 1986 is amended by adding at the end the following new subparagraph:

''(I) TEMPORARY WAIVER OF MINIMUM REQUIRED DISTRIBUTION

''(i) IN GENERAL.—The requirements of this paragraph shall not apply for calendar year 2020 to—

''(I) a defined contribution plan which is described in this subsection or in section 403(a) or 403(b),

''(II) a defined contribution plan which is an eligible deferred compensation plan described in section 457(b) but only if such plan is maintained by an employer described in section 457(e)(1)(A), or

''(III) an individual retirement plan.

''(ii) SPECIAL RULE FOR REQUIRED BEGINNING DATES IN 2020.—Clause (i) shall apply to any distribution which is required to be made in calendar year 2020 by reason of—

''(I) a required beginning date occurring in such calendar year, and

''(II) such distribution not having been made before January 1, 2020.

''(iii) SPECIAL RULES REGARDING WAIVER PERIOD.—For purposes of this paragraph

''(I) the required beginning date with respect to any individual shall be determined without regard to this subparagraph for purposes of applying this paragraph for calendar years after 2020, and

''(II) if clause (ii) of subparagraph (B) applies, the 5-year period described in such clause shall be determined without regard to calendar year 2020.''

"(b) ELIGIBLE ROLLOVER DISTRIBUTIONS.—Section 402(c)(4) of the Internal Revenue Code of 1986 is amended by striking ''2009'' each place it appears in the last sentence and inserting ''2020''.

"(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply for calendar years beginning after December 31, 2019."

There is no distinction between lifetime RMDs and post-death RMDs—all are "suspended" for 2020. Neither IRA owners, nor employees covered by company plans, nor beneficiaries of any type of covered plan or IRA are required to take a "required minimum distribution" in the year 2020.

Double dip

People who reached age 70½ in 2019 were required to begin receiving their RMDs in that tax year. However, to ease taxpayers into that annual requirement the tax code permits the first RMD to be deferred until April 1 of the following year. Taxpayers who choose this approach will end up having two RMDs in the same tax year. Depending upon the taxpayer's other income, that may not be a problem.

However, the CARES Act provides for the possibility that both of those RMDs may be dodged. Any individual who has a required beginning date of April 1, 2020, and who has a distribution he must take by that date because the distribution was "not made before" 2020 may have that RMD suspended. Those who already took their 2019 RMD during 2019 do not get this relief.

In subsequent years, the taxpayer will not get a new required beginning date but will be treated as if 2020 had been a normal year.

Rollover until July 15, 2020

An RMD normally is not permitted to be rolled over into an IRA. However, the CARES Act retroactively changed the character of distributions made in 2020, which means that taxpayers could have had 60 days to return any such distribution to their IRA.

In Notice 2020-23, the IRS extended various tax filing deadlines to July 15, 2020. Among those was the deadline for completing an IRA rollover. The effect is that anyone who took an RMD in February or later has until July 15 to return the money to an IRA to avoid current income taxation on the distribution. RMDs taken in January are not eligible. On the other hand, RMDs taken in January happened when the stock market was near its peak, and so taxpayers may be pleased to have locked in their gains.

There is another rule to keep in mind, however, before rolling money into an IRA. Taxpayers are allowed only one rollover in any 12-month period. If the taxpayer completed a rollover within the prior year—for example, by moving the account to a new financial services provider—the deadline extension does not help. Note that a "trustee-to-trustee" transfer is not considered an IRA rollover for these purposes.

Not a "get out of jail free" card

What about a taxpayer who missed his or her RMDs in earlier years, and so must take withdrawals to cover what was missed? Those distributions will still have to be made in 2020, as the suspension does not apply to liabilities from earlier tax years.

The five-year rule

The general rule for required distributions following the death of a retirement plan owner who dies before his/her "required beginning date" is that the funds must be distributed within five years. The life expectancy payout and the "10-year rule" are exceptions to this general rule, applicable where the benefits are payable to a "designated beneficiary" as explored later in this Study, thanks to the SECURE Act.

The most common application of the five-year rule is for an IRA or retirement plan owner who dies before his/her required beginning date without naming a designated beneficiary, as a result of which the benefits pass to the decedent's estate as default beneficiary. Under IRS regulations, the participant's estate is not a "designated beneficiary." This rule also applies if the participant names a beneficiary that does not qualify as a designated beneficiary, such as his/her own estate, a trust that does not qualify as a see-through trust, or any nonindividual such as a charity. As applied under regulations, the five-year rule means that the benefits must be distributed by the end of the year that contains the fifth anniversary of the participant's death.

The CARES Act says that in the case of an individual who died in the years 2015-2019 leaving benefits subject to the five-year rule, the five-year period is computed as if 2020 did not exist. Thus, for these situations the five-year rule has become a six-year rule.

Qualified charitable distributions

The other issue that frequently comes up in the context of required minimum distributions is the direct transfer from an IRA to a charity, a "qualified charitable distribution" (QCD). Taxpayers who are 70½ or older may direct up to $100,000 from their IRA to a qualified charity. The distribution will not be included in the taxpayer's income, which can have many positive effects beyond tax avoidance, but it will count toward meeting the RMD mandate.

The CARES Act had no direct effect on QCDs; they remain permitted for those who meet the age requirements. The absence of an RMD this year may reduce the impetus for resorting to this tax strategy. The QCD is available in addition to the standard deduction, and so may be preferred by those taxpayers who will not be itemizing.

THE SECURE ACT

In December, as part of the budget deal, the Congress passed the Setting Every Community Up For Retirement Enhancement (SECURE) Act, and the President quickly signed it. The SECURE Act includes a variety of tax provisions intended to promote retirement savings and increase access to qualified retirement plans. For individuals, the three most significant changes are:

• those over age 70½ are no longer prohibited from contributing to a traditional IRA (they must have compensation income to do so);

• Required Minimum Distributions (RMDs) are no longer mandated until age 72 (those who turned 70 before July 1, 2019, still must begin their RMDs as under prior law); and

• up to $10,000 may be distributed from a Section 529 plan to pay down student debt (that's a lifetime cap, not an annual one).

Paying for the tax breaks

To pay for the many tax breaks included in the SECURE Act, the treatment of inherited IRAs has been drastically changed, effective the first of the year. In general, an inherited IRA will have to be distributed by the end of the tax year that includes the tenth anniversary of the owner's death. That works out to 11 tax years for receiving and reporting the IRA distributions. There is no requirement for annual distributions during the ten years—they may be front loaded, back loaded, or paid roughly equally over the period, which should provide the greatest tax efficiency.

Only "eligible designated beneficiaries," as defined in the new law, are allowed to stretch the IRA payouts over their life expectancies, rather than ten years.

There are five categories of those who can continue to have lifetime IRA RMDs:

Surviving spouses. The surviving spouse may use the life expectancy tables to take RMDs over his or her lifetime. A surviving spouse continues to have the option of making an inherited IRA his or her own. With that approach, RMDs won't be required until the spouse reaches age 72, and then they may be spread over the life expectancy.

Minor children of account owner. Until they reach the age of majority, the RMDs for minor children may be determined from the actuarial tables. Once they reach the age of majority, presumably 18 or 21 depending upon state law, the ten-year rule kicks in. The definition of "age of majority" in the SECURE statute refers to an obscure ERISA section, the gist of which implies that if a student is still being educated, the age of majority may be deferred to 26, but this point is unsettled at the moment.

Note that the minor must be the account owner's child, not simply a minor. This tax treatment is not available to grandchildren, nieces, or nephews.

Disabled beneficiaries. If the designated beneficiary is disabled within the meaning of IRC §72(m)(7), RMDs may be stretched over the lifetime. Entitlement to Social Security disability benefits may be a litmus test for eligibility. Note that eligibility is determined at the account owner's death. If an able-bodied heir who has been receiving IRA distributions under the ten-year rule becomes disabled in, for example, year five, there is no ability to switch over to the life expectancy payouts. At the disabled beneficiary's death, the ten-year rule must apply.

Chronically ill beneficiaries. A chronically ill designated beneficiary, as that condition is defined in IRC §7702B(c)(2), may stretch the payouts over his or her lifetime. Again, at this beneficiary's death the ten-year rule kicks in.

Less than ten years younger than the account owner. Life expectancy may be used if the heir is less than ten years younger than the account owner, such as a sibling. However, a blood relationship is not required.

SAMPLE PAYOUT PERIODS

Over the life of the beneficiary	*Over ten years*	*Over five years*
Spouse	Adult children or grandchildren	Charities
Persons less than ten years younger than the owner	Successor beneficiary of account inherited before 2020	Estates
Disabled persons	Trust with non-spouse beneficiary	Some trusts
Chronically ill persons		
Minor children until they reach the age of majority		

Source: IRC; M.A. Co.

Using a trust

Under the prior law, anyone who inherited an IRA had the right to take RMDs over his or her lifetime. However, some account owners did not trust that the heir would take this tax-minimizing approach. Thus trust strategies were created, to make certain that the stretch really happened to the inherited IRA.

Conduit trusts. With a conduit trust, all RMDs from the retirement plan pass to the trust and then to the trust beneficiary, who will pay the income tax on the distributions. The conduit beneficiary is considered the only trust beneficiary for RMD purposes. Conduit trusts should continue to work largely as before depending upon the beneficiary. A conduit trust for a surviving spouse will be unaffected by the SECURE Act. But a trust for anyone other than one of the five categories of eligible designated beneficiaries will have to receive all of the IRA assets in ten years. If the IRA owner can accept that result, no change will be needed. If the conduit trust is used for a Roth IRA, which provides tax-free income, the only change is that the tax-deferred growth lasts only ten years. Query: For future estate plans, will it be worth the effort to set up a conduit trust when the IRA payout must happen within
ten years?

Accumulation trusts. In general, accumulation trusts that keep retirement plan distributions for later distribution to beneficiaries will be subject to the ten-year rules, even if they are see-through trusts, because an eligible designated beneficiary is not the sole beneficiary of the trust. However, an exception is made for a trust for a disabled or chronically ill beneficiary.

Charitable remainder trusts. One emerging strategy to provide lifetime income payments to an heir from an IRA is to create a charitable remainder trust, either an annuity trust or a unitrust. The entire IRA may be paid to the trust, which will be tax exempt and so no income tax will be due. Therefore all the assets will be available to create the income interest, which may last for the beneficiary's life.

This strategy may be appropriate for an IRA owner who has philanthropic desires to be satisfied through his estate plan, but it does not really "beat" the new limits of the SECURE Act.

Direct gifts to charity

Current law permits IRA owners who are at least 70½ to make a direct transfer to a charity of up to $100,000 from their IRA. The transfer will not be included in the owner's income, but it will satisfy the RMD requirement. This rule is not changed by the SECURE Act; the 70½ age rule applies even though RMDs are no longer needed until age 72.

Caveat: If one is working and makes contributions to a traditional IRA after age 70½, the $100,000 limit is reduced by the amount of the IRA contributions. This determination happens cumulatively. For example if taxpayer makes a $6,000 traditional IRA contribution in Year 1 (when he is 70½), and he makes no transfers to charity in Year 1 or Year 2, in Year 3

his maximum exclusion for a direct gift to charity from the IRA would be limited to $94,000. The offset is extinguished once it is used, so in Year 4 he could exclude up to $100,000 for a direct charitable gift from his IRA.

Retroactive effect

Someone who inherited an IRA before 2020 and who is taking life expectancy RMDs may continue to do so. However, when that individual dies in 2020 or later, the ten-year rule comes into play. Under the prior law, if the individual's remaining life expectancy at death was, for example, 18 years, his or her heir would succeed to that 18-year period. Not anymore.

Post-SECURE estate planning ideas

The stretch IRA had become a routine recommendation for estates that included substantial retirement assets, so its loss comes as a shock. Estate planners will need to develop alternatives to discuss with clients. Here are some of the choices.

Leave the account untouched for as long as possible. For non-eligible designated beneficiaries, there is no requirement of any distribution before the tenth year after the owner's death. One approach might be to take full advantage of ten years of tax-deferred growth, especially if it appears that the beneficiary is likely to have retired or be in a lower tax bracket in ten years. The risk in this strategy is that the very large payout at the end of the period may push the beneficiary into a much higher tax bracket, even if his or her regular income is then much lower. An additional risk is that tax rates could go much higher ten years down the road. The current income tax rates are already set to expire in 2026.

Leaving the account untouched makes the most sense for smaller accounts that are less likely to push the beneficiary into a higher tax bracket, and for beneficiaries who expect to continuously be in the top tax bracket regardless of the IRA distributions.

Spread distributions equally over 10 or 11 years. An alternative to accumulating as much tax-deferred money as possible is to spread distributions through the years as equally as possible. One may have eleven such distributions if death occurs early in the year, because the year of death will be the zero year, with ten additional years beginning with the year after death. On the other hand, with a death in, for example, December, arranging for a quick distribution during the zero year may be problematic.

For example, a $250,000 IRA that grew by 7% would grow to roughly $500,000 after ten years. Rather than pay income tax on the whole half million dollars in a single year, the beneficiary could withdraw roughly $35,000 per year, making the income tax burden more manageable.

Time the distributions. If a beneficiary's career is one that involves significant volatility of income from year to year, it may be advisable to make larger distributions in years of low income and omit distributions altogether in the high-income years.

There are many situations that could call for unequal distributions, such as:

- The beneficiary plans to retire in a few years.
- The beneficiary who is single plans to marry, and so will later enter the lower tax brackets that apply to married couples.
- The beneficiary plans to move to a lower tax state.
- The beneficiary's life expectancy is less than ten years, and the inherited IRA could be left to a surviving spouse.
- A large charitable gift is planned.

Increase the number of beneficiaries. The stretch IRA expanded the number of years for distributions. As an alternative, the owner might consider stretching the number of beneficiaries for the IRA. For example, rather than naming just children as beneficiaries, one might name children and grandchildren. Note, however, that taxable distributions from IRAs are considered unearned income, and as such they are subject to the "kiddie tax," limiting the tax benefits.

Convert to a Roth IRA. The great benefits of the Roth IRA are that, in general, distributions are free from income tax and there are no required minimum distributions during the life of the owner. Freedom from income tax extends to the beneficiaries who inherit the account, but they are subject to the ten-year rule if they are non-eligible designated beneficiaries.

For a top wealthholder whose estate is expected to be required to pay a federal estate tax, conversion to a Roth IRA and

payment of the resulting income tax liability will reduce the taxable estate even as it makes the IRA inheritance more valuable in the hands of the beneficiaries. The inheritor of a Roth IRA may defer all distributions for ten years, gaining maximum tax deferral, without having to worry about the bunching of the distribution at the end of the term.

The tax savings may be less compelling for an estate that is likely to be small enough to avoid the federal estate tax. In that case, a phased conversion to a Roth IRA may be appropriate, paying income taxes when the account owner is in the lower tax brackets.

Aim for after-tax parity. If an estate will include both Roth and traditional IRA accounts, as well as an after-tax investment account, the account owner may want to explore an unequal division of assets. The Roth IRA will be the most valuable to heirs in the highest-income tax bracket, as will any assets that receive a step-up in basis at death. The traditional IRA comes with a built-in income tax liability, and so should probably be directed to heirs who are in lower tax brackets. Another tactic would be to leave the taxable assets to a trust, directing the trustee to make distributions so as to equalize the after-tax legacy for each heir.

However, an unequal division of assets can sow family discord if the rationale is not fully explored with heirs early on.

Employ a charitable remainder trust. If the estate planning object is to create a secure lifetime income, a charitable remainder trust (CRT) may be an acceptable alternative worth exploring. The CRT won't pay income taxes on receipt of the retirement funds, so the entire capital base is available for building the income stream. The income interest may be defined as a fixed dollar amount (an annuity trust) or a fixed percentage of the trust assets, determined annually (the unitrust interest).

This approach does have the feature that the assets pass to charity when the trust terminates; they do not remain within the family as was possible with the stretch IRA. Accordingly, it is appropriate only for the philanthropically minded.

Estate planning options in the post-SECURE environment

- Leave the account untouched for as long as possible
- Spread distributions equally over 10 or 11 years
- Time the distributions
- Increase the number of beneficiaries
- Convert to a Roth IRA
- Aim for after-tax parity
- Employ a charitable remainder trust

Summing up

At the 2020 Heckerling Conference on Estate Planning attorney Jonathan Blattmachr said "Congress gave us a great gift in December. You could spend all your time during the next year on the SECURE Act." No one then could have anticipated the extent to which our lives would be complicated by the novel coronavirus emanating from China, the economic calamity it caused, and the Congressional reactions to that financial pain.

Ironically, estate planning has become more important at just the moment when the contact between estate planners and their clients has been restricted. As those limits are eased in the coming months, there should be a boomlet in the estate planning business.

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